The Future Direction of Takeover Law in Korea?

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Preliminary Abstract

This Essay compares the legal takeover regimes of Korea and the United States and makes several points. First, important institutional differences exist between Korea and the United States (the model for many of Korea's recent corporate governance-related reforms including Regulation FD and Sarbanes-Oxley Act-like reforms). Controlling shareholders dominate Korean Chaebol firms. Non-Chaebol Korean companies are smaller on average than U.S. companies. Korea lacks a specialty corporate court and a well-developed plaintiffs' attorney bar. These differences call for a different emphasis in the package of laws controlling agency costs within Korean firms.

Second, deciding upon the exact package of laws that is optimal for Korean companies is a formidable task—particularly since market participants are constantly evolving the techniques used in corporate control transactions. The Essay offers several suggestions—including expanded fiduciary duties, fixed bounties for private class action attorneys, and "reverse" tag-along rights for minority shareholders in the case of a failed hostile takeover bid against a Chaebol member firm.

Third, the Essay contends that establishing the proper decisionmaker to determine corporate governance and takeover-related regulation into the future is crucial, particularly given the market's ability to react to new regulations and evolve over time. The Essay argues that the Korea Stock Exchange (KSE) is well positioned to provide regulatory protections for listed companies into the future. Compared with other regulatory decisionmakers, officials at the KSE face substantial competitive pressure, leading to potentially more responsive regulatory decisionmaking. Officials at the KSE also are closely involved with listed companies in Korea, allowing them to focus more quickly on key areas of concern for shareholder welfare. Because Korea's Ministry of Finance and Economy (MOFE) retains regulatory oversight over the KSE, regulatory officials at the MOFE may act as a safety net to ensure that the KSE continues over time to protect the interests of investors.

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I. Introduction

In large publicly-held corporations, shareholders face an agency problem. Because the shareholders are dispersed and individually lack an incentive to monitor management closely, management has freedom to operate the corporation in the management's private best interest. A hostile takeover, in theory, helps align the incentives of management with shareholders. Managers that expropriate value from the corporation will result in a depressed share price. The greater the expropriation of private benefits of control, the more the corporation's share price will be depressed, making the corporation a greater target for a hostile takeover.

Not all hostile takeovers benefit shareholders. Acquiring companies suffer from their own agency problems. The CEO at an acquirer may seek a takeover not to reduce agency costs at the target company but instead simply to expand the CEO's own business empire. To the extent the market determines share price with some degree of myopia (an assumption not shared by all), hostile takeovers may lead to a short-term focus on the part of managers. Still others express concern about the welfare of third parties affected by corporate takeovers, including employees, customers, suppliers, and local communities. Target shareholders may also not always approve takeovers that are in the target shareholder's own individual or collective best interest. Some forms of takeover, particularly contingent, two-stage offers with a lower second-stage price, may coerce target shareholders to agree to a first-stage hostile bid to avoid the second-stage price even if not in the collective best interest of the target shareholders as a group.

In the United States, takeover law attempts to balance both the advantages and disadvantages of hostile takeovers. While hostile takeovers are not banned entirely, those seeking to obtain a control of another company in a hostile transactions faces several legal and legally-sanctioned hurdles. Part II of this Essay discusses the hurdles facing hostile bidders in

the United States. What works for companies in the United States may not translate to other regimes. Part III discusses the agency problem in Korean corporations, focusing in particular on Chaebol firms, and the role of hostile takeovers and other mechanisms to reduce the agency cost. Given the institutional differences between Korea and the United States, the Part offers some tentative suggestions at reform. Knowing exactly what reforms will work best is a difficult endeavor. Given the uncertainty, Part IV assesses possible decisionmakers best suited to determine the future direction of takeover law in Korea.

II. The United States Regime

Two categories of law apply to takeovers in the United States: (A) the law governing all corporate control transactions (including friendly transactions) and (B) the law specific to hostile takeovers.

A. General Background Law

The key theme of U.S. law regarding corporate control transactions is choice. Managers at acquiring and target companies have a number of options at their disposal to execute a transaction in which control of substantially all of the target's assets and business is transferred to the acquiring company. The acquirer and target may simply combine through a statutory merger, transferring all the assets and liabilities from the target to the acquirer and eliminating the existence of the target corporation. Alternatively, the acquirer may purchase the assets of the target, typically avoiding the transfer of the target's liabilities to the acquirer.[1] As yet another alternative, the acquirer may purchase a controlling block of shares of the target. The acquirer

[1] Under successor liability, some liabilities (particularly tort liabilities) may nonetheless travel with the assets to the purchasing corporation. See Note, Successor Liability, Mass Tort, and Mandatory-Litigation Class Action, 118 Harvard L. Rev. 2357 (2005).

may then keep the target as a subsidiary corporation or eliminate the remaining minority shareholders of the target through a later squeezeout merger.

Given this choice in transactional form, lawmakers in the United States wrestle with the question of how much the law should take into account the separate interests of shareholders of the target and acquiring corporations. Even where target and acquiring company management agree on a particular control transaction, shareholders of both companies may not necessarily benefit. Target managers may agree to a statutory merger that is not in the best interests of target shareholders, for example, in return for a separate payment through a golden parachute agreement or a post-merger consulting agreement. An acquiring company may pay too much for the shares of a target corporation where the acquiring company's CEO is a significant shareholder of the target or receives other private benefits from the acquisition. Target controlling shareholders may approve a transaction to obtain a control premium not shared with the target minority shareholders.

How much veto power shareholders have in a corporate control transaction in the United States depends largely on the state of incorporation.[2] By far, the most important state in terms of mergers and acquisition deal activity is Delaware. Delaware state law provides a number of protections for shareholders of acquiring and target corporations including: (a) the requirement that a majority of outstanding shares must vote to approve certain corporate control transaction and (b) appraisal rights. Delaware also provides for (c) enhanced scrutiny of whether transactions are consistent with director fiduciary duties in certain circumstances.

Delaware does not make voting or appraisal rights universally available for change in control transactions. In a statutory merger, the target shareholders receive voting and appraisal rights. The acquiring company shareholders only receive voting and appraisal rights if 20% or

[2] Under the U.S. internal affairs doctrine, the law of the state of incorporation governs corporations.

more of the outstanding common shares are issued as part of the offering.[3] Both voting rights and appraisal rights decrease for other forms of corporate control transactions. In a purchase of substantially all the assets of the target company, the target shareholders receive the right to vote on the acquisition but no appraisal rights.[4] Delaware does not generally provide for voting approval or appraisal rights for acquiring company's shareholders in an asset purchase transaction. In a tender offer, where the acquirer purchases the shares of the target corporation, the target shareholders receive neither voting nor appraisal rights.[5] Similarly, the acquiring company shareholders typically receive neither voting nor appraisal rights.[6]

What does choice mean in practice for change in control transactions involving Delaware companies? Those planning a change in control transaction may take advantage of choice to provide as much (or little) voting and appraisal rights as desired.[7] Companies that desire to avoid a vote and appraisal rights on the part of the target and acquirer shareholders, for example, may directly purchase the shares of the target company from the target's shareholders in a tender offer using cash consideration.

Delaware provides special rules for control transactions involving a controlling shareholder. Under Delaware law, controlling shareholders enjoy substantial freedom to profit from control. Target controlling shareholders are allowed to obtain a premium when selling their shares.[8] Controlling shareholders are also allowed to vote their shares in their own private best interest—for example, voting down a merger with a third party that increases the overall value

[3] See Del. GCL §251(f).
[4] Del. §271
[5] Other regulatory bodies may require additional protections, nonetheless. NYSE and Nasdaq rules require a shareholder vote where an acquiring corporation issues more than 20% of its current outstanding common stock, among other situations.
[6] Situations can arise where the acquiring shareholders are entitled to vote. Where an acquiring corporation needs to issue more stock than authorized in its corporate charter in an acquisition using the acquiring stock as consideration, the acquiring shareholders must vote to authorize an amendment to the corporate charter.
[7] See Dale A. Oesterle, The Law of Mergers and Acquisitions (3d ed. Thomson West).
[8] See Zetlin v. Hanson Holdings, Inc. 48 N.Y.2d 684 (1979).

for all shareholders but eliminates the controlling shareholders' private benefits for control. Despite this freedom, Delaware law imposes restrictions on controlling shareholders and directors of controlled corporations in certain control transactions. Controlling shareholders are prohibited from selling their control block to a third party where the controlling shareholder has reason to believe that the third party is "dishonest or in some material respect not truthful".[9] Controlling shareholders are prohibited from taking certain corporate opportunities for themselves.[10] Controlling shareholders may not use their influence to obtain a disproportionate dividend from the corporation greater than that given to minority shareholders.[11]

Controlling shareholders that attempt a squeezeout merger to eliminate the minority shareholders may, if minority shareholders protest, face scrutiny from a Delaware court under the strict entire fairness standard.[12] Under the entire fairness standard, a Delaware court will assess the procedures used to approve the squeezeout transaction (fair dealing) as well as substantive fairness of the deal for minority shareholders (fair price).[13] Where a majority of the minority shareholders approve the squeezeout transaction, the burden of proof in the entire fairness analysis rests with the dissenting minority shareholders.[14] Otherwise, the controlling shareholder bears the burden of proof.

Even in a squeezeout, controlling shareholders may keep undisclosed their top bid for the minority shares.[15] Furthermore, Delaware provides choice to controlling shareholders to avoid

[9] See Harris v. Carter, 582 A.2d 222 (Del. Ch. 1990).
[10] For the contours of the corporate opportunities doctrine as applied to controlling shareholders see Thorpe v. Cerbco, Inc., 676 A.2d 436 (1996).
[11] See Sinclair Oil Corp. v. Levin, 280 A.2d 717, 720 (Del. 1971) ("Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary."). Where self-dealing occurs, Delaware courts will apply the intrinsic or entire fairness test to the self-dealing transaction. See id.
[12] See Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110 (1994); Orman v. Cullman, 794 A.2d 5 (2002).
[13] For a description of the entire fairness standard see Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (1995).
[14] See Weinberger v. UOP, 457 A.2d 701 (1983).
[15] See Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985).

the enhanced scrutiny test. Controlling shareholders that desire to avoid the entire fairness test for a squeezeout merger may, for example, structure the transaction as a non-coercive tender offer to acquire the remaining minority shares. Delaware takes a much more permissive view toward non-coercive tender offers that work to cash out minority shareholders, eschewing the entire fairness test and allowing minority shareholders to determine for themselves whether to accept the tender offer price.[16]

In addition to state law provisions, the federal securities laws also apply to certain change in control transactions. For situations where a shareholder vote is required, the transmissions of proxy materials relating to the vote are regulated under the proxy rules of the federal securities laws. In a friendly merger or asset purchase where a shareholder vote is required, the target company must, among other things, complete a detailed disclosure form under Schedule 14A and distribute such disclosure form to investors prior to the vote. Where an acquiring corporation attempts to purchase stock of a target through a broad-based and public offer to shareholders in the market place at a fixed price, the purchase will be deemed a tender offer and fall under the Williams Act, a component of the Securities Exchange Act of 1934 (Exchange Act). Among other things, the Williams Act requires the acquirer to make certain disclosures,[17] keep the offer open to everyone for at least 20 business days,[18] give the best price to all tendering shareholders,[19] and allow withdrawal of tendered shares at any time while the tender offer is open.[20]

[16] See Solomon v. Pathe Comm., 672 A.2d 35 (Del. 1996); In re Pure Resources, Inc., Shareholders Litigation, 808 A.2d 421 (2002).
[17] See Section 14(d)(1), Exchange Act.
[18] See Rule 14e-1(a), Exchange Act.
[19] See Rule 14d-10(a)(1), Exchange Act.
[20] See Rule 14d-7, Exchange Act.

B. Hostile Takeover Law

Two related problems face target shareholders in a hostile takeover. First, acquirers may use aggressive tactics to coerce target shareholders to tender their shares even when not in their own best interests. Second, defensive tactics, often installed to protect against coercive tender offer bids, can work instead to entrench target management at the expense of shareholder welfare.

Acquirers may coerce target shareholders into bidding through a number of ways. Consider a two-stage contingent tender offer.[21] Suppose a target's shares trade at $100 per share. An acquirer may make a tender offer for shares at $95 per share contingent on receiving 90% of the shares. The acquirer may then make it known that it will do a short-form merger[22] for the remaining shares if it obtains the 90% block at $80 per share. In such a situation, investors will rush to tender their shares at $95, despite the previous market price of $100, to avoid the possibility of being a shareholder who receives only $80 in the second stage short form merger.[23]

While the Williams Act requires disclosure and implements procedural protections to reduce the time pressure to tender on shareholders, the Act does not alleviate the coercive aspect of two-stage contingent tender offers. Target management filled the gap left by the Williams Act with various defensive tactics to protect target shareholders from coercive tenders offers.[24] Through a poison pill, for example, a target company may severely dilute the value of the shares

[21] See Lucian Arye Bebchuk, Toward Undistorted Choice and Equal Treatment in Corporate Takeovers, 98 Harv. L. Rev. 1693 (1985).

[22] Delaware allows a Delaware corporation with a controlling shareholder with 90% or more of the equity shares to eliminate the minority shareholders without a vote through a short-form merger. See Del. Gen. Corp. L. Section 253. The minority shareholders nonetheless receive appraisal rights.

[23] Of course, appraisal rights apply to the minority shareholders who are cashed out in the second-stage short form merger. To the extent appraisal rights provide equal or better value than the tender offer price, the coercive pressure to tender is removed.

[24] In addition, many states enacted antitakeover statutes. For example, Delaware employs a business combination statute, limiting the ability of shareholders that acquires a 15% or more interest in a target company to enter in a transaction to combine with the target for three years unless the target's board gives prior approval of the combination. See DEL. CODE ANN. tit. 8, § 203(a)(2), (c)(5).

of an acquirer who crosses a predetermined threshold of target share ownership. Acquirers, realizing that their shares face dilution, will choose not to acquire target shares above this threshold—allowing target companies to "just say no" to a hostile bid.

The use of hostile antitakeover devices by target management, ostensibly to block coercive tender offers among other things, however, also works to entrench target management from even value-increasing tender offers. Where target management use defensive tactics, target shareholders receive neither voting rights nor appraisal rights. Target shareholders receive no direct say in the decision to use defensive tactics. Instead, target shareholders are left only with the ability to go to court to challenge the use of antitakeover devices as inconsistent with the target boards' fiduciary duties under Delaware state law.

The range of defensive tactics is broad. Prior to the appearance of a hostile takeover, a company may enact amendments to the corporate charter requiring a supermajority vote to approve any merger. A company may also install staggered board of directors, delaying the ability of an acquirer to obtain majority control over the board. After the commencement of a hostile takeover, target companies have paid greenmail to make acquirers leave.[25] Target companies also will issue shares to friendly parties or a "white knight" third-party acquirer who will give the target managers (although not necessarily the target shareholders) better terms. Target companies may attempt to sell key "crown jewel" assets to third parties, reducing the desirability of the target company as a hostile takeover target. And by far the most popular technique today is to install a poison pill provision. Combined with a poison pill, a staggered board is a particularly effective defensive tactic. Because of the staggered board, acquirers that win a proxy contest are unable immediately to replace a majority of the board to redeem the

[25] Greenmail payments were among the earliest defensive tactics, popular in the 1980s. Today, a number of states employ anti-greenmail statutes, prohibiting the use of payment of greenmail to relatively short-term shareholders. See, e.g., MINN. STAT. § 302A.553.

poison pill, increasing the cost of a takeover and leading many potential acquirers never to make a hostile bid in the first place.

Delaware's response to defensive tactics has evolved over the past several decades, tracking the development of defensive tactics over time. Determining the proper balance between allowing and removing target management defensive tactics is not easy. Too pro-defensive tactic a position will lead to high levels of management entrenchment. Too anti-defensive tactic a position will result in takeovers that may not necessarily improve on target shareholder welfare. The inquiry will also depend on the specific defensive tactic at issue and the facts of the particular hostile takeover.

Grounded in the fiduciary duties of the target directors, Delaware's case law has moved away from the permissive business judgment rule toward intermediate scrutiny of the target's decision to implement or continue defensive tactics in the face of a hostile bid. Under the *Unocal*-standard, directors of the target corporation may employ defensive tactics that are reasonable in relation to the threat posed by the takeover.[26] The exact contours of the intermediate standard depend on the facts of the particular hostile acquisition. Where the target company puts itself up for sale, the target board must seek only to maximize the immediate return to the target shareholders pursuant to the *Revlon* decision.[27]

Importantly, the market is constantly adjusting to Delaware case law. Delaware's judiciary plays a cat-and-mouse game with market participants in responding to both new innovative hostile takeover techniques and defensive tactics. For example, after Delaware courts

[26] See Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (1995) (discussing the Unocal standard); see also Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989) (discussing Unocal threats against which a board may implement defensive tactics).

[27] See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). Whether Revlon applies turns on whether there is in fact a decision on the part of the target board to put itself up for sale in a transaction where shareholders will not get any subsequent control premium. See Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994).

allowed the use of poison pills, companies started to introduce variations on the pill including dead hand and no hand pills. Dead hand pills provide that only board members who originally adopted a poison pill may redeem the pill. Dead hand pills undermine attempts by acquirers to first use a proxy contest to remove the adopting directors and then second have the new directors redeem the pill to pave the way for a tender offer bid. Under a no hand pill, no one can remove the pill for a specified period of time following the announcement of a bid (committing the board to blocking the bid no matter the value of the bid for shareholders).[28] Delaware eventually outlawed both the dead hand and no hand pills, although Georgia and Pennsylvania have taken more permissive positions.[29]

III. Korea

Korea has often looked to the U.S. legal regime as a model for how to regulate the Korean corporations and securities markets. Shortly after the U.S. Securities and Exchange Commission promulgated Regulation FD in 2000, for example, Korea followed suit with its own version of prohibitions against selective disclosures. Korea enacted a class action law that went effective in 2005 similar (although not identical) to the laws in the U.S. allowing class actions. Korea also employs a U.S.-Williams Act-style early warning system in requiring investors holding 5 percent or more of the equity securities of a public company to disclose to Korean Financial Supervisory Commission and the Korea Stock Exchange (KSE) within five days the purpose of their acquisition of shares, among other requirements.[30]

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[28] For a discussion of dead hand and no hand pills see Stephen M. Bainbridge, Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills, 29 J. Corp. L. 1 (2003).
[29] See Camody v. Toll Brothers, Inc, 723 A.2d 1180 (Del. 1998); Invacare Corp. v. Healthdyne Tech, 968 F. Supp 1678 (ND Georgia, 1997); AMP v Allied Signal No 98-4405 LEXIS 15617 (Pennsylvania, 1998).
[30] See http://www.korealaw.com/content/immigration/Immigration01_02.asp?cate=57 (last visited on July 3, 2007).

Simply adopting the laws of the United States, or any other country, may not provide the best laws for Korea.[31] Unlike the United States, many of the larger Korean companies are members of Chaebol conglomerate groups. Chaebol groups represent a large fraction of Korean's economy and stock market capitalization.[32] Typically forty to fifty firms will comprise a Chaebol group.[33] While shares of Chaebol companies often trade on the Korean Stock Exchange and other markets, the founding family of a Chaebol typically holds a controlling interest in each company within the Chaebol group. The controlling interest will typically include direct share ownership by the founding family as well indirect ownership through "pyramid" ownership in other companies that in turn own shares in the particular Chaebol company.[34]

The pyramid ownership scheme in Chaebol groups leads to a large separation of voting and cash flow rights and magnifies the agency costs to minority shareholders.[35] A controlling shareholder that owns 50% of Company A that in turn owns 50% of Company B will have control over Company B with only a 25% ownership interest in Company B. This divergence

[31] See also Ok-Rial Song, The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol, 34 Law & Pol'y Int'l Bus. 183, 187, 221, 244 (2002) (arguing that the transplant of U.S.-style corporate governance into Korea may not be effective without also reforms to the separation of votes and cash flow rights within Chaebols).

[32] See Jeong Seo, Who Will Control Frankenstein? The Korean Chaebol's Corporate Governance, 14 Cardozo J. Int'l & Comp. L. 21, 23-24 (2006) ("In 2002, chaebols were involved in an average of 19.2 industries, ranging 'from chips to ships.' In addition, public firms belonging to ten major chaebols accounted for more than 52% of stock market capitalization as of 2003.").

[33] See Song, supra note 31, at 184.

[34] While dual class stock is prohibited in Korea, the pyramid structure of ownership allows equally if not greater separation of cash flow rights and voting rights. See Song, supra note 31, at 199 (citing Korea's Commercial Act and Monopoly Regulation and Fair Trade Act).

[35] See Song, supra note 31, at 199-201. Song also notes that "all companies in the chaebol designated by the Korean Fair Trade Commission are prohibited from acquiring or owning shares of stock of other domestic companies in excess of 25% of their net assets, and the amount of such net assets is calculated by subtracting the amount of the investment made by the affiliated firms. However, the enforcement of such a strict rule has rarely been observed in practice." See id. at 200-201.

between control and rights to cash flows gives the controlling shareholder an outsized incentive to expropriate private benefits of control at the expense of Company B's minority shareholders.[36]

Not only are agency problems within Chaebol firms exacerbated, but the legal and market mechanisms to limit such agency problems in Korea are weaker compared with firms in the United States. Regardless of the legal regime in Korea with respect to explicit defensive tactics, hostile takeovers are presently difficult in Korea due to the pyramid share holding schemes that concentrate voting power (but not cash flow rights) with the controlling shareholder. The controlling shareholder's pyramid control over each Chaebol firm provides a defensive tactic even more powerful than a poison pill. Similarly, proxy contests and other forms of shareholder vote are typically ineffective in disciplining the controlling shareholder in a Chaebol group. This Part canvasses three areas of possible reforms to improve on corporate governance within Chaebol firms.

A. Fiduciary Duties

Due to the difficulty of takeovers, regulators may wish instead to focus on other mechanisms to improve corporate governance within Chaebol firms. For example, Korea could increase the fiduciary duties imposed on controlling shareholders. As discussed above, the United States imposes various limitations on controlling shareholders. Controlling shareholders may not usurp corporate opportunities or pay themselves a disproportionate dividend. In addition, controlling shareholders face court review under the strict entire fairness standard for squeezeout mergers (but not non-coercive, cash-out tender offers).

[36] See Seo, supra note 32, at 25-26 (reporting that "[i]n a typical Korean chaebol, the dominant family usually owns only a small equity share in the conglomerate--less than 10% of the total equity in many cases."). Seo provides examples of Chaebol private benefits of control, including mismanagement and outright expropriation of value through "tunneling" transactions. See id. at 52-56.

Despite the limits imposed on them, controlling shareholders enjoy substantial freedom in the United States. A controlling shareholder is under no duty to force the corporation to undertake any actions, even if maintaining the status quo is disproportionately in the controlling shareholders interest. Nor is any duty imposed on how a controlling shareholder votes its shares. Controlling shareholders may elect directors of their choosing to the corporation. When faced with a value-increasing merger proposal, a controlling shareholder may vote its shares to block such a proposal to further its own private interests. Controlling shareholders are also under no obligation to contribute more capital to a corporation, or sell or purchase their shares even if such actions will improve the welfare of all shareholders. When they do sell, controlling shareholders may receive a control premium for their shares not shared with minority shareholders. Control, in other words, is valuable.

Korean regulators may wish to focus more specifically on the agency problems involving controlling shareholders. The ability of controlling shareholders in Korean Chaebols to use their control to extract value through transactions between related companies in the Chaebol group provides a large source of the private benefits of control for the controlling shareholders.[37] Greater fiduciary limits on controlling shareholders will reduce such private benefits and thus lessen the benefits from maintaining the pyramid ownership structures common in Chaebol groups.

Until the late 1990s, controlling shareholders enjoyed great leeway to extract private benefits of control in Korea. Among the reforms installed after the 1997 Financial Crisis, Korea imposed direct legal liability on controlling shareholders within Korea's corporate law.[38] It is

[37] See Seo, supra note 32, at 75 ("Perhaps the reason that pyramidal group structures are relatively rare in the United States and the United Kingdom is that many transactions inside a group would be challenged on fairness grounds by minority shareholders of subsidiaries, who would get a receptive hearing in court.").
[38] See Song, supra note 31, at 224. See Commercial Act, art. 401-2 (Korea).

unclear how far direct liability will go in punishing controlling shareholders who act opportunistically and whether this punishment will deter such behavior. The ability of controlling shareholders to extract private benefits is wide ranging across a number of different transactions. Controlling shareholders may extract value through the hiring of family members at substantial salaries. Controlling shareholders may divert corporate opportunities away from Chaebol member firms in which they hold a lower fraction of the cash flow rights to firms where they hold a greater fraction. Controlling shareholders may order firms in the Chaebol to enter into self-dealing, intragroup transactions designed to increase the profit of firms in which the controlling shareholder holds a larger fraction of the cash flow rights.[39] Controlling shareholders may attempt to repurchase minority shares at an overly large discount. And the list goes on.

Despite the institutional differences between Korea and the United States, the methods through which controlling shareholders in both countries extract private benefits of control are similar. While U.S. controlling shareholders lack the pyramid ownership structure, courts in the U.S. have long dealt with self-dealing transactions, usurpation of corporate opportunities, share repurchases from minority shareholders at inadequate prices and so on. Korea could therefore benefit in this particular area of substantive law from piggy-backing on the developed body of fact intensive law within Delaware on conflicted transactions with controlling shareholders.

Indeed, in addition to mere piggybacking, Korea could consider expanding the fiduciary duties placed on controlling shareholders. The division between permissible and impermissible

[39] The Monopoly Regulation and Fair Trade Act (MRFTA), as administered by the Korean Fair Trade Commission (KFTC) in Korea governs intra-group transactions. The MRFTA requires approval of transactions where the amount of the transaction exceeds 10% of the firm's capital or 10 billion won by the board of directors of involved companies. In addition to approval, the Chaebol must disclose the transaction to the public. The KFTC is also given the authority to review the transaction and can either block or adjust the transaction or impose a surcharge of up to 5% of the sale price on the purchasing company. See Seo, supra note 32, at 77 (citing the MRFTA, art 11-2(1)). Problems exist with the MRFTA procedure. The purpose of the MRFTA regulation of intra-group transactions is not to protect minority shareholders. Instead, as Seo notes "it is rather intended to protect competitors of a preferentially treated party." See id. (citing MRFTA, art. 23(1); 24;24-2). Any KFTC review will not necessarily result in the protection of minority shareholders.

actions on the part of controlling shareholder in the United States does not necessarily represent the best division for Korea. The present high level of entrenchment among Chaebol controlling shareholders in Korea argues for some amount of expansion of fiduciary duties. In the United States, one might worry about the increased probability of frivolous suits that may come with an expanded set of fiduciary duties. As well, expanded fiduciary duties on controlling shareholders may deter some from becoming controlling shareholders in the first place, exacerbating agency problems involving managers at companies with dispersed shareholders. Korea's situation however is different. The problem in Korea is not agency costs involving managers with dispersed shareholders but rather with large controlling shareholder blocks. Because control shareholder blocks already exist, the cost of deterring their formation is less important in Korea.

What sorts of enhanced fiduciary duties are possible? Korea, for example, could consider applying a strict enhanced scrutiny review of large Chaebol intragroup transactions (above a specified won amount) that are not approved by a majority of the minority, non-Chaebol shareholders. Korea could also prohibit controlling shareholders or their relatives from taking management positions at Chaebol firms in which the controlling shareholder does not own a direct shareholder interest above a specified amount (for example 20% of the shares). Similarly, Korea could implement a strict corporate opportunity doctrine, prohibiting a controlling shareholder from using any opportunity derived from a Chaebol firm regardless of whether the opportunity is in the Chaebol firm's line of business.

Rather than give controlling shareholders of a Chaebol complete freedom to vote their shares and obtain a control premium on the sale of their shares, Korea could also take a different stance than the United States. The Paper discusses later one such proposal to alter the incentives on how controlling shareholders vote their shares in the context of a hostile takeover.

B. Shareholder Litigation

In addition to strengthening fiduciary duty standards, Korean regulators may consider increasing the private enforcement of fiduciary duty standards through derivative suits and securities class actions. Korea recently enacted the Securities Class Action Act (SCAA) that went effective in 2005. The SCAA allows investors to bring a class action against publicly-listed companies for a defined list of investor harms, including insider trading, share manipulation, and misrepresentations in a securities offering registration statement or periodic filing.[40]

While Korea has implemented a class action law, the law as presently designed is unlikely to generate many law suits. In Korea, public companies in Korea are generally smaller in size compared with public companies in the United States. Consider the range of companies trading on the KSE. In 2002, there were 683 companies listed on the KSE. The largest company listed on the KSE, Samsung Electronics, had a market capitalization of U.S. $39.1 billion. Market capitalizations dropped rapidly, however, after Samsung Electronics. The tenth largest firm, Samsung Electro-Mechanics, had a market capitalization of U.S. $2.5 billion in 2002. After taking away the thirty largest market capitalization firms, the remaining 653 listed firms had an average market capitalization of only U.S. $83.4 million. In 2002, the entire NYSE had a global market capitalization of $13.4 trillion and about 2783 listed firms, giving an average market capitalization of $4.82 billion.

Evidence exists that plaintiffs' attorneys file suit primarily against larger issuers, offering greater securities damage awards, in the United States. Whatever the loss in deterrence caused by the tendency of plaintiffs' attorneys to file suit only against larger companies in the U.S., the

[40] For a description of Korea's securities class action law see Dae Hwan Chung, Introduction to South Korea's New Securities Class Action, 30 J. Corp. L. 65 (2005).

problem is only magnified in Korea. Samsung Electronics would likely qualify under even the most stringent size screens employed by U.S. plaintiffs' attorneys. Perhaps not coincidentally, the second derivative suit in Korea where shareholders won a judgment against directors of a Korean corporation was against Samsung Electronics. Nonetheless, Samsung Electronics is an outlier in terms of market capitalization among KSE-listed firms. It is unclear what impact a class action regime will have in Korea outside of the top thirty listed firms on the KSE.

In the United States the laws governing securities class actions depend on the presence of a robust plaintiffs' attorneys bar to bring such class actions. In comparison, the lack of any professional plaintiff firms in Korea exacerbates the lack of class action enforcement. The number of practicing attorneys is much lower in Korea. As of the early 2000s, South Korea had only about five thousand practicing attorneys serving a population of forty-eight million people.[41] In contrast, the state of California has approximately 157,710 active attorneys providing services for a population of over thirty-five million people.[42]

Regulators may wish to consider ways of improving on the derivative suit and class action regime in Korea. One possibility is for regulators to provide fixed bounties for plaintiffs' attorneys who successfully bring a derivative or class action suit. Regulators could set the fixed bounty at an amount sufficient to cover the fixed costs of litigation and provide a profit above these costs for plaintiffs' attorneys. Even if the damages from such an action are small, due to the relatively small market capitalization of many Korean companies, a fixed bounty to cover the fixed costs of litigating a class action suit may increase the incentive of some attorneys to file class action suits. With sufficient bounties, some attorneys may choose to specialize as

[41] See Misasha Suzuki, The Protectionist Bar Against Foreign Lawyers in Japan, China, and Korea: Domestic Control in the Face of Internationalization, 16 Colum. J. Asian L. 385, 391-92 (2003).

[42] The State Bar of California, Membership Demographics, at http://members.calbar.ca.gov/search/demographics.aspx (visited on December 3, 2003).

plaintiffs' attorneys. With the rise of specialized plaintiffs' attorneys will come increased expertise in assessing corporate actions and monitoring of public companies for activities harmful to minority shareholders.

C. Hostile Takeovers and Reverse Tag-Along Rights

Even with a more vigorous fiduciary duty regime to control agency costs among non-Chaebol firms, developing a strong takeover regime is important. Not all actions on the part of managers that reduce shareholder value are the same. Managers may extract value over time by, for example, shirking at their work. Other managers may extract a large amount of value in one isolated transaction, such as transferred a corporate asset to themselves at a bargain price. A fiduciary duty regime works best to stop isolated and large expropriations of value (through a self-dealing transaction for example). Fiduciary duties work less well in disciplining managers that engage in mismanagement or low levels of expropriation over a large number of transactions and decisions. Takeovers, on the other hand, because of the focus on overall share price and not any particular transaction, work better at deterring low level (but in the aggregate egregious) expropriation of private benefits of control.[43]

Hostile takeovers involving Chaebol group firms presently face enormous hurdles.[44] Korea has made changes over the past 15 years that have increased the possibility for takeovers. In 1994, Korea repealed Article 200 of the former Security Exchange Act, allowing outside

[43] Song similarly makes the point that not all costs controlling shareholders impose on minority shareholders are the same. While rules focusing on misappropriation of assets, insider trading, and self-dealing work well, according to Song, other costs are not so easy to reduce. See Song, supra note 31, at 239. Song notes that the large degree diversification present within Chaebol businesses will likely persist absent a more radical change to the alignment of voting and cash flow rights (or, alternatively, government direct intervention). See id.

[44] See Song, supra note 31, at 211 ("[O]ne of the most important barriers to hostile takeovers is the CM structure itself. Because the controlling shareholders have over 40% of outstanding voting power, the bidder has to acquire almost all of the remaining shares.").

investors to retain more than 10% of a firm's equity.[45] Since the Asian Economic Crisis in 1997, various limitations on foreign investors have also been lifted, opening up Korea's market to a new set of investors more willing to engage in aggressive tactics to improve corporate governance and share value.[46] In 2004, Korea began to allow domestic private equity funds.[47] Korea also repealed a provision requiring acquirers that acquired more than 25% of a target's shares to make a bid for a majority of the shares.[48]

Despite the reforms in Korea, hostile takeovers against Chaebol firms remain a daunting undertaking in Korea today due to the voting power of controlling shareholders. Normally a hostile takeover is, for practical purposes, impossible against a Chaebol firm because the controlling shareholder can simply not tender its shares or vote against a merger, defeating the takeover attempt. In response, regulators in Korea may wish to alter the incentives of controlling shareholders of Chaebol firms faced with a hostile bid. As discussed above, Delaware takes an intermediate position with respect to target company defensive tactics. While the business judgment rule is not applied, courts eschew applying an entire fairness standard. Instead, an intermediate standard of review is applied following *Unocal*, *Revlon*, and other major Delaware cases.

Korea may wish to go a step further than Delaware law given the entrenchment of the controlling shareholders at the Chaebol corporations. One tender offer provision increasingly popular among other countries is the provision for tag-along rights in a tender offer.[49] If an

[45] See Seo, supra note 32, at 68.
[46] See Seo, supra note 32 at 68.
[47] See Hee Chul Kang, The Current State of Equity Investments By Foreign Funds [In South Korea] and Related Legal Issues, 15 Pac. Rim L. & Pol'y 73, 86 (2006).
[48] See Bernard Black et al., Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness: Final Report and Legal Reform Recommendations, 26 J. Corp. L. 538, 555 (2001).
[49] See John C. Coffee, Jr., Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance, 102 Colum. L. Rev. 1757, 1808-1811 (discussing tag along rights in Brazil and Mexico).

outside acquirer obtains more than a specified percentage of a target's equity (for example 90%), then the acquirer must purchase the remaining shares at the same price. Tag along rights prevent the acquirer from profiting through the extraction of value from minority shareholders who do not tender their shares in a first stage of a tender offer. Tag along rights not only protect minority shareholders, they help ensure that the acquirer who obtains control of the target company through a tender offer in fact values the entire enterprise more than the target shareholders. Acquirers that do not value the target more highly will be unwilling to pay the same high price to all the target's shareholders. Tag along rights therefore have the virtue of ensuring that assets move to those who value them more highly.

Commentators on Korean corporate governance have supported the adoption of tag along rights in Korea.[50] Regulators may use a modified version of tag along rights to alter the incentives of the controlling shareholders and improve the efficient allocation of resources in Korea. In particular, regulators could force controlling shareholders that reject a hostile acquisition bid to put money behind their rejection. Under this proposal (termed here "reverse tag-along rights"), those who vote against a hostile bid would have an obligation to repurchase a specified fraction of the shares of those who voted for the hostile bid at the bid price. The proposed reverse tag-along rights would treat the controlling shareholder in rejecting the bid price of a hostile acquirer as implicitly deciding to purchase its own shares at the bid price. The reverse tag-along rights would then force the controlling shareholder to offer this same bid price to the target minority shareholders. If the controlling shareholder truly believes that the bid is inadequate and that the corporate value is greater than the bid price, the controlling shareholder

[50] See Black et al., Corporate Governance in Korea at the Millennium, 26 J. Corp. L. 537, 605 (2001) (proposing that "a mandatory offer for the company's remaining ordinary shares following acquisition of a controlling interest by any such company, person or group of affiliated persons, unless the obligation to make such an offer is waived by majority vote of the shareholders who would otherwise be entitled to accept the offer").

will profit from purchasing additional shares at the bid price. On the other hand, the share purchase provision will impose a penalty on those controlling shareholders that reject the bid not because they believe it undervalues the company but instead to maintain their own private benefits of control.

A reverse tag-along rights scheme is not without costs. Some hostile acquirers may seek to abuse the rule by filing false tender offer bids, seeking to harass the controlling shareholder of a Chaebol and drain the controlling shareholder of its cash resources. Even in a legitimate bid, the controlling shareholder of a Chaebol may lack the liquid resources to buy back the necessary number of shares from the minority shareholders. Even in situations where the target corporation is in fact worth more than the hostile bid price, the lack of liquidity may cause the controlling shareholder to acquiesce to the bid. The controlling shareholder may also not wish to take such an undiversified position in any one company.

While these complaints are legitimate, at least two responses are possible. First, the deep entrenchment of the Chaebol firms and their current insulation from hostile bids coupled with the ineffectiveness of current private rights of action in Korea lead to large private benefits of control. The need to reduce such private benefits is correspondingly greater in Korea compared with countries with stronger corporate governance protections. Not only are shareholders harmed, but the general economy is harmed from the inability to move corporate assets to their highest value use due to the concern of controlling shareholders to maintain their private benefits of control. While not all hostile bids may improve on shareholder welfare, the entrenched private benefits enjoyed by Chaebol controlling shareholders and the benefit from moving assets to more efficient uses counsel in favor of a radically more pro-takeover regime.

Second, procedural protections are possible to alleviate some of the concerns of a reverse tag-along rights regulatory requirement. Government regulators may intervene to moderate the level of market pressures imposed through reverse tag-along rights. Consider, for example, the following three step process that Korea could impose on hostile bids for control:

(1) In the first step, a government regulatory body such as the Korean Financial Supervisory Commission (KFSC) or other regulatory decisionmaker (including the KSE) could assess the hostile tender offer bid. The regulator can take into account the reputation of the bidder, assessing whether there is a true motivation to acquire the company versus a desire simply to harass the controlling shareholder of the company. The initial assessment can also look at whether the bid price is likely to be adequate, taking into account the performance of the target company relative to comparable companies. Because of the possibility of regulatory error in assessing the fairness of a bid price, such a review should not impose too stringent standards. Instead, so long as the bid is within the range of possible bid prices that a shareholder might accept, the bid should be allowed to go forward. To provide for consistency (and to limit the possibility of a regulatory decisionmaker from choosing to block a hostile bid for reasons other than overall shareholder welfare), the regulatory decisionmaker could be required to write up a set of reasons for its decisions. Potential hostile bidders could then review these reasons to predict how future bids may fare.

(2) In the second step, shareholders of the corporation should be given the ability to vote as a group on the hostile tender offer bid. The ability to vote as a group provides another layer of

protection for the target shareholders against coercive tender offer bids.[51] So long as the vote is separate from the decision whether to tender or not, the vote of the group of shareholders provides an effective deterrent to coercive bids. If the vote approves the tender offer, the tender offer should proceed.

(3) In the third step, if the hostile bid fails (either because the target shareholder vote did not approve the bid or insufficient shares were tendered in the case of a contingent bid), those shareholders who voted against the bid would become obliged to make an offer to purchase a predetermined fraction of the shares of those who voted for the bid and tendered their shares. Shareholders who supported the hostile bid, at their choice, could either sell to the shareholders opposing the bid or, in the alternative, keep their shares. Regulators can adjust the purchase fraction to take into account liquidity problems. For small-size hostile bids, for example, those who voted against the bid could be made to repurchase all of the shares of those in favor of the hostile bid. For larger bids where liquidity is an issue, those who oppose could be forced to repurchase only a fraction (say one-quarter for example) of the shares of those who favor the bid.

One may wonder whether any acquirers will appear even if Korea opens Chaebol companies up to more hostile bids in the future using a reverse tag-along rights rule. Significantly, hostile takeover attempts do occur in Korea today, although infrequently. Kumkang Korea Chemical, for example, recently launched a hostile takeover attempt of Hyundai

[51] See Lucian Bebchuk, The Case Against Board Veto in Corporate Takeovers, 69 U. Chi. L. Rev. 973, 982 (2002) ("A voting mechanism provides a 'clean' way of enabling shareholders to express separately their preferences [in relation to whether a takeover should go ahead, and whether they want their shares acquired under the takeover]."); Lucian Bebchuk, Towards Undistorted Choice and Equal Treatment in Corporate Takeovers, 98 Harv. L. Rev. 1695, 1697-98 (1985) ("According to the undistorted choice objective, a target should be acquired if and only if its shareholders, or at least shareholders holding a majority of its shares, judge the offer acquisition price to be higher than the independent target's value.").

Elevator, Inc.[52] The growing influence of large institutional investors, particularly foreign funds, provides the prospect of financially-well backed bidders in the future. Since 1997, foreign investment in Korean equity has grown rapidly. As of 2004, foreigners owned over 40% of the total aggregate market capital in the Korean securities market.[53] Foreign funds represented about half of the foreign invested capital.[54] Foreign private equity funds have already taken concentrated positions in Korean companies, sometimes with control. Management control in Korea First Bank, KorAm Bank, and Korea Exchange Bank has changed hands in recent years.[55] In addition, the Korean government recently amended the Act on Business of Operating Indirect Investment and Assets to allow for more domestic private equity funds.[56]

Another objection to reverse tag along rights focuses on the overall desirability of hostile acquisitions from the perspective of society as a whole. Labor union and employees will likely resist hostile takeovers into the future in Korea,[57] adding political pressure against such takeovers. Regulators at the Fair Trade Commission of Korea have stated: "[I]t will not be acceptable, socially and politically, if frequent and massive downswings and restructuring of corporations by M&A activities result in a serious unemployment problem."[58]

Against the interests of labor unions and employees is the possibility that hostile takeovers, by increasing overall efficiency within Korean corporations will result in faster economic growth, more job creation, and higher standards of living for all Koreans. While special interests opposed to hostile takeovers are vocal, the broader beneficiaries from faster economic growth are less vocal. It is unclear, therefore, whether the objections of unions and

[52] See Kang, supra note 52.
[53] See id. at 80.
[54] See id. at 80.
[55] See id. at 74
[56] See id. at 74.
[57] See id. at 86.
[58] See Seo, supra note 32, at 68 (citing the Fair Trade Commission of Korea).

displaced employees should represent the preferences of Korean society as a whole. Even if they do, the disruptions caused to unions and employees is not unique to hostile takeovers. Friendly acquisitions occur. And even without an acquisition, companies can reorganize in ways that dramatically affect worker welfare. It is unclear therefore why hostile takeovers are singled out as disruptive in particular to unions and employees.

An important impact of hostile takeovers is on the structure of Korean Chaebol groups. Strong fiduciary duties against intra-group transactions coupled with a more permissive takeover environment will put pressure on group structures that are put together less for efficiency reasons and more to benefit the controlling shareholders of the group. Regulators, of course, could simply mandate a change in the present pyramid ownership scheme within groups. Korea, for example, presently places ceilings on intra-group shareholding. These ceiling provide a crude way to reduce the influence of a controlling shareholder in a pyramid ownership structure by depriving group companies of voting power in other group companies.[59] The government also attempted to require Chaebols to identify their primary industry and "voluntarily" exchange some of their non-primary businesses in what is referred to in Korea as the "big deal".[60]

[59] Seo describes the limits as follows:

> The MRFTA limits individual affiliated companies from holding other affiliated companies' equity when the companies belong to an enterprise group with more than 6 trillion won (equivalent to $6 billion) in assets. Such an enterprise group is defined as a shareholding-capped enterprise group. More specifically, a member company of the shareholding-capped enterprise group cannot acquire other affiliated companies' shares surpassing 25% of its net assets. The net assets of a company refer to the amount obtained by subtracting the amount of equity investment made by the company's other affiliates in the company from the larger amount between the company's capital sum and equity capital.

Seo, supra note 32, at 60-61. See id. at p. 56-57 ("With the reinforcement of the ceiling on intra-group shareholding in 2001, the Chey family became unable to exert leveraged voting power on the SK Corp. through the member companies, such as SK C&C. Of the 10.83% of the SK Corp.'s shares owned by SK C&C, approximately 9.5% were deprived of voting rights. As a result, the family would have lost control over a large part of the conglomerate.").

[60] See Song, supra note 31, at 222. Song observed though that: "[O]nly a few of the big deals have been completed at present. Meanwhile, Chaebol have no stopped diversifying their investments." Id. at 222.

However, regulators may make mistakes.[61] Government regulators may not have full information on the value of bringing certain types of operating companies together nor the expertise to determine the best financial ownership structure. While the pyramid scheme of ownership of the Chaebol groups appears to allow controlling shareholders to expropriate large levels of private benefits of control, perhaps such structures allow for synergies between group companies.[62] Commentators have observed that the ceilings may result in inefficiencies, limiting the ability of Chaebol firms to establish new subsidiaries to take advantage of limited liability to engage in specific new business operations.[63] Rather than mandate any particular control structure, allowing the market to determine for itself the value of the Chaebol control structure (with background fiduciary duties to control obvious attempts to grab value through conflicted transactions) introduces an alternative decisionmaker with better expertise and incentives to adjust ownership structures to maximize shareholder welfare. Providing a mechanism, such as reverse tag-along rights, to expose the Chaebol pyramid ownership structure to greater market discipline has the promise of allowing value-increasing pyramid structures (if any) to remain intact while unwinding value-decreasing structures.

Exposing Chaebol companies to the limited possibility of a hostile takeover provides for a market mechanism to determine the optimal organization of Chaebol firms. The proposed reverse tag-along rights do not force controlling shareholders to divest themselves of any specific

[61] Indeed, Korea's government policy in the 1960s and 1970s largely led to the creation of the Chaebol structure in the first place. See Song, supra note 31, at 185-186.

[62] See Seo, supra note 32, at 26 (noting that "the potential dissipation of corporate wealth cannot explain the surging popularity of at least some chaebol firms among investors. For example, Samsung Electronics, a core company of the Samsung chaebol, accounts for 18.18% of capitalization in the Korean stock market as of March 2005."). Seo goes on to remark that the Chaebol structure may be useful in reducing the agency cost from the rising use of professional managers to run corporations in Korea. See id. at 28-29, 49 (mentioning the failure of Kia Motors as an example of the dangers associated with professional managers). See also Song, supra note 31, at 185 (noting that "the Chaebol system has historically produced some great successes.").

[63] See Seo, supra note 32, at 64 (noting the possibility that "a firm may abandon a risky yet profitable project because of limitations on equity-holding.").

Chaebol firm. Instead, reverse tag along rights simply impose market discipline on Chaebol ownership structures. If a particular firm is truly at maximum value within a Chaebol, the controlling shareholder will match any hostile bid for control. If not, then the firm and its shareholders are better off outside of the Chaebol. The reliance on a regulatory authority, such as the Korean FSC or the Korea Stock Exchange, to impose some limits on hostile bids reduces the problems of opportunism on the part of bidders that may come with a reverse tag along rights regime. While problems still exist, the deeply entrenched nature of the Chaebol pyramid ownership structure and the more error-prone alternative of relying on government direct intervention argue for using limited market pressures to restructure the Chaebol groups when possible, as within a reverse tag along rights regime.

IV. The Proper Decisionmaker

Taking into account Korea's institutional structure and the presence of Chaebol groups, this Essay proposed several reform possibilities to enhance corporate governance. Determining precisely what reforms are best suited to Korea's situation, however, is an arduous task. One of the hallmarks of mergers and acquisitions in the United States over the past several decades has been the ingenuity of the investment bankers and attorneys working on such deals. Starting with a plain-vanilla statutory merger, these investment bankers and attorneys have devised a myriad of ways to obtain control over the assets and operations of another corporation (including tender offers, assets purchases, reverse and forward triangular mergers) while adjusting, and sometimes circumventing, the legal protections afforded shareholders in a statutory merger. Similarly, as Delaware's doctrine on hostile takeover evolved, so did the types of defensive tactics. Starting with simple greenmail payments to fend off a hostile acquirer, defensive tactics evolved toward

golden parachutes, shark repellent amendments, and today's poison pill. Even among poison pills, there exist variations including no-hand and dead-hand poison pills.

What may work in Korea today, therefore, may not work in the future as the market evolves to changes in the investor base and the continuing globalization of business and capital. Rather than propose more specific reforms, this Part explores the various possible decisionmakers for adjusting Korea's corporate governance and takeover-related laws into the future. Putting in place the best decisionmaker in Korea has the benefit of generating good corporate governance laws for Korea not only presently but into the future. Because of the fast pace with which change can occur in deal structures, flexibility and responsiveness are important attributes in a regulatory decisionmaker charged with maintaining a takeover regime.

This Part (A) examines Delaware as a baseline point of comparison and (B) analyzes various alternate decisionmakers in Korea.

A. The Delaware Model

In the United States, the state of Delaware has taken the lead in developing takeover related doctrine. The crucial aspects of Delaware law that regulate takeovers is not found in the statute itself. The Delaware General Corporation Law provides a framework for business control transactions and some broad outlines of the duties of officers and directors. The details of takeover regulation are instead found in the case law developed by the Delaware Chancery Court and Supreme Court.

Several features combine to give Delaware its lead in the development of takeover-related law in the United States. First, Delaware is responsive. Delaware is one of the smallest states in the U.S. and derives a large fraction of its state revenues from incorporation fees. The

incorporation fees represent over 20% of Delaware's state revenues.[64] This dependence on the revenues from incorporation gives corporations assurance that Delaware will adjust its law to changes in the market and new takeover practices with an eye towards maintaining (and growing) these incorporation fees.

Second, Delaware has an active and politically powerful attorneys' bar that represents the interests of out-of-state corporations in Delaware. The Delaware bar benefits financially as more companies incorporate in Delaware. Consequently, the bar uses its political influence on Delaware's state legislature to ensure that large numbers of companies continue to incorporate in Delaware.[65]

Third, Delaware's judges are specialized in corporate law. Corporate cases are channeled to Delaware's Chancery Court. The high volume of cases gives Delaware's judges good information on the types of issues at stake in striking the appropriate balance of legal intervention to protect shareholder interests. The high volume of cases also allows judges to develop expertise in judging corporate matters. In particular, the large number of incorporated public companies in Delaware leads to a similarly large number of mergers and acquisitions, including hostile takeovers. Judges in Delaware are therefore conscious of the importance of takeover-related law for maintaining this large number of incorporations. The large numbers also lead to a large volume of litigation. With more litigation comes greater opportunities to observe how previous decisions affect the incentive of market players in the takeover market and to change the direction of the law when needed. Delaware also spends great resources on its judicial system, allowing it to provide speedy resolution to many litigation issues surrounding a takeover.

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[64] See Robert Daines, The Incorporation Choices of IPO Firms, 77 N.Y.U. L. Rev. 1559, 1566 (2002).
[65] See Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469, 503-04 (1987).

A debate exists whether competition among jurisdictions in the provision of corporate law benefits shareholders. Under the "race-to-the-top" view, those who make the incorporation decision (typically the promoters of an IPO or the managers of an established company) seek to maximize the share price of the corporation.[66] An incorporation decision that harms shareholder welfare will put downward pressure on share prices. States will therefore strive to implement corporate law rules that maximize overall corporate value to attract more incorporations. In contrast, the "race-to-the-bottom" view holds that managers care most about maximizing their private benefits of control.[67] Corporate law rules, under this view, will cater to these preferences in a competitive regime, particularly for areas of corporate law where private benefits are greatest—including change in control transactions and conflicted transactions between corporate officers and directors and the corporation.[68]

The evidence on whether a race-to-the-top or race-to-the-bottom exists is mixed. Daines examined the valuation of Delaware-incorporated firms compared with other firms.[69] Using the Tobin's Q measure of valuation, he found that Delaware-incorporated firms enjoyed a significant premium above book value compared with non-Delaware firms—a difference Daines attributed to the value of Delaware corporate law rules (in particular merger-related rules) for shareholders.

[66] See Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251, 257-58 (1977); Roberta Romano, The Genius of American Corporate Law 14-24 (1993)
[67] See William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L.J. 663, 666 (1974).
[68] See Lucian Ayre Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1435 (1992). Some also question whether other states, where the incorporation revenues represent a much smaller fraction of state revenue, have large incentives to compete against Delaware. See Marcel Kahan & Ehud Kamar, The Myth of State Competition in Corporate Law, 55 Stan. L. Rev. 679 (2002). Significantly, the competition for incorporations in the United States focuses primarily on larger, publicly-held corporations. Most smaller corporations simply remain in their home jurisdiction. The corporate law of Delaware, thus, is more attuned to the needs of larger public companies. The lack of voting and appraisal rights for many forms of corporate control transactions in Delaware reflects this bias toward the needs of larger, public companies.
[69] See Robert Daines, Does Delaware Law Improve Firm Value?, 62 J. Fin. Econ. 525 (2001).

Others have disputed the results of the Daines study.[70] Subramanian[71] and Bebchuk and Cohen[72] report that firms tend to incorporate in their home state (where the firm headquarterss are physically domiciled) if the home state employs antitakeover statutes. In contrast, Kahan examines the determinants of a firm's incorporation decision.[73] He finds that firms favor states that give flexibility in how to structure the firms' corporate governance and provide higher quality judicial systems. On the other hand, he reports no evidence that the presence of anti-takeover statutes affects the incorporation decision one way or the other.

B. The Decisionmaker in Korea

This Part examines three possible decisionmakers for takeover-related regulations in Korea: (1) courts, (2) governmental regulatory agencies (such as the KFTC or the Ministry of Finance and Economy ("MOFE")), and (3) the Korean Stock Exchange.[74]

1. Courts

If courts work for Delaware (at least for those that believe in the race-to-the-top), then why not for Korea? While Korea does use a number of specialized courts, including a bankruptcy court, no analogue to the Delaware Chancery Court exists today in Korea. Employing a similarly specialized court with expert judges may provide significant benefits to

[70] See Guhan Subramanian, The Disappearing Delaware Effect, 20 J.L. ECON. & ORG. 32 (2004) (reporting that the Delaware valuation effect identified by Daines (2001) disappears for larger companies over the 1991 to 2002 time period).
[71] See Guhan Subramanian The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching," 150 University of Pennsylvania Law Review 1795 (2002).
[72] See Lucian A. Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate, 46 Journal of Law & Economics 383 (2003).
[73] See Marcel Kahan, The Demand for Corporate Law: Statutory Flexiblity, Judicial Quality, or Takeover Protection?, 22 J. Law. Econ & Org 340 (2006).
[74] Sections of the analysis in this Part are based on the analysis from Stephen J. Choi & Kon Sik Kim, Establishing a New Stock Market for Shareholder Value Oriented Firms in Korea, 3 Chi. J. Int'l L. 277 (2002).

shareholders in Korea. Black et al. recommend the adoption of a commercial law specialty court in Korea.[75] Specialized corporate law judges could determine with greater precision when hostile takeover bids are coercive, on the one hand, or have the potential to offer profit for target shareholders, on the other hand. Through repeat decisionmaking and the provision of opinions, a specialized corporate law court may also help provide certainty as to takeover-related law in Korea for market participants.

Korea, of course, could adopt a specialized corporate law court. Even with such an adoption, specialized corporate law courts in Korea may fall short of Delaware's provision of corporate law in the United States. Delaware's competition with other states and the large financial revenues it derives from incorporations gives Delaware a strong incentive to ensure that it tailors corporate law to meet the interests or incorporating firms. A Korean specialty court with monopoly jurisdiction over corporate matters would not have the same financial incentives. Similarly, Korea lacks an active corporate-related bar to put pressure on the Korean legislature if the specialty court ruled against the best joint interests of corporations and shareholders.

Even if Korea were to establish such a court, developing expertise among the judges may be difficult. The volume of corporate cases in Korea will likely be far lower than that of the United States. While Delaware's economy is even smaller than Korea, because Delaware attracts companies from across the entire U.S., the amount of business transactions going through the Delaware courts is significantly greater than the deal volume in Korea. Without a steady volume of cases, even a specialty court may find it difficult to obtain the expertise necessary to judge complex business change of control transactions.

[75] See Black, supra note 50, at 603 ("Consideration should be given to creation in Korea's major cities of a separate bench of the District Court to handle large or complex commercial and financial disputes, including shareholder litigation.").

2. Government Agencies

Korea may also look to its regulatory agencies, including the MOFE or the KFSC, to monitor and regulate change of control transactions. Relying on top-down regulation, however, is not without its problems. Government bureaucrats, similar to court judges in Korea, may lack financial incentives to provide regulations that maximize the joint welfare of market participants. The mandatory nature of most government regulations also leads to little or no regulatory competitive pressures. Regulators may make a mistake and impose too high a level of regulation. Without the ability to escape, other than exiting Korea altogether, corporations and their shareholders must simply suffer the costs of such regulations.

Regulators also often respond more to public outcry and scandal than to the market needs of shareholders and corporations. After well-publicized scandals, regulators face great pressure to appear to be "doing something".[76] Immediately following the Asian economic crisis, numerous reforms affecting corporate governance were implemented in Korea.[77] Regulators may also over-react to a scandal, resulting in too much regulation (as some would describe the Sarbanes-Oxley Act in the United States). In contrast, absent any particular scandal, the impetus for change may diminish among lawmakers and regulators. Since the early 2000s, the pace of reform in Korea has slowed. Top-down regulations often results in cycles of either too many reforms all at once (often resulting in overregulation) and periods of too scant attention paid to

[76] See Stuart Banner,What Causes New Securities Regulation? 300 Years of Evidence, 75Wash. U. L.Q. 849, 850 (1997) (contending that the major legislative moves to enact new securities regulation over the past 300 years followed large and sustained price collapses in the stock market).

[77] These reforms include optional cumulative voting and the requirement of independent directors at Korean public corporations. Korea presently requires that at least 25% of the board members consists of independent outside directors for KSE listed firms. If the listed company's assets exceeds 2 trillion Won, then more than 50% of the board must consist of independent outside directors. See also Black et al., supra note 50, at 554-556 (listing reforms that took place in Korea after the 1997 Financial Crisis).

the need for regulatory change. At least one commentator has called into question the efficacy of top-down regulation in Korea.[78]

On the other hand, Korea can boast of a professional and expert group of financial regulators at the KFSC, MOFE, and other government entities. Government regulators have access to investigatory resources and tools unavailable to other sources of investor protection. Government regulators may also call upon penalties, including prison sentences, unavailable to other sources of investor protection. In Korea, government regulators may therefore play a valuable role in enhancing Korea's capital markets and corporate governance system. A hybrid system where government regulators work in conjunction with other sources of investor protection, such as the Korea Stock Exchange as discussed below, may combine the best qualities of government regulation while minimizing the problems of both regulatory error and scandal-driven reform.

3. Korea Stock Exchange

Installing a Delaware-style competition system for the development of corporate governance and takeover-related law is likely infeasible in Korea today. On the other hand, relying on top-down, government-driven intervention is also unlikely to have the necessary flexibility and expertise to keep up with market needs. Professor Kon Sik Kim and I have argued elsewhere that a better approach is to rely on the Korea Stock Exchange.[79] Basing corporate governance and takeover-related regulation in the KSE provides several benefits compared with government agency top-down regulation:

[78] See Seo, supra note 32, at 29-30 (arguing that the top-down regulation of Chaebols in Korea has resulted in "government failure" and that "[d]espite regulation, the disparity between cash-flow rights and voting rights has increased.").
[79] See Choi and Kim, supra note 74.

First, incentives are important. The KSE faces competitive pressure from securities exchanges around the globe for listings. This competition will grow with the growing globalization of world securities markets. To retain listings, the KSE will have strong incentives to implement takeover-related regulations that cater to the joint interests of companies and their shareholders.

Second, officials at the KSE enjoy an information advantage as to public companies and their practices. Given the myriad forms of transactions possible in a merger or acquisition, closeness to actual business practices is important. Understanding the types of control transactions and the problems that may arise from these transactions will allow KSE regulators to focus their regulatory efforts more effectively than more distant government regulators.

Third, the MOFE can provide a safety net to guard against a possible race-to-the-bottom within KSE regulations. While competitive pressures likely will lead the KSE to implement regulations that cater to the joint needs of companies and their shareholders, a race-to-the-bottom is theoretically possible in a competitive environment. To guard against a race-to-the-bottom, the MOFE could reserve the right to approve any new KSE takeover-related regulations. The MOFE could also establish a set of baseline regulations, including the present Williams-Act style disclosure provisions applying to Korean tender offers.

Lastly, relying on the Korea Stock Exchange provides for the ability to differentiate and experiment with regulation for different types of firms. The KSE, for example, could differentiate its levels of regulation, providing a base level (possibly incorporating the enhanced fiduciary duties on controlling shareholders and reverse tag-along right provisions discussed above) and a separate optional section providing even greater corporate governance protections. The separate section could, for example, limit takeover defensive tactics or provide for reverse

tag-along rights for bids without the safety net of KSE or KFSC approval of hostile bids. The separate section could also impose more stringent independence director requirements for boards. As I discussed in my prior article with Professor Kim, limited choice may prove both politically feasible of raising the level of corporate governance for a subset of companies while avoiding some amount of the political backlash of attempting to improve corporate governance at the Chaebol firms.

What companies will opt into the separate KSE section? Companies initially going public, for example, may desire a more takeover-friendly regime as a method of bonding their commitment to strong corporate governance to their shareholders. If a company performs poorly, then a hostile takeover may possibly displace current management. Because the rules of the separate KSE section would not apply to Chaebol firms, the Chaebol will not resist the creation of the separate section.

Other markets have established separate sections within established securities exchange available by choice for companies desiring higher corporate governance standards. The experience of separate corporate governance sections is mixed. The Deutsche Boerse AG established the Neuer Markt as a separate section to cater to the interests of primarily high technology IPO companies. The higher corporate governance standards in the Neuer Markt did not make it immune to scandal. Several accounting and insider trading scandals and bankruptcies hit Neuer Markt listed companies. Comroad AG, for example, a company listed on the Neuer Markt for two years, announced in 2002 that almost its entire 2001 revenue was falsified.[80] Once the Neuer Markt lost its reputation as a high standard market, investors punished all companies listed on the market. Some of the most vocal critics of the Neuer

[80] See Neal E. Boudette, Neuer Markt Suffers a Setback with Comroad Invoice Scandal, Wall St. J., April 11, 2002, at C8.

Markt's corporate governance standards were listed companies themselves.[81] The Neuer Markt responded with efforts to elevate its listing standards. However, after the Neuer Markt benchmark plummeted over 90%, the Deutsche Boerse shut down the Neuer Markt.

The failure of the Neuer Markt, nonetheless, should be taken more as a cautionary tale rather than conclusive evidence on the infeasibility of separate corporate governance sections. The Neuer Markt, in part, fell victim to the general decline in interest among investors for high technology stocks in the early 2000s that affected multiple markets including the U.S. Nasdaq market. Since the closing of the Neuer Markt, other Neuer Markt-like separate corporate governance sections have enjoyed more success. Brazil's Novo Mercado, a separate listing section of the Sao Paulo Stock Exchange, has grown rapidly to over 60 listed companies in 2007. This growth has included the listing of larger, established companies in Brazil. Embraer, a manufacturer of aircrafts, and Perdigao SA, a poultry maker, abolished their dual class stocks and switched their listing to the Novo Mercado.[82] Companies listed on the Novo Mercado enjoy a large price premium over other Brazilian companies.[83] Even companies not listed on the Novo Mercado have followed the separate exchange's corporate governance lead. Telemar, Brazil's largest telecommunications company, announced in 2006 that it would eliminate its dual class structure and install corporate governance improvements.[84]

The movement of larger, established companies in Brazil to the Novo Mercado is instructive for the usefulness of a separate section of the Korea Stock Exchange. Brazil's Novo Mercado explicitly provides rules governing tender offers, including special obligations for

[81] See Neal E. Boudette, Frustrated Neuer Markt Members Push for Tightening Listing Rules, Wall St. J., July 11, 2001, at C12.
[82] See Geraldo Samor, Dialing for a Higher Stock Price --- Brazilian Telecom Shifts to a Single, More Popular Class of Stock, Wall St. J., April 18, 2006 at C14.
[83] See id.
[84] See id.

tender offers that will result in a the delisting or cancellation of the registration of a public company – requiring that the tender offer proceed according to "economic value criteria" to ensure that the public shareholders receive a fair value for their shares.[85] Under the economic value criteria, the acquirer must undertake and report a valuation analysis of the target shares using well-established finance principles (such as the discounted cash flow method). The Novo Mercado also mandates tag along rights, giving all common shareholders the right to receive the same price as the controlling shareholders in a change of control transaction.[86] Focusing on not only direct corporate governance measures, such as the independence of directors, but also on the market for corporate control will allow the KSE to make itself a more attractive marketplace.

V. Conclusion

Korea's economy has been dominated by Chaebol groups for the past several decades. Following the 1997 Asian financial crisis, foreign investment and deal activity escalated rapidly in Korea. Given the predominance of Chaebol firms in Korea's economy, this Essay makes several points. First, there exist important institutional differences between Korea and the United States (the model for many of Korea's recent corporate governance-related reforms, such as Regulation FD and Sarbanes-Oxley Act-like reforms). Controlling shareholders dominate Korean Chaebol firms. Non-Chaebol Korean companies are smaller on average than U.S. companies. Korea lacks a specialty corporate court and a well-developed plaintiffs' attorney bar. These differences call for a different emphasis in the package of laws controlling agency costs within Korean firms.

[85] See http://www.bovespa.com.br/Companies/NovoMercadoSpecial/NovoMercadoi.htm.
[86] See id.

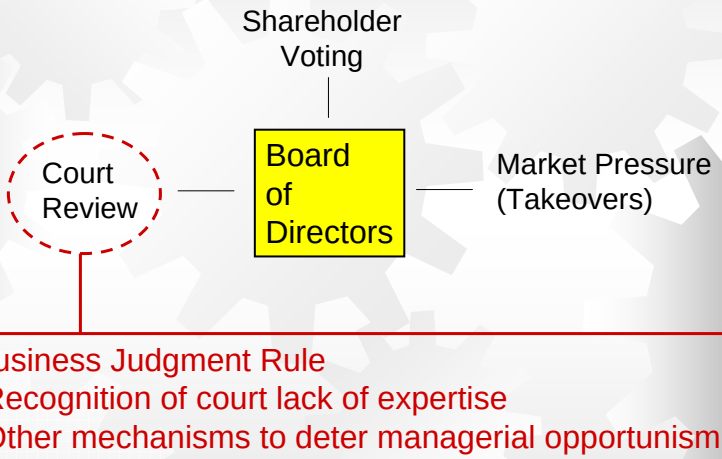
Second, deciding upon the exact package of laws that is optimal for Korean companies is a challenging task—particularly since market participants are constantly evolving the techniques used in corporate control transactions. The Essay makes several suggestions—including expanded fiduciary duties, fixed bounties for private class action attorneys, and "reverse" tag-along rights for minority shareholders in the case of a failed hostile takeover bid against a Chaebol member firm.

Third, the Essay contends that determining the proper decisionmaker to determine corporate governance and takeover-related regulation into the future is crucial, particularly given the market's ability to react to new regulations and evolve over time. The Essay argues that the Korea Stock Exchange is well positioned to provide regulatory protections for listed companies into the future. Compared with other regulatory decisionmakers, KSE officials face substantial competitive pressure, leading to more responsive regulatory decisionmaking. Officials at the KSE also are closely involved with listed companies in Korea, allowing them to focus more quickly on key areas of concern for shareholder welfare. Because Korea's MOFE retains regulatory oversight over the KSE, regulatory officials at the MOFE may act as a safety net to ensure that the KSE continues over time to protect the interests of investors.

The Future Direction of Takeover Law in Korea?

Stephen Choi
NYU Law School

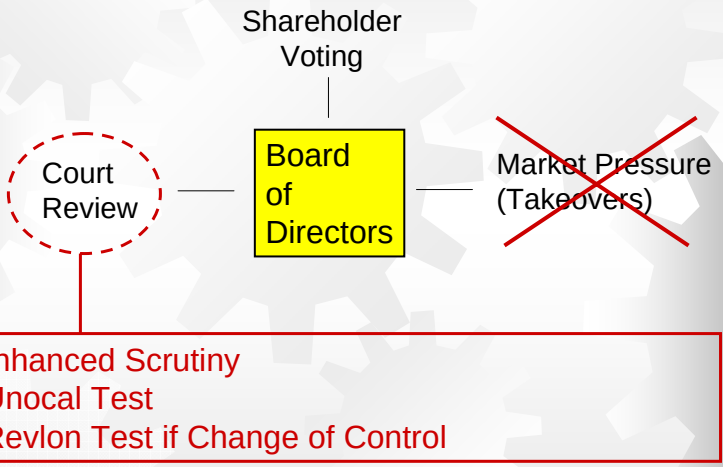
The Agency Problem in the U.S.



Failure of Other Mechanisms

- Hostile Takeover Defensive Tactics
- Controlling Shareholder

Hostile Defensive Tactics

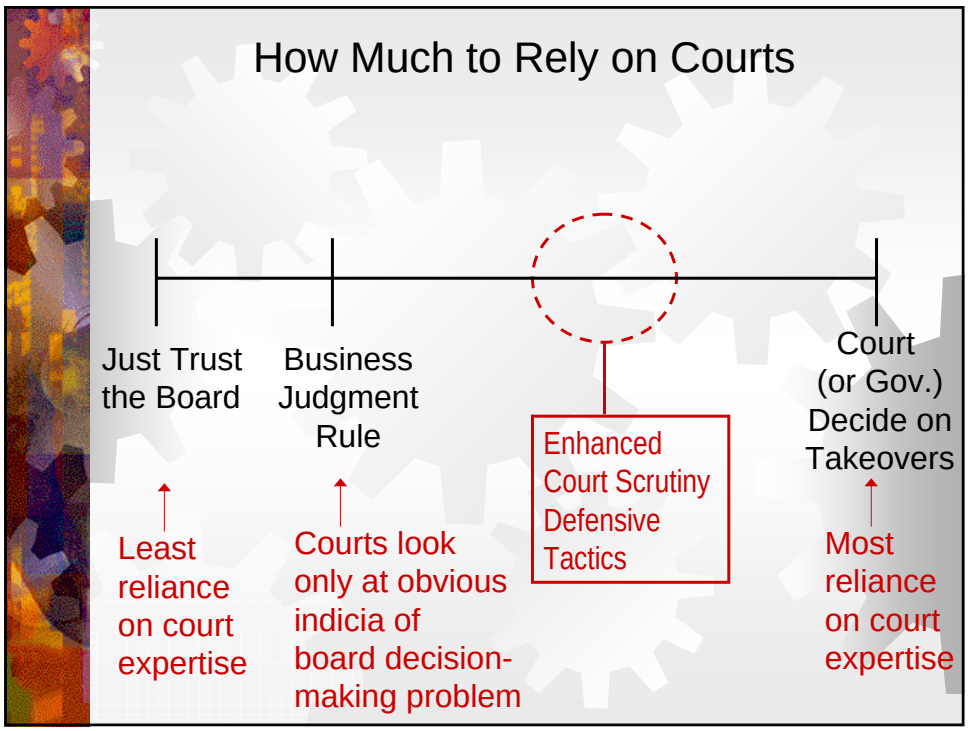


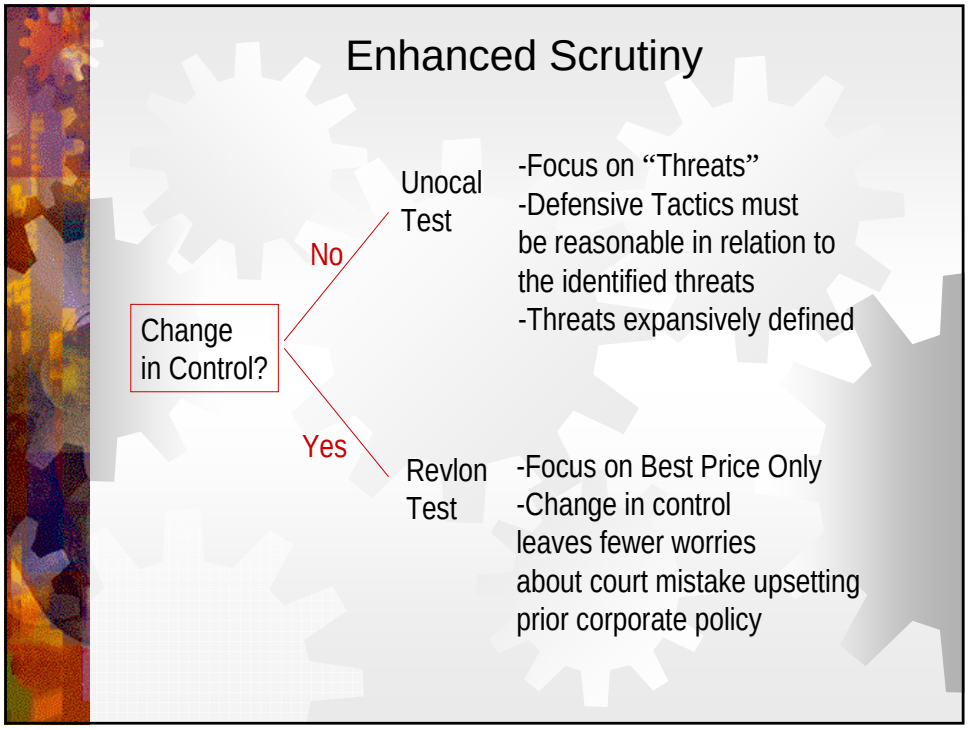
Defensive Tactics

- Poison Pills
- Greenmail
- White Knight
- Favoring one bidder (No Shop Clause, No Talk Clause, Termination Fee, Lock-Up Clause)
- Shark Repellent Amendments
- Pac Man defense
- Litigation

Poison Pills

- Board of Directors establishes a shareholder rights plan and issues a dividends of rights to the shareholders.
- "Flip-In" Poison Pill:
  - (a) triggered by a shareholder (the acquirer) obtaining over a specified amount of target company stock (e.g., 20% of stock) or upon the announcement of a tender offer for more than a specified amount of stock (e.g., 30% of stock).
  - (b) Available to all shareholders except the acquirer.
  - (c) Gives shareholders the right to purchase stock or notes of the target company at a (often extreme) discount
  - (d) Redeemable by the target board


How Much to Rely on Courts
Just Trust the Board
Business Judgment Rule
Enhanced Court Scrutiny Defensive Tactics
Court (or Gov.) Decide on Takeovers
Least reliance on court expertise
Courts look only at obvious indicia of board decision-making problem
Most reliance on court expertise


Enhanced Scrutiny
Change in Control?
No
Unocal Test
-Focus on "Threats"
-Defensive Tactics must be reasonable in relation to the identified threats
-Threats expansively defined
Yes
Revlon Test
-Focus on Best Price Only
-Change in control leaves fewer worries about court mistake upsetting prior corporate policy

Takeovers Not Impossible
(Just Difficult)

Payoffs to Target Managers

- Golden Parachutes: Severance Payments
- Confidentiality/Non-Compete Agreements
- Consulting Contracts
- Employment Agreements

Combination Tender Offer-Proxy Fight

- Tender Offer for shares conditional on waiver of defenses by the target board
- Target board typically refuses to waive defenses claiming that the “offer is inadequate”
- Acquirer then attempts to replace a majority of the board through a proxy fight. Usually passive shareholders focus on the possible tender offer premium.
- If the Acquirer wins, the new board waives the defenses and the tender offer closes.

Defensive Tactics that Undermine Proxy Contests

Redeeming the Pill

- Dead Hand Poison Pill – Only the directors on the board when the pill was first adopted may redeem the pill
- No Hand Poison Pill – Pill is not redeemable
- Slow Hand Poison Pill – New board may redeem a poison pill but only after a delay (i.e., 180 days)

Delaware has struck down all three types of redemption roadblocks

Interfering with the Shareholder Vote (Post-Bid)

- Delay Shareholder Meeting
- Install Classified Board
- Expand the Board (and fill seats with directors friendly with incumbents)
- Issue new shares to friendly parties to dilute shares of hostile shareholders

Blasius Ind. v. Atlas (Delaware)

"The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."

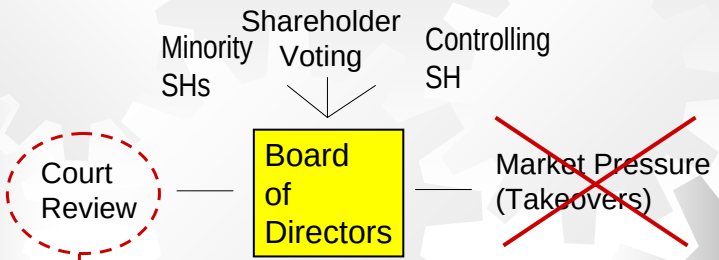
"[T]he board bears the heavy burden of demonstrating a compelling justification for such action."

Two Balances

- Balance of Substantive Law
  - Cannot Block all Takeovers
- Balance of Court's Role
  - Appreciation of Limits of Court Expertise
  - Balance between Lack of Expertise and Importance of Controlling Firm Agency Problem
- Nothing magic about this balance—just a policy choice and balance may differ in different countries

Special Case of Controlling Shareholders

Controlling Shareholders



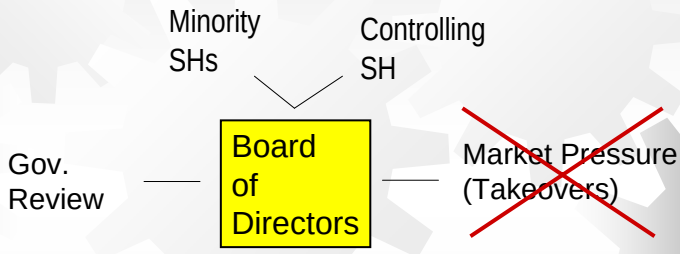
Greater Court Review if Conflicted Transaction
--Squeezeout Merger of Minority Shareholders
Receives Entire Fairness Review
--Ratification by Majority of Minority SHs (or by Indep. Board Committee) only shifts burden of proof

Control Is Profitable

- No Duty on How Cast Votes
- No Duty to Sell Shares
- Control Premium Upon Sale is Allowable
- May use Influence to Remove Board of Directors Ahead of Sale of Control Block

Agency Problems in Korea Chaebol Group

Controlling Shareholders



-- Efficiency of the Chaebol unclear
-- Pyramid Structure results in voting power > cash flow rights
-- Prevalence of Chaebol in Korea's Economy
-- Heavy Emphasis on Government Review (KFTC)

Possible Reforms?

- Fiduciary Duties
  - --Enhanced Fiduciary Duties Placed on Controlling Shareholders
  - -- Private Enforcement of Duties (Class Actions)
- Majority of Minority Voting
- Limited Hostile Takeover Market

Generating a Limited Takeover Market for Chaebols

Tag-Along Rights

- Provides that acquirer of control must purchase remaining minority shares at same (or similar) price as for control block shares.
- "Brazilian law (Lei das S.A., Article 254-A)… assures that the disposal, direct or not direct, of a company's control shall be carried out on conditions that the buyer undertakes to tender a public offer for acquisition of all further common shares held by the other shareholders in the company, so that they may be accorded as minimum price 80% of the value paid for the selling controlling shareholder."

Reverse Tag-Along Rights Proposal

- In a hostile tender offer situation, treat existing controlling shareholder as a competing bidder for control.
- If the controlling shareholder blocks the hostile bid then treat the controlling shareholder as purchasing its own shares at the hostile bid price
- Provide "tag along" rights to the remaining minority shareholders to receive same hostile bid price from the controlling shareholder who blocks the bid.

Reverse Tag-Along Rights Problems

- Liquidity Problems
- Opportunistic Hostile Bids
  - Competitor harass Controlling Shareholder

Reverse Tag-Along Rights Mechanism

1. Government Authorization of Bid
   --Not that different from U.S. (where courts make final call on hostile bid defensive tactics)
   --Limited screen for obviously opportunistic bids—just as U.S. courts make only limited analysis of defensive tactics under Unocal and Revlon (repeat bidder, insufficiently financed bid, grossly inadequate bid--less than premium bid)
   --Provide written reasons for allowing or stopping a bid
2. Shareholder Vote on the Bid. Only if majority approval does bid move forward.
3. If bid fails then those who voted against the bid must offer to purchase a government determined ratio of the shares of those who voted for the bid at the bid price.

Example

- XYZ Hedge Fund makes an all cash bid for all Samsung Chem. shares at a 20% premium over the pre-bid market price (say at 50,000 won per share)
- Step 1: Government assessment that bid is not coercive and at a significant premium over the market price (so bid allowed). Government supplies written reasons.

Example

- Step 2: Samsung Controlling Shareholder (and friends) vote against the bid (60% of the votes) with all other shareholders voting for the bid (40% of the votes). Tender offer is halted as a result of the vote.

Example

- Step 3: Samsung Controlling Shareholder (and friends) would then be obligated to repurchase a specified fraction of the shares of those who voted for the tender offer.
- For example, the government may take into account liquidity problems and set a 1/10th fraction. Samsung's Controlling Shareholder would then have to offer to repurchase 1/10th of the minority shares at a price of 50,000 won per share.

Reverse Tag-Along Rights Proposal

1. Government Authorization of Bid
2. Shareholder Vote on the Bid.
3. If Bid Fails then Those Who Vote Against Buy From Those Who Voted For the Bid

Either Results in:
(1) Greater alignment of cash flow rights and voting rights; or
(2) Less Resistance by Controlling Shareholder to a Change in Control

Further Thoughts on Reverse Tag-Along Rights

- Reduces value of control
  - But less fear in Korea of fewer control blocks forming (greater fear is problems with existing control blocks)
- Government may make errors
  - Alternatives are worse (either no intervention or too heavy handed intervention – including “Big Deal” style mandated sell-off of assets)
  - Reverse Tag-Along rights introduces partial market mechanism to reallocate Chaebol assets to highest value use

Conclusion

- U.S. situation not same as in Korea but some similarities
- Differences with respect to prevalence of controlling shareholders in Chaebol groups in Korea
- Stronger controlling shareholder grip calls for stronger intervention (a different balance)
  - Fiduciary Duty? Private Enforcement?
  - Minority Shareholder Ratification?
  - Limited Takeover Pressure