Legal Update
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General Corporate

Share Classes under the Amended Korean Commercial Code

The classes of shares under the amended Korean Commercial Code

Under the limited types of shares provided for in the existing Korean Commercial Code, companies were hamstrung in being able to raise funds in response to rapid changes in the market environment. In response, the amended Korean Commercial Code now allows a company to issue various types of shares according to the demands of the capital market. Below is a brief examination of the newly introduced or revised provisions relating to the system of classes of shares in the amended Korean Commercial Code.

Key details of amendment

1. Classes of shares under the amended Korean Commercial Code are generally placed into the following 4 categories: (i) a class different from a common class concerning the dividend of profits or the distribution of remaining assets; (ii) a class different from a common class concerning the exercise of the voting right in the general meeting of shareholders; (iii) a redeemable class of shares; and (iv) a convertible class of shares. Notably, redeemable shares and convertible shares are also categorized as a class of shares under the amended Korean Commercial Code though it was a prevailing view in the past that the two types of shares should not be recognized as a separate class of shares (Article 344).

2. Under the existing Korean Commercial Code, the minimum dividend payout ratio on a preferred class of shares (preferred as to dividends) is determined in the Articles of Incorporation. This determination has been deleted from the amended Korean Commercial Code, and instead the amended Korean Commercial Code stipulates (i) the type of dividend assets (This provision is included in the amended Korean Commercial Code as it permits dividend in kind), (ii) how to determine the value of dividend assets and (iii) conditions for the dividend of profits. In doing so, it is possible to issue a share preferred as to dividends for which a fixed amount is paid out as a preferred dividend (e.g., the profit of KRW 500 per share is paid out as a preferred dividend) or a share preferred as to dividends with the variable dividend ratio in which the dividend ratio of a share preferred as to dividends is linked to market interest rates (Article 344-2).

3. Under the amended Korean Commercial Code, it is possible to issue not only a share preferred as to dividends without voting right but also a share preferred as to remaining-asset distribution without voting right and a share with the same conditions as those of a common share but without voting right. Since Article 370 of the existing Korean Commercial Code requiring that voting rights be restored if preferred dividends cannot be paid out was deleted from the amended Korean Commercial Code, it is now possible to include various provisions relating to the restoration of the voting right in the Articles of Incorporation without limitation (Article 344-3).

4. In addition, under the amended Korean Commercial Code, it is now possible to issue both a completely nonvoting share as well as a share with a limited voting right for which the voting right is recognized only for certain matters. For example, it is possible to issue a share for which the voting right is recognized only for important corporate matters requiring special resolution of the general meeting of shareholders including business transfer, merger and amendment of the Articles of Incorporation. However, as the amended Korean Commercial Code does not yet introduce a class of shares with a veto over certain matters, for example, the so-called "veto share" requiring a resolution of the general meeting of shareholders of a certain class of shares for business transfer, merger, amendment of the Articles of Incorporation, it is still impermissible to have the veto of minority shareholders, which is commonly provided in an agreement among shareholders (Article 344-3).

5. The amended Korean Commercial Code expressly provides that a share of a convertible or redeemable class may be converted or redeemed at the request of a shareholder or unilaterally by the company when certain causes for redemption or conversion occur for a redeemable share or a convertible share, and imposes a duty of notice on the company in the case of unilateral decision of conversion or redemption by the company (Articles 345 and 346).

6. Under the amended Korean Commercial Code, it will now be possible to redeem in securities or other assets as well as in cash for a redeemable share. Therefore, the company may redeem a redeemable share in, e.g., debentures. However, the book value of such assets must not exceed the profits available for dividend (Article 345, Paragraph 4). Further, issuing a common share as a redeemable share will not be allowed under the amended Korean Commercial Code (Article 345, Paragraph 5). Such issuance is prohibited in order to prevent the management of a company from protecting its position in a way similar to a poison pill (which has yet to be introduced in Korean legislation), by unilaterally redeeming a common share.

Implications of the amended Korean Commercial Code for the classes of shares

The amendment of the Korean Commercial Code concerning the classes of shares is meaningful in that the amendments have (i) reduced the rigidness that was built into the existing Korean Commercial Code which strictly limited the types of shares that could be issued by a company and (ii) created the basis for the diversification of shares a company may issue. Under the amended Korean Commercial Code, the details on classes of shares shall be provided in the Articles of Incorporation. However, the amended Korean Commercial Code is silent on the degree of detail with which the Articles of Incorporation should regulate the conditions of a class of shares and to what extent a company can independently establish relevant provisions. Such standards should be established under the general principles of corporate law including the principles of the fair treatment of all shares and from the perspective of the director's due diligence, and the interests of various stakeholders of a company including shareholders need to be fully taken into consideration in the process of establishing such standards. Therefore, we believe it would be wise for a company newly introducing classes of shares under the amended Korean Commercial Code to seek the assistance of legal experts in rearranging its Articles of Incorporation and following relevant procedures in order to reduce possible legal issues that may arise in relation to classes of shares.

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