Increased Flexibility in Types of Merger Consideration and Introduction of Cash-out Merger

Cash-out merger, which has caused controversy over its enforceability and scope under the Korean Commercial Code ("KCC") currently in effect, will be fully permitted under the amended KCC. (The amended KCC will take effect on April 15, 2012.) Under Article 523, Paragraph 4 of the amended KCC, a cash-out merger refers to a merger in which the surviving company pays cash in consideration for the shares of the company absorbed.

Even the current KCC permits cash payment as consideration for the shares of the company being absorbed (See. KCC Article 523 Paragraph 4, Article 524 Paragraph. 4). However, there have been conflicting views among legal scholars regarding the scope and applicability of those provisions. The amended KCC legislatively resolves such uncertainty by explicitly permitting cash-out merger. Further, the amended KCC allows not only cash but also "other corporate assets" to be used as merger consideration. "Other corporate assets" are interpreted to include, among other things, bonds, shares and other securities. Accordingly, under the amended KCC, merger consideration may be paid solely by cash or any other corporate assets, such as bonds issued by the surviving company or shares of the surviving company's parent company.

As the amended KCC repeals Article 470 of the current KCC which limits the total principal amount of bonds issuable by a Korean corporation, there will be an increase in the number of cash-out mergers where consideration is paid in bonds. Additionally, the amended KCC will permit triangular mergers that provide shares issued by the surviving company's parent company as consideration to the absorbed company's shareholders. This will likely boost efficiency in corporate restructuring and promote strategic affiliations between companies.

It is worth noting that under the amended KCC, cash-out merger may not be used in any consolidation (i.e., the combination of two or more companies into a newly created company). Also, the amended KCC prohibits the use of cash-out merger in some other types of corporate restructuring prescribed by the KCC, such as a merger of a spun-off company into another company (referred to as "hup-soo-boon-hal-hap-byung" in Korean) and comprehensive share swap (referred to as "po-gwal-jeok-joo-sik-gyo-hwan" in Korean).

Cash-out merger will simplify corporate restructuring and increase corporate efficiency. In addition, it could help reduce management costs by squeezing out minority shareholders or be utilized as an alternative tool for delisting. That is, the majority shareholder of a listed company can easily squeeze out minority shareholders by taking the following series of action: (i) establish an unlisted, wholly-owned subsidiary, (ii) merge the listed company into the newly established company, and (iii) pay the minority shareholders merger consideration in cash. In terms of squeezing out minority shareholders, cash-out merger can be more advantageous than the compulsory acquisition right which permits a controlling shareholder holding 95% or more shares in a Korean company to require minority shareholders to sell their shares to the controlling shareholder at a fair price. This compulsory acquisition right also is newly introduced under Article 360-24 of the amended KCC.

Cash-out merger may raise concerns about minority shareholder protection, though, at least in theory, minority shareholders could protect their interests by exercising the appraisal right granted to the dissenting shareholders in a merger if they find the cash consideration unfairly low.

An important issue would arise as to whether an unfair cash consideration for a merger would constitute a legal ground for a minority shareholder to file a lawsuit to void the merger. While there is no precedent in Korea specifically addressing this issue, courts in Japan have decided negatively on this issue. It would be interesting to see how Korean courts will rule in this regard.

If there is any question regarding the above, please contact us as set out below.

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