
NEW SQUEEZE-OUT DEVICES AS A PART OF CORPORATE LAW REFORM IN KOREA: WHAT TYPE OF DEVICE IS REQUIRED FOR A DEVELOPING ECONOMY?

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ABSTRACT

A squeeze-out is a mechanism used by a majority shareholder in a corporation to force out those in the minority. This article begins with a discussion of whether a squeeze-out should be allowed under the fundamental corporate law principle of majority rule. In spite of concerns for minority shareholders, it is reasonable to seek legislation to minimize the negative aspects of squeeze-outs rather than to simply deny the mechanism altogether. To reduce the risk of the majority's exploiting minority shareholders through squeeze-outs, any squeeze-out legislation should be carefully designed, thereby guaranteeing fair compensation for minority shareholders.

For comparative research, this article reviews squeeze-out devices available in the United States, the United Kingdom, and Germany and classifies the devices into three categories: (1) tender offer squeeze-outs, as in compulsory acquisitions in the U.K.; (2) cash-out merger squeeze-outs, as in the long-form mergers in the U.S.; and (3) supermajority type squeeze-outs, as stipulated in the German Stock Corporation Act. Alternatively, a squeeze-out may be characterized in one of two conditions by either: (1) controlling shareholder or incumbent management (control-maintained type); or (2) outside investors (control-transferred type). This article attempts to demonstrate the way each condition affects the risk of the majority shareholder's exploiting the minority shareholders. For example, tender

offer squeeze-outs, whether combined with control-maintained or control-transferred situations, are likely to provide fair compensation. However, cash-out merger squeeze-outs and supermajority type squeeze-outs, when combined with control-maintained situations, might fail to provide sufficient protection in the process of forcing out the minority.

The Korean government announced its plan to introduce cash-out merger squeeze-outs and supermajority type squeeze-outs in its KCC Reform Bill of 2008. This article supports the decision by the Korean government to move in the direction of creating more flexible squeeze-out mechanisms. The government, however, should take into consideration some of the unique features of Korean business practice. The government should also account for the fact that Korea's corporate governance system is still based on a developing economy. Specifically, many Korean companies have dominant or controlling shareholders, and the level of general protection for minority shareholders is still limited in Korea. If the Korean government, as suggested in the Reform Bill of 2008, was to adopt cash-out mergers and supermajority type squeeze-outs, it needs to be cognizant of the risk of expropriation of minority shareholders and appropriately address the risk in its legislation.

I. INTRODUCTION

When the incorporated entity first emerged, the operation of the corporation was based on mutual agreement among its shareholders.¹ Because the charter was viewed as a contract among shareholders,² the management of the corporation was subject to consensus among its shareholders.³ Thus, the nineteenth-century corporate law effectively allowed all shareholders a veto right whenever their corporation wanted to amend its charter or to adopt fundamental changes in its operation.⁴ A veto right, however, turned out to be an easy tool for minority sharehold-

¹ In other words, shareholders in a corporation would stipulate to their rights and obligations, the governance of the corporation, and other material terms on management in the corporate charter and then operate the corporation pursuant to that charter.

² See Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 627 (1981) ("The basis for this rule was the view that the charter was a contract, both among the corporation's shareholders and between the corporation and the state, in which every shareholder had vested rights.").

³ See *id.*

⁴ Alexander Khutorsky, *Coming in from the Cold: Reforming Shareholders' Appraisal Rights in Freeze-Out Transactions*, 1997 COLUM. BUS. L. REV. 133, 137 (1997); Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L. J. 613, 618-19 (1998).

ers to use to block a change that would serve collective interests, thereby frustrating desirable economic progress.⁵

The appraisal right was developed in response to the inevitable tension between shareholders, as parties to the corporate contract, and the economic reality that granting a veto right to every minority shareholder crippled the governance of large corporations.⁶ The appraisal right allowed the majority to decide what they thought was appropriate for the corporation and provided a right of exit to minority shareholders by forcing the corporation to repurchase minority shareholders' shares if the minority disagreed with the majority decision. Corporate statutes in many countries, including Korea, have adopted the appraisal remedy in a bid to enable the majority to operate a corporation with flexibility while providing sufficient protection to the minority for the minority shareholders' investment.⁷

The squeeze-out or freeze-out is another retreat in terms of minority shareholders' rights. Generally speaking, a squeeze-out is a mechanism used by a majority shareholder in a corporation to force out those in the minority.⁸ A squeeze-out may be executed through various strategies including a cash-out merger,⁹ reverse stock split,¹⁰ two-step merger,¹¹ or compulsory acquisition.¹² In contrast to the appraisal remedy—where minority shareholders decide whether to follow a blueprint suggested by the majority—under a squeeze-out scheme, it is the majority shareholder who decides the transfer of minority shareholders' shares.

The relationship between the minority appraisal right and majority squeeze-out right is illustrated in Table 1 below. The implication of the appraisal right in Korea (as described in this paper) is slightly different from the appraisal remedy in the United States. According to the American appraisal remedy, squeezed-out shareholders may invoke their right of appraisal if *ex post* they are not satisfied with the amount of cash compensation.¹³ However, according to the Korean appraisal right, the minority shareholders who are faced *ex ante* with an important corporate

⁵ See *In re Timmis*, 93 N.E. 522, 523-24 (N.Y. 1910); see also Weiss, *supra* note 2, at 629 (describing this phenomenon as “tyranny by the minority”).

⁶ ROBERT C. CLARK, *CORPORATE LAW* 443-44 (1986).

⁷ See, e.g., DEL. CODE ANN. tit. 8, § 262 (2010); CAL. CORP. CODE § 1300 (West 2010); Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, art. 299-2 (S. Kor.).

⁸ See F. Hodge O’Neal, *Minority Owners Can Avoid Squeeze-outs*, 41 HARV. BUS. REV. 150, 150 (1963); John C. Coates IV, “Fair Value” as Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions, 147 U. PA. L. REV. 1251, 1253 (1999).

⁹ See CLARK, *supra* note 6, § 12.1, at 501-02.

¹⁰ See *id.* at 502.

¹¹ See *id.* § 12.2, at 516.

¹² See *id.* § 12.1, at 503.

¹³ See DEL. CODE ANN. tit. 8, § 262 (2010).

decision directed by the majority may choose not to continue their investments and may instead seek repurchase of their shares.¹⁴

TABLE 1: APPRAISAL RIGHT V. SQUEEZE-OUT RIGHT

	No Appraisal Right by Minority SH	Appraisal Right by Minority SH
No Squeeze-out Right by Majority SH	(A) Amendment to the AOI under the KCC	(B) Business Transfer, Statutory Merger under the KCC
Squeeze-out Right by Majority SH	(C) Claims for Sale By Dominant SH under the German Stock Corporation Act	(D) Compulsory Acquisition Right v. Sell-out Right under the U.K. Companies Act

Table 1 shows the occasions under which minority shareholders' appraisal rights and/or majority shareholders' squeeze-out rights can be exercised. Where the appraisal rights or squeeze-out rights are legitimately exercised, the minority shareholders' investments would terminate. It is true that minority shareholders may sell their shares in the stock market at any time, thereby withdrawing their investments. The appraisal right, however, plays an important role for the protection of minority shareholders where the shares are unlisted or not actively traded.

If an event does not provide minority shareholders with an appraisal right or majority shareholder with a squeeze-out right, the event belongs in category (A) in Table 1. An example of such an event would be an amendment to the Articles of Incorporation under the Korean Commercial Code ("KCC"). If an event provides minority shareholders with an appraisal right while banning squeeze-outs by the majority, it would be categorized as (B). An example of such an event would be a business transfer and statutory merger under the KCC.

Once a squeeze-out by the majority is allowed (e.g., as in categories (C) and (D)), the appraisal right held by minority shareholders becomes subordinate to the squeeze-out right. Major events in a corporation tend to be organized and arranged by the majority shareholder.¹⁵ Thus, if the majority has already decided to squeeze the minority out and legitimately exercise the majority's rights, the minority has little choice: it may ask the court for a re-evaluation of the stock price offered by the majority, but it cannot hold out against the squeeze-out. Category (C) includes events where the majority has a squeeze-out right even though no appraisal right is conferred onto the minority. Claims by a dominant shareholder for the remaining minority shares under the German Stock Corporation Act

¹⁴ Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, art. 299-2 (S. Kor.).

¹⁵ See CLARK, *supra* note 6, § 12.2.5, at 513.

would be an example of an event in this category. Meanwhile, category (D) covers events that trigger both squeeze-out and appraisal rights. For example, where an offeror succeeds in obtaining 90% or more of the total shares in a tender offer in the U.K, the offeror is entitled to compulsorily obtain the remaining shares while the remaining shareholders may exercise a sell-out right.¹⁶

As is noted in Table 1, an appraisal right is not necessarily intertwined with a squeeze-out right; corporate statutes may allow an appraisal right in some cases while allowing a squeeze-out by a majority shareholder in some other cases. However, the introduction of squeeze-out devices would have an enormous impact on minority shareholders, and would influence the functioning of appraisal rights.

Generally speaking, appraisal rights give disgruntled shareholders an option to decide whether to continue their investment.¹⁷ Under an appraisal rights regime, dissenting shareholders would not be forced to exit. Dissenting shareholders may believe that the suggested change by the majority, while not desirable, would not be seriously harmful to the corporation. Once squeeze-out devices are introduced, however, and the majority decides to eliminate the minority through the use of those devices, the authority would fall to the majority shareholder.¹⁸ Thus, one needs to balance the interests of the majority shareholder and minority shareholders in adopting squeeze-out devices. Further, the regulation of squeeze-out rights has become very important in corporate law, since a squeeze-out is closely related to changes in corporate control,¹⁹ and the possibility of a squeeze-out often influences the structure of a takeover itself.²⁰

The KCC does not provide shareholders with a veto right when deciding major issues in a corporation. Instead, dissenting shareholders are entitled to an appraisal right when a shareholders' meeting approves a business transfer, a comprehensive share exchange, or a statutory merger. The current KCC thus seems to be based upon a vested-right theory—the idea that every shareholder has the right to continue his investment in a corporation. As such, the KCC strictly limits squeeze-out transactions.

¹⁶ See *id.* § 10.6, at 450.

¹⁷ See *id.* at 444.

¹⁸ See *id.* § 12.1, at 499.

¹⁹ Joseph A. McCahery et al., *The Economics of the Proposed European Takeover Directive*, in *REFORMING COMPANY AND TAKEOVER LAW IN EUROPE* 575, 643 (Guido Ferrarini et al. eds., 2004).

²⁰ Some Japanese scholars have pointed to the absence of cash-out merger as a primary reason that hostile takeover is rare in Japanese corporate practice. See Masatsugu Yoshioka, *A Comparative Critique of Cash-out Mergers in Japan and the U.S.*, 5 J. CORP. L. STUDIES 465, 465 (2005).

Since the Korean government's submission of the KCC Reform Bill ("Reform Bill of 2008"),²¹ which contained several provisions on squeeze-out rights, the controversy surrounding squeeze-out rights in Korea has become increasingly important. This paper aims to explore squeeze-out strategies in Korean corporate practice and to suggest legislative alternatives. This paper will also analyze squeeze-out mechanisms in other countries by way of comparison. This article will focus mainly on the "statutory" squeeze-out device, rather than the *de facto* or indirect oppressive methods that the majority may use to drive out the minority.²²

The balance of this article will proceed as follows. In section II, various rationales for and against squeeze-outs will be reviewed, and the fundamental questions over squeeze-outs will be addressed. Namely, what are the concerns about squeeze-outs and why do we need new devices vis-à-vis those concerns? Section III will examine current squeeze-out devices in other countries and will separate those devices into three general categories. This comparative analysis will provide a useful insight for new legislation that enables efficient squeeze-outs while reducing the risk of expropriating the shares of minority shareholders. Section IV will analyze demands for new squeeze-out devices in Korea and review current and proposed squeeze-out devices. Section IV will also propose better legislation for squeeze-outs. Finally, section V summarizes and concludes this article.

II. CONFLICTING OBJECTIVES: MINORITY PROTECTION V. DEMANDS FOR SQUEEZE-OUT DEVICES

The fundamental dilemma of squeeze-out regulations is that a squeeze-out device, while serving the efficient operations of a company, would infringe upon minority shareholders' property rights.

A. *Concerns About Minority Protection*

Shareholders in a company expect to maintain their investment until either the company goes bankrupt or they voluntarily sell their shares. This expectation is betrayed when minority shareholders are subject to a squeeze-out. The following concerns have been raised about protecting the minority in squeeze-out situations:

Proprietary Interest Argument²³ – As most countries acknowledge, "[e]very natural or legal person is entitled to the peaceful enjoyment of

²¹ The Korean Commercial Code Reform Bill, Bill No. 1801566, Oct. 21, 2008 (S. Kor.).

²² See McCahery et al., *supra* note 19, at 591-92, 636.

²³ For general discussions on theoretical bases for protecting minority shareholders in a company, see Joseph Lee, *Four Models of Minority Shareholder Protection in Takeovers*, 16 EUR. BUS. L. REV. 803, 809-13 (2005), which sets forth the reasons as: (i) proprietary argument, (ii) contractarian argument, (iii) fiduciary-duty-based

her possession.”²⁴ According to this principle, all shareholders (whether holding majority shares or not) have a proprietary interest in the company and should be protected from any threat against peaceful enjoyment of that possession. From this perspective, a squeeze-out would constitute a critical infringement upon minority shareholders’ property rights. In addition, fair compensation, as is argued by the majority shareholder, tends to be an insufficient replacement for the original investment. For example, (i) squeeze-outs may incur a significant tax burden and reinvestment transaction costs to minority shareholders, (ii) some investors may be sentimental towards a particular company that cannot be covered by monetary compensation, and (iii) the market price, a common indicator for compensation, may not reflect the true value of the shares due to market inefficiencies.²⁵

Opportunistic Behavior Argument – If a controlling shareholder attempts to squeeze the minority out, minority shareholders are likely to be exploited by opportunistic behavior.²⁶ A controlling shareholder tends to have more information than minority shareholders²⁷ and may be inclined to use that information in a squeeze-out. For example, a controlling shareholder with critical inside information might squeeze minority shareholders out with compensation at a market price that is substantially lower than the stock’s intrinsic value. It is true that a controlling shareholder may use inside information unknown to the minority whether or not a squeeze-out is feasible. However, minority shareholders would be subject to a more serious risk once squeeze-out devices are introduced. That is, where a controlling shareholder with inside information attempts to buy shares in the stock market, minority shareholders can refuse to sell their stock, which is not possible under a squeeze-out transaction. Furthermore, the attempt by a controlling shareholder to buy shares in the market would deliver some signals to market participants, thereby raising share price and making additional purchases more difficult. Given that

argument, (iv) utilitarian argument, (v) corporate democracy argument, and (vi) distributive justice argument.

²⁴ Convention for the Protection of Human Rights and Fundamental Freedoms art. 1, Nov. 4, 1950, 213 U.N.T.S. 221.

²⁵ CLARK, *supra* note 6, § 12.2.1, at 504-07.

²⁶ In a conflict of interest situation between majority shareholders and minority shareholders, there is a risk that “majority shareholders, if left unchecked, could unilaterally implement transactions to the detriment of minority shareholders.” Bradley R. Aronstam, R. Franklin Balotti & Timo Rehbock, *Delaware’s Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of Siliconix and Unocal Exploration*, 58 BUS. L. 519, 520 (2003).

²⁷ Kimble Charles Cannon, *Augmenting the Duties of Directors to Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obliging Directors to Express a Valuation Opinion in Unilateral Tender Offers After Siliconix, Aquila and Pure Resources*, 2003 COLUM. BUS. L. REV. 191, 194 (2003).

the “lemon effect”²⁸ takes place in real business transactions, the risk of expropriating minority shareholders by manipulating the timing of a squeeze-out increases as long as the courts regard market price as fair compensation. One might further argue that the opportunistic behavior by a controlling shareholder here merely redistributes wealth between the majority and the minority and does not influence the wealth of society as a whole. However, such redistribution is far from ideal from a corporate regulation perspective. Opportunistic squeeze-outs might decrease overall social wealth, because squeeze-out transactions might incur enormous transaction costs.²⁹

How persuasive are the above arguments? Most of the concerns are baseless and can be addressed with appropriate legislation.

First, the invocation of property rights in a squeeze-out is based on the assumption that protecting those rights would enhance overall welfare by ensuring the continued use of assets.³⁰ Just as one should be protected from the unwanted sale of her own house or car, as the proprietary interest argument would assert, so should a minority shareholder be protected from the unwanted sale of her shares. This argument, however, fails to recognize the differences between shares and other assets. First, shares, unlike a house or car, are not intended for physical use. Individual minority shareholders do not directly control the company’s underlying assets, the value of which is reflected in their shares, but focus upon their shares’ market value. Second, shares are basically a reflection of a company, and the features of shares are subject to the company’s business and/or performance. For example, an equity investment in a furniture company might end up in a sports equipment company following a merger, acquisition, or other corporate reorganization. Thus, the investment decision to buy shares naturally includes a risk that the invested company would operate by majority rule as opposed to the investor’s

²⁸ Professors Bebchuk and Kahan argue that a “lemon effect” is created when controllers are able to use their own private information to establish freeze-out terms favorable to the controller. Under a regime where frozen out minority shareholders receive compensation equal to the pre-freezeout market price, this “lemon effect” causes the pre-freezeout market prices to be set at a level below the expected no-freezeout value of minority shares. See Lucian A. Bebchuk & Marcel Kahan, *Adverse Selection and Gains to Controllers in Corporate Freezeouts*, in CONCENTRATED CORPORATE OWNERSHIP 247-64 (Randall K. Morck ed., 2000), available at <http://ssrn.com/abstract=147568>.

²⁹ In a typical squeeze-out transaction of \$1 billion, legal/consulting fees may exceed \$20 million and notification/posting often costs more than \$0.1 million. Coates, *supra* note 8, at 1324.

³⁰ Mads Krohn, *Minority Squeeze-outs and the European Convention on Human Rights*, 15 EUR. BUS. L. REV. 159, 168 (2004).

wishes. A minority shareholder's wish to hold shares, despite a resolution by the majority, cannot be an absolute right to be respected at all times.³¹

The proprietary interest argument is also based on the notion of unfair compensation. But the criticism itself is unfair. It is true that a squeeze-out may force minority shareholders to bear an additional tax burden and/or transaction cost for reinvestment, but increased taxes and transaction costs are not a sufficient reason to bar squeeze-outs. If squeeze-out rules could be fixed and shareholders could reasonably predict such costs, the minority would not be exposed to unexpected disadvantages. Such costs might also be considered in calculating fair compensation. While some shareholders might attach special feelings to a company, those personal feelings cannot be a conclusive reason for banning squeeze-outs, because the stock market is based upon certainty and objectivity, and the introduction of personal sentiment would lead to vagueness and uncertainty.³² Additionally, market inefficiency cannot be a sufficient reason for banning squeeze-outs, because squeeze-out devices do not always resort to market price and legislation may include a process that would guarantee fair compensation to minority shareholders.

Second, concerns under the opportunistic behavior argument can also be addressed by well-organized squeeze-out regulations. In a developed securities market with sophisticated squeeze-out regulations, the minority shareholders are not likely to be exploited by a controlling shareholder's opportunistic behavior. First, the superior position of a majority shareholder resulting from inside information cannot last long.³³ A typical example of such an unfair squeeze-out is where a controlling shareholder, having obtained information on a lucrative business plan, attempts to eliminate minority shareholders without disclosure of the secret plan. In order for the controller to squeeze-out the minority at a cheap market price, the business plan should be kept confidential and be delayed until the closing of the squeeze-out. The period could also be quite long, should there be litigation against the squeeze-out.³⁴ Thus, a commentator reported that inside information held by a controlling shareholder would

³¹ Other than squeeze-out, "[m]inority shareholders [in the U.S.] do not have a right to remain shareholders – however willing they may be – in the face of majority voting rules on such questions as asset sales, liquidations, mergers and reverse stock splits." William J. Carney & Mark Heimendinger, *Appraising the Nonexistent: The Delaware Courts' Struggle with Control Premium*, 152 U. PA. L. REV. 845, 869 (2003).

³² Yoshioka, *supra* note 20, at 493-94.

³³ Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. CORP. L. 119, 144 (2005); *see also* FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 138 (1991).

³⁴ Since 1993, the average duration for appraisal litigation in the U.S. is five years. Hamermesh & Wachter, *supra* note 33, at 144 n.102.

not influence squeeze-out practices in the U.S.³⁵ Second, while it is true that a majority shareholder may select a depressed period for a squeeze-out, this problem can be solved by modifying the method by which market price is determined. For example, legal provisions may give courts the authority to reconsider the fairness of compensation in cases where the majority appears to have manipulated the timing of a squeeze-out.³⁶ Also, since it is very difficult to determine whether a stock price is currently depressed or whether it will rise in the near future, the majority will not always be able to manipulate the timing.

In a developing securities market, however, the market may fail to monitor or limit opportunistic behavior of controlling shareholders, and the adoption of squeeze-out devices may pave a new way for exploiting minority shareholders. But there are several variations of squeeze-out devices, as is discussed in sections III and IV, and a developing securities market can reduce the risk of opportunistic behavior by adopting a device that properly balances the interests of the majority shareholder and minority shareholders.

B. *Justification for Squeeze-out*

We have reviewed several concerns regarding the adoption of squeeze-out devices. It seems that most of those concerns are baseless and can be addressed by well-organized regulation. Still, what are the expected benefits of squeeze-out devices? That squeeze-out devices are not detrimental to minority shareholders is not a sufficient ground for adopting new devices. In order to adopt new devices, we need further justifications. While some have pointed to the greed and lust for power of the majority as the driving force behind squeeze-outs,³⁷ the strategy is also backed by legitimate economic rationales. Two major justifications, among others, are as follows.

1. To Reduce Costs Associated with Minority Shareholders

One common justification for squeeze-out devices is to reduce the costs of retaining minority shareholders.³⁸ Attracting outside investors would be an effective strategy for extending a company's business. For example, a company listed on a stock exchange is more likely to enjoy external funding than a closed or private company. However, the existence of minority shareholders often results in additional costs in the operation of

³⁵ See Zohar Goshen & Zvi Wiener, *The Value of the Freezeout Option* 2-3 (The Ctr. for Law and Econ. Studies in Columbia Law Sch., Working Paper No. 260, 2003). Goshen and Wiener view the squeeze-out right as a call option and conclude that, given the limited ability to predict the future, personal information of a controlling shareholder does not have critical value in calculating the price of the call option.

³⁶ McCahery et al., *supra* note 19, at 637-38.

³⁷ O'Neal, *supra* note 8, at 152.

³⁸ McCahery et al., *supra* note 19, at 636.

a company.³⁹ Minority shareholders may seek the distribution of dividends despite a new investment plan by the management.⁴⁰ Furthermore, the existence of minority shareholders requires the management of a company to follow strict procedural requirements, including notifications for shareholders' meetings. Additionally, minority shareholders might challenge major business decisions or commence a lawsuit seeking damages from management and/or controlling shareholders.

Another important motivation for squeeze-outs is the pursuit of corporate group interests by eliminating troublesome minority shareholders. For example, a holding company may legitimately wish to operate its subsidiaries in the interest of the whole group, and would be able to do so more easily if the subsidiaries were wholly-owned.⁴¹ In a company that is wholly-owned by its holding company, the interests of shareholders do not matter. Additional motivations include the protection of confidentiality and tax benefits.⁴²

Lastly, it might be argued that adoption of statutory squeeze-out devices may actually lower the overall economic costs for society, because a controlling shareholder who has already decided to squeeze-out minority shareholders would resort to expensive and time-consuming *de-facto* or substantial oppressive methods as long as statutory devices are not allowed.

2. To Enhance Socially-Desirable M&A by Excluding Free-Riders

From the market for corporate control perspective, an availability of squeeze-out devices may boost efficient or socially-desirable M&A. In their seminal thesis, Professors Grossman and Hart pointed to the possibility that socially-desirable tender offers occur at a less-than-optimal level because of offerees who want to "free-ride."⁴³ Expecting the share price will rise following a successful tender offer, each offeree shareholder has an incentive not to tender while hoping other shareholders will tender. Such free-riding behavior by minority shareholders operates as an obstacle against efficient M&A in two ways: (1) where too many minority shareholders free-ride, the tender offer is ultimately frustrated; and (2) where some minority shareholders free-ride in a successful tender offer, the offeror will effectively share the fruits of the M&A with the remaining minority shareholders. An acquirer, who will bear the full cost of the M&A but enjoy only a portion of the benefits,⁴⁴ may decide not to

³⁹ Khutorsky, *supra* note 4, at 136.

⁴⁰ Rodman M. Elfin, *Changing Standards and the Future Course of Freezeout Mergers*, 5 J. CORP. L. 261, 262 (1980).

⁴¹ See JOHN H. FARRAR ET AL., FARRAR'S COMPANY LAW 535 (2d ed. 1988).

⁴² See ELIZABETH BOROS, MINORITY SHAREHOLDERS' REMEDIES 307 (1995).

⁴³ Sanford J. Grossman & Oliver D. Hart, *Takeover Bids, the Free-rider Problem, and the Theory of the Corporation*, 11 BELL J. OF ECON. 42, 43 (1980).

⁴⁴ See *id.*

make a tender offer in such an environment, thereby reducing the number of socially-desirable mergers and acquisitions.

In order to solve this problem and to enhance socially-desirable takeovers, Professors Grossman and Hart suggest that acquirers be given permission to extract private benefits of control from the company by transferring a certain part of minority shareholders' wealth to acquirers.⁴⁵ This method, however, may be unrealistic in practice, because it is very difficult to measure the optimal level of wealth transfer.⁴⁶ However, freeze-out devices would provide at least one⁴⁷ possible alternative to Grossman and Hart's somewhat unrealistic suggestion.⁴⁸ Specifically, if the offeror is entitled to squeeze out the remaining shareholders following a successful tender offer, the ability of minority shareholders to engage in free-rider behavior would be limited.

C. Conclusion

As described by the proprietary interest argument and the opportunistic behavior argument, squeeze-out devices may be misused to threaten minority benefits while enriching the majority. However, one cannot dismiss the apparent positive aspects of squeeze-out mechanisms. The continued presence of minority shareholders can lead to inefficient and costly corporate management. Since profits are likely to be eroded by free-riders in a takeover situation, strong minority shareholder protections discourage bidders. It would be wise to provide legislative constraints to minimize the negative aspects of squeeze-out mechanisms rather than simply to deny them altogether.

These general justifications for squeeze-out devices also apply to Korea. There are already several devices in Korean corporate law which may dilute minority rights pursuant to majority resolutions. For example, according to the KCC, in the case of a business transfer, third-party allotment or capital reduction, the rights of minority shareholders are limited.⁴⁹ Thus, shareholders' rights are not regarded as sacred under the

⁴⁵ See *id.* at 46 ("Whichever method is used, the result is the same: the value to shareholders of not tendering their shares to the raider and of becoming minority shareholders in the raider-run firm is reduced.").

⁴⁶ G.K. Yarrow, *Shareholder Protection, Compulsory Acquisition and the Efficiency of the Takeover Process*, 34 J. INDUS. ECON 3, 4 (1985) ("[I]t will usually be extremely difficult to control the level of oppression at all precisely.").

⁴⁷ Erik Berglöf & Mike Burkart, *European Takeover Regulation*, 18 ECON. POLICY 171, 183-85 (2003). Berglöf & Burkart suggest other means of solving the free-rider problem, including the acquisition of a stake prior to the tender offer.

⁴⁸ Yakov Amihud, Marcel Kahan & Rangarajan K. Sundaram, *The Foundations of Freezeout Laws in Takeovers*, 59 J. FINANCE 1325, 1326 (2004).

⁴⁹ Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, arts. 41 to 45, 438 to 446, 522-2 (S. Kor.).

KCC, and adoption of squeeze-out devices would not contradict conventional provisions.

If Korea was to adopt squeeze-out devices, it should take into account the particular features of Korea's business environment. Specifically, in crafting a squeeze-out mechanism suitable for Korea, Korea must consider the predominance of dominant and controlling shareholders, which stands in stark contrast to the relatively dispersed shareholding environment that typically exists in large U.S. and U.K. companies.⁵⁰ Furthermore, it is commonly understood that the level of general protection for minority shareholders and market monitoring is relatively low in Korea. Thus, the Korean corporate environment creates a real possibility that controlling shareholders may seek to exploit minority shareholders if a squeeze-out mechanism becomes readily available. Therefore, the implementation of a squeeze-out process in Korea should be carefully crafted to reduce the risk of such exploitation.⁵¹

The critical prerequisites for permitting a squeeze-out must be fair compensation and adequate disclosure to minority shareholders. Yet because it is quite difficult for a court to estimate the exact compensation to be given to minority shareholders, it would be better to establish a squeeze-out process that would guarantee fair compensation, with little discretion left to the courts. Squeeze-out provisions in different countries may provide some insight into the new squeeze-out devices that would fairly compensate squeezed-out shareholders.

III. COMPARATIVE ANALYSIS: VARIOUS TYPES OF SQUEEZE-OUT LEGISLATION

Given that squeeze-out devices have many positive aspects, what legislative options are available and what are the merits of each legislative alternative? As discussed later, Korea currently provides very limited methods for a squeeze-out. A comparative research into statutory squeeze-out devices adopted in other countries would further elucidate the pros and cons of each legislative option and assist in developing more well-organized squeeze-out regulations in Korea.

Some legislative devices included substantial as well as procedural requirements for squeeze-outs. For example, under early U.S. case law, in order to squeeze-out minority shareholders, a company had to prove

⁵⁰ See McCahery et al., *supra* note 19, at 584-85 fig. 1 & fig. 2.

⁵¹ In dealing with the European Union Directive on takeover, the High Level Group of Company Law Experts, chaired by Japp Winter, took the view that "this facility [squeeze-out] can only be justified in exceptional circumstances and where there are sufficient safeguards in place." *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, at 61 (Jan. 10, 2002), available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlgreport_en.pdf.

that a specific business purpose would be achieved by the transaction.⁵² In addition, Securities and Exchange Commission Rule 13e-3 of 1979 required controlling shareholders to disclose the purpose of the squeeze-out and the reason that controlling shareholders had to choose a squeeze-out among various other methods of achieving the same purpose.⁵³

However, the substantial requirements historically imposed in the U.S. were so vague that they did not necessarily function as a safeguard against abusive squeeze-outs: almost every squeeze-out might be viewed as having a business purpose, because, at a minimum, the elimination of minority shareholders would normally reduce some governance costs.⁵⁴ Therefore, it may be wiser instead to focus on fair compensation for minority shareholders and procedural requirements (including the threshold for approving squeeze-out transactions) rather than substantial requirements similar to those that have historically existed in the U.S.⁵⁵ Using what process and with how many shares can a majority shareholder force out minority shareholders? From this perspective, squeeze-out legislation can be categorized as one of three types: (1) tender offer type;⁵⁶ (2) cash-out merger type;⁵⁷ or (3) supermajority type.⁵⁸

A. *Tender Offer Type: Compulsory Acquisition in the U.K.*

In tender offer type squeeze-out legislation, as opposed to a squeeze-out through a statutory merger, a two-step transaction is required.⁵⁹ First, in the tender offer stage, the offeror makes a public offer to attract shareholders in a target company. Second, having successfully acquired the minimum level of shares required by the squeeze-out regulation, the offeror is allowed to acquire shares held by the remaining minority shareholders in the compulsory acquisition stage.⁶⁰ After a successful tender offer and the subsequent acquisition of remaining shares, the offeror will have obtained 100% ownership of the target company.⁶¹ Where the

⁵² See, e.g., *Singer v. Magnavox Co.*, 380 A.2d 969, 978-80 (Del. 1977). See also Weiss, *supra* note 2, at 625 n.4.

⁵³ Rule 13e-3, 17 C.F.R. § 240.13e-3. See also Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 10 (2005).

⁵⁴ See CLARK, *supra* note 6, § 12.2, at 514.

⁵⁵ See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983). See also STEPHEN KENYON-SLADE, *MERGERS AND TAKEOVERS IN THE U.S. AND U.K.: LAW AND PRACTICE* 63-86 (2004); Marc I. Steinberg & Evalyn N. Lindahl, *The New Law of Squeeze-out Mergers*, 62 WASH. U. L. Q. 351, 351-414 (1984); Robert B. Thompson, *Squeeze-out Mergers and the "New" Appraisal Remedy*, 62 WASH. U. L. Q. 415, 423-34 (1984).

⁵⁶ See CLARK, *supra* note 6, § 12.2, at 531-33.

⁵⁷ See *id.* § 12.1, at 501-02.

⁵⁸ See *id.* § 18.3.2, at 775-76.

⁵⁹ KENYON-SLADE, *supra* note 55, at 514-17.

⁶⁰ See Boros, *supra* note 42, at 262-65.

⁶¹ See *id.*

offeror is an inside controlling shareholder, the aim of the squeeze-out is to take the company private and to eliminate the cost of maintaining minority shareholders in the company.⁶² Where the offeror is an outside acquirer, the aim of the squeeze-out might be to enjoy the increased value of the target company exclusively.⁶³

A typical tender offer type squeeze-out can be found in the U.K. According to the U.K. Companies Act of 2006,⁶⁴ where a takeover offer is made for all shares in a company (or for all shares of any class or classes), and the offeror has acquired nine-tenths of the shares (or nine-tenths of the shares of any class to which the offer relates), the offeror is able to acquire the shares of the dissenting minority shareholders on the same terms as the offer, subject to the right of the dissenting shareholders to apply to the court.⁶⁵ Both public and private companies fall within the scope of this legislation, regardless of whether the City Code on Takeovers and Mergers is applied to the squeeze-out transaction.⁶⁶ The offeror must provide non-assenting shareholders with a notice informing them of the rights of compulsory acquisition.⁶⁷ The notice should be sent to the target company, along with a statement from the offeror declaring that the statutory requirements for giving such notice have been met.⁶⁸ Where the terms of an offer give shareholders a choice of consideration, the remaining shareholders in the target company may, within six weeks from the date of the notice, indicate their choice.⁶⁹ At the end of the six weeks from the date of the notice, the offeror must pay or transfer the compensation for the shares that are being acquired by the target company.⁷⁰

It is true that the statutory remedy against oppressive or unfairly prejudicial conduct against minority shareholders has been emphasized in common law countries.⁷¹ However, the courts are generally unsympathetic when minority shareholders challenge compulsory acquisition, because the courts are swayed by the fact that 90% of shareholders have

⁶² See *id.* at 306-07.

⁶³ See *id.* at 306.

⁶⁴ The Directive of the European Parliament and of the Council on Takeover Bids, Council Directive 2004/25, art. 15, 2004 O.J. (L 142) (EC), which took effect on April 21, 2004, was reflected in the Companies Act of 2006.

⁶⁵ Companies Act, 2006, c. 3, § 979(1-4), § 986(1) (Eng.).

⁶⁶ TAKEOVERS: LAW AND PRACTICE 573 (Gary Eaborn ed., 2005).

⁶⁷ Companies Act, 2006, c. 3, § 980(1) (Eng.).

⁶⁸ *Id.* § 980(4).

⁶⁹ *Id.* § 981(3).

⁷⁰ *Id.* § 981(6).

⁷¹ See, e.g., Elizabeth Boros, *Altering the Articles of Association to Acquire Minority Shareholdings*, in *THE REALM OF COMPANY LAW* 107, 107-08 (Barry A.K. Rider ed., 1998) (“There is growing judicial sympathy for the complaints of minority shareholders, reflected in part in the increasing role and importance of the statutory remedy against oppressive or unfairly prejudicial conduct.”).

approved the transaction.⁷² In the absence of special circumstances, therefore, the minority shareholders bear the burden of proof of establishing why their shares should not be acquired.

On the other hand, the Companies Act of 2006 also provides a so-called “sell-out right” for minority shareholders. Under section 983, when an offeror has acquired 90% of all the company shares, holders of shares to which the offer relates who did not accept the offer may require the offeror to purchase their remaining minority interest shares on the same terms and for the same consideration as under the offer.⁷³ The sell-out right is seen as the opposite side of the same coin: a benefit for the minority that mirrors the benefit of compulsory acquisition for the majority.⁷⁴

The U.K. is not the only country that applies this type of squeeze-out. Since the adoption of the European Directive on Takeover Bids in 2004,⁷⁵ which is broadly consistent with the U.K. company law concerning squeeze-out devices,⁷⁶ many European countries have introduced tender offer type squeeze-outs.⁷⁷ Tender offer type squeeze-outs in the U.K. have two distinctive features. First, a tender offer is a prerequisite for the squeeze-out. Second, the shares already held by the offeror or its associate⁷⁸ are not counted toward the threshold percentage required for the second step of the squeeze-out.⁷⁹ For example, even where an offeror or its associate has more than 90% of the shares (under U.K. law), the

⁷² BRENDA HANNIGAN, *COMPANY LAW* 912 (2003).

⁷³ Companies Act, 2006, c. 3, § 983(1-2) (Eng.).

⁷⁴ See Lee, *supra* note 23, at 826-27. But see Paul L. Davies, *The Notion of Equality in European Takeover Regulations*, in TAKEOVERS IN ENGLISH AND GERMAN LAW 9, 22 (Jennifer Payne ed., 2002) (explaining that some commentators do not agree to accept the equivalence of the sell-out and squeeze-out rights at the 90%-plus level).

⁷⁵ Council Directive 2004/25, The Directive of the European Parliament and of the Council on Takeover Bids, art. 15, 2004 O.J. (L 142) (EC).

⁷⁶ See DEPARTMENT OF TRADE AND INDUSTRY (DTI), *COMPANY LAW IMPLEMENTATION OF THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS: A CONSULTATIVE DOCUMENT* 34 (2005).

⁷⁷ See generally Christoph van der Elst & Lientje van den Steen, *Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-out and Sell-out Rights*, EUR. COMPANY & FIN. L. REV. 391 (2009).

⁷⁸ Companies Act, 2006, c. 3, § 988(1) (Eng.) (explaining that an associate of an offeror means: a nominee of the offeror; a holding company, subsidiary or fellow subsidiary of the offeror or a nominee of such a holding company, subsidiary or fellow subsidiary; a body corporate in which the offeror is substantially interested; a person who is, or is a nominee of, a party to a share acquisition agreement with the offeror; or, where the offeror is an individual, his spouse or civil partner and any minor child or step-child of his).

⁷⁹ *Id.* § 974(1), § 977(2).

offeror or its associate may not squeeze minority shareholders out unless 90% of the minority shareholders have tendered their shares.

B. Cash-out Merger Type: Long-form Mergers in the U.S.

In some countries, a statutory merger allows a majority shareholder to force out minority shareholders. Specifically, in a stock-for-cash merger, according to the merger contract between the acquiring company and the target company, minority shareholders in the target company are supposed to receive cash in return for their shares in the target company. Thus, majority shareholders in the acquiring company and those in the target company will decide whether to squeeze-out minority shareholders in the target company. Long-form mergers in the U.S. provide a good example.⁸⁰ Pursuant to section 251 of the Delaware General Corporation Law (DGCL), a merger contract, approved by an ordinary shareholders' resolution, may provide that minority shareholders in a target company shall be given cash or securities other than an acquiring company's shares.⁸¹

In the U.S. it is common to force out minority shareholders through a statutory merger.⁸² Why is a merger so closely associated with a squeeze-out? As will be shown by the supermajority type squeeze-out, a squeeze-out mechanism is not necessarily related to a combination of two companies. However, a statutory merger, in which the acquirer generally expects an enormous increase in the value of the target company, would provide a fertile environment for a squeeze-out mechanism, as the acquirer would normally want to eliminate free riders who want to remain as minority shareholders and enjoy the fruits of the merger. In addition, in terms of compensation for minority shareholders, the acquirer, being confident about the positive effects of the merger, might be willing to provide generous compensation for an efficient and smooth transaction.

C. Supermajority Type: German Stock Corporation Act and Short-form Mergers in the U.S.

This type of squeeze-out enables a majority shareholder who has obtained a supermajority threshold ownership in the target company to squeeze-out the minority bloc. Once a dominant shareholder crosses the threshold stipulated by the law, she may demand remaining shareholders to sell their shares. Section 327(a) of the German Stock Corporation Act (*Aktiengesetz*) stipulates a squeeze-out right for a dominant shareholder.

⁸⁰ KENYON-SLADE, *supra* note 55, at 12-13.

⁸¹ DEL. CODE ANN. tit. 8, § 251 (2010).

⁸² Subramanian, *supra* note 53, at 9 (“These laws provided the statutory merger mechanism for freezing out minority shareholders, which remains the most common procedure today.”).

A shareholder who owns 95% or more of a company's legal capital may squeeze-out minority shareholders provided that appropriate compensation is given to them.⁸³

Another example of a supermajority type of squeeze-out can be found in U.S. short-form merger. According to section 253 of the DGCL, an offeror who succeeds in obtaining 90% of a target company may proceed with a short-form merger.⁸⁴ As opposed to a "merger freeze-out" that relies on a statutory long-form merger, a "tender offer freeze-out" is based upon a tender offer and subsequent short-form merger.⁸⁵ The tender offer freeze-out in the U.S. is similar to a compulsory acquisition in the U.K., in that both require a two-step transaction comprised of a tender offer and a compulsory acquisition of minority shares. However, U.S. tender offer freeze-outs have an important "supermajority feature." Such a feature requires 90% ownership of "all outstanding" shares of the target company.⁸⁶ Meanwhile, compulsory acquisition in the U.K. requires 90% approval of "shares to which the offer relates."⁸⁷ Thus, even where a dominant shareholder has more than 95% ownership, she cannot squeeze-out minority shareholders should she fail to obtain 90% of the remaining shares through a tender offer first.

D. *Conclusion: Comparison from the Perspective of Minority Protections*

Thus far, we have considered the various options for crafting legislative squeeze-out devices. However, in order for any potential squeeze-out device to be effective, we must also consider the business environment in which the squeeze-out device will be enacted. Some squeeze-outs are geared towards incumbent controlling shareholders who want to eliminate minority shareholders, while other squeeze-out devices are tailored to outside acquirers who want to obtain 100% ownership of the target company in the course of a statutory merger or share acquisition. The latter would also include an acquisition of a company with dispersed ownership. The former might be called a "control-maintained type," while the latter might be called a "control-transferred type" squeeze-out. For example, according to a survey on appraisal litigation in the U.S. from 1984 to 1994, the most frequent recurring situation was that of a majority

⁸³ Nils Krause, *The New German Takeover Law: An Overview of the New Regime*, 4 INT'L & COMP. CORP. L.J. 345, 366 (2002); see also Frank Wooldridge, *The New German Takeover Act*, 14 EUR. BUS. L. REV. 86 (2003).

⁸⁴ DEL. CODE ANN. tit. 8, § 253 (2010).

⁸⁵ See Subramanian, *supra* note 53, at 7 (explaining how some scholars categorize squeeze-out in the U.S. into two groups: tender offer freeze-out which combines tender offer and short form merger, or merger freeze-out which uses statutory cash-out merger (long-form merger)).

⁸⁶ DEL. CODE ANN. tit. 8, § 253(a) (2010).

⁸⁷ Companies Act, 2006, c. 3, § 979(2)(4) (Eng.).

shareholder in a widely-traded corporation seeking to force out the minority shareholders in a control-maintained type squeeze-out. However, there were also a significant number of cases where a third party took over the corporation with a cash-out as the second step in a control-transferred type squeeze-out.⁸⁸

Generally speaking, a control-maintained type squeeze-out is more likely to threaten the benefits of minority shareholders than a control-transferred type. In a control-maintained type of squeeze-out, the interests of incumbent controllers and minority shareholders are in direct conflict with one another, while those interests are aligned in control-transferred type of squeeze-out.⁸⁹ Furthermore, it is very difficult to identify fair compensation for squeeze-outs in control-maintained type situations. In control-transfer type situations, on the other hand, the suggested price by the acquirer for obtaining a controlling block would indicate the fair price of the shares.

The three aforementioned squeeze-out devices may then be combined with these two types of squeeze-out situations as follows:

TABLE 2: THE RISK OF MINORITY EXPLOITATION IN SQUEEZE-OUTS

	Control-Transferred	Control-Maintained
Cash-out Merger Type	Low Risk	High Risk
Tender Offer Type	Low Risk	Low Risk
Supermajority Type	⁹⁰	High Risk

If minority shareholders are able to challenge the suggested compensation for squeeze-outs without incurring substantial costs, and courts are able to determine the precise level of fair compensation for the minority shareholders, then any squeeze-out device in any business environment will be justifiable and efficient. However, in actuality, appraisal litigation

⁸⁸ Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 26 (1995).

⁸⁹ See Stephen W. Hamilton, *An Apology for the Unwanted Public Shareholder: The Business-Purpose Test and The Freeze-Out Merger*, 4 J. CORP. L. 97, 102 (1978) (classifying freeze-out transactions as an "arm's length freeze-out" and a "conflict-of-interest freeze-out," and adding that the latter would create a traditional self-dealing issue. Most control-maintained type of squeeze-outs are conflict-of-interest freeze-outs.); see also Yedidia Z. Stern, *The Private Sale of Corporate Control: A Myth Dethroned*, 25 J. CORP. L. 511, 513 (1999) ("The commercial reality is that parties to such transactions are reluctant to transfer corporate control without first having involved minority shareholders. The parties and their legal advisors have traditionally structured transactions in a manner that enables minority shareholders to participate (directly) or benefit (indirectly) from the transactions results.").

⁹⁰ A supermajority type squeeze-out is usually sought by controlling shareholders who, based upon existing controlling block, want to obtain 100% ownership. Thus, in general, the control over the company would be maintained.

is costly and time-consuming. Courts are not experts at estimating the fair price for a company's shares. Thus, one needs to be cognizant of the differences between each legislative alternative on squeeze-outs.

First, if a cash-out merger type is combined with a control-maintained structure, the resulting combination is likely to fail to provide fair compensation to minority shareholders. This result is especially likely where the rights of minority shareholders are not substantially protected by legal enforcement. With insufficient monitoring from minority shareholders, a majority shareholder might be tempted to drive minority shareholders out with inadequate compensation through a cash-out merger between affiliated companies under the majority shareholder's control.⁹¹

Should the cash-out merger be negotiated with a third party acquirer in a control-transferred structure, however, the risk of exploitation by a majority shareholder would be diminished.⁹² Also, if the third party acquirer has obtained a founding block of the target before a cash-out merger, minority shareholders in the target may refer to the price paid for the block, thereby reducing the possibility of the minority shareholders' receiving unfair compensation.

Second, if a tender offer type situation is combined with a control-maintained or control-transferred structure, there is likely to be fair compensation provided to minority shareholders. This type of squeeze-out requires a tender offer and an approval of the tender offer by a certain threshold of minority shareholders (e.g., 90% under the U.K. Companies Act⁹³). Because a majority shareholder cannot succeed in persuading a sufficient percentage of minority shareholders to tender their shares for unfair compensation, minority shareholders seem to be sufficiently protected under this tender offer type situation.

Third, in a supermajority type situation, which allows an incumbent controlling shareholder with a supermajority to force the minority out, minority shareholders are likely to receive unfair compensation. This scenario assumes that a dominant shareholder, while keeping her control over a company, freezes out minority shareholders. Like a majority shareholder in a cash-out merger type squeeze-out in a control-maintained situation, the dominant shareholder has a strong incentive to lower the compensation for minority shareholder unless appropriately regulated.⁹⁴

⁹¹ Cannon, *supra* note 27, at 194 (“[T]he risk that a controlling shareholder will use this control and informational advantage to the detriment of minority shareholders in the context of acquiring the shares that it does already own is significant.”).

⁹² Stern, *supra* note 89, at 513.

⁹³ Companies Act, 2006, c. 3, § 979(1-4), § 986(1) (Eng.).

⁹⁴ Cannon, *supra* note 27, at 194 (suggesting that the related-party transaction is similar to the acquisition of minority shareholders' shares through supermajority type squeeze-outs as opposed to the arm's length transaction).

As is shown by Table 2, the tender-offer type squeeze-out is a relatively safer way to guarantee fair compensation for squeezed-out shareholders. But it would be too hasty to assert that this type would always prevail over the other two types. For example, based on implementation costs, a supermajority type squeeze-out could be more cost-effective, because it requires neither a tender offer nor a statutory merger. Thus, before concluding about the most suitable squeeze-out system, one needs to look into the current legal and business surroundings associated with squeeze-outs.

IV. SQUEEZE-OUTS IN KOREA: THE CURRENT SITUATION AND THE WAY TO REFORM

A. Introduction

The general economic justification for squeeze-outs discussed in section II above would seem to apply to Korean businesses as well. Specifically, some Korean enterprises might want to eliminate minority shareholders in order to cut the costs associated with minority shareholders and to enhance the synergy gains from combining businesses. In addition, in the case of 100% ownership, which can be reached through a squeeze-out, companies are able to enjoy benefits under the Korean corporate regulatory regime. For example, under the Monopoly Regulation and Fair Trade Act⁹⁵ and its guidelines, a loan by a financial holding company to its wholly-owned financial affiliate at a lower interest rate shall not constitute an unfair transaction between affiliated companies.⁹⁶ However, most provisions in Korean corporate or anti-trust law do not differentiate between a company that is wholly-owned and a company that has minority shareholders. Thus, demands for squeeze-out, if any, are normally based upon an economic or business rationale, rather than any marginal legal benefits that are attained through 100% ownership.

The question that then naturally arises is whether there is any evidence of a significant demand from Korean companies for squeeze-outs that would justify the introduction of new squeeze-out devices? While it is understood that squeeze-outs can be justified in an economic sense, the government may choose not to introduce new devices as long as the demand for such legislation is not urgent. Thus, we need to evaluate whether there is a demand for squeeze-outs in the Korean business community and assess what devices, if any, would best satisfy this demand.

⁹⁵ Dokjeom gyuje mit gongjeong georaeae gwanhan beobyul [Monopoly Regulation and Fair Trade Act], Act No. 10303, May 17, 2010 (S. Kor.).

⁹⁶ IV-3-Ma of Guideline for Regulating Unfair Assistance of a Person with Special Interest, available at <http://www.ftc.go.kr/laws/laws/laws.jsp?lawDivCd=01>.

B. *Business Surroundings and New Trends in Korea*

1. Shareholder Activism and Adoption of Consolidated Tax Return System

It seems that minority shareholders have become very active these days in Korea. The Korean courts have recently begun to take a more accommodating position with regards to minority shareholders' activism in several derivative actions, than they have done in the past. For example, in the application of the demand requirement,⁹⁷ which requires minority shareholders to demand that the corporation sue the directors before they file a derivative action, the recent case law shows flexibility. Under the traditional approach, a derivative action that was filed without having satisfied the demand requirement would have been dismissed.⁹⁸ In a recent case, however, the Seoul District Court ruled that the absence of the demand process was cured, because the plaintiff shareholders had called for the corporation to seek the responsibility of the director right after the commencement of the derivative action, but the corporation didn't pursue the director's responsibility.⁹⁹ The liberal interpretation on the demand requirement may also be found in other lower court cases.¹⁰⁰

Accordingly, shareholder derivative actions have become more frequent these days.¹⁰¹ For example, in October 2005 the Korean Supreme Court decided that the current and former directors of Samsung Electronics were required to pay 12 billion Korean won (approximately \$10 million USD) to Samsung Electronics,¹⁰² a decision that was interpreted as emphasizing the responsibility of directors or shadow directors under the KCC. Additionally, the newly-introduced 2005 Securities Class Action Act¹⁰³ may ultimately become a weapon which minority share-

⁹⁷ Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, art. 403 (S. Kor.).

⁹⁸ See Changwon District Court [Dist. Ct.], 2001Ga-Hap4231, Sept. 6, 2002 (S. Kor.); Seoul Central District Court [Dist. Ct.], 2004Ga-Dan232721, Dec. 17, 2004 (S. Kor.); Daejeon District Court [Dist. Ct.], 2006Ga-Hap4186, Jul. 3, 2006 (S. Kor.).

⁹⁹ Seoul Central District Court [Dist. Ct.], 2005Ga-Hap97694, Nov. 30, 2006 (S. Kor.).

¹⁰⁰ E.g., Seoul High Court [High Ct.], 2003Na5360, Jun. 27, 2003 (S. Kor.).

¹⁰¹ From 1962 to 2001 there were only 18 derivative suits filed in the Korean courts, but from 2002 to 2006, around 30 derivative suits were filed. Jooyoung Kim, *Woori-Nara-Jooju-Daepyo-Sosongae-Jaeso-Hyunwhang-Mit-Pankyul-Kyeonghyangae-Kwanhan-Gochal* [Survey on Derivative Actions and Analysis on Court Decisions], 34 CG REVIEW 09/10 (2007).

¹⁰² Supreme Court [S. Ct.], 2003Da69638, Oct. 28, 2005 (S. Kor.). See also Hwa-Jin Kim, *Directors' Duties and Liabilities in Corporate Control and Restructuring Transactions: Recent Developments in Korea*, OXFORD U. COMP. L. F. 2 (2006).

¹⁰³ Jeunggwon gwanlyeon jipdan sosong beob [Korean Securities Class Action Act], Act. No. 7074, Jan. 20, 2004 (S. Kor.). See also Stephen Choi, *Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1521-22 (2004) (suggesting that deterrent effects on controlling shareholders may be one of the direct benefits of the

holders may use to threaten directors and majority shareholders. For directors and majority shareholders who are directly or indirectly engaged in corporate management, stronger protections for minority shareholders may mean increased costs and decreased management efficiency. Thus, the growth in minority shareholder activism and supervision may spark an increased demand by management for companies devoid of minority shareholders altogether.

In addition, the consolidated tax return system took effect in the 2010 fiscal year.¹⁰⁴ According to the new provisions, a holding company and its wholly owned subsidiary may have the consolidated tax return system applied to them with the approval of the Commissioner of the National Tax Service.¹⁰⁵ Under the consolidated tax return system, more holding companies may try to satisfy the 100% shareholding requirement, and accordingly, such companies may seek a way to squeeze out minority shareholders from their subsidiaries.

In sum, the growth of shareholder activism is likely to increase the costs associated with minority shareholders. In addition, the new tax return system is likely to reduce the tax burden on wholly-owned subsidiaries once 100% ownership of those subsidiaries is first obtained. The combination of these two novel features in Korea's business environment is likely to increase the demand by controlling shareholders or management for devices to squeeze out minority shareholders.

2. Some Anecdotal Evidence of the Increasing Demand for Squeeze-outs

There is no published survey on the demand for new squeeze-out devices among Korean companies. An analysis of tender offers used for delisting public companies would be helpful towards understanding the business atmosphere surrounding squeeze-outs. This is because voluntary delisting for the purpose of going private usually reflects the intent of the offeror to eliminate minority shareholders—a goal that is pursued by utilizing squeeze-out devices.¹⁰⁶ Although not required by law, most listed companies first announce a tender offer and provide minority shareholders with an opportunity to sell their shares in order to accom-

new Securities Class Action Act); Dae-Hwan Chung, *Introduction to South Korea's New Securities-Related Class Action*, 30 J. CORP. L. 165, 170 (2004) (listing protection of minority shareholders' rights as one of the benefits of the new Securities Class Action Act).

¹⁰⁴ Beobin sae beob [Korean Corporate Tax Act], Act No. 10337, May 31, 2010, arts. 76-8 to 76-12 (S. Kor.).

¹⁰⁵ Beobin sae beob [Korean Corporate Tax Act], Act No. 10337, May 31, 2010, arts. 76-8 (1) (S. Kor.).

¹⁰⁶ See Chang-Hyun Song et al., *Analysis of Freeze-outs in Korea: Quest for Legal Framework Synchronizing Transactional Efficiency and Protection of Minority Shareholders*, 8 J. KOREAN L. 277, 283-93 (2009).

plish a smooth delisting. Thus, the current tender offer practices to achieve delisting would show the demand for squeeze-outs. In fact, the “going private phenomenon” is closely related to the recent trend towards shareholder activism.¹⁰⁷

An analysis of tender offers in the Korean stock market illustrates that going private through a tender offer is not a foreign idea any more. A tender offer for delisting purposes was rarely made before 2002.¹⁰⁸ About 31.7% (or 26 out of 82 cases) of tender offers between January 2002 and October 2010, however, were aimed at delisting.

TABLE 3: PURPOSES OF TENDER OFFER
FROM JAN. 2002 TO OCT. 2010¹⁰⁹

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
Delisting	-	1	12	5	-	2	3	2	1	26
Securing of Managerial Right	1	8	-	3	1	4	2	1	-	20
Meeting Holding Co. Requirement ¹¹⁰	-	-	-	-	-	8	2	1	6	17
M&A	-	1	3	-	2	2	3	2	1	14
Others	-	-	1 ¹¹¹	-	-	2	1	-	1	5
Total	1	10	16	8	3	18	11	6	9	82

¹⁰⁷ *Id.* at 279.

¹⁰⁸ The Financial Supervisory Service of Korea only provides the statistics on the going-private tender offer made after 2002 (*see* www.fss.or.kr). The author reviewed the tender offer reports between January 1990 and December 2001 through the Data Analysis, Retrieval and Transfer System (DART), but could not find any tender offer proposed for delisting. *See* Financial Supervisory Service of Korea, DART, *available at* <http://dart.fss.or.kr>.

¹⁰⁹ Press Release, Financial Supervisory Service of Korea, 2004 Report (Jan. 14, 2005), *available at* http://www.fss.or.kr/kr/nws/nbd/bodobbs_v.jsp?seqno=9392&no=2&gubun=01&menu=nws020100; Press Release, Financial Supervisory Service of Korea, 2006 Report (Feb. 2, 2007), *available at* http://www.fss.or.kr/kr/nws/nbd/bodobbs_v.jsp?seqno=11833&no=11&gubun=01&menu=nws020100; Press Release, Financial Supervisory Service of Korea, 2009 Report (Apr. 14, 2010), *available at* http://www.fss.or.kr/kr/nws/nbd/bodobbs_v.jsp?menu=nws020100&seqno=14299&gubun=01; for information on year 2010, the author looked through the Data Analysis Retrieval and Transfer System (DART), Financial Supervisory Service of Korea, DART, *available at* <http://dart.fss.or.kr>.

¹¹⁰ Dokjeom gyuje mit gongjeong georaeae gwanhan beobyul [Monopoly Regulation and Fair Trade Act], Act No. 10303, May 17, 2010, art. 8-2 (S. Kor.) (requiring a certain type of holding companies in a corporate group to acquire and maintain minimum shareholdings in their subsidiaries).

¹¹¹ The Financial Supervisory Service classified a tender offer by STX Corp. dated Jan. 7, 2004 as having been made for delisting purposes, but the delisting was not aimed at eliminating minority shareholders. Rather, the offer was made for the

Eliminating minority shareholders might not be the only reason for tender offers that are undertaken for delisting. For example, a company may be forced to delist when it fails to meet the qualifications for listing companies.¹¹² In order to find out the precise reason for delisting, one needs to review the tender offer reports submitted by the offeror.

Here, this author analyzed all 26 tender offer reports aimed at delisting from 2002 to 2010. Based on this analysis, this author found that in 19 cases, controlling shareholders tried to get rid of minority shareholders and obtain 100% ownership (*See Exhibit 1*). Only 7 cases were not directed to secure complete management control.¹¹³ One may need to note two points about these statistics. First, some companies tried very hard to have full ownership. For example, Pulmuone Holdings Co., Ltd. provided its first tender offer on Sep. 22, 2008 in order to raise its shareholding ratio in Pulmuone Co., Ltd. from 57.71% to 100%. Unsatisfied with the result of the first offer, it made a second offer on Dec. 2, 2008. Similar to Pulmuone Holdings Co., Ltd., Asahi Glass Co., Ltd. placed two tender offers towards minority shareholders in Hankook Electric Glass Co. Ltd. Those repetitive tender offers show the pursuit of full ownership by controlling shareholders. Second, no controlling shareholder, among the 19 cases aforementioned, was able to achieve its goal. The tender offer, which basically depends on voluntary tenders by minority shareholders, has its limit in terms of fulfilling sole ownership.

While these statistics are limited to listed companies and tender offers, they indicate a preference of majority shareholders to drive out the minority.

C. *Methods of Squeeze-out Under the Current Korean Commercial Code*

Under the KCC, a majority shareholder may try to squeeze out minority shareholders through such oppressive methods as limiting dividends, changing the corporate structure, and siphoning off earnings. However,

benefit of preferred-stock owners by way of share repurchase. Thus, Table 3 reclassifies the purpose of the offer as “others.”

¹¹² For example, a listed company will get delisted from KOSPI Market where annual financial statements of the company have been disapproved by the auditor, where checks or promissory notes issued by the company have been dishonored, or where the annual turnover fails to reach a certain minimum level. *See Yuga jeunkwon sijang sangjang kyujeong* [KOSPI Market Listing Regulation], art. 80 (S. Kor.), available at http://eng.krx.co.kr/m7/m7_1/m7_1_1/JHPENG07001_01.jsp.

¹¹³ (1) D .Y. Holding Ltd. and (2) Shin Dongbang CP Co., Ltd. were forced to be delisted because of a termination of business and financial difficulties, respectively; in (3) Chohung Bank and (4) Good Morning Shinhan Securities Co., Ltd., the Shinhan Financial Holding Co. did not seek 100% ownership, because a comprehensive share exchange was scheduled right after the tender offers; in (5) Pacific Glass Inc., (6) iRevo Co., Ltd., and (7) CDNetwork Co., Ltd., the offerors just set a lower target than 100% ownership.

such oppression has its limits since each share must be treated equally in terms of voting rights and dividend rights under articles 368, 538, and 464 of the KCC. Statutory squeeze-out methods represent an alternative to these traditional, indirect, and oppressive devices. These statutory methods are reviewed below.

1. Cash-out Merger

The feasibility of cash-out mergers, the basic method of squeeze-outs in the United States, has long been debated in Korea. Under a cash-out merger, minority shareholders are forced to sell their shares, provided that the merger is approved by shareholders and fair compensation is made. Under the KCC, shareholders of a target company in a statutory merger are generally expected to receive shares in the acquiring company.¹¹⁴

The KCC does not directly address the possibility of cash-out mergers. However, section 4 of article 523 stipulates that the merger agreement should include a cash payment provision if the acquirer has promised to pay cash to the target company's shareholders. Based upon this provision, some Korean scholars have argued that the acquiring company may rely upon cash consideration instead of shares in the acquiring company.¹¹⁵ That being said, most Korean practitioners and scholars construe the application of section 4 of article 523 much more narrowly to allow only the cash consideration described in the section to be used to supplement default consideration, or in addition to the shares provided in the acquiring company.¹¹⁶ According to this logic, cash consideration should be supplementary and would be allowed if and only if it facilitates an accurate exchange ratio between a target company's share price and an acquiring company's share price. The short-form merger, another major method of squeeze-outs in the United States, cannot be used as a device for squeeze-outs in Korea. Although a company can easily merge its 90%-subsidiary without shareholder approval,¹¹⁷ it cannot squeeze out the minority shareholders of a subsidiary using cash consideration.¹¹⁸

¹¹⁴ See, e.g., Song et al., *supra* note 106, at 296.

¹¹⁵ See, e.g., Jin-Gi Hong, *Joosikhoesau-Habbyungae-Isseoseoui-Kyobookuem* [Cash Consideration in a Statutory Merger], OVERALL LEGAL ISSUES: IN MEMORY OF DR. HONG 385 (1977) (arguing that the acquiring company may offer to each target company's shareholder one nominal share and cash consideration).

¹¹⁶ See, e.g., CHUL-SONG LEE, HOESABUP-GANGUI [LECTURE OF COMPANY LAW] 838 (12th ed. 2005).

¹¹⁷ Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, art. 527-2 (S. Kor.).

¹¹⁸ Art. 527-2 of the KCC does not provide any exception for the consideration in short-form mergers; the logic about the long-form merger would apply. LEE, *supra* note 116, at 838.

2. Comprehensive Share Transfer and Share Exchange

An acquiring company that desires to obtain all of the shares in a target company may do so through a comprehensive share exchange under article 360-2 of the KCC.¹¹⁹ With the approval of the shareholders of both the acquiring and target companies, all of the shares in the target company can be transferred to the acquiring company, making the acquiring company a holding company with 100% share ownership in the target company.¹²⁰ Shareholders of the target company would receive shares of the acquiring company, either in the form of newly-issued shares or as the shares already issued and held by the acquiring company. In the case of a comprehensive share transfer under article 360-15 of the KCC,¹²¹ a new company is established. With shareholder approval by a transferring company (the transferor), all of the transferor's shares would be transferred to the new company (the transferee), which would become a holding company that holds 100% of the transferor's shares. The shareholders of the transferor would be given shares newly-issued by the transferee. In most cases, share transfer is carried out by several companies together and not by a single transferor. Through collective share transfer, which requires the approval of the shareholders of all of the companies concerned, a newly-established holding company is able to own all of the shares in several companies at the same time.

Both share exchanges and share transfers are “comprehensive”; they do not require individual notification or delivery of possession. Even if a shareholder of the target company or transferor votes against a share exchange or share transfer, his or her shares still must be transferred.

Under the KCC, a comprehensive share exchange is similar to the share-for-share offering scheme in the U.K. The new Korean scheme follows the same steps as the U.K. scheme: (1) the cancellation of all target company shares (other than those owned by the offeror), and (2) the issuance of new offeror shares to the former shareholders of the target company as compensation for the cancellation of their shares.¹²² As a result, the target company will become a wholly-owned subsidiary of the offeror, and the former shareholders of the target company will own a proportionate equity interest in the offeror—which is incidentally the same result as in a comprehensive share exchange.

The comprehensive share exchange and share transfer were introduced in Korea in 2001, and are viewed as steps towards liberalizing squeeze-

¹¹⁹ Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, art. 360-2 (S. Kor.).

¹²⁰ *Id.*

¹²¹ *Id.* art. 360-15.

¹²² See KENYON-SLADE, *supra* note 55, at 576 (outlining details of share-for-share offer by way of scheme of arrangement).

outs because they allow for the transfer of target company's shares held by dissenting shareholders to the acquiring company.¹²³

3. Other Methods

Although a majority shareholder may change the articles of incorporation or reduce the paid-in capital of a company by special resolution, it is impossible to squeeze out dissenting minority shareholders through amending the articles of incorporation or employing selective capital reduction. Based on the traditional vested-right theory, the KCC still emphasizes the equal treatment of all shareholders.¹²⁴

Another device used for the purpose of squeeze-outs is the so-called fractional share. While it is not so common in the United States, fractional shares resulting from a reverse-split are said to be available as a squeeze-out technique.¹²⁵ What about in Korea? For example, a company may try to effect a reverse-split under which ten shares will be merged into seven. If shareholder A has 21 shares and shareholder B has nine, what would happen? In such cases, the KCC does not offer specific provisions for dealing with fractional shares. If shareholder B cannot receive any shares, such as where holders of fewer than ten shares are only eligible to receive cash consideration, shareholder A could become the sole shareholder of the company, allowing for a substantial squeeze-out. However, most Korean scholars agree that the reverse-split provision and fractional shares should not be used to facilitate squeeze-outs.¹²⁶ Reverse-splits should be exercised so that the shareholding ratio is not substantially changed. In the above example then, shareholder B would receive six shares and remaining cash consideration ($9 \times 7/10 = 6.3$; therefore, he or she has the right to six new shares and 0.3 fractional shares in cash), even though he or she has fewer than ten shares.

In all, it is very difficult to squeeze out minority shareholders using the devices currently in place in the KCC.

D. *The Suggested Squeeze-out Devices and the Way to Reform*

1. The Suggested Squeeze-out Devices

In 2008, the Korean government submitted a Reform Bill to amend the KCC.¹²⁷ The Reform Bill of 2008 is so comprehensive that it covers

¹²³ Hwa-Jin Kim, *The Case for Market for Corporate Control in Korea*, 8 J. KOREAN L. 227, 264-67 (2009).

¹²⁴ See Sangbeob [Korean Commercial Code (KCC)], Act No. 10281, May 14, 2010, arts. 368, 538, 464 (S. Kor.).

¹²⁵ CLARK, *supra* note 6, § 12.1, at 502.

¹²⁶ See LEE, *supra* note 116, at 723.

¹²⁷ The Korean Commercial Code Reform Bill, Bill No. 1801566, Oct. 21, 2008 (S. Kor.).

almost every major topic in corporate governance and corporate finance. New squeeze-out devices are also adopted in the bill.

According to the bill, two types of squeeze-outs may become available. First, a cash-out merger, similar to the U.S. long-form merger, is included in the Reform Bill of 2008. According to the provision, an acquiring company and target company may agree in a statutory merger contract that shareholders in the target company would be given cash or property other than shares in the acquiring company.¹²⁸

Second, the bill adopts a supermajority-type squeeze-out device, as described above. A dominant shareholder who holds 95% or more of a company's outstanding shares may require minority shareholders to sell their remaining shares in order to accomplish a business objective.¹²⁹ In calculating the 95% threshold, the dominant shareholder includes shares held by another company that are controlled by the dominant shareholder.¹³⁰ While the bill requires that the squeeze-out must be approved by the shareholders' meeting and that the dominant shareholder must explain at the meeting the purpose and other details of the squeeze-out,¹³¹ the approval does not have critical implications once the controller has obtained more than 95% of the shares. If the dominant shareholder and minority shareholders cannot reach an agreement on the amount of fair compensation, the court will determine a fair price in the same manner as in an appraisal procedure. As a counterpart to a dominant shareholder's squeeze-out right, minority shareholders are provided with sell-out rights: minority shareholders may require being "cashed out" where there is a dominant shareholder holding more than 95% of the shares in a company.¹³² This new right seems to be a Korean version of the sell-out right under the 2006 U.K. Companies Act.¹³³

2. Analysis of the Bill and the Right Way to Reform

The Reform Bill of 2008, if passed, would bring about drastic changes to current squeeze-out practices. In Korea, it has been almost impossible to get rid of minority shareholders as long as they want to hold out.¹³⁴ Traditional reluctance of the KCC to allow squeeze-outs raises several questions about new devices adopted in the bill. Does Korea need squeeze-out devices? If so, are the two devices in the bill suitable for the Korean business environment? The two questions will be answered based upon the analyses in the preceding section.

¹²⁸ The Korean Commercial Code Reform Bill, Bill No. 1801566, Oct. 21, 2008, art. 523 (S. Kor.).

¹²⁹ *Id.* art. 360-24 § 1.

¹³⁰ *Id.* art. 360-24 § 2.

¹³¹ *Id.* art. 360-24 §§ 3-4.

¹³² *Id.* art. 360-25.

¹³³ Companies Act, 2006, c. 3, § 983 (Eng.).

¹³⁴ *See, e.g.,* Song et al., *supra* note 106, at 297.

a. *Whether or Not to Introduce New Squeeze-out Devices*

Under the KCC, comprehensive share exchange and share transfer are in actuality the only means for implementing a squeeze-out. However, these devices are far from satisfying the demand from businesses. It is true that through a comprehensive share exchange, an acquiring company may force minority shareholders in a target company to transfer their shares to the acquiring company. But minority shareholders in a target company, while leaving the target company, may still try to influence the target company as shareholders of its 100% parent company.¹³⁵

In this author's opinion, it is necessary to introduce new squeeze-out devices in Korea. Provided that minority shareholders are paid fair compensation, there is no reason to prohibit squeeze-outs. When someone invests in a company, he or she has already accepted the possibility that the nature and value of that investment might change as a result of a majority shareholders' resolution. Under the KCC, such change may result from a merger, spin-off, capital reduction and/or liquidation. Also, the allotment of new shares to a third party, already allowed under the KCC in some cases, may legitimately dilute shareholders' rights (e.g., a shareholder's shareholding of 10% might be reduced to 5% due to an issuance of new shares to a third party). On that basis, why not allow a 10% shareholder to be reduced to a 0% shareholder, as long as it is accompanied by fair compensation?

In a takeover or a transfer of control, the squeeze-out mechanism can help to attract socially-desirable takeover bids, since the bidder would expect to become better off after free-riders have been taken out of the picture. In addition, a holding company may pursue the interests of a whole corporate group without any regard for each subsidiary's minority shareholders, if the holding company fully owns its subsidiaries.

Under Korean constitutional law, an individual is entitled to the peaceful enjoyment of his or her property.¹³⁶ However, this does not necessarily mean that property rights should be placed above other rights accorded by constitutional law. Minority shareholders' property rights can be limited, under reasonable and objective standards, for reasons of public interest or mutual economic benefit.

Although protecting minority shareholders is a major concern for those who oppose squeeze-outs, such protection could be achieved by the imposition of strict procedural regulations and the payment of fair compensation. Prohibiting squeeze-outs entirely is an excessive measure that does not give fair weight to the importance of majority shareholders' economic activities.

¹³⁵ There was a so-called double derivative suit in 2002 in which shareholders of the parent company brought a derivative action on behalf of its subsidiary against the subsidiary's director. See Seoul High Court [High Ct.], 2002Na13746, Aug. 22, 2003 (S. Kor.); Supreme Court [S. Ct.], 2003Da49221, Sept. 23, 2004 (S. Kor.).

¹³⁶ Daehanminkuk Hunbeob [The Constitution of Korea] art. 23 (S. Kor.).

Recent Korean takeover statistics and the trend of taking companies private show an increasing demand in the business community for squeeze-out transactions.¹³⁷ The KCC must endeavor to catch up with rapid changes in the Korean business community. It is not a coincidence that a number of other countries have recently introduced more flexible squeeze-out devices in their own legal systems.¹³⁸

b. *What is the Best Legislation for Squeeze-outs in Korea?*

Creating legislative provisions for new squeeze-out devices would be beneficial for Korean businesses. However, which squeeze-out devices are best suited for the unique Korean business environment requires further analysis. In evaluating the effectiveness of each potential squeeze-out device, we may apply two criteria: (1) the costs of the execution of a squeeze-out; and (2) the protection of minority shareholders.

First, from the cost-execution perspective, the supermajority type mechanism seems to be the simplest of the three squeeze-out devices, provided that the supermajority shares have already been obtained by a controlling shareholder. This is because it does not require a tender offer or a statutory merger. According to the supermajority squeeze-out device in the Reform Bill of 2008, a dominant shareholder with 95% or more shares would be able to invoke a squeeze-out without difficulty. It is hard to tell, though, whether a cash-out merger and a tender offer squeeze-out would cost less in practice.

Second, the protection of minority shareholders through fair compensation has critical importance. While new squeeze-out devices are required for various reasons, the interests of minority shareholders should not be ignored in designing a new system. In fact, fair compensation to minority shareholders should be provided. However, estimating a precise and fair price for shares is not an easy task. Once the compensation for minority shareholders has been decided by the company, it would be very costly and time-consuming for them to deny the price and to rearrange it. Thus, we need to design the process for squeeze-outs cautiously, so that the majority shareholder may not expropriate the minority shareholders.

Out of the three types of squeeze-out devices, the Reform Bill of 2008 adopted two: (1) a cash-out merger type; and (2) a supermajority type. The tender offer type squeeze-out was not addressed. We need to compare the three alternatives in the context of the two aforementioned situations: the “control-transferred” scenario and the “control-maintained” scenario. In the control-transferred situation, the risk of minority share-

¹³⁷ See *supra* Part IV.B.

¹³⁸ For European countries, see van der Elst & van den Steen, *supra* note 77. Japan also recently adopted cash-out mergers. See Kaisha-ho [Company Act], Act No. 86, July 26, 2005, arts. 749 (1), 751(1) (Japan).

holders' being expropriated is not high.¹³⁹ The risk is not high, because there is no controlling shareholder who is in direct conflict with minority shareholders. If a third party has purchased a controlling block before the squeeze-out offer, the purchase price could be a benchmark for fair compensation. Thus, it seems that whatever squeeze-out device is used, there would not be a serious threat to the minority. In a control-maintained situation, a tender offer squeeze-out device bears little risk of being abused. Specifically, a majority or even supermajority shareholder cannot entirely ignore the intent of minority shareholders in a tender offer squeeze-out. In a cash-out merger type or a supermajority type squeeze-out, however, a controlling shareholder with sufficient shares can exercise her squeeze-out right without regard to minority shareholders.

In this author's opinion, the Korean government should adopt the tender offer type squeeze-out in future legislative amendments. It is true that the supermajority type squeeze-out, as it exists in the Reform Bill of 2008 (art. 360-24), would provide a cost effective and simple way to undertake a squeeze-out. In addition, one may argue cash-out mergers would be a better squeeze-out device than tender offer squeeze-outs, because the offeror tends to normally offer a higher price than pre-bid or market prices. However, supermajority type or cash-out merger type devices might be misused to undermine minority interests, especially where the controlling shareholders' interests are in conflict with the minority. If the business practice and corporate governance in Korea effectively monitor the majority shareholder and protect minority shareholders from unfair treatment, the conflict between majority and minority may not be an important issue. However, statistics on international corporate governance research demonstrate that minority shareholders in Korea are subject to majority expropriation, and Korean corporate governance has yet to be fully developed.¹⁴⁰

If the Korean government were to adopt cash-out mergers and supermajority type squeeze-outs, as was suggested in the Reform Bill of 2008, it needs to add some conditions to protect against possible exploitation. For example, the court may apply a standard favorable to squeezed-out shareholders or impose the burden of proof on the company or the majority when deciding fair compensation to the minority.

¹³⁹ See *supra* Table 2.

¹⁴⁰ For example, according to the GovernanceMetrics International, an international agency for corporate governance rating, Korea ranked 33rd out of 39 countries in a 2009 survey, GOVERNANCEMETRICS INTERNATIONAL, COUNTRY RANKINGS AS OF SEPTEMBER 22, 2009 (2009), available at <http://www.gmiratings.com/Performance.aspx>. According to Asia Corporate Governance Association, Korea ranked 6th out of 11 countries in a 2007 survey, ASIA CORPORATE GOVERNANCE ASSOCIATION, CG WATCH 2007: CORPORATE GOVERNANCE IN ASIA (2007), available at <https://www.clsa.com/the-independent-view/issues-that-matter.php> Asia-Pacific Markets.

V. CONCLUSION

This article began with a discussion of whether squeeze-out devices should be allowed pursuant to the fundamental corporate law principle of majority rule. In spite of concerns for minority shareholders, it seems reasonable to seek legislation to minimize negative aspects of squeeze-outs rather than to simply deny the mechanism altogether. In order to reduce the risk of the majority's exploiting minority shareholders through squeeze-outs, squeeze-out legislation should be carefully designed to guarantee fair compensation for minority shareholders.

For comparative research, this article reviewed squeeze-out devices available in the U.S., U.K., and Germany and classified them into three categories: (1) tender offer squeeze-outs as in the compulsory acquisitions in the U.K; (2) cash-out merger squeeze-outs as in the long-form merger in the U.S.; and (3) supermajority type squeeze-outs as stipulated in the German Stock Corporation Act.

On the other hand, a squeeze-out may be characterized by either controlling shareholder or incumbent management (control-maintained type) or outside investor (control-transferred type). This article showed the difference in the risk of the majority's exploiting minority shareholders. Specifically, tender offer squeeze-outs, whether combined with the control-maintained or control-transferred type, is likely to provide fair compensation. For cash-out merger type and supermajority type squeeze-outs in a control-transfer situation, there is no critical risk of expropriating minority shareholders. However, those two types of squeeze-outs in a control-maintained situation might fail to provide sufficient protections in the process of forcing the minority out.

The article then focused on Korea's business environment and current legislative amendments to explore the use of squeeze-outs in a developing economy with very limited squeeze-out devices. General justifications for squeeze-outs discussed above would apply to the Korean economy as well. In addition, there are a number of pieces of evidence—including the change in the trend in tender offers between 2002 and 2010—that show that Korean businesses are demanding new squeeze-out devices.

The Korean government announced its plan to introduce cash-out merger squeeze-outs and supermajority type squeeze-outs by drafting the Reform Bill of 2008. This author supports this decision by the Korean government to move in the direction of creating more flexible squeeze-out mechanisms. However, the government should take into consideration some of the unique features of Korean business practice and the fact that Korea's corporate governance system is based on an economy that is still developing. Specifically, many Korean companies have dominant or controlling shareholders, and the level of general protection for minority shareholders is still limited in Korea.

In this author's opinion, the Korean government should adopt tender offer type squeeze-out devices in future squeeze-out legislation. If the Korean government, as was suggested in the Reform Bill of 2008, were to adopt cash-out merger and supermajority type squeeze-outs, it needs to be cognizant of the risk of expropriating minority shareholders and properly address this risk in its legislation. For example, the court may apply a standard favorable to minority shareholders or impose the burden of proof on the company or its majority when deciding what constitutes fair compensation to be awarded to the minority. A harmonization of the demand for squeeze-outs and the protection for minority shareholders should always be emphasized in future discussions over new squeeze-out legislation.

EXHIBIT 1: TENDER OFFERS FOR DELISTING
BETWEEN JAN. 2002 AND OCT. 2010^{141*}

No.	Date of Registration	Target Company	Offeror	Offeror's Shareholding Ratio(%)**		
				Before TO	Intended by TO	After TO
1	Oct. 15, 2003	Chemiglas Co., Ltd.	Essilor Korea Co., Ltd.	71.74	100	81.68
2	Mar. 10, 2004	D.Y. Holding Ltd.	D. Y. Holdings Ltd.	83.63	90.74	90.74
3	Mar. 30, 2004	Hanmi Bank	Citibank Overseas Investment Corp.	36.55	100	97.5
4	Apr. 13, 2004	Korea Computer Holdings Inc.	Korea Computer Holdings Inc.	75.4	100	95.7
5	Apr. 20, 2004	Chohung Bank	Shinhan Financial Holding Co.	81.15	84.92	84.92
6	Jun. 17, 2004	Keukdong Electric Wire Co.	Nexans Corp.	45.29	100	50.54
7	Jun. 17, 2004	Nexans Korea Ltd.	Nexans Corp.	50	100	82.03
8	Jul. 20, 2004	Busan Mutual Savings Bank	Park, Yeon-Ho (Individual)	99.09	100	99.55
9	Sep. 9, 2004	Auction Co., Ltd	eBay KTA (UK) Ltd.	97.04	100	99.73
10	Sep. 20, 2004	Good Morning Shinhan Securities Co., Ltd.	Shinhan Financial Holding Co.	56.53	57.44	56.80
11	Oct. 12, 2004	Seah Metal Co., Ltd.	Seah Holding Corp.	79.99	100	92.83
12	Nov. 29 2004	Sewon Chemical Co., Ltd.	Misung Trading Corp.	48.87	100	96.00
13	Dec. 20, 2004	Dongseo Industrial Co., Ltd.	Dongseo Industrial Co., Ltd.	59.58	100	80.11
14	Feb. 2, 2005	Isu Ceramics Co., Ltd.	Isu Corp.	69.55	100	93.08
15	Feb. 17, 2005	Shin Dongbang CP Co., Ltd.	CJ Corp.	94.9	100	98.34
16	Apr. 15, 2005	KDB Capital Inc.	The Korean Development Bank	97.49	100	99.53
17	Apr. 19, 2005	Pacific Glass Inc.	AmorePacific Corp.	76.78	78.68	78.54

¹⁴¹ All data is from the tender offer reports submitted to the Financial Supervisory Service of Korea. See Financial Supervisory Service of Korea, Data Analysis, Retrieval and Transfer System (DART), available at <http://dart.fss.or.kr>.

No.	Date of Registration	Target Company	Offeror	Offeror's Shareholding Ratio(%)**		
				Before TO	Intended by TO	After TO
18	Aug. 5, 2005	PKL Co., Ltd.	Photronics, Inc.	89.98	100	96.51
19	Jun. 12, 2007	LG Card Co.	Shinhan Financial Holding Co.	85.7	100	93.36
20	Nov. 1, 2007	Hankuk Electric Glass Co., Ltd.	Asahi Glass Co., Ltd	62.76	100	71.47
21	Sep. 22, 2008	Pulmuone Co., Ltd.	Pulmuone Holdings Co., Ltd.	57.71	100	89.12
22	Oct. 15, 2008	iRevo Co., Ltd.	iRevo Assa Abloy Korea Co., Ltd	45.33	90.14	81.52
23	Dec. 2, 2008	Pulmuone Co., Ltd.	Pulmuone Holdings Co., Ltd.	91.97	100	94.67
24	Jun. 19, 2009	CDNetworks Co., Ltd.	Oak Asia Infrastructure, LLC	59.69	86.86	77.62
25	Oct. 30, 2009	Sung Woo Mold Co., Ltd.	Lee, Myung-Geun (Individual)	72.81	100	96.52
26	Oct. 7, 2010	Hankuk Electric Glass Co., Ltd.	Asahi Glass Co., Ltd.	78.57	100	95.87

* The shadowed boxes (19 cases) indicate voluntary tender offers directed to eliminate all minority shareholders.

** In calculating the ratio, the shares held by those specially related to the offeror (e.g., family members of the offeror) were added to the offeror's shares.

