Share Redemption and Retirement under the Amended Korean Commercial Code

Under the previous Korean Commercial Code ("KCC"), the redemption of shares was not allowed except for several limited situations. One of the main reasons for restricting share redemptions was a concern that companies would abuse such mechanism by distributing retained profits to only certain shareholders and in effect, violate the principle of equality among shareholders. However, to deny all fiscally responsible and financially healthy companies the opportunity to redeem their own shares was deemed unfair (particularly considering that the value added to shareholders was equal to that of the distribution of dividends). Furthermore, the previous KCC was criticized for discriminating against unlisted companies, as listed companies are permitted to redeem their shares under the Financial Investments Services and Capital Markets Act.

As a way to ease the foregoing concerns, the amended KCC now permits share redemptions as a general rule and instead has abolished share retirements (which has the same economic effect as share redemptions). Below is a summary of the major revisions relating to share redemptions and retirements under the amended KCC.

Revised Provisions

1. Share redemptions are allowed as a general rule

If the financial statement for the year suggests that the company has the capacity to dispose of retained profits, it may do so by (i) redeeming the shares on the open-market, or (ii) making an offer to all shareholders to redeem their shares under equal conditions for all (Article 341-10 of the KCC). The rule intends to protect shareholder equality during the redemption of shares process. If a company chooses to redeem its shares by making an equal offer to all shareholders, the process will be further detailed in a Presidential Decree.

2. Share redemption process

A share redemption process may be implemented by resolution at a shareholders meeting, if the following matters are discussed: (i) the type and number of shares that are being redeemed, (ii) the total redemption value limit, and (iii) a time period, not exceeding one year, in which the share(s) can be redeemed.

If the company's articles of incorporation allow the redemption process to be adopted by resolution of the board of directors, then the board may prescribe the above process without requiring a shareholder meeting (Article 341-2 of the KCC).

3. Financial responsibility of directors

A company shall not redeem its shares if it is projected that the company will have insufficient retained profits during the relevant fiscal year. In case the company has already redeemed its shares but the redemption value exceeds that of retained profits at the end of the fiscal year, the directors shall be personally liable and reimburse the deficit caused by the redemption of shares.

If the directors, however, can prove that the projection of retained profits was based on good faith and due care, the directors shall not be liable for reimbursement (Article 341-3; 341-4 of the KCC). As such, the board of directors and each director shall thoroughly evaluate the company's business records and data before making a decision on the redemption of shares.

4. Exceptions to the share redemption process

Under the amended KCC, a company may redeem its shares without consideration of the company's retained profits in the following cases: (i) the merger of companies or of the acquisition of the entire business of another company, (ii) it is necessary to do so for achieving its objectives in the course of exercising the rights of the company, (iii) it is necessary to deal with the fractional shares, or (iv) the exercise of an appraisal right by a shareholder. Because share redemptions are deemed necessary under the foregoing circumstances, the process does not require the evaluation of the company's retained profits (Article 341-2 of the KCC).

5. Disposition of redeemed shares

Under the previous KCC, disposition of the redeemed shares was required within "a reasonable time period." As such, it was unclear how long the company was allowed to possess such shares before disposition.

Under the amended KCC, provided that the articles of incorporation do not state otherwise, the redeemed shares may be disposed of at a reasonable time determined by resolution of the board of directors.

6. Abolishment of share retirements

Under the previous KCC, share retirement is a process whereby the company retires its shares by using retained profits reserved for distribution to shareholders. The retirement price, method and director duties are also prescribed by the previous version of the KCC (Proviso of Article 343-1; Article 343-2 of the KCC). However, because the amended KCC permits share redemptions, the share retirement system is no longer of any use to companies: the economic effect (distribution of retained profits without capital fluctuation) is the same. As a result, to eliminate any confusion or overlapping, share retirements were abolished and in the event the company redeems its shares by resolution of the board of directors, the company is no longer subject to the capital reduction regulations under the amended KCC (Proviso of Article 343-1 of the KCC).

Implications of the amended KCC regarding share redemptions

By giving unlisted companies the right to redeem their own shares, the amended KCC is meaningful in that it provides shareholders with flexible options regarding return on investments and capital financing. In return, the amended KCC holds company directors to strict standards involving the duty to protect the principle of equality of all shareholders and to maintain the financial well-being of the company. We believe the foregoing issues will continue to evolve as the amended KCC is being implemented, and thus, it is recommended to seek legal advice to reduce possible legal issues that may arise in relation to the redemption of shares and director duties.

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