

Putting the squeeze on shareholders

Extensive revisions to the Korean Commercial Code last year increased the rights of majority shareholders. But concerns have been raised about whether enough has been done to protect the rights of the minority. Market observers are waiting for the courts to interpret key terms

Since the Korean Commercial Code (KCC) was enacted in 1962, amendments have been made at a steady pace. But in April 2012 some of the most extensive revisions introduced large scale changes with significant implications for corporate governance, corporate finance, M&A and joint ventures in Korea. The changes are widely expected to have most effect on the financial structures of chusik hoesa (joint-stock companies) and on M&A transactions, making it easier to do business in Korea.

One interesting amendment is to allow the so-called “squeeze-out” of minority shareholders through a compulsory acquisition. The

controlling shareholders holding 95% or more of the shares in a Korean company can require the minority shareholders to sell their shares to the controlling shareholders at an agreed price or fair price that will be determined by the court if no agreeable price is attained. The amendment also provides for a right of minority shareholders to demand a sell-out, yet this provision also means it is possible for a sell-out to take place at the same time as a squeeze-out, exposing potential conflicts.

Concerns for minority shareholders

Korea has no case precedent applicable to compulsory acquisitions, so this right

for compulsory acquisitions has created uncertainty. More importantly, the law governing compulsory acquisitions should protect minority shareholders from exploitation and guarantee fair competition for minority shareholders. The Korean government also needs to bear in mind the different classes of squeeze-outs and how they will affect Korean business practices, because Korea's corporate governance culture is still developing. Korean companies are still characterised by dominant and controlling shareholders and the level of protection for minority shareholders is limited.

Furthermore, squeeze-outs can incur an additional tax burden and reinvestment costs to the minority shareholders, while some may be sentimentally attached towards a particular company that cannot be compensated by money alone.

Promoting efficiency

The justifications for allowing squeeze-outs are to reduce costs eliminate troublesome minority shareholders. From a corporate





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Shin & Kim**

control perspective, squeeze-outs boost M&A efficiency by allowing the majority shareholder (offeror) to squeeze-out the remaining minority shareholders following a successful tender offer. In the absence of a compulsory acquisition, the isolated groups of minority shareholders would hold out expecting a rise in share price, so that each minority shareholder (offeree) has an incentive to sell-up and hope that others will tender higher prices. This behaviour presents an obstacle to efficient M&A since it prolongs the tender process and increases

the overall cost, which is shared among all minority shareholders.

Tong-Gun Lee from Shin & Kim sees the benefits of the new ruling: “The squeeze-out rule is intended to promote greater organisational efficiency. Nevertheless, it would also have the effect of promoting M&A transactions, since acquirers would be encouraged to pursue more M&As, relying on the benefit of owning 100% shares in target companies”. “Investors who are concerned about possible procedural burdens and other difficulties relating to minority shareholders will welcome the squeeze-out mechanism,” he adds.

The German model

Korea, like other countries that have squeeze-out laws, requires compulsory acquisitions to have a business purpose, but what differentiates one country from another is the type of squeeze-out adopted. While the KCC provides for a business purpose as a requirement for squeeze-out, senior foreign attorney at Shin & Kim Myong-Hyon (Brandon) Ryu believes this is somewhat open to debate: “It is not clear what the term “business purpose” means and how it will be interpreted by the Korean courts”.

The tender offer type adopted by the UK uses a two-step transaction; first, is the tender

stage where the offeror makes a public offer to the shareholders of the target company, and second, having acquired the minimum number of shares required for the squeeze-out, the offeror is allowed to acquire the remaining shares held by the minority shareholders.

The cash-out merger type adopted by the US allows the majority shareholders to force out the minority shareholders via a stock-for-cash merger. Under this arrangement the minority shareholders in the target company will receive cash in exchange for their shares of the target company.

The supermajority type adopted by Germany enables a majority shareholder who has obtained supermajority ownership in the target company to squeeze-out the minority. Once a dominant shareholder reaches the necessary threshold, by law a demand can be made to the remaining shareholders to sell their shares.

According to Ryu, Korea’s squeeze-out mechanism is modelled after, or is similar to, Germany, in that a squeeze-out is not required to be carried out in the context of or following a tender offer as is the case in the UK. Yet, Korea’s model is different from the US in that a controlling shareholder is granted the right to make a compulsory purchase of the minority shareholders shares without resorting to a cash merger. ◀