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Putting on the squeeze

Will compulsory acquisitions under the amended Korean Commercial Code work in practice?

The most extensive revisions of the Korean Commercial Code (KCC) took effect on April 15 2012. Of these amendments, the most notable is the express inclusion of a new squeeze-out mechanism through compulsory acquisition. It means minority shareholders can be required to sell their shares at an agreed price to a controlling shareholder. If no agreement is attained, the shares must be sold at a fair price as determined by the court.

Though quite straightforward at first glance, the compulsory acquisition entails many issues and uncertainties. This is because the relevant KCC provisions are unclear in some respects and there are no court precedents in Korea directly applicable to compulsory acquisition.

In this context, it's important to consider the major requirements and procedures for a compulsory acquisition under the KCC, and some of the practical issues being encountered by lawyers utilising the mechanism.

Requirements and procedures

There are five requirements that must be satisfied before for a compulsory acquisition can be used.

First, the controlling shareholder must hold at least 95% of the target company's issued and outstanding shares. Second, the proposed compulsory acquisition must be necessary to accomplish what the KCC deems a 'business purpose' of the target company.

Third, the minority shareholders' shares should be appraised by a certified appraiser. The outcome of this (together with the purpose and other details of the compulsory acquisition) must be disclosed in the shareholder notice sent to convene the target company's general meeting (GSM) where the compulsory acquisition is to be approved. The controlling shareholder must also explain the appraisal outcome at the GSM, the compulsory acquisition must be duly approved at the GSM, at least one month's public and individual notice on the compulsory acquisition should be provided to the target company's shareholders.

Without any unforeseen complications, it will take two to three months to complete a compulsory acquisition. The process may take much longer, however, if the controlling shareholder and a minority shareholder(s) cannot reach agreement on the price to be paid for the shares. The general schedule for the process is set out in the table opposite.

Practical issues

Since compulsory acquisitions became possible, the following practical issues have been encountered.

Definition of controlling shareholder

Who would be considered a controlling shareholder when a parent company does not hold any target company shares, but instead indirectly holds target company shares through its subsidiaries?

Under the KCC, a shareholder who holds at least 95% of the target's shares would be considered a controlling shareholder. In calculating that threshold, shares of the target company owned by a parent company and its subsidiaries are aggregated. In this regard, however, the question arises as to who should be viewed as the controlling shareholder, the parent company or the subsidiaries.

There could be conflicting views on this issue. First, some would argue that the parent company, though not holding any target company shares for itself, should be viewed as the controlling shareholder. A second view is that the shareholder holding the largest number of shares for its account constitutes the controlling shareholder. Third, it could be argued that the parent company and its subsidiaries holding any target company shares, together as a group, should be viewed as the controlling shareholder.

The third view would be the most persuasive. Among other grounds, minority shareholders could be best protected if there are more controlling shareholders from whom the minority shareholders could receive payment. Also, the legislative history and legislative intent of the relevant KCC provisions – which grant the compulsory acquisition right to beneficial owners of target company shares (as opposed to mere title holders) – indicate that the KCC provisions are intended to focus on the actual controlling shareholder.

This view, however, could be countered with an opposing argument that a parent company not owning any share is not a so-called shareholder who is entitled to vote for and explain the compulsory acquisition at the GSM. To dodge this counter argument, the parent company may consider purchasing one or more target company shares from a subsidiary or a cooperative minority shareholder. However, such a purchase may trigger negative tax implications under Korean law, such as deemed acquisition tax. Therefore, it may not be feasible in some cases.

To avoid any unnecessary controversy or dispute, a parent company not holding any target company shares may be well-advised to: purchase a share(s) from its subsidiary or a cooperative minority shareholder, provided that such purchase would have no or manageable negative tax implications and other circumstances permit; or, carry out the GSM procedure together with its subsidiaries (for example by sending a collective shareholder meeting notice and attending and voting at the GSM jointly with its subsidiaries).

Definition of business purpose

Another issue is how the 'business purpose' requirement could be satisfied. It is not

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Compulsory acquisition process

Date of event	Required procedure	Details and notes
Prior to GMS	Appraisal by a certified appraiser	The appraisal report should set out the basis and fairness of the calculation of the purchase price.
	Guarantee to secure payment of the purchase price	
When board meeting is held (D-Day)	Board of directors meeting to convene a GSM	
	Delivery of notice of GSM	
D-Day + 15	GSM	
D-Day + 16	Public notice of compulsory acquisition by publishing the notice in a daily newspaper Separate notice of compulsory acquisition to minority shareholders and pledgees, if any	The public notice must state the following: - the minority shareholders are required to deliver the respective share certificates simultaneously upon receipt of the purchase price; and - in any case where a share certificate is not delivered, such share certificate will become null and void on the date when the purchase price is paid to, or received by, the minority shareholder or when the controlling shareholder deposits the purchase price with the court (*gong-tak*).
D-Day + 47	Exercise by the controlling shareholder of the compulsory acquisition right	
	Compulsory acquisition right exercise becoming effective	
D-Day + 78	Decision of the purchase price (to be agreed between the parties)	If the purchase price cannot be agreed between the controlling shareholders and the minority shareholders within 30 days from the exercise of the compulsory acquisition right, either the controlling shareholder or any minority shareholder may request the court to determine the purchase price.
D-Day + 139	Obligation of the minority shareholders to compulsorily sell out their shares	The minority shareholders are required to sell out the shares at the purchase price agreed with the controlling shareholder within 2 months from the exercise of the compulsory acquisition.
Payment of the purchase price or deposited with the court	Transfer of shares of the minority shareholders	The shares are deemed to have been transferred on the date when the purchase price is paid to the minority shareholder. If the controlling shareholder does not know who a minority shareholders is, or a minority shareholder refuses to accept the payment of the purchase price, the controlling shareholder may deposit the purchase price with the court (*gong-tak*), in which event, the share is deemed to be transferred on the date of such deposit.

clear what circumstances would constitute a business purpose' under the KCC. Two conflicting views could be presented.

The first is that the mere existence of a minority shareholder is insufficient and it should be proven that there are other circumstances justifying a squeeze-out (such as a minority shareholder's abuse of shareholder rights incurring too much cost due to a minority shareholder). It must also be shown that the existence of a minority shareholder, without any further justification, is sufficient to meet the business purpose requirement, since having a minority shareholder costs the company a great deal of expense and causes inefficiency attributable to additional corporate processes and procedures.

While there is no clear guidance or court precedent, the second view is stronger and more persuasive. This is on the basis of discussions among task force team members who participated in the process of amending the KCC. Also, it is consistent with the legislative intent of the relevant provisions of the KCC that allow

> **"There could be conflicting views on this issue"**

compulsory acquisitions. Further, the first view would make the compulsory acquisition ineffective and cause substantial costs for litigation.

To minimise potential objections or claims by any dissenting minority shareholder, it would be advisable for the target company, with assistance from the controlling shareholder, to prepare supporting arguments or evidence. This could consist of, for example, specific past instances where the target company incurred additional costs to resolve a conflict with minority shareholders, or the anticipated benefits of the squeeze-out for the business.

Losing shareholder status

If the purchase price for the compulsory acquisition cannot be agreed on, it is not clear when the minority shareholders lose their status as shareholders. In this context, it is important to consider a number of provisions in the KCC regarding the manner in which the purchase price will be determined, and the timing when the compulsory acquisition occurs or is deemed to occur.

- Article 360-24(5) states that at least one month prior to the exercise of its compulsory acquisition right, the controlling shareholder must issue a public notice, and give such notice individually to the shareholders and pledgees listed on the shareholder registry, setting out the following: the minority shareholder is required to deliver the share certificate(s) to the controlling shareholder simultaneously upon receipt of the purchase price for the minority shareholder's shares (Purchase Price); and, in any case where the share certificate(s) is not delivered, such share certificate will become null and void on the date when the Purchase Price is paid to, or received by, the

minority shareholder or when the controlling shareholder deposits the Purchase Price with the court.

- Article 360-24(6) states that the minority shareholder must sell its shares to the controlling shareholder within two months of the compulsory acquisition right being exercised.
- Article 360-24(7) states that the Purchase Price will be decided through consultation between the controlling shareholder and the minority shareholder.
- Article 360-24(8) states that if consultation about the Purchase Price is not completed within 30 days of the date the compulsory acquisition right is exercised, then the minority shareholder or the controlling shareholder may file a request with the court to decide the Purchase Price.
- Article 360-24(9) states that the court, if requested pursuant to article 360-24(8), shall determine a fair price as the Purchase Price based on the financial condition of the company and other relevant circumstances.
- Article 360-26(1) states that shares purchased pursuant to article 360-24 are deemed to be transferred at the time the controlling shareholder pays the Purchase Price to the minority shareholder.
- Article 360-26(2) states that if the controlling shareholder does not know the minority shareholder to be paid the Purchase Price pursuant to article 360-26(1), or the minority shareholder refuses to receive the Purchase Price, then the controlling shareholder may deposit the Purchase Price with the court. In this event the shares shall be deemed transferred as of the date the Purchase Price is deposited with the court.

It is not clear, under these provisions, when the minority shareholder loses its shareholder-status if it and the controlling shareholder fail to agree on the purchase price and either of them files a request with the court to decide the purchase price. To elaborate on this article 360-26 states that shares shall be deemed transferred when the Purchase Price is paid or, if the payment is rejected by the minority shareholder, as of the date the Purchase Price is deposited with the court. Accordingly, under article 360-26(2), if the minority shareholder refuses to receive the Purchase Price, then the controlling shareholder may force the minority shareholder to lose its status as shareholder by depositing the Purchase Price with the court. In this regard, ambiguity arises as to what the term Purchase Price refers to within the meaning of article 360-26(2). If, as suggested or indicated by the wording of the provisions, the term refers to a price finally agreed to between the controlling and minority shareholder, the minority shareholder will remain a shareholder until all the court proceedings are completed to finally determine the purchase price. It may take longer than three to four years to go through the full three instances of court proceedings in Korea. If, on the other hand, the term Purchase Price could be interpreted as the price appraised by a certified appraiser which is presented at the GSM, then the controlling shareholder would be able to make the minority shareholder lose its status as shareholder earlier.

Two conflicting views could be presented on this issue. First, the minority shareholder, if it refuses to get paid by the controlling shareholder, loses its shareholder status as of the date the controlling shareholder deposits with the court an amount equal to the price appraised by a certified appraiser. Second, the minority shareholder maintains its shareholder status until a purchase price is paid to the minority shareholder after the court decides the final and non-appealable price.

The first view is based on the premise that the price appraised by a certified appraiser to be included in the GSM notice should be deemed the Purchase Price, since it will not be finally decided until the completion of court proceedings. The second view holds that since the term Purchase Price is expressly otherwise defined in the KCC, it should be interpreted as a price finally decided.

Again there is no clear guidance on this issue. However, the first view is stronger and more persuasive. If the second view were adopted, the minority shareholder would be entitled to interest on the purchase price, as well as dividends paid for its shares. Also, this view is consistent with the spirit of the compulsory acquisition right granted under the KCC, the structure and intent of the relevant KCC provisions, and its (ie to prompt the squeeze-out of minority shareholders). Other arguments could be made for this view. One is that since the price included in the GSM notice is a price appraised by a certified appraiser, it is not entirely unfair to view such price as the Purchase Price. It's notable that other countries' laws, such as Germany, take similar stances.

Nevertheless, the possibility of the second view being adopted can't be ruled out. Among other grounds, article 360-26(2) specifically refers to 'Purchase Price'. It is also used in other KCC provisions including those relating to minority shareholders' sell-out right. As such, 'Purchase Price' could not be interpreted as a price presented by a controlling shareholder. In addition, the court may take a position sympathetic to minority shareholders.

Accrued interest

An additional issue is when interest on the purchase price starts to accrue. If a controlling and minority shareholder fail to reach agreement on the purchase price, it's likely that the court will require that interest be paid for the period starting from the expiration date of the two-month period provided for under article 360-24(6) of the KCC until the date the purchase price is paid. The Korean Supreme Court ruled to that effect in a

More changes

Alongside the compulsory acquisition right, the amended KCC grants minority shareholders a sell-out right. This allows them require the controlling shareholder, at any time, to buy out their shares at an agreed price or a fair price determined by the court if no agreement is attainable.

"The reverse stock split would be a more tax efficient structure than the other squueze-out mechansims"

similar situation involving dissenting shareholders' exercise of their appraisal right for a business transfer, and we believe that the court would apply the same logic in the context of compulsory acquisition. In this case the court applied the interest rate of 6%, which is the statutorily-mandated interest rate applied for commercial matters in the event the parties have not agreed on the applicable interest rate.

While the controlling shareholder can deposit the price appraised by a certified appraiser with the court to avoid the payment of such interest, if the minority shareholder does not withdraw the deposited amount and the court determines the purchase price to be higher than the deposited amount, the controlling shareholder would be required to pay interest on the total purchase price determined by the court. This is because under Korean law, a partial court deposit is not valid.

In light of this, it is advisable for controlling shareholders to induce minority shareholders to amicably agree on the purchase price within the two-month period. If such agreement cannot be attained, the controlling shareholder should pay the minority shareholders (at least) an undisputed portion of the purchase price. Alternatively, the controlling shareholder may consider depositing a sufficient amount with the court to avoid accruing interest on the purchase price.

"Without any unforeseen complications, it will take two to three months to complete a compulsory acquisition"

Exercising minority shareholder rights

If the controlling shareholder and minority shareholders cannot reach agreement on the purchase price, the minority shareholders may attempt to exercise their shareholder rights (such as voting rights, rights to convene a GSM and bring derivative suit, right to receive dividends, and statutory preemptive right) until the court renders a final decision on the purchase price.

Decision on this issue would depend on when the minority shareholder is deemed to lose its shareholder status. If the first view set (as out *Losing shareholder status*) is adopted, then the minority shareholder would not be allowed to exercise its shareholder rights upon deposit of the appraised price with the court. If, on the other hand, the second view is adopted, the minority shareholder would be permitted to exercise shareholder rights. Even in such case, however, in our view, the right to receive dividends during the interim period would not be recognised. This is because the prevailing view in legal academia in other comparable circumstances is that it is unfair to receive dividends as well as interest accrued on the purchase price.

Alternative structures

Under the KCC, there are other routes that could be explored to squeeze out minority shareholders. One option is a cash-out merger whereby minority shareholders are paid cash consideration instead of shares in the surviving entity. Another is a reverse stock split (stock consolidation) in which a large number of outstanding shares of the Korean company would be consolidated into fewer shares by increasing the par value, such that minority shareholders will only have fractional shares.

The KCC expressly permits cash-out mergers, which may be used to squeeze out minority shareholders. The cash-out merger has advantages in this regard. Among other things, unlike with a compulsory acquisition, the KCC does not expressly require a business purpose for a cash-out merger. In addition, minority shareholders lose their status as shareholders upon the registration of a merger with the corporate registry even if consideration for the merger is still in dispute.

"The KCC does not expressly require a business purpose for a cash-out merger"

Nevertheless, there are uncertainties and questions about the permissibility or practicability of the cash-out merger in the context of a minority shareholder squeeze-out. First, it is not entirely clear whether the business purpose requirement that applies to the compulsory acquisition would also be imposed with respect to a cash-out merger intended to squeeze out minority shareholders. Second, if different types of consideration are paid to shareholders of the merged company (for example, if cash consideration is paid to some shareholders while shares of the surviving company are provided to other shareholders), a thorny issue arises regarding the principle of shareholder equality. This is one of the fundamental corporate law principles widely upheld and acknowledged in Korea. Third, from a tax perspective, a cash-out merger may fail to meet the requirements for a tax-qualified merger (which requires at least 80% of the aggregate consideration received by the shareholders of the merged company to consist of shares of the surviving company and/or its parent company). Such a failure would bring about significant negative tax implications.

The reverse stock split would be a more tax efficient structure than the other squeeze-out mechanisms. However, it is doubtful that this route would be permissible for squeeze-out purposes. This is because the KCC allows a reverse stock split only under limited circumstances (such as a capital reduction). Also, unlike under the compulsory acquisition and cash-out merger structures, the minority shareholders would not be granted an appraisal right for minority shareholder protection.

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