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Favoritism and Corporate Law: The Confused Corporate Opportunity Doctrine in the Hyundai Motor Case

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FAVORITISM AND CORPORATE LAW: THE CONFUSED CORPORATE OPPORTUNITY DOCTRINE IN THE HYUNDAI MOTOR CASE

Hwa-Jin Kim,* Seung Hwan Lee†, and Stephen M. Woodcock††

Core legal principles of U.S. corporate law are often met with perplexity in foreign jurisdictions. This is especially true for legal principles that are controversial even in the U.S. This Article takes the corporate opportunity doctrine and examines how it has been exported to the civil law regime in Korea. Korean conglomerates such as Samsung Group and Hyundai Motor Group have become major players in the global market, but corporate law and practice in Korea have had a difficult time keeping up with developments in the business sector. The Hyundai Motor Case demonstrates an ambitious, but ill-fated, attempt at the adoption of U.S. doctrine in Korea. This Article explains and analyzes the case and the new codified corporate opportunity doctrine rule in the Korean Commercial Code from a comparative perspective, and suggests that the dialogue surrounding the corporate opportunity doctrine in Korean legal and business communities is oriented in the wrong direction and that the new rule needs substantial refinement.

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I. INTRODUCTION

Suppose that you control one of the biggest corporations in the world as the “controlling shareholder-manager.”¹ As you approach retirement, a succession plan becomes necessary, and you desire to pass control of the

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1. The controlling shareholder-manager is one of the characteristics of a concentrated ownership economy and family-controlled firms. See Ronald J. Gilson, *Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange*, 60 STAN. L. REV. 633

corporation to your son.² You want to prove to your shareholders and managers that your son is a capable and experienced leader and that he has the potential to be as successful as you have been in running the business. Towards that end, you form a new, small firm, providing 40 percent of the capital contribution; your son contributes the remaining 60 percent. Your son will manage this new firm, and its success will prove his ability to take your controlling position at the corporation once you step down. The new firm engages in the business of providing certain services that are necessary to your corporation and its affiliated companies, and you instruct your officers and employees to purchase those services exclusively from your son's firm, sometimes for a price higher than what could be bargained for at arm's length. Over a relatively short period of time, the new firm grows into a public corporation, and the relationship between your companies strengthens, resulting in massive profits for both you and your son. This is the story of Hyundai Motor Company ("Hyundai Motor") and Hyundai Glovis Co., Ltd. ("Hyundai Glovis").³ We pose the following questions: under the corporate legal regime as it is today, has a wrong been committed?; if so, what was it, and what legal principle has been violated?; and, more specifically, is it against the law to favor your son's firm through the exercise of your managerial power?

Some activist shareholders of Hyundai Motor believed that the CEO had violated the corporate opportunity doctrine and ought to be held liable; they brought a shareholder derivative lawsuit against Hyundai Motor's chief executive.⁴ The problem for the suing shareholders was that Korean law did not recognize the corporate opportunity doctrine at that time.⁵ The doctrine was eventually written into the Korean Commercial Code ("KCC")⁶, which has since been amended to adopt the corporate opportunity doctrine as it has developed over the decades in the United

(2007); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006).

2. Passing control of the conglomerate is not easy due to the low cash-flow rights of controlling shareholders and inheritance tax issues in Korea. For example, the average ownership of the controlling shareholders of non-public member firms of Samsung Group, the biggest conglomerate in Korea, was 78.43 percent as of 2007, whereas their cash-flow rights were as low as 19.43 percent. See James Jinho Chang & Hyun-Han Shin, *Family Ownership and Performance in Korean Conglomerates*, 15 PACIFIC-BASIN FIN. J. 329, 334 (2007).

3. See Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.); PEOPLE'S SOLIDARITY FOR PARTICIPATORY DEMOCRACY ECON. REFORM RESEARCH INST., REPORT ON THE SHARE TRANSACTION OF THE HEAD'S FAMILY MEMBERS OF 38 CONGLOMERATES 11 (Apr. 6, 2006) [hereinafter SHARE TRANSACTION REPORT].

4. Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.).

5. For Korean Business Law in the English language, see KOREAN BUSINESS LAW (Kim Hwa-Jin ed., 2012).

6. Commercial Act, Act No. 1000, Jan. 20, 1962, art. 397-2, amended by Act No. 10600, Apr. 14, 2011 (S. Kor.) [hereinafter KCC].

States.⁷ Even so, courts have struggled with interpreting the doctrine and the language of the statute, and confusion amongst legal professionals and scholars in Korea persists. This is due, at least in part, to the fact that the corporate opportunity doctrine is regarded as one of the most difficult legal principles in U.S. corporate law and remains open to regular reinterpretation and criticism.⁸ This Article will explain the Hyundai Motor Case and attempt to comparatively analyze the corporate opportunity doctrine codified in the new KCC rule.

II. BACKGROUND OF THE CASE AND COURT'S RULING

A. *The Economic Background*

South Korean conglomerates, or '*Chaebols*' in Korean, are typically global multinational companies that own numerous international enterprises, where each *Chaebol* is controlled by a single chairman.⁹ The *Chaebols*' rise, which was supported by various policies favoring large companies and their owners, was tolerated by the Korean populace under the belief that they greatly contributed to the rapid and remarkable growth of the Korean economy.¹⁰ These conglomerates have grown to be very large relative to the size of Korea's overall economy. Samsung Group, the biggest *Chaebol*, accounted for 13 percent of Korea's GDP in 2011.¹¹

One of the key characteristics of the *Chaebols*' business operations is the regular occurrence of related-party transactions amongst affiliated firms. According to a report released by the Korea Fair Trade Commission (the "KFTC") on August 30, 2012,¹² inter-affiliate transactions constitute 13.6 percent of all transactions by conglomerates with a "controlling

7. See THE LEGISLATION AND JUDICIARY COMMITTEE, COMMERCIAL ACT PROPOSED AMENDMENT (INTRODUCED BY THE GOVERNMENT) REVIEW REPORT (CORPORATE LAW) 149-155 (2008) [hereinafter REVIEW REPORT].

8. See generally ROBERT CLARK, CORPORATE LAW ch. 7 (1986); Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 YALE L.J. 277 (1998).

9. Dong-Hyeon Jung, *Korean Chaebol in Transition*, 40 CHINA REPORT 299, 299-303 (2004). See also Jeong Seo, *Who Will Control Frankenstein? The Korean Chaebol's Corporate Governance*, 14 CARDOZO J. INT'L & COMP. L. 21 (2006); MYUNG HUN KANG, THE KOREAN BUSINESS CONGLOMERATE: CHAEBOL THEN AND NOW (1996).

10. See Hwa-Jin Kim, *Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea*, 17 BERKELEY J. INT'L. L. 61, 63 (1999).

11. See Simon Mundy & Song Jung-a, *Mighty Samsung weighs heavy on S Korea*, FIN. TIMES, [Nov. 14, 2012, 1:43 PM] www.ft.com/intl/cms/s/0/e2ecef2-3e72-11e2-829d-00144feabdc0.html#axzz2wkq.nVhc.

12. See FAIR TRADE COMM'N, ANALYSIS OF INTER-AFFILIATE TRANSACTIONS IN CHAEBOL (2012) [hereinafter KFTC REPORT], available at http://www.ftc.go.kr/news/ftc-reportView.jsp?report_data_no=4906&tribu_type_cd=&report_data_div_cd=&currpage=1&searchKey=1&searchVal=대규모기업집단&startdate=&enddate=.

head,”¹³ which is 2.5 percent higher than conglomerates without controlling heads. Companies with a higher percentage of equity owned by affiliates, the chairman’s relatives, and the second generations of the chairman’s family were similarly found to have a relatively higher ratio of inter-affiliate transactions and, in particular, when descendants of the chairman’s family owned more than 50 percent of the company’s shares, the ratio of inter-affiliate transactions was as high as 56.3 percent.¹⁴

This propensity for inter-affiliated transactions, along with the predatory business expansions made by some *Chaebols*, has caused the Korean public to become highly skeptical of the ‘*Chaebol-centric*’ economic structure of Korea. In their 2012 presidential campaigns, all candidates promised that they would impose reform on the *Chaebols* and their corporate governance and practices.¹⁵ The opposition leaders went further and contended that *Chaebols* should be disassembled like Standard Oil and AT&T in the United States and big Japanese conglomerates before World War II.¹⁶ Such an action would wreak havoc on Korea’s corporate governance and industrial policies. Corporate governance and finance scholarship and practice will also face new and difficult questions, and will do so in an increasingly globalized business and financial environment.¹⁷ In this Article, we analyze *Chaebols* from the perspective of corporate law.

B. *The Scheme and Background of the Case*

The actions taken by Hyundai Motor’s controlling shareholder-manager are typical of business practices in Korea in the past decade. Korean conglomerates commonly either split off segments of their affiliates’ existing businesses into a separate enterprise or establish a new company altogether to engage in a closely related business, with the chairman’s family members acquiring the new company’s shares at the time of its establishment or sometime thereafter.¹⁸ Such transactions cannot, with any certainty, be lumped together and presumed to all serve the same purpose (especially considering the limited publicly-available information). How-

13. In this context, a “controlling head” means a “natural person” who substantially controls the whole conglomerate pursuant to the standards prescribed by the Enforcement Decree of the Monopoly Regulations and Fair Trade Act of Korea.

14. KFTC REPORT, *supra* note 12, at 8.

15. See PUBLIC PROMISE BOOK OF SAENURI PARTY 150-151 (2012); PUBLIC PROMISE BOOK OF DEMOCRATIC UNITED PARTY 106-107 (2012); PUBLIC PROMISE BOOK OF UNITED PROGRESSIVE PARTY 75-80 (2012).

16. PUBLIC PROMISE BOOK OF UNITED PROGRESSIVE PARTY, *supra* note 15, at 75-78.

17. For Korea’s efforts in improvement of corporate governance, see Bernard Black et al., *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537 (2001); Bernard S. Black et al., *Does Corporate Governance Predict Firms’ Market Values? Evidence from Korea*, 22 J.L. ECON. & ORG. 366 (2006); Hwa-Jin Kim, *Toward the “Best Practice” Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, 2 J. CORP. L. STUD. 345 (2002).

18. See KIM HWA-JIN, *CORPORATE FINANCE AND GOVERNANCE* 322 (2nd ed. 2012) [hereinafter KIM, *CORPORATE FINANCE AND GOVERNANCE*].

ever, one can easily conclude that these transactions, when combined with the so-called “Funneling of Business” to the newly established company (*Mul-lyang-mol-a-ju-gi*, in Korean), are being used to solve the succession problem that many conglomerates face. This is not a new observation, nor have the transactions gone unnoticed or unopposed: activist shareholders have been vocal critics of the practice, and an active public dialogue on the issue is ongoing.¹⁹

Although activist shareholders have frequently asserted that the conglomerate transactions are really veiled appropriations of corporate opportunities, there are relatively few cases in which suit has been filed and a court has had the opportunity to examine the transaction and apply corporation law. This can be partially explained by Korea’s unique legal system and culture. More fundamental explanations are (i) the lack of a specific and explicit regulation governing the corporate opportunity doctrine in Korea’s civil law system, and (ii) the fact that, despite the doctrine’s basis in director duty of loyalty under KCC Article 382-3,²⁰ there is insufficient precedent or other legal underpinnings to convincingly apply the corporate opportunity doctrine to inter-affiliate transactions. Despite these circumstances, one Korean court recently took a remarkable step toward strengthening the corporate opportunity doctrine. Below, we discuss the court’s ruling in the Hyundai Motor Shareholder Derivative Suit (“Hyundai Motor Case”).

C. *The Case and Court’s Ruling*²¹

The plaintiffs in the case against Hyundai Motor are the civic group Solidarity for Economic Reform and minority shareholders of Hyundai Motor. The defendants are Chung Mongkoo, Hyundai Motor’s CEO and head of Hyundai Motor Group, and Kim Dongjin, President of Hyundai Motor. According to the court ruling, the facts of the case are as follows:²²

19. SHARE TRANSACTION REPORT, *supra* note 3, at 11. According to the report, ‘appropriation of corporate opportunity’ has been found in nearly all conglomerates, and it has been widely used as a tool for illegal succession taking advantage of loopholes in the KCC and the Korean tax act. The report has been updated four times between its first publication and November 2012. PEOPLE’S SOLIDARITY FOR PARTICIPATORY DEMOCRACY ECON. REFORM RESEARCH INST., THE FIFTH REPORT ON THE PROBLEMATIC SHARE TRANSACTION OF THE HEAD’S FAMILY MEMBERS OF CONGLOMERATES (2012) [hereinafter THE 5TH REPORT]. According to the last report, there were 66 cases suspected of “appropriation of corporate opportunity.” *Id.* at 12. By the end of 2011, the wealth of chairmen’s families had increased from such cases by approximately KRW 10.4299 trillion, and their average earning rate had increased by 1,256 percent. *Id.* at 25.

20. KCC art. 382-3 (“Directors shall perform their duties in good faith for the interest of the company in accordance with Acts, subordinate statutes, and the articles of incorporation.”).

21. Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.).

22. *Id.* at 3-4, 6-11, 42-44.

Hyundai Glovis, a company specializing in the distribution service business, was established to unify and combine Hyundai Motor Group's distribution services. At the time of Hyundai Glovis's establishment, its shareholders were Chung Mongkoo (40%) and his eldest son Chung Uiseon (60%). Hyundai Motor Group's affiliates, such as Hyundai Motor, Kia Motors Corporation, Hyundai Mobis Co., Ltd. ("Hyundai Mobis"), and Hyundai Steel Company, did business with Hyundai Glovis in nearly all areas, including automobile, steel and component delivery; leasing services for distribution equipment; domestic PDI (Pre-delivery Inspection) work; T/P (Transporter) sector; and other delivery-related services, through business transfers or private contracts. The aggregate financial payments between Hyundai Motor Group and Hyundai Glovis reached KRW 568.9 billion between March 2001 and June 2004.²³ During that time, the KFTC imposed a penalty surcharge of KRW 4.7 billion on Hyundai Motor for illegally supporting Hyundai Glovis. The KFTC levied the penalty on the grounds that Hyundai Motor Group was providing excessive financial return to Hyundai Glovis by allotting most of its affiliate companies' transportation needs to Hyundai Glovis on terms that were not arm's length. It further noted that the business capabilities of the relatively new Hyundai Glovis had not been tested or verified.²⁴

Numerous issues were raised in the litigation. Among them, the plaintiffs argued that the directors of Hyundai Motor had usurped a corporate opportunity, stating:

(i) Transportation or distribution services including transportation broker service that Hyundai Glovis is engaged in, provides essential assistance to Hyundai Motor Group's affiliates. Hyundai Motor's working group has for a long time, been striving to establish an integrated distribution company through share investments by Hyundai Motor Group and its affiliates. (ii) Therefore the distribution service by Hyundai Glovis falls under the scope of business opportunity for Hyundai Motor. (iii) It can be expected that Chung Mongkoo as a controlling shareholder and CEO of Hyundai Motor would have gained enormous benefits by acquiring shares of the integrated distribution company. Furthermore Hyundai Motor's distribution service is one of the most important sectors in the company's scope of business. Therefore, since Hyundai Motor could financially afford to acquire major shares of Hyundai Glovis, such a plan should have been reviewed and reported to the board of directors and measures should have been taken, so that the board of directors could make a resolution for the acquisition of the shares of Hyundai Glovis. (iv) Nevertheless, CEO Chung Mongkoo and his son secretly acquired the shares of Hyundai Glovis, without any process of reporting such agenda to the board of directors. (v) Such an act clearly constitutes appropriation of Hyundai Motor's corporate opportunity as CEO Chung Mongkoo and his son Chung Uiseon

23. After June 2004, Chung Mongkoo and Chung Uiseon sold some of their shares of Hyundai Glovis to Wilhelmson, a Norwegian shipping company, and received approximately KRW 100 billion from the sale. Hyundai Glovis was subsequently listed in the KOSPI stock market in January 2006, at which time Chung Mongkoo and Chung Uiseon earned approximately KRW 400 billion of book valuation profit. SHARE TRANSACTION REPORT, *supra* note 3, at 21.

24. Hyundai Motor Group filed, but lost, a lawsuit for revocation of the KFTC's disposition. Supreme Court [S. Ct.], 2009Du15494, Oct. 25, 2012 (S. Kor.).

privately gained benefits by depriving Hyundai Motor of its business opportunity.²⁵

At the time this judgment was rendered, the Amended KCC's Article on Prohibition against Appropriation of Company's Opportunities and Assets (discussed *infra*, Part III) was not in effect.²⁶ Nevertheless, the court acknowledged that a bar against the appropriation of a corporate opportunity could be derived from concepts already existing in the pre-amendment KCC: the duty of good manager's due care or duty of loyalty.²⁷ It then defined the concept of appropriation of corporate opportunity as "a principle that anyone, such as the director or executive member of the company, who has a duty of loyalty shall not unfairly seize the company's opportunity for [his] own benefit, by using his status as a fiduciary and fiduciary relations."²⁸ However, the court also ruled that the director is not obliged to actively transfer all of the business opportunities of which he or she is aware to the company, since 'business opportunity' is an expansive and vague concept; moreover, the duty of good manager's due care and the duty of loyalty are fiduciary duties owed in conjunction with the performance of corporate activities, not a general duty to take every action potentially beneficial to the company.²⁹

The court provided a narrow interpretation of the doctrine. In determining whether a director has deprived the company of its expectation profits by violating the duty of loyalty, the analysis of the business opportunity should be restricted to "realistically existing specific business opportunities."³⁰ In other words, for a business opportunity to have been properly owed to the company, there must have been: (i) an existing, realistic, and specific opportunity for the company, of which it was the subject of specific discussions or advantageous conditions; and (ii) substantial probability that the company would have taken that business opportunity, the reasonable basis for which was derived from the existing company's business judgment and based on factors such as business strategy, business type, financial conditions, business characteristics, investment size, burden of risk, and expected income. When both conditions hold true, then the director has the duty of good manager's due care or duty of loyalty to cause the company to take such business opportunity. Conversely, when, under such circumstances, the director has seized or usurped the company's business opportunity, there exists a violation of duty of good manager's due care or duty of loyalty.

25. See Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 40-41.

26. The bill amending the relevant portion of the KCC was before Parliament at the time but had not yet been passed.

27. See KCC art. 382-3.

28. See Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 41.

29. *Id.*

30. *Id.* at 41-42.

The court ruled that there was an insufficient basis to prove that the market segment entered by Hyundai Glovis was Hyundai Motor's existing, realistic and specific business opportunity.³¹ CEO Chung Mongkoo did not, therefore, have a duty of good manager's due care or duty of loyalty to offer Hyundai Motor the opportunity to purchase Hyundai Glovis shares when it was established.³² Because Chung Mongkoo did not have a duty to do so, he did not unfairly seize or usurp the Hyundai Motor Group's business opportunity. The considerations behind the court's decision were: (i) while Hyundai Glovis's distribution services were related to Hyundai Motor Group's manufacturing and sales, an automobile company does not *have* to conduct its own distribution or establish a subsidiary for its distribution – this is a business judgment decision and, thus, whether to establish an internal business unit, establish a subsidiary, or outsource it to another company is fundamentally at the discretion of the company's directors' business judgment; (ii) the decision to establish Hyundai Glovis was spurred by the desire to effectively manage the distribution services of *all* of the Hyundai Motor Group's affiliates, the direct trigger for which was CEO Chung Mongkoo's order; and (iii) employees of Hyundai Motor Group's affiliates, not just those of Hyundai Motor itself, worked to establish and advance Hyundai Glovis, and Hyundai Glovis similarly provides services for Hyundai Motor Group's affiliates, including Kia Motors Corporation, Hyundai Mobis, and Hyundai Steel Company.³³

Although the court did not rule that CEO Chung Mongkoo had usurped Hyundai Motor Group's business opportunity, it did find that, by unfairly raising freight charges to be paid to Hyundai Glovis, Hyundai Motor caused a loss of approximately KRW 14.3 billion.³⁴ Further, the KFTC imposed a KRW 4.7 billion penalty for this illegal action,³⁵ resulting in a total loss to Hyundai Motor of KRW 19 billion. Taking the overall circumstances into consideration,³⁶ Chung Mongkoo's liability was limited to 90

31. *Id.* at 46.

32. *Id.* at 47-48.

33. *Id.* at 44-46.

34. *See* Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 50-54.

35. *Id.* at 9-11.

36. The Korean Court has ruled that:

where the director is liable for damages from violating laws or articles of associations, or from neglecting duties, then the amount of damages can be limited according to equity in apportionment of damages, which is the ideology of indemnification of damages, taking every circumstance into consideration, including but not limited to, the substance and nature of the business, the type and process of the director's breach of duties, objective circumstances or the extent of the occurrence of the damages, the director's contributions to the company, the director's profit from the breach of duties, lack of organizational system in the company or lack of risk management system.

See, e.g., Supreme Court [S. Ct.], 2002Da60467, Dec. 10, 2004 (S. Kor.); Supreme Court [S. Ct.], 2003Da69638, Oct. 28, 2005 (S. Kor.); Supreme Court [S. Ct.], 2005Da34797, Sept. 21, 2007 (S. Kor.). In the Hyundai Motor Case, the court considered Chung Mongkoo's contribution to Hyundai Motor, the possibilities of inaccuracy in calculating damages, the amount of

percent of the loss (about KRW 17.1 billion).³⁷ He and the minority shareholders all waived their rights to an appeal.³⁸ The litigation ultimately concluded when plaintiff Solidarity for Economic Reform and Chung Mongkoo mutually agreed that he would divest his interest in Hyundai Glovis within a reasonable period of time, the goal of which was to avoid any further controversy around the issue.³⁹

III. THE NEW COMMERCIAL CODE

Korea amended its Commercial Code (the “KCC” or the “Code”) as of April 14, 2011.⁴⁰ The amendment inserted Article 397-2, which expressly adopted the corporate opportunity doctrine. The newly inserted Article 397-2 reads as follows:⁴¹

KCC Article 397-2 (Prohibition against Appropriation of Company’s Opportunities and Assets)

- (1) No director shall use any business opportunity of the company which corresponds to any of the following subparagraphs and may be of present or future benefit to the company, for his/her own account or for the account of a third party, without the approval of the board of directors. In such cases, the approval of the board of directors shall be granted with two thirds or more of the total number of directors;
 1. A business opportunity which has become known to the director in the course of performing his/her duty, or a business opportunity taking advantage of information of the company;
 2. A business opportunity closely related to the business that is being currently conducted or is to be conducted by the company;
- (2) A director who has violated paragraph (1) and thereby incurred damage to the company and the director who approved the same shall be jointly and severally liable for compensation of the damage; and the benefit earned by the director or a third party from the violation shall be presumed to be the damage suffered by the company.

personal profit from the breach of duties etc. *See* Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 58-59.

37. *See* Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 58-59. Whether there were illegal supporting actions to Hyundai Mobis Co., Ltd. and Kia Motors Corporation was also an issue, which is irrelevant to the subject of this article. *Id.* When considering these issues as well, the damages totaled approximately KRW 185.8 billion, with KRW 82.6 billion of that sum owed by CEO Chung Mongkoo.

38. THE 5TH REPORT, *supra* note 19, at 16.

39. After this settlement was reached, Chung Mongkoo both paid out or sold some of his shares in Hyundai Glovis as damages and donated some of the shares to Hyundai Motor Chung Mongkoo Foundation. *Id.* As of now, Chung Uiseon owns 31.88 percent, Chung Mongkoo owns 11.51 percent, Hyundai Motor owns 4.88 percent, and Hyundai Motor Chung Mongkoo Foundation owns 4.46 percent of Hyundai Glovis’s shares.

40. The newly-amended KCC came into effect on April 14, 2012.

41. KCC Article 397-2 is very much like AM. LAW INSTITUTE, PRINCIPLES OF CORP. GOVERNANCE (1994) and its relevant rules. The KCC, its case law, and its interpretation have developed in such a way as to incorporate laws regarding Anglo-American director liability. The insertion of Article 397-2 in the KCC can be seen as a continuation of such tendency in the KCC.

The legislative process to adopt this corporate opportunity doctrine amendment was controversial.⁴² Some felt the legislation was superfluous since the appropriation of a corporate opportunity can be theoretically covered by existing articles of the Code, particularly those related to a director's duty of loyalty (Article 382-3), a director's prohibition against competitive business (Article 397 paragraph 1), or a director's prohibition against self-dealing transactions (Article 398).⁴³ Others argued that ambiguities in the new legislation could lead to excessive lawsuits, discourage CEOs from pursuing innovative business opportunities, and have negative effects on social welfare.⁴⁴ On the other hand, supporters of the legislation pointed to both the practical difficulties of holding directors responsible under the general duty of loyalty and the fact that in Korea many corporate opportunity appropriation cases are not based on directors' prohibited operation of competing businesses or self-dealing transactions.⁴⁵ They argued that an explicit provision for the corporate opportunity doctrine was necessary to clarify the substantive and procedural applicability as well as liability for violation.⁴⁶

The Korean Ministry of Justice initially announced that the corporate opportunity doctrine would be adopted as a declaratory article, providing that "no director shall use any business opportunity of the company that may be of present or future benefit to the company, for his/her own ac-

42. The newly-inserted corporate opportunity doctrine was one of the three major issues for the Ministry of Justice in the legislative process, along with double derivative suits and executive director legislation. Because the issue had huge potential social and political ramifications, the Commercial Code Issue Mediation Committee went through a lengthy and arduous process to finalize the provision. Koo Seungmo, *Legislative Process in Corporate Law of the Commercial Code and Tasks to be Solved*, 55 *ADVANCED COM. L. REV.* 115, 123 (2011).

43. In the above Hyundai Motor Case, the court also acknowledged that the concept "appropriation of corporate opportunity" could be derived from the existing KCC concepts of duty of good manager's due care or duty of loyalty. Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 41.

44. Legal professionals and scholars who are against the legislation are as follows: Choi Junseon, *The Doctrine of Corporate Opportunity*, 95 *JUSTICE* 123 (2006) [hereinafter Choi Junseon, *Corporate Opportunity*]; Choi Wanjin, *Critical Observation of the Commercial Law Draft Revision*, 17 *BUS. ADMIN. & L.* 1 (2007); Kim Jeongho, *The Doctrine of Corporate Opportunity*, 17 *BUS. ADMIN. & L.* 129 (2007) [hereinafter Kim Jeongho, *Doctrine of Corporate Opportunity*]; Jae Yeol Kwon et al., *Corporate Opportunity Doctrine—A Comparative Law Analysis of a Compromise Reform Proposal on the Commercial Code*, 25 *COM. L. REV.* 71 (2007); S. KOR. LISTED COS. ASS'N, *REVIEW ON THE AMENDED COMMERCIAL LAW* (2009).

45. Legal professionals and scholars who are for the legislation are as follows: Lim Jai Yun, *Usurpation of Corporate Opportunity*, 363 *HUM. RTS. & JUST.* 176 (2006); Baik Jeong-Woong, *The U.S. Corporate Opportunity Doctrine and the Korea Commercial Code*, 25 *COM. L. REV.* 361 (2006); Kwon Soon-Hee, *A Study on Usurpation of Corporate Opportunity in Article 398 Section 3 of the Reform Proposal to the Commercial Code*, 26 *COM. L. REV.* 27 (2007).

46. *See supra*, note 45.

count or for the account of a third party.”⁴⁷ Upon submission to the National Assembly, however, the doctrine itself materialized with respect to cases of appropriation arising via self-dealing director transactions, no longer a mere declaratory article.⁴⁸ Some members of the National Assembly still argued that a powerful regulation by law was necessary. Six amendments to the bill were proposed,⁴⁹ including one that would have expanded the doctrine’s applicability to also include major shareholders and related persons and granted a right of intervention in appropriation of corporate opportunity cases similar to that permitted against a director’s operation of competitive business (KCC Article 397 paragraph 2).⁵⁰ An agreement was eventually reached to insert new Article 397-2, as written above. Such a complicated legislative history is an indication of how sensitive public opinion was to the incorporation of the corporate opportunity doctrine into law.⁵¹ It also reveals that no clear or consistent consensus on the content or legal nature of the corporate opportunity doctrine has been formed yet in Korea.⁵²

It must be noted that, unlike the U.S., Korea has sought to regulate its conglomerates’ so-called “Funneling of Business,”⁵³ the transfer of wealth to controlling shareholders and their related persons by conglomerates’ affiliates. As discussed above, major civic groups in Korea have repeatedly opposed such practice as a suspected case of the usurpation of corporate

47. See Press Release, Ministry of Justice, Republic of Kor., Main points on the Amendments to the Commercial (Company) Act (Mar. 11, 2011), http://www.moj.go.kr/HP/COM/bbs_03/ShowData.do?strNbodCd=noti0005&strWrtNo=2430&strAnsNo=A&strFilePath=moj/&strRtnURL=MOJ_30200000&strOrgGbnCd=100000.

48. For appropriation of corporate opportunity that was not classified as a self-dealing transaction, Article 382-3, the provision governing directors’ duty of loyalty, applied.

49. See *Amendments to the Commercial Act*, NAT’L ASSEMBLY OF THE REPUBLIC OF KOR., http://likms.assembly.go.kr/bill/jsp/BillDetail.jsp?bill_id=PRC_R1U1N0Y3S0E9Y1W5A5L0X1G7J3Q7I9 (last visited January 29, 2014).

50. KCC Article 397 states:

(1) No director shall, without the approval of the board of directors, engage in for his/her own account or for the account of a third party any transaction in the same line of business of the company or become an unlimited liability member or a director of any other company, the business purposes of which are the same as those of the company. (2) If any director has engaged in a transaction for his/her own account in contravention of paragraph (1), the company and if he/she has made a transaction for the account of a third party, the company may request the pertinent director to transfer any interest accrued therefrom. (3) Rights under paragraph (2) shall be extinct upon the lapse of one year after the date such transaction has been made.

51. Chun Kyung Hoon, *How to Interpret New Regulations on Usurpation of Corporate Opportunity under the Recent Amendment to the Korean Commercial Code*, 30 *CORP. PRIVATE L. REV.* 143, 145 (2011).

52. Some scholars argue that, in Korea, discussions about the “need” to regulate directors’ appropriation of corporate opportunity are taking place despite a lack of consensus regarding, or criteria for determining, what exactly corporate opportunity is, what kind of liability should be imposed, and through which standards. See Kim Hongki, *Corporate Opportunity Doctrine and its [sic] Implication for the Interpretation and Regulations in Korea*, 21 *COM. L. CASE REV.* 99, 101 (2008) [hereinafter Kim Hongki, *Corporate Opportunity*].

53. KIM, *CORPORATE FINANCE AND GOVERNANCE*, *supra* note 18, at 322.

opportunities. This “Funneling of Business” practice likely heavily influenced Korea’s adoption of Article 372-2. This proposition is reflected in the Legislation and Judiciary Committee’s Review Report on the proposed amendment of the KCC submitted to the National Assembly.⁵⁴ The Review Report points to the Hyundai Motor Case, stating that “[r]ecently a number of representative directors or controlling shareholders have usurped business opportunities to reinforce their control over the company or transfer their management control. However [,] it is difficult to regulate these transactions through existing regulations such as duty of loyalty or prohibition against self-dealing transactions by directors.”⁵⁵ According to the Review Report, in order to regulate these types of transactions, a provision incorporating the corporate opportunity doctrine is needed.

IV. THE U.S. LAW

Because the origins of the corporate opportunity doctrine can be traced back to case law developed under the United States legal regime, a study of Korean Commercial Code Article 397-2 and the concept of a “business opportunity” thereunder logically begins with a survey of the U.S. doctrine. This is especially true considering that the Korean doctrine is understood to have adopted the American Law Institute’s defining principles on the corporate opportunity doctrine.⁵⁶ Consequently, preceding our analysis of Korean Commercial Code Article 397-2, this section provides a look at the history and formulation of the corporate opportunity doctrine in the United States. The state of Delaware is the dominant jurisdiction for corporations in the United States;⁵⁷ as such, the focus is on the development of Delaware case law.

A. *History of the Corporate Opportunity Doctrine in the United States*

The classic statement of the corporate opportunity doctrine is set forth in *Guth v. Loft*,⁵⁸ a case decided in 1939 by the Delaware Supreme Court (discussed further below). The doctrine is a logical extension of the duty of loyalty, one of the oldest and most basic fiduciary principles.⁵⁹ The fiduciary duty of loyalty embodies the general principle that one who undertakes to act on behalf of another must not place his own interests ahead of the interests of his principal,⁶⁰ a concept that can be traced back more

54. REVIEW REPORT, *supra* note 7, 150-51.

55. *Id.* at 152-53.

56. AM. LAW INSTITUTE, PRINCIPLES OF CORP. GOVERNANCE § 5.05(b) (1994).

57. See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering Competition Over Corporate Charters*, 112 YALE L.J. 553, 553-54 (2002).

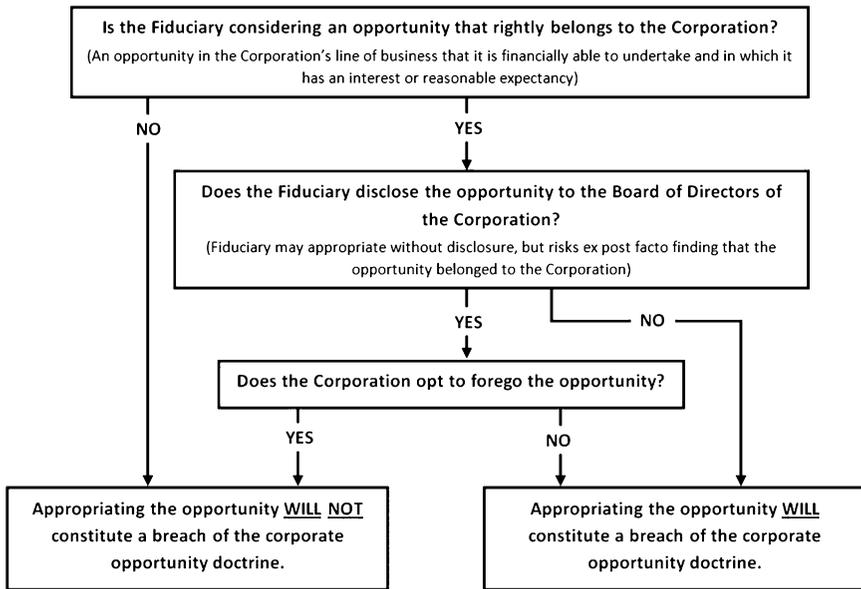
58. *Guth v. Loft*, 5 A.2d 503, 510-11 (Del. 1939).

59. John E. Jackson III, *Corporate Opportunity Doctrine: A Historical View with a Proposed Solution*, 53 MO. L. REV. 393, 394 (1988).

60. See generally *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928).

than eight centuries and is found in many of the earliest written codes of law.⁶¹

While the duty of loyalty can be stated succinctly and is a foundational principle in many areas of law, applying the principle to a set of facts has often proven to be complicated and controversial—a challenge that has been especially true of the corporate opportunity doctrine. The opinions in *Guth* and subsequent corporate opportunity cases reveal a judiciary that has struggled to create a standard for the straightforward application of doctrine to facts and, in the process, has created a complex body of tests, factors, and case law precedent. Before exploring the path that the doctrine has taken through judicial inquiry and analysis over the past 70 years, however, it is helpful to understand its basic framework. The simplified illustration below shows the basic steps to consider when determining whether taking a business opportunity may constitute a breach of the corporate opportunity doctrine under U.S. law:



B. The Evolution of Case Law

Application of the corporate opportunity doctrine in Delaware generally begins with a statement of the doctrine from *Guth v. Loft*.⁶² In *Guth*, the president and director of Loft Incorporated (a candy, syrup and foods manufacturer) acquired a controlling interest in the Pepsi-Cola Corporation and began secretly using the resources of Loft to support Pepsi's oper-

61. See, e.g., Hammurabi's Code of Laws; The Great Qing Code.

62. See, e.g., Stephen Bainbridge, *Rethinking Delaware's Corporate Opportunity Doctrine* 5 (UCLA Sch. of Law, L. & Econ Res. Paper Series, Research Paper No. 08-17, 2008).

ations.⁶³ Loft sued Guth, alleging that Guth had an obligation, as its president and a director, to offer Loft the opportunity to acquire that interest in Pepsi.⁶⁴ The court found in favor of Loft, and the Delaware Supreme Court has since stated:

The rule of the *Guth* case is that when there is presented to a corporate officer a business opportunity which the corporation is financially able to undertake, and which, by its nature, falls into the line of the corporation's business and is of practical advantage to it, or is an opportunity in which the corporation has an actual or expectant interest [(respectively, the "line of business" test and the "interest or expectancy" test)], the officer is prohibited from permitting his self-interest to be brought into conflict with the corporation's interest and may not take the opportunity for himself.⁶⁵

The court also observed that the prohibition against corporate officers and directors using their position of trust and confidence to further their private interests is essentially public policy; it is derived from a profound knowledge of human characteristics and is merely one of the manifestations of the general duties of loyalty and good faith.⁶⁶ The judiciary itself struggled to apply the *Guth* rule and to adapt it to factual scenarios, stating "[t]he occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated . . . [t]he standard of loyalty is measured by no fixed scale."⁶⁷ The court thus foresaw the application problems that would arise in the following decades.

Johnston v. Greene came before the Delaware Supreme Court 17 years later and presented a more complex set of facts.⁶⁸ The director who was offered the relevant opportunity was involved in the management of many similar businesses (each of which plausibly had an interest in the offer) and had received the offer in his individual capacity, rather than as a director of any corporation (the offeror was not aware of his affiliations).⁶⁹ Furthermore, the Court found that the key corporation in question had no well-defined "line of business."⁷⁰ Although the court stated that it was applying the *Guth* rule, it focused almost exclusively on the line-of-business test and the fact that the director had received the offer in his per-

63. *Guth*, 5 A.2d at 506.

64. *Id.* at 507-08.

65. *Equity Corp. v. Milton*, 221 A.2d 494, 497 (Del. 1966).

66. *Guth*, 5 A.2d at 510.

67. *Id.*

68. *Johnston v. Greene*, 121 A.2d 919 (Del. 1956).

69. *Id.* at 923.

70. *Id.* at 921 (This finding allowed the Court to avoid applying the "line of business" test as set forth in *Guth*, which simply states that an opportunity is presumed to belong to a corporation if the opportunity is one that would logically fall within the "line of business" that the corporation is engaged in. This is an important point because it further highlights the difficulty of developing a rigid framework for applying the corporate opportunity doctrine and the importance of a flexible, fact-based application.).

sonal capacity.⁷¹ The court held that, where an officer receives an offer in his individual capacity, a much stricter standard should be applied to determine if the opportunity is one to which the corporation is entitled.⁷² In such a scenario, it must be shown that the opportunity is either directly or closely related to the corporation's business, or one to which the corporation has a specific interest or expectancy.⁷³ The court also repeatedly referenced "fairness" in the analysis, stating that "whether an opportunity is corporate or personal depends on the facts—upon the existence of special circumstances that would make it unfair for the director or officer to take the opportunity for himself."⁷⁴ *Johnston* presented an especially difficult question for the line-of-business test of corporate opportunity, since a finding that the director took a corporate opportunity then raises the challenge of determining to which of the corporations the opportunity would belong, likely pushing the court to employ a fact-based fairness analysis.⁷⁵

In the 1971 case of *Kaplan v. Fenton*, the Delaware Supreme Court identified two additional factors for assessing corporate opportunity appropriation that it found relevant to affirming the Delaware Chancery Court's holding that a director had not usurped a corporate opportunity.⁷⁶ In *Kaplan*, the director purchased shares in a corporation for his own account, but only after (i) a similar offer was rejected by the board of the corporation months before and (ii) the director disclosed the second offer to the CEO of the corporation and asked him whether it should be presented to the entire board (the CEO said that it should not).⁷⁷ The Delaware Supreme Court found both of these events to be relevant to their analysis and to their findings that (i) the offer was not one in which the corporation had an interest (as it had been expressly disclaimed), (ii) it was not an opportunity that was essential to the corporation, and (iii) it was not one in which the corporation's resources had been improperly put to use.⁷⁸

Science Accessories Corp. v. Summagraphics Corp., decided by the Delaware Supreme Court in 1980, demonstrates the ongoing struggle in the application of the corporate opportunity doctrine, now interpreting the *Guth* and *Johnston* standards as a straightforward three-prong analysis: "[An] officer may not seize the opportunity for his own if: (a) the corporation is financially able to undertake it; (b) it is within the corporation's line of business; (c) the corporation is interested in the opportunity."⁷⁹ Furthermore, the facts of *Science Accessories* caused the court to consider the

71. *Id.* at 923.

72. *Id.* at 923-25.

73. *Id.* at 923.

74. *Johnston*, 121 A.2d at 924.

75. *Id.* at 923.

76. *Kaplan v. Fenton*, 278 A.2d 834 (Del. 1971).

77. *Id.* at 835.

78. *Id.* at 836.

79. *Science Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957, 963 (Del. 1980).

corporate opportunity doctrine alongside a competing public interest, the “policy ‘recognized by the courts . . . of safeguarding society’s interest in fostering free and vigorous competition in the economic sphere.’”⁸⁰ The court, citing the Restatement of Agency, concluded that “while an agent may not put himself in a position antagonistic to his principal, an agent is not thereby prevented from acting in good faith outside his employment even though it may adversely affect his principal’s business.”⁸¹ Further, an agent may “make arrangements or plans to go into competition with his principal before terminating his agency, provided no unfair acts are committed or injury done his principal.”⁸²

Broz v. Cellular Information Systems later incorporated this balancing act into the corporate opportunity doctrine test itself by adding a fourth prong: does an officer or director create a conflict between his self-interest and the interests of the corporation by taking the opportunity for himself?⁸³ When applying *Broz* in a later case, however, the court again emphasized that “no single factor is dispositive,” and that “[i]nstead the Court must balance all factors as they apply to a particular case.”⁸⁴ *Broz* is also important for its treatment of the requirement that an opportunity be presented to the board before it is usurped (discussed further below).

C. Presentment of Opportunity to the Corporation as a Safe Harbor

In *Broz*, Robert Broz was a director of Cellular Information Systems (CIS) and also the sole shareholder of RFBC.⁸⁵ The suit alleged that, by purchasing a cellular license over a bid by PriCellular (a company that was simultaneously attempting to acquire CIS), Broz and RFBC violated a fiduciary duty to CIS.⁸⁶ PriCellular brought suit in the name of CIS, alleging that Broz had usurped a corporate opportunity of CIS and that he had a duty to PriCellular, since they were trying to acquire CIS, even though the opportunity was presented to Broz in his capacity as the owner of RFBC.⁸⁷ Broz argued that his duty was to CIS alone, and that CIS was unable to purchase the license because it was undergoing a Chapter 11 reorganization that required it to sell the cellular licenses that it did have.⁸⁸ Broz did not take steps to hide the transaction from CIS and discussed the opportunity with a number of CIS officers and directors individually.⁸⁹ He took the position that a formal presentation of the

80. *Id.* (quoting *Maryland Metals, Inc. v. Metzner*, 382 A.2d 564, 568 (Md. 1978)).

81. *Id.* at 962 (citing RESTATEMENT (SECOND) OF AGENCY § 387 cmt. b (1957)).

82. *Id.* (citing RESTATEMENT (SECOND) OF AGENCY § 303 cmt. e. (1957)).

83. *Broz v. Cellular Info. Sys.*, 673 A.2d 148, 154-55 (Del. 1996).

84. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 972 (Del. Ch. 2003).

85. *Broz*, 673 A.2d at 150.

86. *Id.* at 151.

87. *Id.*

88. *Id.* at 151-52.

89. *Id.* at 152.

opportunity to the board was unnecessary because, among other reasons, the company was in no position financially to take advantage of the opportunity.⁹⁰ Although the Delaware Chancery Court had held that Broz had usurped an opportunity rightfully belonging to CIS,⁹¹ the Delaware Supreme Court overturned the decision, holding that no single factor is dispositive and that formal presentment to the board is not strictly necessary.⁹² The court went on to state, however, that where a director or officer does take the step of formal presentment, he may enjoy the protection of a safe harbor and will be free from the danger of later being found to have usurped an opportunity, since the board has disclaimed it.⁹³

Cases succeeding *Broz* have reaffirmed the safe harbor, reiterating that where the corporation had a clear interest in the opportunity, a director or officer who chooses not to formally present the opportunity to the board “acts at his peril, unless he is ultimately able to demonstrate *post hoc* that the corporation was not deprived of an opportunity in which it had an interest in or a capability of engaging.”⁹⁴ In *Telxon Corp. v. Meyerson*, the court clarified that the safe harbor applies only when the opportunity is formally presented to the board of directors; presentment of an opportunity to an individual officer or director of the corporation (in *Telxon*, the CEO) will not give the presenter the protections of the safe harbor because approving or rejecting a corporate opportunity is a decision that correctly lies with the corporation’s board of directors and not individual members of the board.⁹⁵

V. DISCUSSION AND ANALYSIS

A. Corporate Opportunity Doctrine and the “Funneling of Business”

As discussed above, KCC Article 397-2 is recognized as a tool to regulate the so-called “Funneling of Business,” which is a practice often used to increase or transfer the wealth of controlling shareholder-managers. However, there are fundamental doubts about whether the corporate opportunity doctrine properly applies to the “Funneling of Business.”⁹⁶ Whether a company transfers or consigns its existing business activities to a third party, and to whom the activities are transferred or consigned, is a matter of company discretion (i.e., it is a choice of “allocation of business

90. *Id.* at 151.

91. *Cellular Info. Sys., Inc. v. Broz*, 663 A.2d 1180, 1186-87 (Del. Ch. 1995).

92. *Broz*, 673 A.2d at 155, 158.

93. *Id.* at 158 n.10.

94. *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 442 n.7 (Del. 1996) (citing *Broz*, 673 A.2d at 157).

95. *See Telxon Corp. v. Meyerson*, 802 A.2d 257, 263 (Del. 2001).

96. KIM, CORPORATE FINANCE AND GOVERNANCE, *supra* note 18, at 320; Jaeyoung Chang & Junhyeok Jung, *Prohibition of Appropriation of Corporate Opportunity According to the Amended KCC*, 51 BUS. FIN. L. 31, 34 (2012).

activities”).⁹⁷ It is, therefore, difficult to consider “Funneling of Business” a new corporate opportunity. A true corporate opportunity should be distinguishable from the company’s existing business. The “Funneling of Business” is not so much a matter of corporate opportunity, then, as it is a choice between internalizing or outsourcing its existing business; when outsourced, the company must decide how and to whom. In other words, while the recipient of the outsourced business might consider that business to be a corporate opportunity, the act of outsourcing part of an existing business should not itself be seen as a corporate opportunity, since an opportunity that is created by a company’s active operation and management of its existing business is not deemed to be a corporate opportunity.⁹⁸

To return to the case of Hyundai Motor, the company had been outsourcing its non-core businesses, including distribution, since well before Hyundai Glovis was established.⁹⁹ The distribution business was previously outsourced to Dongsuh Dynasty Co. Ltd. and SungWoo Corporation.¹⁰⁰ The efficiency and customer service issues that characterized those business arrangements led the management of Hyundai Motor to conclude that it was necessary to establish an affiliate of its own to specialize in distribution, and Hyundai Glovis was born.¹⁰¹ The initial decision to outsource Hyundai Motor’s distribution needs to a non-affiliated company is the type of business decision that would come under the protection of the business judgment rule.¹⁰² The business judgment rule¹⁰³ would also apply to the decision to internalize a business function or to establish an affiliate to meet the company’s business needs. In the Hyundai Motor Case, no questions were raised about the outsourcing of distribution to other companies before the establishment of Hyundai Glovis. However, once Hyundai Motor began to direct that business to a firm controlled by the chairman and his son, civic groups and shareholders vocalized serious con-

97. Stephen J. Choi & Eric L. Talley, *Playing Favorites with Shareholders*, 75 S. CAL. L. REV. 271, 305-07 (2002).

98. According to U.S. law, appropriation of corporate opportunity is limited to external opportunities, that is, opportunities created by third parties or that arise from the company’s existing business. It does not apply to an opportunity created by a company’s active conduct using its existing business. See *Broz*, 673 A.2d at 155 (Del. 1996). However, since KCC Article 397-2 contains a broad definition of corporate opportunity, there is a strong argument that, in Korea, Article 397-2 can be applied to the “Funneling of Business” concept, as it was in the Hyundai Motor Case. Chun, *supra* note 51, at 200; Koo, *supra* note 42, at 125.

99. Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 43.

100. *Id.*

101. *Id.* at 43-44.

102. The above-reviewed Hyundai Motor Case raises these points. See Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.).

103. For the Korean Supreme Court cases on the business judgment rule, see Hwa-Jin Kim, *Directors’ Duties and Liabilities in Corporate Control and Restructuring Transactions: Recent Developments in Korea*, OXFORD UNIV. COMP. L.F. (2006), available at <http://ouclf.iuscomp.org/articles/kim.shtml>.

cerns.¹⁰⁴ Thus, the point of contention regarding the “Funneling of Business” in Korea is not the funneling itself, but to whom the business is funneled and whether it is done on terms that are fair and negotiated at arm’s length.

As described above, a company’s existing business and the opportunities related to that existing business could be corporate opportunities for a third party, but they are not “corporate opportunities” for that company itself. In Korea, cases that are scrutinized as potential “Funneling of Business” cases might involve (i) issues regarding the scope of applicability of the prohibition on self-dealing transactions from the perspective of corporate law,¹⁰⁵ (ii) issues regarding the wealth acquired by controlling shareholders through “Funneling of Business” from the perspective of tax law, or (iii) illegal supporting actions from the perspective of antitrust law.

It is appropriate, then, to resolve these issues under those applicable areas of law. First, the KCC, amended as of April 14, 2011, tightened its regulations on self-dealing transactions.¹⁰⁶ Not only are transactions between a director and the company regulated, but transactions between the company and its major shareholders, their spouses or relatives, and affiliated companies within a certain range, as prescribed by KCC Article 398, are also regulated. Second, per the provisions of the amended Inheritance Tax and Gift Tax Act, for corporations whose total turnover to a specially-related corporation (the “Beneficiary Corporation”) is more than 30 percent of all of its turnover, the controlling shareholders, their spouses, and any relatives holding more than 3 percent of company’s shares, respectively, are presumed to reap the company’s business profits as their own;

104. SHARE TRANSACTION REPORT, *supra* note 3. This point is made all the more clear by the fact that, according to the Report, nearly all of the cases in which usurpation of corporate opportunity is doubtful turn on mega transactions between a company’s existing business and another company in which the controlling shareholders’ families have significant shares.

105. The regulation of self-dealing transactions emphasizes “fairness,” while the regulation of appropriation of corporate opportunity emphasizes “disclosure.” E. G. Orlinsky & G. J. Benoit, *The Treacherous State of Director and Officer Conflicts of Interest*, 37 MD. B. J. 36, 38 (2004).

106. KCC Article 398 states:

When a person falling under any of the following subparagraphs intends to engage in a transaction with the company for his/her own account or for the account of a third party, he/she shall in advance disclose material facts of the relevant transaction to the board of directors and shall obtain approval therefrom. In such cases, the approval of the board of directors shall be granted with two thirds or more of the total number of the directors, and the relevant transaction shall be fair in terms of its particulars and procedures: 1. A director or a major shareholder under Article 542-8(2)6; 2. The spouse and lineal ascendants or descendants of a person falling under subparagraph 1; 3. Lineal ascendants or descendants of the spouse of a person falling under subparagraph 1; 4. A company in which a half or more of the total number of issued and outstanding shares with voting rights is held by a person falling under any of subparagraph 1 through 3, solely or jointly with others, or its subsidiary company; 5. A company in which a half or more of the total number of issued and outstanding shares with voting rights is held by a person falling under any of subparagraph 1 through 3, together with a company falling under subparagraph 4.

gift tax is then imposed on these profits.¹⁰⁷ Finally, the Monopoly Regulation and Fair Trade Act prohibits “assisting a person with a special interest, or other companies by providing advanced payment, loans, manpower, immovable assets, securities, goods, services, right on intangible properties, etc. thereto, or by transacting under substantially favorable terms therewith[.]”¹⁰⁸ It imposes regulatory measures, such as penalty surcharges and corrective measures, and even criminal punishment for violation of its terms.¹⁰⁹

In conclusion, the “Funneling of Business” concept is fundamentally unrelated to the issue of appropriation of corporate opportunity; insofar as the legislative intention behind KCC Article 397-2 was to address the funneling problem, it has been flawed from its inception.

B. Drawbacks of KCC 397-2

Apart from the issue of whether the new Code provision should even apply to the fact pattern of the Hyundai Motor Case, the doctrine, as adopted, has inherent drawbacks, which we discuss below.¹¹⁰

1. The Ambiguity of the Meaning of “Corporate Opportunity”

KCC Article 397-2 (Prohibition against Appropriation of Company’s Opportunities and Assets) specifies business opportunities that directors are prohibited from usurping as follows:

A business opportunity which has become known to the director in the course of performing his/her duty, or a business opportunity taking advantage of information of the company (subparagraph 1); and

A business opportunity closely related to the business that is being currently conducted or is to be conducted by the company (subparagraph 2).

Such business opportunities must also have “present or future benefit to the company.” It is difficult to determine, however, whether a certain transaction falls under the scope of this definition, since the Code uses abstract terms such as “business opportunity,” “future benefit to the company,” “business to be conducted by the company,” “closely related to,”

107. Gift Tax presumption is calculated as follows: after-tax business profit of Beneficiary Corporation X (Transaction rate with specially related corporation – 30 percent) X (percentage of share ownership – 3 percent). See Inheritance Tax and Gift Tax Act, Act No. 5193, Dec. 30, 1996, art. 45-3, *amended by* Act No. 10361, June 8, 2010 (S. Kor.); Enforcement Decree of the Inheritance Tax and Gift Tax Act, Presidential Decree No. 22042, Feb. 18, 2010, art. 34-2 (S. Kor.).

108. Monopoly Regulation and Fair Trade Act, Act No. 3320, Dec. 21, 1980, art. 23(1)7, *amended by* Act No. 9554, Mar. 25, 2009 (S. Kor.); Enforcement Decree of the Monopoly Regulation and Fair Trade Act, Presidential Decree No. 10267, April 1, 1981, tbl. 1-2, *as amended* (S. Kor.).

109. See Monopoly Regulation and Fair Trade Act, Act No. 3320, Dec. 21, 1980, arts. 24, 24-2, 68(2), *amended by* Act No. 9554, Mar. 25, 2009 (S. Kor.).

110. See B. S. Moon & Kim Hwa-Jin, *Corporate Opportunity Doctrine in the Draft New Commercial Code*, 30 CORP. GOVERNANCE REV. 15, 30-33 (2007); KIM, CORPORATE FINANCE AND GOVERNANCE, *supra* note 18, at 326-29.

and “taking advantage of.”¹¹¹ One year after adoption, there is still not sufficient academic analysis or case law precedent that speaks to the corporate opportunity doctrine’s specific meaning and requirements under the Code. Even in the U.S., where the corporate opportunity doctrine has developed over decades, no precise definition for these concepts truly exists. Indeed, leading corporate law scholars in the U.S. continue to wrestle with the imprecise nature of the doctrine, despite decades of analysis and case law.¹¹²

In Korea, theoretical attempts to specify business opportunities that cannot be usurped are based on principles of U.S. case law.¹¹³ Most U.S. cases that have recognized a director’s liability based on his appropriation of corporate opportunity are either (1) self-dealing transactions in a “vertical” relationship (e.g., where there is a transaction between the director and the company) and the director usurps the corporate opportunity, as in the *Guth* case, discussed above; or (2) competitive business transactions in a “horizontal” relationship (e.g., where a director’s business is in competition with the company’s business), as in the *Broz* case, discussed above. Accordingly, it is difficult to apply the doctrine to a business opportunity without a vertical or horizontal relationship, even in a broad sense (we will refer to this theory as “Theory A”). On the other hand, some argue that the standard applied by the Korean Supreme Court in the Hyundai Motor Case, that is, restricting the scope of business opportunity to “realistically existing specific business opportunities,” is reasonable because it relieves businesses’ anxiety over the unsettled standard, at least until a clearer application of KCC Article 397-2 is established (“Theory B”).¹¹⁴

Theory A, the notion that the doctrine is difficult to apply absent a vertical or horizontal relationship, is useful in the sense that it implies that appropriations of corporate opportunity mainly exist where there is a “close relationship” to the business of a corporation because of a “competitive business relationship” or “self-dealing relationship.”¹¹⁵ Nevertheless, it still does not clearly define any standards for determining what a corporate opportunity is.¹¹⁶ Theory B is criticized on the basis that, since the

111. Of course, subparagraph 1 seems to be clearer, in that it can be read as information obtained at company’s costs. The text of subparagraph 2, “closely related to the business[.]” however, is a very vague concept.

112. See, e.g., Bainbridge, *supra* note 62.

113. Chun, *supra* note 51, at 162-82.

114. CHOI JUNSUN, COMMENTARY ON THE AMENDED CORPORATE LAW 2011, at 128-29 (2011) [hereinafter CHOI JUNSUN, COMMENTARY]; SHIN HEUNGCHEOL, KOREA CHAMBER OF COMMERCE AND INDUSTRY, MAIN CONTENTS OF THE AMENDED COMMERCIAL CODE AND BUSINESS ACTIONS 16, (2011); Park Sun Jong, *Appropriation of Corporate Opportunity Under the Revised Commercial Code*, 22 HANYANG L. REV. 240, 255 (2011).

115. However, this theory raises the question of whether, even without the new Article on corporate opportunity, the same result could have been achieved by supplementing the KCC’s Article 397, Prohibition against Competition, or Article 398, Self-Dealing Transaction.

116. Even according to the theory, since KCC Article 397-2 defines “corporate opportunity” very comprehensively, there are rarely cases where corporate opportunity may not be

amended KCC has come into effect, there are no longer grounds to restrict business opportunity to “realistically existing specific business opportunities.” The standard that the Korean Supreme Court applied in the Hyundai Motor Case was only reasonable, the argument goes, since at the time of the judgment there was no explicit provision governing corporate opportunity; business opportunity could be derived only from a director’s duty of loyalty.¹¹⁷

Therefore, as there is no distinct standard under the law (or any accepted theories or case law on the question) as to what constitutes a “corporate opportunity,” there is concern that courts could arbitrarily apply the corporate opportunity doctrine.¹¹⁸ Furthermore, the existing ambiguities may not only prevent Article 397-2 from functioning as a standard for future action, but also induce risk aversion,¹¹⁹ impose unnecessary burdens on companies, and repress entrepreneurial spirit. Corporate opportunity doctrine has the benefit of preventing appropriation of corporate opportunities by directors or fiduciaries, but the drawback of potentially interfering with the establishment of new businesses.¹²⁰

found under Article 397-2. Furthermore, the broad nature of corporate opportunity itself should not prevent Article 397-2’s use, since to do so would be in contravention of the amendment’s aim. KCC art. 397-2. *See also* Chun, *supra* note 51, at 179, 181 (explaining that applying Article 397-2 in individual cases is a separate question).

117. Koo, *supra* note 42, at 125; Chun, *supra* note 51, at 181; LEE EONJU, KOREA CHAMBER OF COMMERCE AND INDUS., MAIN CONTENTS OF THE AMENDED COMMERCIAL CODE AND BUSINESS ACTIONS 76-77 (2011).

118. KIM, CORPORATE FINANCE AND GOVERNANCE, *supra* note 18, at 327.

119. According to KCC Article 400 paragraph 2, “A company may, in accordance with its articles of incorporation, absolve the liability of a director under Article 399 with respect to the amount exceeding six times (in cases of outside directors, three times) his/her remuneration (including bonuses and the profit from exercise of stock option) for the latest one year prior to the date of the act or misconduct of the director.” KCC art. 400(2). However, the liability of a director is strictly regulated because under KCC Article 397-2 the liability of a director cannot be absolved. KCC art. 397-2. Furthermore, according to KCC Article 397-2 paragraph 2, “[T]he benefit earned by the director or a third party from the violation shall be presumed to be the damage suffered by the company.” *Id.* Because it is presumed (but not deemed), there is still a chance to disprove that fact. Nevertheless, the director has to prove that the company would have had less profit if it had had such an opportunity, a very hard burden for the director to meet. Moreover, according to the Korean Criminal Act Articles 355 and 356, a person “shall be punished by imprisonment for not more than five years or by a fine not exceeding fifteen million won[.]” where “a person who, administering another’s business, obtains pecuniary advantage or causes a third person to do so from another in violation of ones [sic] duty, thereby causing loss to such person.” Criminal Code, Act No. 293, Sept. 18, 1953, arts. 355-56, *amended by* Act No. 7623, July 29, 2005 (S. Kor.). The Supreme Court of Korea broadly interprets “in violation of one’s duty” as “including any act that loses trust to a person, from not acting in trust and good faith, which is expected to be done or not to be done, according to the relevant contents, nature, detailed circumstances of the business.” Supreme Court [S. Ct.], 94Do902, Sept. 9, 1994 (S. Kor.). Therefore, directors should consider the danger of a criminal penalty resulting from the appropriation of a corporate opportunity. There are discussions in Korea against punishing a director criminally for the act of misappropriation. *See* Lee Jongsang, *A Critical Review on Liability of Director and Crime of Misappropriation*, 19 BUS. FIN. L. 44, 44-64 (2006).

120. CHOI JUNSUN, COMMENTARY, *supra* note 114, at 124.

A balanced solution is required that accounts for both impacts of the doctrine. This is a difficult and nuanced question. Indeed, in the U.S., the courts wrestled with this issue in the 1980s and 1990s in *Science Accessories* and *Broz* respectively, ultimately recognizing the public policy interest in allowing free competition.¹²¹ U.S. law employs fiduciary principles to address the issue by allowing agents to plan and develop new enterprises while in the employ of another, so long as the agent acts in good faith and such undertakings do not put the agent in a position antagonistic to his principal.¹²² As discussed above, the *Broz* case incorporated this issue into the corporate opportunity doctrine analysis by adding an element that considers whether the agent's actions create a conflict with the interests of his principle.¹²³

2. The Meaning of "Director Who Approved" According to KCC Article 397-2 paragraph 2

KCC Article 397-2 paragraph 2 states that "a director who has violated paragraph (1) and thereby incurred damage to the company and the director who approved the same shall be jointly and severally liable for compensation of the damage," and since paragraph 1 states that "in order to use any business opportunity of the company, an approval of the board of directors (by two thirds or more of the total number of directors) is required," it seems to be clear that "a director who has violated paragraph (1)" is a director that usurped corporate opportunity without the approval of the board of directors. But to whom is "director who approved" referring? If there were director approval, then it would mean that, at the very least, there was no breach of paragraph (1). The provisions do not seem to be coherently integrated.

The following are two possible interpretations of the contradicting provisions: (i) the first is that the phrase "director who approved" only applies to directors whose approval has violated their duty of good manager's due care and, as a result, have approved the appropriation of corporate opportunity (Theory I);¹²⁴ and (ii) the second is that the phrase refers to a director who gave a personal or de facto approval (which abets, aids, or supports) with a knowledge of the appropriation of corporate opportunity and without the formal approval of the requisite threshold of the board of directors (Theory II).¹²⁵

121. See *Broz v. Cellular Info Sys.*, 673 A.2d 148, 157 (Del. 1996); *Science Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957, 962-63 (Del. 1980).

122. See *Equity Corp. v. Milton*, 221 A.2d 494, 497 (Del. 1966).

123. See *Broz*, 673 A.2d at 157.

124. See *Chun*, *supra* note 51, at 205. See also *Chang & Jung*, *supra* note 96, at 52; OK-RIAL SONG, LECTURE ON COMMERCIAL LAW 1027 (2d ed. 2012).

125. KO CHANGHYEON, KOREA CHAMBER OF COMMERCE AND INDUSTRY, MAIN CONTENTS OF THE AMENDED COMMERCIAL CODE AND BUSINESS ACTIONS SEMINAR SOURCEBOOK 54 (2011); Kim Heecheol, *An Analysis of the Newly Enacted "Restriction of Usurping Corporate Opportunity and Assets" in the Korean Commercial Code*, 660 JUDICIAL OFFICERS 208, 217 (2011).

Neither theory fully resolves the contradiction of KCC Article 397-2 paragraph 2. According to Theory I, directors whose approval violated their duty of good manager's due care could be disciplined in accordance with a violation of the duty of good manager's due care itself, so that there is not really a need to provide an independent means via Article 397-2. Furthermore, it seems unreasonable that a director who actively usurped corporate opportunity and a director who only approved the process should face the same liability. According to Theory II, it seems strange to interpret the "approval" in paragraph 1 and paragraph 2 differently. Furthermore, if a director has usurped a corporate opportunity without the approval of the board of directors, then that director has violated KCC Article 397-2 paragraph 1, and directors who detect such an act must report it to the company and ask for corrective measures according to their inspection¹²⁶ or reporting obligations.¹²⁷

The legislative intent behind the adoption of KCC Article 397-2 is likely more closely related to Theory I than Theory II,¹²⁸ and Theory I is reasonable according to a textual interpretation. Nonetheless, it seems that the phrase "director who approved" in KCC Article 397-2 paragraph 2 ought to be deleted, and directors who did not usurp a corporate opportunity should be liable only for violating their duty of good manager's due care.¹²⁹

3. Liability of Approving Directors

Where a director pursues a corporate opportunity in the manner contemplated in Article 397-2 (i.e. the opportunity is reported to and ap-

126. According to the Korean Supreme Court, a director of a corporation must not only approve or disapprove an agenda introduced to the board of directors, but also inspect the overall business, including his or her business and other active directors' business. Even a part-time director has such obligations. Supreme Court [S. Ct.], 2005Da51471, Dec. 11, 2008 (S. Kor).

Inspection obligations could be different according to company's size, organization, business type, regulations, business conditions and financial standings, and in a highly divided and specialized company, it could be inevitable that a joint representative director and active director has its own specialized area to handle, but such circumstances cannot exempt directors from their inspection obligations, and in such a case each director of the board of directors has liability to construct reasonable information, reporting system and internal control system, and when there was not such an effort or when directors intentionally disregarded company's inspection or supervision although there was such a system, and as a result did not know the danger that directors had to care about including illegal improper business, then directors cannot escape from their liability for a reason that they did not know the illegal or improper act of other directors, and if damages occur from continuous organizational carelessness of inspection, directors have liability for these damages occurred from other directors or officers. Supreme Court [S. Ct.], 2006Da68636, Sept. 11, 2008 (S. Kor).

127. KCC Article 412-2 states, "If a director finds any fact that is likely to inflict a substantial loss on the company, he/she shall immediately report such to its auditors."

128. Koo, *supra* note 42, at 127.

129. Chang & Jung, *supra* note 96, at 52; Chun, *supra* note 51, at 205; SONG, *supra* note 124, at 1027.

proved by the board of directors) and the other directors approve that pursuit in violation of their duty of good manager's due care, it is counter-intuitive for the pursuing director to face liability for his actions. According to the U.S. Model Business Corporation Act § 8.70, Business Opportunities,

(a) A director's taking advantage, directly or indirectly, of a business opportunity may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against the director, in a proceeding by or in the right of the corporation on the ground that such opportunity should have first been offered to the corporation, if before becoming legally obligated respecting the opportunity the director brings it to the attention of the corporation and: (1) action by qualified directors disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 8.62, as if the decision being made concerned a director's conflicting interest transaction, or (2) shareholders' action disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 8.63, as if the decision being made concerned a director's conflicting interest transaction; except that, rather than making "required disclosure" as defined in section 8.60, in each case the director shall have made prior disclosure to those acting on behalf of the corporation of all material facts concerning the business opportunity that are then known to the director.

(b) In any proceeding seeking equitable relief or other remedies based upon an alleged improper taking advantage of a business opportunity by a director, the fact that the director did not employ the procedure described in subsection (a) before taking advantage of the opportunity shall not create an inference that the opportunity should have been first presented to the corporation or alter the burden of proof otherwise applicable to establish that the director breached a duty to the corporation in the circumstances.¹³⁰

Nevertheless, many Korean scholars still argue that when the approval of other directors¹³¹ constitutes a violation of the duty of good manager's due care, then the act usurping corporate opportunity is itself illegal, and the director who approved such act in violation of his or her duty of due care shall be held jointly and severally liable for the damage, since such compensation is based on post-benefit correction.¹³²

It stands to reason that, where a director has reported the corporate opportunity to the company, has provided sufficient information for the board to determine whether to take the opportunity, and has not exerted any improper influence on other directors, such a result is excessive.

130. MODEL BUS. CORP. ACT § 8.70 (2005).

131. KCC art. 391(3). As applied using KCC Article 391 paragraph 3, KCC Article 368 paragraph 4 would read, "no person who has special interests in a resolution by a [meeting of board of directors] shall exercise his/her voting rights thereupon." Therefore, a director who is willing to use corporate opportunity shall not exercise his or her voting rights by a meeting of board of directors for approving appropriation of corporate opportunity.

132. LEE CHEOLSONG, 2011 COMMENTARY ON AMENDED KCC 154 (2012) [hereinafter LEE CHEOLSONG, 2011 COMMENTARY]; Choi Junseon, *Corporate Opportunity*, *supra* note 44, at 126-27; Chun, *supra* note 51, at 200; Chung Chan-Hyung, *Contents and Problems of 2011 Revised Korean Corporation Law*, in SYMPOSIUM, SEOUL BAR ASSOCIATION/KOREAN LEGAL CENTER QUESTIONS ABOUT 2011 REVISION TO THE COMMERCIAL CODE 30 (2011).

Where potential liability may arise despite a person's adherence to protocol, the incentive for a director to pursue or participate in a new business will decrease, leaving only negative effects of the prohibition on appropriation of corporate opportunities. In other words, in practice, most of the business opportunities that are likely to fall under scrutiny will arise from the apt relationships and undertakings of the pursuing director, and, unless the law provides a safe harbor for that director, strict scrutiny is being imposed on the director's entrepreneurial activities, while the action of the board of directors is overlooked.¹³³ The focus of the corporate opportunity doctrine should instead be on regulating the presentation of corporate opportunities to the board and the independence of their approval process.

4. Quorum for Resolution by Board of Directors

KCC Article 397-2 requires that a business opportunity that is presented to the board of directors be approved by two thirds of the board.¹³⁴ The quorum requirement under this Article is stricter than the general quorum requirement under the KCC, which requires a majority of the directors to be present at the meeting and the affirmative votes of a simple majority of those present.¹³⁵ The stricter quorum parameters are specially applied to resolutions approving self-dealing transactions¹³⁶ and appropriations of corporate opportunities under the amended KCC. There is no persuasive reason for increasing the quorum threshold for resolutions regarding these two circumstances alone. In the U.S., a director or officer seeking to pursue an opportunity that may belong to the corporation is not required to make any presentation to the board of directors;¹³⁷ if such a presentation is made, the board may vote on the matter, but there is no special quorum requirement. The rationale for requiring approval by the board of directors in corporate opportunity cases is to ensure that the company is aware of the potentially beneficial opportunity and may decide whether to forego or pursue the opportunity. This can be accomplished without the stricter quorum and approval requirements.¹³⁸

Interestingly, where the board instead considers a resolution to override the statutory prohibition against a director's ability to compete with

133. KIM, *CORPORATE FINANCE AND GOVERNANCE*, *supra* note 18, at 326-27.

134. When counting the total number of directors, directors who are willing to use corporate opportunity are excluded. *See supra* note 131. Such directors have special interest in a resolution by a meeting of the board of directors, so that such director shall not exercise his/her voting rights thereupon.

135. KCC art. 391(1). ("A resolution of the board of directors shall be adopted in the presence of a majority of directors in office by the affirmative votes of a majority of directors present at the meeting: Provided, that the voting requirement may be increased by the articles of incorporation.")

136. KCC art. 397-2.

137. *See Broz v. Cellular Info Sys.*, 673 A.2d 148, 158 (Del. 1996).

138. Park, *supra* note 114, at 250.

the company (article 397 paragraph 1), the general quorum requirement for resolution by the board of directors is applied, per KCC 391 paragraph 1 (i.e. the majority of the board must be present at the meeting and the affirmative votes of a simple majority of directors present must be obtained). However, the operation of a competing business is much more likely to directly endanger the present, existing business of the company. Indeed, a powerful right of intervention is available in the event of a violation of the prohibition against competitive business, so that stricter liability is actually imposed in that circumstance than in situations of appropriation of corporate opportunity.¹³⁹ Therefore, it is inconsistent to increase the quorum threshold for a resolution by the board in the case of an appropriation of a corporate opportunity.¹⁴⁰ Furthermore, the increased affirmative vote requirement has the *de facto* effect of preventing any operating committees within the board of directors¹⁴¹ from approving the resolution, often preventing rapid decision-making.¹⁴²

5. Outside Director Liability

The KCC imposes the same liability on both inside and outside directors for appropriation of corporate opportunities. This is questionable logic considering the significant difference between directors who manage the company and outside directors in terms of the accessibility to internal information and the opportunity to divert property or resources of the company. Given these disparities, corporate opportunity regulations applicable to outside directors should be less stringent than those applicable to directors who manage the company on a day-to-day basis.¹⁴³ By comparison, the ALI Principles of Corporate Governance in the U.S. applies the “line of business test” to CEOs and the “interest or expectancy test” to outside directors.¹⁴⁴ There are similar arguments in Korea that an outside director’s liability should be restricted to those cases involving use of the company’s information or assets closely related to current or future business.¹⁴⁵

6. Defense on the Ground of Corporate Inability

As discussed above, a director or officer in the U.S. may take a corporate opportunity without consulting the board when the company is unable

139. KCC art. 397(2).

140. LEE CHEOLSONG, *CORPORATE LAW* 730 (20th ed. 2012).

141. According to the KCC, the board of directors may establish committees composed of two or more directors, within the board, as prescribed by the articles of incorporation, and allows the board of directors to delegate its power to the committees (other than as prohibited by law). KCC art. 393-2.

142. Chun, *supra* note 51, at 188-89.

143. KIM, *CORPORATE FINANCE AND GOVERNANCE*, *supra* note 18, at 327.

144. See AM. LAW INSTITUTE, *PRINCIPLES OF CORP. GOVERNANCE* § 5.05 (1994).

145. Lee Yun Seok, *A Study on Appropriation of Corporate Opportunity*, 3 YGBL 119, 147-48 (2011) [hereinafter Lee, *Appropriation*].

to pursue the opportunity (e.g., for financial reasons). In any case, where the corporation is unable to pursue an opportunity, it follows that it cannot establish wrongful appropriation of the opportunity merely by virtue of the fact that it was taken by a director or officer. However, according to KCC Article 397-2, there is no explicit provision setting forth a defense based on corporate inability in Korea. Generally, the reasons for corporate inability are financial, legal (based on articles of association¹⁴⁶ or law), or a refusal to deal with the company by a potential counterparty. There is an ongoing discussion over whether such a defense *could* be justified by KCC Article 397-2.¹⁴⁷

In many situations it is difficult to determine objectively whether a company is able to pursue an opportunity; an assessment by the board of directors may be needed in order to establish such ability or inability. For example, when (i) there is a short-term shortage in funds that could be overcome with financing, (ii) business objectives are limited by the articles of association but could be resolved by amending the articles, or (iii) there is a way to persuade an objecting third party or regulator to support the transaction, the potential inability may be overcome. When there is an inability that, objectively, cannot be overcome by action of the board, then such a situation should be recognized as a ground for defense, where the burden of proof lies with the director. If such a defense is not recognized, directors may be forced to disclose unnecessary or detrimental information (e.g., that causes the loss of the opportunity), and the corporation must call an otherwise unnecessary meeting of the board.¹⁴⁸

146. According to the Supreme Court of Korea, the “Company’s capacity of enjoyment of rights are limited to objects of laws that act as establishment basis for the company and company’s articles of association, but an act in the area of company’s competence is not limited to the competence stated in the articles of association, but includes direct, indirect necessary acts, and when determining whether it is needed for performing its obligations, it will be judged according to the act’s objective nature, not the performer’s subjective, specific will.” Supreme Court [S. Ct.], No. 86Daka1349, Sept. 8, 1987 (S. Kor.).

147. According to Kim Hongki, *Corporate Opportunity*, *supra* note 52, at 117-18, corporate financial inability can be established as a ground for defense; however, according to Park, *supra* note 114, at 257, a ground for defense should not be allowed to be established by a director’s personal determination of inability, in lieu of the board’s. Meanwhile, according to Bae Do, *A Study on the Corporate Opportunity Doctrine*, 21 SOONGSIL UNIV. L. REV. 79, 96 (2009), when a third party has provided opportunity to a director, but the director refused to provide it to the corporation, then no corporate opportunity is established. On the other hand, according to Kim Hongki, *Corporate Opportunity*, *supra* note 52, at 117-18, legal inability or third party refusal cannot be permitted as grounds for a defense, since the taking of a corporate opportunity violates the director’s duty of loyalty. Further, according to Kim Jeongho, *Doctrine of Corporate Opportunity*, *supra* note 44, at 167, and Lee, *Appropriation*, *supra* note 145, at 100, even corporate opportunity that could not have been pursued, as dictated by law or the company’s articles of association, must still be provided to the corporation and measures to amend the articles of association or evade those law must be considered. By contrast, according to LEE CHEOLSONG, 2011 COMMENTARY, *supra* note 132, at 732, since actionable corporate opportunities are limited to existing or future corporate benefit, the corporation’s inability to pursue the opportunity should be a judgment factor in determining whether such benefit exists.

148. KIM, CORPORATE FINANCE AND GOVERNANCE, *supra* note 18, at 327-28.

As noted, the KCC approach to corporate inability is currently quite different than the approach under U.S. law. While many aspects of the U.S. corporate opportunity doctrine are imperfect, the safe harbor rule propagated by the *Broz* and *Texlon* line of cases is an efficient and practical way to approach the matter of corporate inability. Permitting the director or officer who is pursuing the opportunity to avoid a formal presentation to the board and discussion of corporate inability, while at the same time rewarding him for undertaking such discussions, when appropriate, by protecting him from later liability, properly incentivizes the parties to consider the issues of corporate opportunity and inability, but also allows them to avoid disclosing sensitive information and calling unnecessary meetings, when appropriate.

7. No Consideration of Conglomerates

In contrast to the U.S.,¹⁴⁹ in which cases of corporate opportunity usurpation tend to involve only individual corporations, Korea commonly faces the issue in the context of conglomerates, a highly prevalent corporate structure in the country. When a business opportunity has presented itself and the question of appropriation arises, it can be difficult to determine to which affiliated corporation under the conglomerate the business opportunity truly belonged.

Such a problem surfaces most acutely when a director of one corporation is also a director of another corporation under the same conglomerate. However, since KCC Article 397-2 regulates the appropriation of corporate opportunity both inside a conglomerate and of a third party, this challenge is not limited to circumstances of concurrent directorship. In order to solve this issue of proper ownership of the business opportunity, the opportunity's nature should be evaluated. It should first be considered whether the opportunity can be used together by several corporations. When an opportunity can only be enjoyed by one corporation, then the opportunity should belong to the most appropriate company. If that company chooses not to pursue the opportunity, then it should pass to the next most appropriate company.¹⁵⁰ This argument can only be applied when there is a fixed standard to regulate how to allocate common business op-

149. In U.S. cases, nearly all issues regarding appropriation of corporate opportunity pertain to individual corporations. There are not many cases where appropriation between affiliates of conglomerates was concerned apart from *Sinclair Oil Corp v. Levien*, 280 A.2d 717 (Del. 1971), and *Johnston v. Greene*, 121 A.2d 919 (Del. 1956), which contained a different, but somewhat analogous, fact pattern. See Part IV.B, *supra*.

150. Chun, *supra* note 51, at 186. Cf. Terence Woolf, *The Venture Capitalist's Corporate Opportunity Problem*, 2001 COLUM. BUS. L. REV. 473, 496-497 (2001) ("[Venture Capitalists] do not make investments in a single enterprise, but instead allocate resources across a different number of companies . . . [So] [i]f fiduciary duties were strictly enforced, VCs like Apex would not be able to make investments in multiple ventures If fiduciary duties do not provide any ascertainable benefit to a company or its shareholders, but instead create negative costs by preventing directors, officers and [VC] firms from investing their human and economic capital in other ventures, logic would dictate that the imposition of such duties should be relaxed. The Revised Uniform Partnership Act and the Uniform Limited Liability

portunities between affiliates. In reality, it is very hard to create such a standard.¹⁵¹

In Korea, in particular, shareholders and corporations are treated as entirely different personalities. The Supreme Court of Korea has ruled that internal transactions between a parent company and its wholly-owned subsidiary are unfair, since it failed to recognize that such transactions do not create agency costs.¹⁵² While focusing on the need for regulation, the legislation of KCC Article 397-2 overlooked the unique conglomerate environment in Korea and left unresolved many unresolved issues particular to those conglomerates.

VI. HOW TO APPROACH FAVORITISM

A. Was Tunneling Involved?

Favoring an individual or a company in a commercial transaction should not be *per se* illegal. Freedom of contract protects our choice of counterparty. The trouble is that interested corporate managers exercise their power to choose the counterparty. What if the personal interest of the manager wrongly affects the choice? Even in such cases, if nobody in the company is worse off after the managerial decision, i.e., if the price was fair, then what is the problem?¹⁵³

Let us revisit the Hyundai Motor Case. Hyundai Motor had been outsourcing its distribution services since well before the establishment of Hyundai Glovis and simply shifted its existing outsourced business to a new provider: Hyundai Glovis. From Hyundai Motor's perspective, the only difference is that the new counterparty is an affiliate, the shareholders of which were CEO Chung Mongkoo, director of Hyundai Motor and controlling shareholder of Hyundai Motor Group, and his son. Yet, is it really important to Hyundai Motor who the other party to the transaction is and what corporate governance that other party has? For Hyundai Motor, it seems that only the business terms of the relationship truly matter. For example, let us assume that Apple Inc. ("Apple") decided to change its manufacturer/supplier for a product's display device from Samsung Electronics Co., Ltd. ("Samsung Electronics") to LG Electronics Inc. ("LG

Company Act provides a means to address this misallocation, by allowing parties to waive their fiduciary duties through a system of disclosure, negotiation and contract.”)

151. Choi Munhui, *Appropriation of Corporate Opportunity in Conglomerates*, 19 BFL 22, 38-41 (2006). In theory, there are other standards of allocation that have been proposed: (i) to calculate net present value of business opportunity of each company and give the opportunity to the company with the highest value, (ii) to give the opportunity to a subsidiary instead of a holding company; when there is more than one subsidiary, then give the opportunity to the subsidiary with the lowest holding company shares, and (iii) to allocate the opportunity proportionally to the market value of the company. Yet, none of these proposals have sufficient legal grounds to serve as a complete standard of allocation. Furthermore, it is not always possible to apply such standards to specific cases.

152. Supreme Court [S. Ct.], No. 2001Du7411, Sept. 5, 2003 (S. Kor.).

153. See generally Choi & Talley, *supra* note 97.

Electronics”). What matters to Apple is which company, Samsung Electronics or LG Electronics, is better able to satisfy Apple’s manufacturing and supply needs. Arguably, it does not really matter who owns Samsung Electronics or LG Electronics.

So, then, why did the shareholders of Hyundai Motor question the transaction with Hyundai Glovis? Perhaps the shareholders believed that Hyundai Motor had been harmed, since, had Hyundai Glovis been established instead as a wholly-owned subsidiary, Hyundai Motor could have obtained the profits earned by that affiliate through cost cutting, a share dividend, or an increase in share prices. Yet, such questions are unreasonable. According to theories of law and economics, there are two ways by which to organize production and establish order between divisions in the society: (i) a market or (ii) an organization such as a corporation.

When organizing via a market structure, transaction costs are inevitable; when organizing through organizations, the same is true of organization costs.¹⁵⁴ If a corporation, either by itself or through affiliates, internalizes any function, its transaction costs would likely decrease and its organization costs increase. Organization costs depend on a corporation’s initial investment costs (including opportunity costs), the risk of failure, the likely ability to continue its business, its investment capability, its financial situation, the ability to hire professionals, its maintenance costs, and the quality of its goods or services.¹⁵⁵ If Hyundai Motor were to conduct its own distribution or establish Hyundai Glovis as a wholly-owned affiliate, it could conceivably reduce its transaction costs, lessen the risk of not finding a competitive price, and gain the direct profit from transacting distribution services. It should be noted, however, that in doing so, Hyundai Motor also bears the risk of business failure and the organization and maintenance costs. Therefore, it is hard to conclude that Hyundai Motor would have actually gained all the profits that Hyundai Glovis has gained had the transaction occurred differently. Furthermore, it is impossible to consider the profits of Hyundai Glovis as loss of profit (damages) to the shareholders of Hyundai Motor.

Even if the decision not to internalize the distribution business was both appropriate and given proper consideration, was it improper to give the business to a corporation established by controlling shareholders of Hyundai Motor Group? If the outsourcing of distribution services itself was appropriate, then no damage occurred by outsourcing the business to a corporation established by controlling shareholders of Hyundai Motor Group. On the other hand, one might expect that the transactions between Hyundai Motor and Hyundai Glovis were not at arm’s length and, thus, for one or the other to reap the benefit. As anticipated, the court did find

154. See OLIVER E. WILLIAMSON & SIDNEY G. WINTER, *THE NATURE OF THE FIRM—ORIGINS, EVOLUTION, AND DEVELOPMENT* AT 18-30 (1993).

155. Transactions will be internalized to the extent that the increased organizational cost does not exceed transaction cost. The corporation will “extend” itself by doing internally everything that is cheaper than relying on external parties.

that the above-market freight charges applied had caused damages equivalent to KRW 14.3 billion to Hyundai Motor.

To this end, there does appear to have been tunneling.¹⁵⁶ However, the tunneling did not occur from Hyundai Motor's outsourcing its distribution services, but instead from unfairly high freight charges. This clear conflict of interest arising from counterparty identity should be regulated by KCC Article 398, the Code section regulating self-dealing transactions.¹⁵⁷ If it is not in the realm of Article 398,¹⁵⁸ then it should be regulated by the director's duty of good manager's due care in determining the terms of a transaction.¹⁵⁹

B. *The Business Judgment Rule*

In the end, the business judgment rule¹⁶⁰ underlies our entire discussion.¹⁶¹ In the Hyundai Motor Case, whether to internalize Hyundai Motor's distribution service or to outsource them was a matter of the directors' duty of good manager's due care, requiring a comparison of transaction costs and organization costs. These considerations are a matter

156. Tunneling is the transfer of a company's resources for the controlling holder's own benefit through self-dealing transactions, expropriation of corporate opportunities, or other methods. *See generally*, Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, *Law and Tunneling*, 37 J. CORP. L. 1 (2011). For a discussion of tunneling from a Korean perspective, see Kee-Hong Bae et al., *Tunneling or Value Added? Evidence from Mergers by Korean Business Groups*, 57 J. FIN. 2695 (2002).

157. *See generally* Gerard Hertig & Hideki Kanda, *Related Party Transactions*, in THE ANATOMY OF CORPORATE LAW 101 (2004); Koen Geens & Marieke Wyckaert, *Conflicts of Interest: Can a Director Serve Himself or His Kin?*, in VOC 1602-2002 400 YEARS OF COMPANY LAW, 387 (Ella Gepken-Jager et al. eds., 2005).

158. As discussed in Part V, *supra*, KCC Article 398 expanded the notion of the counterparty in a self-dealing transaction. Yet, the transaction between Hyundai Glovis and Hyundai Motor is, as under the former KCC, not regulated as a self-dealing transaction.

159. The KFTC, which imposed a penalty surcharge on Hyundai Motor, questioned the fact that, as a newly established company, Hyundai Glovis's business capabilities had not been verified at the time that Hyundai Motor began outsourcing its business to Hyundai Glovis. However, Hyundai Glovis had taken over an existing company that had previously been entrusted with Hyundai Motor's distribution business. Furthermore, since the Court recognized in the Hyundai Motor Case that Hyundai Glovis had developed an integrated distribution system and increased the effectiveness of the distribution system of the affiliates, it is hard to attribute any damages suffered by Hyundai Motor to Hyundai Glovis's lack of ability.

160. *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954 (Del. 1985) ("The business judgment rule is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."); *Cf.* Dennis J Block, Stephen A. Radin & James P. Rosenzweig, *The Role of the Business Judgment Rule in Shareholder Litigation at the Turn of the Decade*, 45 BUS. LAW 469 (1990); Lynn A. Stout, *In Praise of Procedure: An Economic and Behavioral Defense of Smith v. Van Gorkom and the Business Judgment Rule*, 96 NW. U. L. REV. 675 (2002).

161. Regarding the business judgment rule in Korea, see *supra* note 102.

of business judgment. The same applies to the matters of to whom to outsource business and under what conditions it should be outsourced.

The court ruled on the issue as follows:

Hyundai Glovis's distribution services are in fact, an assistance service for Hyundai Motor Group's manufacture and sales, however an automobile company does not have to directly conduct its distribution services or establish a subsidiary for its service on grounds that distribution services are related to or contingent upon automobile businesses. Whether to outsource its business is not dependent upon relevance to or contingency upon the company's business, rather it is determined according to business judgment. Thus, whether to establish an internal business unit, establish a subsidiary or outsource it to another company for already outsourced the distribution serves, is fundamentally at the discretion of the company's business judgment.¹⁶²

The court thus recognized that the decision to outsource was legal according to the business judgment rule but held that increased freight charges for Hyundai Glovis could not be legitimized under the business judgment rule.

Although the "Funneling of Business" practice, like that seen in the Hyundai Motor Case, is not considered an appropriation of a corporate opportunity, it is a matter of business judgment. If information regarding the corporate opportunity is fully disclosed, and the board of directors decides through a careful and reasonable process¹⁶³ that it is for the benefit of the corporation not to pursue such an opportunity, then this decision should be protected by the business judgment rule.

VII. CONCLUSION

This Article reviewed the controversial corporate opportunity doctrine as it was discussed and promulgated as law in Korea and analyzed the doctrine in the context of the Hyundai Motor Case. One cannot question that the corporate opportunity doctrine has both legitimacy and a useful purpose as a well-founded iteration of the director's duty of loyalty. However, the incorporation of the corporate opportunity doctrine into the KCC may have been premature, as the debate surrounding the concept and the legal nature of the duty of loyalty is not yet sufficiently settled.

The corporate opportunity doctrine is derived from U.S. case law, where it is still a somewhat abstract concept that incorporates different elements and analytical frameworks as the fact patterns change; it is nearly impossible to establish a workable and flexible doctrine in a few codified provisions. Moreover, the doctrine was introduced as law in Korea specifically to regulate the so-called "Funneling of Business," a concept that lies outside the scope of the corporate opportunity doctrine in the US. This makes the development of KCC Article 397-2 in Korea even more diffi-

162. Seoul Central District Court [Seoul C.D. Ct.], 2008GaHab47881, Feb. 25, 2011 (S. Kor.), at 45.

163. Cf. Henry R. Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971 (1994).

cult, calling for an approach that is unique from that in the U.S. and more tailored to particulars of the Korean business environment. On these bases, we conclude that the Korean corporate opportunity doctrine needs substantial refinement before it can become a workable solution to the specific problems facing Korean corporate law today.