The Developments of Capital Increase under the Amended Korean Commercial Code

Under the amended Korean Commercial Code, the following matters have been revised: (i) shareholders must be provided with notice when a third party has been designated to receive a right of subscription for newly issued shares (Article 418-4), (ii) purchasers of the newly issued shares may, with the consent of the company, set off their subscription payments by contributing receivables (Article 334, Article 421-1); and (iii) investigation procedures for contributions in-kind may be exempted in certain circumstances (Article 299, Article 422). The details of the foregoing are provided below.

(1) Requirement of notice to shareholders if a third party has been designated to receive a right of subscription for newly issued shares

The amended Korean Commercial Code provides that when a third party has been designated to receive newly issued shares, the third party must report and prepare to the shareholder(s) (i) the type of class and number of shares, (ii) the issue price and the payment date, (iii) the amount of capital appropriated from the issue price if the shares has no face value, (iv) the subscription method of the shares, and (v) and the name of the investor who makes an in-kind payment for the newly issued shares, the involved assets (type, amount, and value), the shares (type of class and amount) that will be granted, etc., two (2) weeks prior to the payment date, for the purpose of notifying the shareholders of the newly issued shares (Article 418-4). By mandating designated third parties to notify existing shareholders of the newly issued shares, the underlying purpose of the amendment provides existing shareholders a fair opportunity to protect their interests against the newly issued shares.

(2) Permission to set-off against payment of the subscription price (debt-equity swap)

Under the existing rules of the Korean Commercial Code, a shareholder may not assert a set-off against the company as regards to payment of the subscription price for shares (Article 334). However, the law has been controversial, as its purpose and extent has been unclear. For instance, let us assume a company is currently restructuring. As a process of restructuring, it proceeds to execute debt-equity swap (where the creditors become shareholders) and the company determines the issuance of new shares and agrees with the creditors to set off the payment of the subscription price for shares with receivables owed by the company. It is unclear whether the foregoing set-off is actually permitted under the existing Korean Commercial Code. In reality, debt-equity swaps were limited to the use of companies under rehabilitation procedures or work-out companies that were defined under the Corporate Restructuring Promotion Act. As a result, the issue of allowing debt-equity swaps beyond just work-out companies was raised and many deemed it necessary to permit other general companies to take advantage of investment conversions.

The amended Korean Commercial Code provides that the purchaser of the newly issued shares shall not be permitted to set off the payment of the subscription price with receivables owed by the company without the consent of the company. If the company, however, provides consent, the shareholder may set off its receivables owed by the company with its payment for the newly issued shares. Therefore, under the amended Korean Commercial Code, debt-equity swaps can be performed even if the company is not a work-out company or undergoing rehabilitation (Article 421-2).

(3) Exception to the contribution in-kind investigation procedure

Under the existing Korean Commercial Code, all acts of in-kind contribution must be investigated by an inspector who must then submit a report to the court. However, inspector investigations and court reports have been criticized for causing uncertainty and contributing to unnecessarily long deal times and deal expenses. In this regard, the amended Korean Commercial Code provides an exemption to the inspection if:

(i) the total asset value for the contribution in-kind and the ex post facto incorporation shall not exceed 1/5 of the capital amount and shall not exceed the amount defined by Presidential Decree;

(ii) if the assets for the contribution in-kind and the ex post facto incorporation are securities exchanged on the market, and the price stated in the Articles of Incorporation does not exceed the market price (calculated subject to the Presidential Decree);

(iii) during the issuance of new shares, where the mature company's monetary claim is the investment and if such price does not exceed the price recorded in the company's books, the contribution in-kind is not subject to any investigation (Article 422-2,3); and

(iv) other cases subject to Presidential Decree (Article 299-2.1.2.3; Article 422-2.1.2.4)

Implications of the amended Korean Commercial Code for the Development of Capital Increase

The amendment of the Korean Commercial Code is meaningful in that it provides flexible options for investors to increase capital. Although designated third parties who receive the right to subscribe new shares have the duty to report their right to shareholders, the amended law, otherwise, provides room for the payment of shares and contributions in-kind. If the existing Korean Commercial Code was very strict in interpreting contributions in-kind, the amended Korean Commercial Code seeks to loosen the standards by approving exceptions in certain situations.

However, we do not see this amendment as providing a free pass to all contributions in-kind: contributions in-kind of distressed receivables or any other contributions in-kind that have the potential to damage the company or its shareholders will continue to be strictly regulated. As such, issues that will continue to be examined during the process of increasing capital are (i) protecting the rights of the majority and minority shareholders, (ii) securing a fair value-assessment standard for the receivables, and (iii) the fiduciary duty of all directors. We believe the foregoing issues will continue to evolve as the amended Korean Commercial Code surfaces and thus, it would be wise to seek the assistance of legal experts in order to reduce possible legal issues that may arise in relation to the increase of capital.

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