Capital Reduction Procedure under the Amended Korean Commercial Code

Under the newly amended Korean Commercial Code ("KCC"), nominal capital reduction to compensate for capital deficiency may be conducted by obtaining an ordinary shareholder resolution without creditor protection procedure.

Capital reduction means reduction of capital of a company. A "capital reduction" may be categorized into real capital reduction or nominal capital reduction, depending on whether or not the amount of the net assets of the company is reduced.

In a real capital reduction, the proceeds from the capital reduction are distributed to the shareholders in accordance with their shareholding ratio. Because the shareholders are compensated or repaid, a real capital reduction is sometimes referred to as a "capital reduction with consideration." A real capital reduction is often used as a method to reduce the size of the company in order to facilitate a sale or merger of the company or to collect the investment amount.

On the contrary, in a nominal capital reduction, although the nominal amount of capital will be reduced, there will be no change to the total amount of assets of the company. In other words, no proceeds are distributed to the shareholders as a compensation or repayment of their investment. In this regard, it is sometimes referred to as "capital reduction without consideration." A nominal capital reduction is often used by a troubled company to reduce book losses by reducing the book capital in order to close in the gap between the capital and net assets.

The existing KCC does not differentiate between the two different concepts of real capital reduction and nominal capital reduction and requires a special resolution of the shareholders meeting and a creditor protection procedure for all types of capital reductions.

Under the existing KCC, a special shareholder resolution (i.e., the affirmative vote of at least 2/3 of the shareholders present at the meeting and at least 1/3 of the total issued and outstanding shares) is required to conduct a capital reduction, whether it is with or without consideration (Article 438(1) of KCC). Furthermore, the company must conduct a creditor protection procedure whereby the company

is required (i) to notify each known creditor the decision to conduct a capital reduction, (ii) to make a public announcement requesting any creditor dissenting to the capital reduction to submit his objection within a designated period, which shall not be less than one month, and (iii) (x) to compensate such dissenting creditor or otherwise provide a security interest substantially in the amount of such creditor's claims, or (y) to entrust with a trust company the company's net assets corresponding to such amount (Article 439(2), Article 232).

With respect to the foregoing provisions of KCC, the requirement to conduct a creditor protection procedure even in the case of a capital reduction without consideration has been a hot topic subject to continuous criticism by the scholars who viewed such requirement as unnecessary and only causing waste of money and time, in light of the fact that no creditor's rights are directly infringed in a capital reduction without consideration.

The newly amended KCC, however, reflects such opinion of the scholars and includes a provision on exemption of a creditor protection procedure in case of a capital reduction without consideration conducted by a company to compensate for its capital deficiency (Article 439(2) of the amended KCC).

The amended KCC also requires only an ordinary resolution (i.e., at least 1/4 of affirmative vote of all the voting shares of the shareholders present at the meeting and at least 1/4 of the total issued and outstanding shares) for a capital reduction without consideration conducted by a company to compensate for its capital deficiency (Article 438 of amended KCC).

The resultant effect of Article 438 and 439(2) of amended KCC is that it would enable a company to easily conduct capital reduction without consideration notwithstanding dissenting shareholders. The foregoing amendment, however, may potentially be subject to disapproval of certain critiques from the perspective of the protection of minority shareholders.

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