Amendments Relating to Dividend Distribution

The amended Korean Commercial Code ("KCC"), which will take effect on April 15, 2012, (i) gives the board of directors the final authority to approve financial statements and decide to distribute dividends, (ii) explicitly excludes certain unrealized profits from the scope of distributable profits, and (iii) allows in-kind dividend distribution. These amendments are further discussed below.

I. Major Amendments

(1) Board's final authority to approve financial statements and decide to distribute dividends

Under the current KCC, in order for a company to distribute dividends after the end of a fiscal year, the directors first need to prepare a profit appropriation statement and obtain approval from the board of directors. After such approval and the auditor's audit, the directors must obtain final approval at a general meeting of shareholders. Hence, the final authority to distribute dividends lies with the shareholders.

Critics have pointed out that shareholders' approval of financial statements is merely a formality in many cases, because it is difficult for shareholders to understand or form a view on financial statements containing technical terms and concepts. Also, from a company's perspective, as dividend distributions are closely related to the company's future investment decisions, it will boost efficiency if the directors who are in charge of investments and capital raising make decisions on dividends. Even in light of creditor protection, it would be most reasonable to give the board the authority to make decisions on dividend distributions, because interests of shareholders could conflict with those of creditors in relation to dividend distributions, while the board is in a neutral position to make balanced, informed decisions.

To address the foregoing concerns, the amended KCC, subject to the satisfaction of certain conditions, permits the board to have the final authority to approve financial statements and decide on dividend distribution, while, in principle, the authority still belongs to shareholders.

The conditions that must be met for the board to have the final authority are as follows:

- the Articles of Incorporation must provide for such board authority;
- the financial statements, including the balance sheet and income statement, must be audited and approved by an external auditor;
- the statutory auditors (or the audit committee, if one exists) must unanimously approve the financial statements; and
- the board must report to the general meeting of shareholders regarding the financial statements.

(2) Exclusion of certain unrealized profits

Generally accepted accounting principles (GAAP) require in principle that valuation be based on a market price method. The current KCC, on the other hand, adopts the cost method of accounting for liquid assets. Therefore, under the current KCC, distribution of any unrealized profits is not allowed.

The amended KCC, deleting Article 452 of the current KCC which regulates valuation of assets, incorporates GAAP into the commercial code. This results in some unrealized profits being included as distributable profits. Therefore, the amended KCC explicitly excludes certain unrealized profits from the scope of distributable profits. The specific items to be excluded will be specified in the presidential decree to be promulgated subsequently.

(3) In-kind dividend distribution

Under the current KCC, dividends can be distributed only in the form of cash or shares in the company, unless expressly permitted otherwise under special laws, such as the Korea Development Bank Act.

The amended KCC allows companies to distribute dividends-in-kind, such as shares, bonds and options, provided that the Articles of Incorporation provide for such in-kind distribution.

In addition, under the amended KCC, a company may allow shareholders to request for payment in cash instead of in-kind distribution. If so, the company should decide the amount payable in lieu of the non-cash assets to be distributed to the requesting shareholders and the period during which such request could be made. Further, a company may decide to pay in cash for shareholders holding a small number of shares below a certain level, in which case the company should decide in advance the level of shareholding eligible for cash payment and the amount payable per share.

II. Considerations

As mentioned above, there can be advantages to the board's having final authority for dividend distribution. However, the amended KCC might increase directors' liability, because it is not entirely clear about exemption of directors' liability for their decision on dividend distribution. Article 450 of the current KCC provides that the directors and statutory auditor(s) are deemed exempted from liability for their decision on financial statements, unless any shareholder resolution is otherwise passed within two years after the financial statements are approved at the general meeting of shareholders. However, the amended KCC provisions relating to the board's final approval authority are silent on such exemption and, thus, in our view, Article 450 would not likely be applicable to a board's approval of financial statements. A further amendment to the KCC or a ruling by authority seems necessary to clarify the ambiguity.

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

Jaeyoung Chang (TEL: 02 316 4350, E-Mail: jychang@shinkim.com)

Myong Hyon (Brandon) Ryu (TEL: 02 316 4276, E-Mail: mhryu@shinkim.com)

Young-Joon Park (TEL: 02 316 1603, E-Mail: yjopark@shinkim.com)

Clara Miri Kang (TEL: 02 316 1654, E-Mail: cmkang@shinkim.com)