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**MEMORANDUM**

To: Professor Robert G. Eccles/ Harvard Business School  
From: Sang Il Park/ Hwang Mok Park P.C.  
Date: October 29, 2015  
Re: Korean Legal Perspectives on the Statement of Significant Audiences and Materiality

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This memorandum is prepared and submitted upon request of Professor Robert G. Eccles for the purpose of assisting in his analysis of the viability of an Annual Board “Statement of Significant Audiences and Materiality”. Given that the most commonly established corporate entity is a joint stock company (*chusik hoesa*) in South Korea, this memorandum deals mainly with the regime applicable to joint stock companies, whether privately or publicly held. The information contained in this memorandum is solely based on the laws and regulations of South Korea effective as of the date hereof and does not consider the laws or regulations of any other jurisdiction.

**[SETTING THE LEGAL LANDSCAPE]**

- 1. Briefly explain the broader legal landscape regarding the obligations that a company has to its stakeholders or with regard to its impact of stakeholders, and in particular whether its primary duty is or is not to shareholders over all other stakeholders.**

No general duty to stakeholders is recognized under the Commercial Code of Korea which principally governs corporate matters in South Korea. Under the Commercial Code, the primary duties of directors (e.g. duty of care, duty to monitor other’s management, duty of confidentiality, fiduciary duty) are generally owed to the company, rather than to the stakeholders. However, directors who fail to fulfill their duties either willfully or with gross negligence may be subject to joint and several liabilities towards third parties under Article 401 of the Commercial Code. In the absence of provisions defining such third parties in the Commercial Code, it is

generally understood that they include shareholders, creditors and other stakeholders. With respect to shareholders, the Korean Supreme Court has narrowly construed the scope thereof to the extent of shareholders who suffered direct losses from the directors' willful or grossly negligent failure, rather than indirect losses.

It is noteworthy that the Korean Listed Companies Association has prepared and publicized the Model Code of Ethics for listed companies to pursue transparent and ethical business practices and to secure high reliability and ethical standards for all interested parties. The Model Code of Ethics sets out the minimum required level of ethical relationship between listed companies and their interested parties (including shareholders, investors, customers, competitors, business partners and the society), as well as the ethical standards and actions required for executives and employees. However, the Model Code of Ethics works as a guideline for ethical business practices and it is only merely encouraged that listed companies adopt the Code.

The Fair Trade Commission of Korea has introduced the Fair Trade and Collaborative Cooperation System to promote fair trade practices and collaborative cooperation between large companies and small or medium companies, whereby companies that voluntarily establish their own compliance systems for fair trade and supporting sub-contractors or suppliers (e.g., extension of credit, price adjustment in light of fluctuating material costs and exchange rates) are afforded certain benefits and entitlements from government authorities and institutions (e.g., exemption from fair trade investigations, lower interest rates for government loans, extra points in public procurement bids).

## **[REGULATORY FRAMEWORK]**

### **2. To what legal tradition does the jurisdiction belong, i.e. civil/common law, mixed?**

The jurisdiction of South Korea belongs to the civil law tradition as the laws were largely influenced by the European civil law system. However, the common law system has influenced more recent legislations.

### **3. Are corporate/securities laws regulated federally/ nationally, provincially or both?**

South Korea does not recognize a federal system. Corporate and securities laws are regulated at the national level in South Korea. As far as listed companies are concerned, the Financial Investment Services and Capital Markets Act is also applicable.

### **4. Who are the government corporate/ securities regulators and what are their respective powers (in summary only)?**

The National Assembly is the legislative body which drafts and amends the bills and enacts and

promulgates legislations.

The Ministry of Justice drafts the bill on commercial affairs and provides authoritative interpretations to governmental bodies on the application of the Commercial Code.

The Registry Office under the Supreme Court of Korea processes corporate registrations upon receipt of applications from corporations and issues certified copies of the court registration and certificates of corporate seal impression, etc.

The Financial Services Commission is a central government body responsible for financial policy and financial supervision by drafting and amending financial laws and regulations; supervising, inspecting and sanctioning financial institutions; issuing regulatory licenses and approval to financial institutions; and overseeing capital markets.

The Financial Supervisory Service, which is the working arm for the Financial Services Commission, supervises and regulates the business operations of financial institutions such as banking, securities and insurance, and upholds fair business practices and protects consumers.

The Fair Trade Commission supervises and regulates business practices, conducts investigations and delivers corrective orders to promote competition and strengthen consumers' rights.

**5. Does the Jurisdiction have a stock exchange(s)?**

The Korea Exchange (KRX) is the sole securities exchange operator in South Korea. The KRX operates the following stock exchange boards: (i) Korea Composite Stock Price Index (KOSPI) similar to Dow Jones Industrial Average or S&P500 in the United States; (ii) Korea Securities Dealers Automated Quotations (KOSDAQ) similar to NASDAQ in the United States; and (iii) Korea New Exchange (KONEX) focused on small and mid-sized companies and startups.

**6. [INCORPORATION AND LISTING]**

**7. Do the concepts of “limited liability” and “separate legal personality” exist?**

The concepts of limited liability and separate legal personality exist in the jurisdiction of South Korea.

Shareholders' liabilities for the company's debt are limited to the extent of their capital contributions, unless shareholders otherwise agree to personally guarantee the company's debts. However, shareholders who have not been formally appointed as directors but instruct directors to carry out the business by using their influence over the company may also be held liable to third parties as de facto directors under the Commercial Code.

The company itself is a distinct legal entity which is separate and distinguishable from its shareholders. Thus, the company's creditors are not permitted to request the shareholders to repay the company's debt. According to long-established court precedents, the shareholder of a sole-shareholder company who uses corporate funds for personal use may be subject to criminal punishment based on the charge of breach of fiduciary duty or embezzlement. The corporate veil is lifted in South Korea only in very rare exceptional cases.

**8. Did incorporation or listing historically, or does it today, require any recognition by the company or its directors of a duty to society, an obligation to take account of the company's special or environmental impacts, or to respect its stakeholders?**

Incorporation or listing of companies has not required such recognition in South Korea.

**9. Do any stock exchanges have a responsible investment index, and is participation voluntary? (See e.g. FTSE4Good, Dow Jones Sustainability Index, the Johannesburg Stock Exchange's Socially Responsible Investment Index.)**

Korea Exchange (KRX) does not have a responsible investment index. However, there is one (1) notable responsible investment index in South Korea.

The Korea Economic Justice Institute founded by the Citizens' Coalition for Economic Justice, an NGO seeking an ethics driven overhaul of the nation's economic system, has devised the KEJI Index to evaluate companies by taking into account various factors related to social costs and benefits (e.g., unfair labor practices, unhealthy work conditions, environmental degradations, environmentally sound practices, customer satisfaction, creation of employment opportunities, unfair trade practices, contribution to social and economic development and tax evasion). The KEJI Index has been recognized as a useful benchmark for improving the operations of companies by quantifying the contributions made to economic development, fairness, social service, consumer protection, employee satisfaction and environmental protection.

**[DIRECTORS' DUTIES]**

**10. To whom are directors' duties generally owed?**

The primary duties of directors are generally owed to the company. Details of their primary duties are explained in our response to Question 11 below.

**11. What are the duties owed by directors – please state briefly. Please indicate if there are express or implied duties to avoid damage to the company's reputation?**

Under the Commercial Code, directors are subject to a number of specific duties, including the

duty of care as a prudent manager, duty to attend a meeting of the board of directors, duty to monitor the other directors' management, duty to confidentiality and the fiduciary duty.

Unless otherwise approved by the board of directors, directors are not allowed to (a) engage in a transaction in the same line of business as the company, (b) become an unlimited liability member or a director of any other company with a business purpose that is identical to the company, (c) engage in a transaction with the company for their own or another's account, and (d) use any business opportunity for their own or another's account which could be used by the company that may be of present or future benefit to the company. The directors concerned are prohibited from exercising their voting rights at the meeting of the board of directors convened to obtain such approval.

Under the Financial Investment Services and Capital Markets Act, directors of listed companies are not allowed to (a) submit a business report, annual report or other similar documentation containing a false description or false representation of a material fact or omitting a material fact, (b) use any non-public material information related to the company's business in the trading of securities, and (c) permit a third party to use such information.

There is no express duty to avoid damage to the company's reputation under South Korean law. However, the duty of care as a prudent manager may imply an obligation to avoid damage to the company's reputation.

- 12. More generally, are directors required or permitted to consider the company's impacts on non-shareholders, including impacts on the individuals and communities affected by the company's operations? Is the answer the same where the impacts occur outside the jurisdiction? Can or must directors consider such impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction? (see e.g. s. 172 UK Companies Act 2006, and in particular, ss.(1))?**

South Korean law does not provide a provision similar to Article 172 of the UK Companies Act 2006. However, directors are not prohibited from taking into account the company's impacts on non-shareholders. Given that the importance of corporate social responsibility (CSR) has been increasing in South Korea, more companies now pay close attention to CSR and voluntarily take active measures to promote it. In addition, many companies are voluntarily adopting the Model Code of Ethics and standards under the Fair Trade and Collaborative Cooperation System (as explained under Question 1)..

- 13. If directors are required or permitted to consider impacts on non-shareholders to what extent do they have discretion in determining how to balance different factors including such impacts? What, additional liabilities, if any, do the board or individual directors**

**assume in exercising such discretion?**

South Korean directors are permitted to consider impacts on non-shareholders at their own discretion, subject, however, to their statutory and contractual duties owed to the company.

**14. What are the legal consequences for failing to fulfill any duties described above; and who may take action to initiate them? What defenses are available? Can these issues give rise to other causes of action or regulatory routes whereby a stakeholder can exert pressure on a company with regard to its actions?**

Directors who intentionally or negligently violate certain laws or the articles of incorporation of the company, or neglect to perform their duties will be jointly and severally liable to the company. Directors who fail to fulfill their duties willfully or with gross negligence shall also be jointly and severally liable to third parties. However, as explained in response to Question 1, shareholders can only very rarely qualify as third parties, unless otherwise proved to have directly suffered loss.

The company may file an action against its directors. Qualifying shareholders who meet certain statutory thresholds in respect of the shareholding ratio and holding periods may request the company to file an action against directors and may initiate an action against directors for and on behalf of the company if the company fails to comply with such request within thirty (30) days. Where directors act in violation of the law or the articles of incorporation of the company and such act is likely to cause irreparable damage to the company, shareholders meeting the said statutory requirements may, for and on behalf of the company, seek an injunctive order from the court to cease the directors' actions.

In South Korea, the business judgment rule has been recognized and developed by the judiciary as a defensive argument. In particular, directors can defend themselves by contending that (a) they undertook appropriate procedures to collect, investigate and review relevant information to the extent reasonably possible, (b) they acted in good faith with a reasonable belief that their business decision was made in the best interests of the company, and (c) their business decision was an appropriate one which a prudent manager must also have rendered.

Under the Commercial Code, there is no legal mechanism for stakeholders to exert pressure on the company with regard to director's failure to fulfill their duties.

**15. Are there any other directors' duties which are relevant to the interests of stakeholders?**

There are no other general directors' duties relevant to the interests of stakeholders, other than those mentioned above.

- 16. For all of the above, if these exist in your jurisdiction, does the law provide guidance about the role of supervisory boards in cases of two tier board structures? What obligations are owed by senior management who are not board directors? Is this determined by law if no specific contractual provision applies?**

The two-tier board structure is not recognized in South Korea. However, the company may elect to appoint executive officers by a resolution of the board of directors. Executive officers will carry out their duties at the company and make decisions on matters mandated by the articles of incorporation or the board of directors' resolution. Where the company elects to appoint executive officers, it may not appoint a representative director, but instead a chief executive officer elected at the board of directors carry out the duties as a representative director. Executive officers assume similar duties as directors (e.g., duty of care as a prudent manager, duty of confidentiality, fiduciary duty) and are accordingly required to compensate the company for any intentional or negligent breaches of law or the articles of incorporation.

**[REPORTING]**

- 17. Are companies required to disclose the impacts of their operations (including stakeholder impacts) on non-shareholders, as well as any action taken or intended to address those impacts? Is this required as part of financial reporting obligations or pursuant to a separate reporting regime? Please specific for each reporting route whether it is mandatory or voluntary. Please describe any mandatory reporting requirement, major voluntary initiative or trend towards voluntary reporting with regard to transparency (for example, payments to government or state-owned entities, reports on government orders to undertake surveillance or interception, reports on tax payments etc.).**

In South Korea, the company does not have any obligation to disclose the impact of their operations on stakeholders, except for the requirement that the company shall publish the balance sheet of the company once the balance sheet is approved at the general meeting of shareholders of the company (although this requirement is in practice not actively enforced). However, the company may disclose such impact on a voluntary basis.

Under the Financial Investment Services and Capital Markets Act, listed companies are required to submit business reports to the Financial Services Commission and the Korean Exchange within 90 days after a fiscal year; and semi-annual and quarterly reports within forty 45 days after the half-year and quarter-yearly points in the fiscal year. In addition, listed companies have obligations to promptly submit to the Financial Services Commission a report on certain material events which are deemed critical to investment decisions or necessary to ensure that investors are fully informed by no later than the following day of the occurrence of such events.

Under the Act on External Audit of Joint Stock Companies, companies meeting certain thresholds (e.g., total assets of KRW 10 billion or more as at the end of the immediately preceding fiscal year) are required to appoint external auditors to audit their accounts, and external auditors must submit the companies' business reports to the Securities and Futures Commission and the Korean Institute of Certified Public Accountants.

**18. Do legal reporting obligations extend to such impacts outside the jurisdiction; to the impacts of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?**

As explained above, there is no obligation to disclose such impacts in South Korea.

**19. Who must verify these reports; that can access reports; and what are the legal or regulatory consequences of failing to report or misrepresentation? Is there a regulator tasked with investigating complaints of misreporting?**

Under the Act on External Audit of Joint Stock Companies, companies meeting certain thresholds (e.g., total assets of KRW 10 billion or more as at the end of the immediately preceding fiscal year) are required to have their accounts audited by external auditors. Directors of a listed company who submit a business report, annual reports or other similar documentation containing a false description or false representation of a material fact (or omission thereof) can be subject to civil and/or criminal liabilities. The Financial Services Commission is authorized to investigate complaints of misreporting. Please note that the requirement under the Act on External Audit of Joint Stock Companies are not applicable to *yuhan hoesa* or other forms of the company than joint stock company (or *chusik hoesa* in Korean) under the Commercial Code.

**20. What is the external assurance regime for reporting on a company's impacts on stakeholders? Please specify any mandatory requirements and also where reporting is voluntary what the current market practice is as regards to third party assurance. Please summarize any regulatory guidance on reporting that related to impacts on non-shareholder stakeholders.**

There is no external assurance regime for reporting on the company's impacts on stakeholders in South Korea. Please also refer to our explanations under Questions 17 and 18.

**[STAKEHOLDER ENGAGEMENT]**

**21. Are there any restrictions on circulating shareholder proposals which deal with impacts on non-shareholders, including stakeholder impacts?**

There is no restriction on circulating shareholder proposals which deal with impacts on



stakeholders. Under the Commercial Code, however, shareholders are allowed to propose certain items to include in the agenda for a shareholders' meeting by submitting to the directors a document outlining those proposed items at least six (6) weeks prior to the shareholders' meeting.

**22. Re institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions? What is legal duty pension funds owe with regard to investment decisions in this regard? How does the legal duty of the fund align with term and contractual performance criteria of fund managers – does this facilitate or deter consideration of such impacts?**

Institutional investors are not generally required to consider such impacts in their investment decisions in South Korea. However, the National Pension Fund is required to consider impacts of their investments on the national economy and financial markets, given the significant amount of the investments.

**23. Can non-shareholders address companies' annual general meeting? What is the minimum shareholding required for a shareholder to raise a question at a company's AGM?**

Stakeholders, other than shareholders, are not allowed to address the company's annual general meeting. Irrespective of shareholding ratio, each shareholder is entitled to raise a question at the company's annual general meeting of shareholders. Where shareholders wish to propose certain items for the agenda at a shareholders' meeting as explained in response to Question 21, they must hold (a) shares of at least 3/100 of the total issued and outstanding shares with voting rights in case of unlisted companies, (b) shares of at least 10/1,000 of the total issued and outstanding shares with voting rights consecutively for at least the preceding six (6) months in case of listed companies, (c) shares of at least 5/1,000 of the total issued and outstanding shares with voting rights consecutively for at least the preceding six (6) months in case of listed companies with a total capital of KRW 100 billion or more as at the end of the preceding fiscal year.

**24. Are there any other laws, policies, codes or guidelines or standards applied in the context of particular contractual relationships (for example project finance) or through adherence to particular contractual relationships (for example project finance) or through adherence to particular sustainability principles (for example the UN Global Compact, the OECD Guidelines for Multinational Enterprises etc.), related corporate governance that might encourage companies to consider in a structured way their impacts upon and the interests of their wider stakeholders including through a stakeholder engagement process?**

As explained under Question 1, the Korean Listed Companies Association has prepared and publicized the Model Code of Ethics for listed companies to pursue transparent and ethical

business practices and to secure high standard of reliability and ethics for all interested parties. The Fair Trade Commission has introduced the Fair Trade and Collaborative Cooperation System to encourage fair trade practices and collaborative cooperation between large companies and small or medium companies.

**25. Are there any laws requiring representation of particular stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?**

In South Korea, there is no law requiring representation of particular stakeholder constituencies on the company boards. Under the Act on Promotion of Workers' Participation and Cooperation, however, a business or a workplace employing thirty (30) or more employees must establish a labor management council composed of representatives of management and employees, which purports to promote welfare and cooperation between employers and employees. The labor management council does not have the right to initiate or take industrial actions unlike a labor union. The labor management council is entitled to discuss or resolve certain issues, including employment conditions, productivity, salary system, employee welfare, protection of motherhood and work & family balance.

**26. Are there any laws requiring gender, racial/ethnic, religious or other stakeholder representation; or non-discrimination general, on company boards?**

In South Korea, there are no laws requiring gender, racial/ethnic, religious or other stakeholder representation or non-discrimination in respect of company boards. However, listed companies are required to disclose the genders of their directors in the corporate disclosure information, which may encourage listed companies to consider gender diversity.

**27. In your jurisdiction is there any legal route whereby a parent company can incur liability with regard to the impacts that one of its subsidiaries has had on stakeholder groups? Are there any serious proposals to impose such responsibility?**

Given the concept of separate legal personality is fully recognized in South Korea, stakeholders of the subsidiary are not allowed to pursue a claim against the mother company. Where the subsidiary becomes insolvent, the mother company's liabilities in respect of the subsidiary are limited to the extent of its capital contributions, unless the mother company otherwise agreed to guarantee the subsidiary's liabilities. As explained under Question 7, the corporate veil is rarely pierced in South Korea.

**28. Are you aware of any incoming law or proposals that are relevant to the issues raised in this questionnaire? If so please describe, providing an indication of the anticipated date the legislation will come into force or be adopted.**

To encourage responsible investments by the National Pension Fund, certain reforms to the National Pension Act have been suggested and are being discussed in South Korea. If so reformed, the National Pension Fund will be able to consider issues related to environment, society, corporate governance, etc.