

## **FSC HOLDS SEMINAR AND UNVEILS MEASURES TO PROTECT GENERAL SHAREHOLDERS IN M&AS VIA STOCK TRANSFER**

The FSC held a seminar with the Korea Exchange (KRX) and the Korea Capital Market Institute (KCMI) on December 21 and announced measures to protect general shareholders in corporate mergers and acquisitions (M&As) via stock transfer. In his opening remarks, FSC Vice Chairman Kim so-young spoke about the purpose of the seminar and suggested the government's policy direction as follows.

### **SUMMARY OF VICE CHAIRMAN'S REMARKS**

Corporate mergers and acquisitions in domestic market mostly take place in the form of stock transfers. However, it has been suggested that ways to protect general investors in that process have been inadequate thus far. The European Union and Japan, for example, provide protection for general investors by mandatory bid rules, while the United States protects the rights of general shareholders through the strengthened role of board of directors and the advanced system of civil procedure. As such, when a change in the ownership status of management right takes place, the government plans to grant the shareholders of the acquired company an opportunity to sell their shares to the acquiring company. This will help improve the principle of equal treatment of shareholders by enabling general shareholders to share the control premium of the company just like the controlling shareholder. In the meantime, the government will seek a balanced approach to promoting M&As while protecting general shareholders at the same time. In this regard, authorities will prepare compensatory measures to ensure that there is no weakening of the positive function of M&As, which is creating synergetic effects between businesses. With today's announcement, the new administration's policy initiatives to protect general investors in capital markets have all been introduced. For the measures requiring a legislative process, authorities will prepare relevant bills to ensure prompt implementation.

### **KEY MEASURES**

#### **I. BACKGROUND AND OVERVIEW**

When an entity acquires control of a listed company through transfer of stocks, the mandatory takeover bid rule requires the buyer to acquire more than a certain proportion of the acquired company's stocks via a public tender offer. In the process of an M&A, where a change in the controlling shareholder takes place, this rule provides protection for rights and interests of general shareholders by guaranteeing the general shareholders who are against the M&A decision an opportunity to sell their shares to the buyer (new controlling shareholder), thereby ensuring them to collect returns on their investments.

Although stock transfers make up about 84.3 percent of M&As taking place in Korea, it has been suggested that, in comparison to mergers, there have been negative comments that protection mechanism for the shareholders of the acquired company is relatively insufficient. Taking into account this problem, the government has included “measures to protect general shareholders in M&As via stock transfer” as a key policy item aimed at restoring the fairness and trust in capital markets, and prepared detailed measures after performing a commissioned study and holding discussions with experts as well as a seminar.

## II. CURRENT SITUATION OF SHAREHOLDER PROTECTION IN M&As

Under the Commercial Act for M&As via merger or transfer and acquisition of business, there are diverse mechanisms of shareholder protection such as a resolution by general meeting of shareholders, rights to claim on purchase of stocks by the company, etc. However, there exists a relatively low level of shareholder protection mechanisms for M&As via stock transfer even though they also result in a change of control of the acquired company. General shareholders who dissent are not given an opportunity to collect their investments, and it is not possible for them to share control premium with the controlling shareholder.

<Major Shareholder Protection Mechanisms Relating to M&As>

	Merger		Business transfer		Stock transfer	
	Acquiring company	Acquired company	Acquiring company	Acquired company	Acquiring company	Acquired company
Resolution by general meeting of shareholders	Yes (Not for small-sized)	Yes	Yes (material transfer)	Yes (material transfer)	No	No
Right to claim on purchase of stocks by company	Yes (Not for small-sized)	Yes	Yes (material transfer)	Yes (material transfer)	No	No

The revision to the former Securities Transaction Act in January 1997 required a mandatory bid of 50 percent plus one share via a public tender offer for entities acquiring 25 percent or more of shares in a company via stock transfer. However, this rule was abolished in February 1998 because there was a concern that this requirement may act as an impediment to corporate M&As and bring delays in corporate restructuring.

## III. MATERIAL EXAMPLES FROM OVERSEAS CASES

Most advanced economies except for the U.S. currently has a mandatory bid rule in place.

In the case of the U.S., the board of directors has a fiduciary duty to act in the best interest of the shareholders, and so the rights and interests of general shareholders are sufficiently guaranteed through active utilization of representative suits by shareholders, class action, etc.

Jurisdiction	Share purchase requirement	Shares up for takeover	Purchase price
EU	Acquisition of at least a certain proportion (decided by each member state)	All of shares held by remaining shareholders	Including control premium
UK	Acquisition of 30% or more	All of shares held by remaining shareholders	Including control premium
Germany	Acquisition of 30% or more	All of shares held by remaining shareholders	Including control premium
Japan	Acquisition of more than 1/3	Acquisition via public tender offer	Including control premium
	Acquisition of more than 2/3	All of shares held by remaining shareholders	
Former Securities Transaction Act (Korea, Jan 1997 ~ Feb 1998)	Acquisition of 25% or more	Acquisition via public tender offer (at least 50%+one share)	Including control premium
US	No current legislation		

## VI. MEASURES IN DETAIL

In the process of an M&A, general shareholders of the acquired company will be guaranteed sufficient opportunities to sell their shares at a price including control premium to the acquirer.

- **(APPLICATION OF RULE)** When an entity holding 25 percent or more of shares becomes the largest shareholder,<sup>1</sup> a public tender offer should be made to purchase shares from the remaining shareholders.
- **(PURCHASE QUANTITY)** The controlling shareholder should purchase at least 50 percent plus one or more share (including control premium). If the controlling shareholder is obligated to take over all of the shares held by general shareholders, this may shrink M&As by placing too much cost burden. Thus, authorities decided to require a public tender offer on a certain proportion of shares (50 percent plus one share) held by the remaining shareholders. When the proportion of shares accepting the public bid exceeds 50 percent of total shares, the new controlling shareholder will purchase shares up to 50 percent plus one from accepting shareholders in proportion to their bid acceptance. When the proportion of shares accepting the public bid falls below 50 percent, it will be considered that the new controlling shareholder satisfies the mandatory bid requirement if the purchase is made only on the quantity of shares subscribed for the public bid.
- **(EXCEPTION)** If there are reasonable and valid grounds, when considering that there may be potential infringement on the rights and interests of general shareholders, an

<sup>1</sup> An entity newly attaining the status of largest shareholder (owning 25% or more shares) via an M&A deal, a current largest shareholder (with less than 25% shareholding status) acquiring more stocks to own 25% or more in company shares, etc.

exception to the application of this rule can be granted. For example, a case of corporate restructuring deemed necessary for the rationalization of industry, a case of share acquisitions undertaken according to the requirements specified under another law, etc. qualify as exceptions.

- **(PENALTY)** A restriction on voting right, disposition order and administrative action, or criminal punishment can be imposed on those who violate this rule.
- **(ENFORCEMENT DATE)** After the passage of the revision bill of the Financial Investment Services and Capital Markets Act (FSCMA) by the National Assembly, authorities will allow at least one year of a grace period to ensure that market participants can adjust to the new requirement.

### **ANTICIPATED EFFECT**

General shareholders will be entitled to a heightened level of shareholder rights as they are offered an opportunity to sell their shares when a change of control takes place. In addition, the measures will help prevent cases of predatory acquisition where damages<sup>2</sup> are incurred to general shareholders following opaque dealings between the acquiring company and the controlling shareholder.

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<sup>2</sup> When sale of core asset or technology leakage after an M&A leads to profit generation, general shareholders may incur economic damages due to a drop in company value.