

Korea Corporate Governance Service

## 2021 AGM Preview (2)

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(Feb. 9, 2021 by Responsible Investment Team)

### Background

With the 2021 AGM season for the issuers having a December year-end fast approaching, Korea Corporate Governance Service (KCGS) selected the following themes as a preview. This year, the preview comes in two parts. Part 1 covers the legal environment enhancements for the exercise of voting rights, the appointment of women directors, and the revised laws governing the environment, health, and safety(EHS). Part 2 – this subject paper - looks into the impact of the separate election of audit committee members and reviews the foreseen fights over management rights.

### Increasing Shareholder Proposals with Separate Election of Audit Committee Members

In December 2020, the National Assembly passed three legislative/amendment bills aimed at improving corporate governance and establishing a fair market order, the so-called ‘three laws of a fair economy.’<sup>1</sup> ‘Separate election of audit committee members’, ‘relaxed quorum requirements to pass a resolution to appoint an auditor/audit committee member’, and ‘changes in voting rights restriction for the appointment and dismissal of an auditor/audit committee member’ - some of the amendments to the Commercial Act – may have an impact on this AGM season.

As per the requirement of the separate election of audit committee members under Article 542-12(2) of the Commercial Act, a shareholder meeting has to elect at least one director

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<sup>1</sup> Joint Briefing of 「Three Laws of Fair Economy」 by Related Ministries, Financial Services Commission, 2020.12.15

who will also be an audit committee member separately from other directors for increased independence of the elected audit committee members. Under the existing rule, an audit committee member has been appointed through a two-stage election. That is, directors are elected at the shareholder meeting, and an audit committee member is nominated among the elected directors. To reinforce the independence of the members of the audit committee, a 3% voting right restriction (“3% rule”) has been in place. It was pointed out, however, that the 3% rule did not achieve the intended purpose because the rule only applied to the second stage of the election for appointing an audit committee member. With the mandatory separate election of at least one director for an audit committee member coming into force, the 3% rule applies from the first stage of electing a director candidate who will also sit on the audit committee, increasing the likelihood of the appointment of a nominee supported by minority shareholders.

Restricted to the companies that facilitate shareholder voting by adopting an electronic voting system (e-voting or e-proxy), relaxed quorum requirements apply to a resolution to appoint an auditor/audit committee member under Article 542-12(8). The existing rule says that both a majority of the attending shareholders and 1/4 of the shares issued and outstanding have to be satisfied. For a company implementing electronic voting or electronic proxy, however, the latter is not mandatorily required under the new rule.

The restriction on voting rights for the appointment and dismissal of an auditor/audit committee member has also been amended under Article 542-12(4). The details are found in the table below.

**< Changes in '3% Rule' under Commercial Act ><sup>2</sup>**

Category		Mandatory	Current	New
Listed Company	KRW2t+ in assets	Audit Committee	Appointment & dismissal of an auditor/audit committee member who is not an outside director - Largest shareholder: 3% in aggregate General Shareholder: (blank)  Appointment of an audit committee member who is also an outside director - Largest/general shareholder: 3% not in aggregate	Appointment & dismissal of an auditor/audit committee member who is not an outside director - Largest shareholder: 3% in aggregate - General shareholder: 3% not in aggregate
	KRW100b+ ~ KRW2t	Audit Committee	(The same as the rule applicable to issuers with KRW2t+ in assets)	Appointment & dismissal of an audit committee member who is also an outside director - All shareholders: 3% not in aggregate
		(Or) Standing Auditor	- Largest shareholder: (appointment & dismissal) 3% in aggregate - General shareholder: (appointment) 3% not in aggregate	
	Less than KRW100b	Auditor	- Largest shareholder: (appointment & dismissal) 3% in aggregate - General shareholder: (appointment) 3% not in aggregate	
		(Or) Audit Committee	(Appointed by the board)	

Of the KOSPI-listed companies falling under the scope of the newly required separate election of audit committee members (excluding financial companies), 206 issuers have 352 audit committee members who are going to be replaced due to the end of the term or resignation<sup>3</sup>. Thus, it is expected that this AGM season will see quite a few proposals to elect a director who will also serve the audit committee. The separate election will have a bigger impact on the issuers facilitating shareholder voting such as by maintaining cumulative voting in their articles of incorporation or adopting electronic voting, or those under active monitoring from blockholders other than the controlling shareholder. When the convenience of voting is increased through diverse methods and minority

<sup>2</sup> Lee & Ko NEWSLETTER, 2020.12.14

<sup>3</sup> Audit committee members whose terms are coming to an end at the end of March 2021 or who resigned from the role after last year's respective annual general meetings (source: annual reports and filings to report the appointment/dismissal or resignation of outside directors)

shareholders get to vote more, the new rule will have a larger effect. Further, when external blockholders have a keen interest in improving the governance structure in their investee companies and exercise the right to file a shareholder proposal if necessary, the separate election of an audit committee member shall achieve the intended purpose to the maximized extent.

With the separate election of audit committee members coming into play, we expect to see a growing number of shareholder proposals as well as other changes concerning general meetings of shareholders. For example, many issuers used to convert to an audit committee system in place of an auditor to circumvent a shareholder proposal to appoint an auditor. When audit committee members are elected separately from other directors, such attempts are expected to drop. In addition, an increasing number of companies are expected to adopt an electronic voting or electronic proxy system to benefit from the relaxed quorum requirement applicable to the resolution to elect an auditor/audit committee member.

## **Unpredictable Proxy Battles**

Some of the large business groups are expected to see a proxy battle waged among family members or by private equity managers. Shareholders of such companies are advised to monitor relevant developments aggressively. Attention is also paid to whether shareholder proposals will be filed, among others, in annual general meetings this year.

### **1) Hanjin Kal**

Hanjin Kal is the holding company of Hanjin Group and disputes over the management control of the unit have continued for a long time. In addition to the lax governance structure and the family feud, unfavorable business conditions faced by the aviation industry, the mainstay business arm of Hanjin Kal, have made the situation even worse.

#### **① Hanjin Kal vs. KCGI (Grace Holdings)**

In November 2018, Korea Corporate Governance Improvement (KCGI) emerged as the second-largest shareholder of Hanjin Kal and expressed an intention to participate in the management of the company, pointing out that the affiliates of Hanjin Group were

significantly undervalued due to poor governance represented by the owner family members bossing around and sloppy management. Later, the activist fund openly proposed a plan to improve corporate governance of the business group as well as debt ratio and credit rating. For the annual general meeting held in March 2019, the fund filed a shareholder proposal to appoint new outside directors and auditors and reduce the cap for directors' remuneration.

Citing the moral controversy of the owner family and subsequent degradation of firm value, the National Pension Service of Korea (NPS) also sent an open letter to the company and had a closed-door dialogue. In the annual general meeting in March 2019, the NPS also submitted a shareholder proposal to amend the company's articles of incorporation. Although the shareholder proposals were all voted down, it is named as a successful engagement case following the adoption of the stewardship code. Back then, the public sentiment rapidly worsened, and institutional investors and minority shareholders exercised their voting rights aggressively, removing then-chairman of Hanjin Group Cho Yang-ho from inside directorship at Korea Air in the end.

## **② Cho Won-tae vs. Alliance between Cho Hyun-ah, Bando E&C, and KCGI**

Following the sudden death of then-chairman Cho Yang-ho in April 2019, then-president Cho Won-tae became the chairman of the company. At the same time, controlling shareholders of Hanjin Group mounted a fight and Bando E&C declared that it would participate in the management of the company, shaping a new power structure between chairman Cho Won-tae and the tripartite alliance joined by former vice-president Cho Hyun-ah, Bando E&C, and KCGI.

In January 2020, the trilateral alliance agreed on co-ownership of a 32.05% stake in Hanjin Kal and proposed eight new director nominees to secure control over a majority of the board, also arguing that a professional manager needed to be invited. At the time, Cho Won-tae and the three-party alliance engaged in an unreasonable stake buying, which developed into a proxy fight between brother and sister. In the end, the situation unfolded in a way that the votes cast by the NPS and other institutional investors and minority shareholders could determine who controls Hanjin Kal.

As it turned out, the shareholder proposal submitted by the tripartite alliance was all voted

down. It was still encouraging, however, because Hanjin Kal later presented a plan to enhance the firm value, unveiling measures to improve its governance structure. Specifically, the company offered to separate the board chair and the CEO, increase the independence of the outside director nomination committee by appointing outside directors entirely for the committee and reinforce financial soundness through asset sales and business restructuring.

### ③ Changes before and after Capital Increase by KDB

In November last year, the Korea Development Bank(KDB) decided to inject KRW800 billion for the capital increase of Hanjin Kal, the parent company of Korean Air, supporting Korean Air's bid to acquire Asiana Airlines. In response, the tripartite alliance filed a petition for a preliminary injunction to prohibit the issuance of new shares against Hanjin Kal's plan to increase capital through a third-party allocation, citing that the action was likely to violate existing shareholder rights. The court, however, turned the petition down.

As a result, the KDB emerged as the third-largest shareholder with a 10.66% stake in Hanjin Kal, and the market expects that the state-run bank will also support the existing board of directors. This means that the shares friendly to the owner family soared to 47.33%, while the stake held by the trilateral alliance fell to 40.4%. If the tripartite alliance wishes to continue the fight, they would need to purchase extra shares or secure substantial powers of attorney. In financial terms, they will need additional funds of about KRW420.1 billion<sup>4</sup> to obtain a majority stake, according to an estimate.

With the emergence of a blockholder KDB other than the controlling shareholders, Hanjin Kal is expected to face mounting monitoring pressures that can put a brake on the excesses of the owner family. The general meeting of shareholders called this year is anticipated to put to the vote the appointment of director candidates nominated by the new blockholder, among others.

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<sup>4</sup> Based on the closing price of KRW63,400 on January 26, 2021

## 2) Hanjin Transportation

Hanjin Transportation, an affiliate of Hanjin Kal, also received a contents-certified letter from the private equity fund HYK Partners (HYK PEF), calling for better governance structure and shareholder value enhancement, which may ignite a dispute over management control.

In December 2020, HYK PEF proposed i) amending the article of incorporation to increase the maximum size of the board from eight to ten, to adopt interim dividends, and to delete the provision that opted out cumulative voting, ii) giving a board seat to the CEO of HYK Partners (a non-independent non-executive directorship), 3) appointing outside directors and audit committee members nominated by HYK PEF, and 4) paying KRW1,000 per share instead of KRW500. As the rationale of the shareholder proposal, HYK PEF cited minority shareholder rights protection, oversight of risk contagion from the holding company Hanjin Kal, and the reform of the owner family-centered closed management.

When the private equity fund HYK Partners was established, Kyungbang participated as the largest investor(LP). In October 2020, Kyungbang handed over its entire stake in Hanjin Transportation to HYK partners making the fund the second-largest shareholder of Hanjin Transportation with a 9.79% stake. While it was only last year when HYK acquired the stake, the fund can make a shareholder proposal for this year's annual general meeting of Hanjin Transportation as per the revised Commercial Act<sup>5</sup>, which allows minority shareholders to exercise their rights regardless of the holding period once the ownership meets the 3% threshold.

For the forthcoming annual general meeting, Hanjin Transportation has about a 38% friendly stake held by Hanjin Kal and GS Home Shopping. Due to the 3% rule<sup>6</sup>, however, the percentage of shares eligible for voting comes down to around 18%, reducing the gap with HYK owning a 9.79% stake. For this reason, a fierce proxy fight is highly likely as for the agenda item to appoint audit committee members. There is also a possibility where

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<sup>5</sup> Minority shareholders may choose between the general provisions applicable to all companies and the special provisions applicable to listed companies.

<sup>6</sup> When appointing and dismissing audit committee members of a listed company, the largest shareholder and its related parties cannot vote for the shares exceeding 3% in aggregate. The 3% threshold also applies to general shareholders but for their independent shareholding, not in aggregate with the shares held by other shareholders.

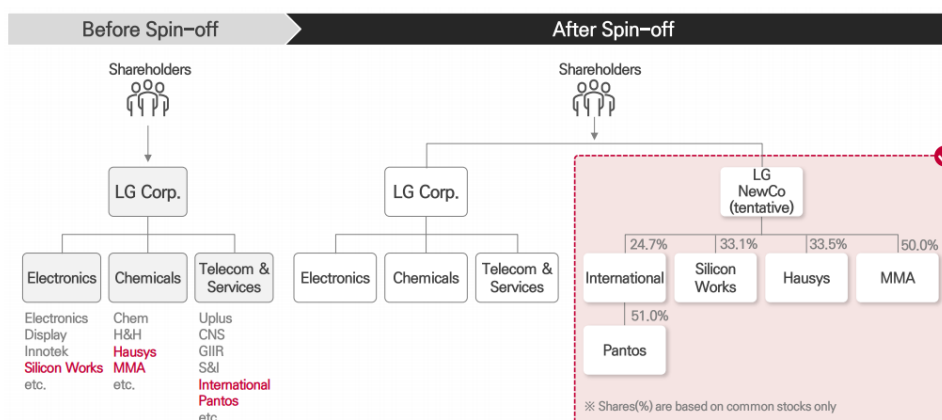
HYK joins hands with KCGI who also has an issue with Hanjin Kal. The voting decisions of the institutional investors such as the NPS holding a 6.2% stake and those of minority shareholders will play an important role.

### **3) LG Corp. to Spin-off Affiliates**

The US hedge fund Whitebox Advisors owning around a 1% stake in LG sent a shareholder letter, making official its opposition to the business group's spin-off plan. Whitebox argues that creating a new holding company and spinning off affiliates is to enable family business succession at the expense of shareholder value and thus it opposes the spin-off plan itself. It points out that what is urgent is to raise the undervalued share price for shareholder value recovery.

On November 26, 2020, LG Corp.'s board of directors made a unanimous decision to spin-off the company's four affiliates, i.e., LG International Corp., Silicon Works, LG Hausys, and LG MMA, out of 13 affiliates and set up a new holding company. The new entity will be led by Koo Bon-joon, a senior advisor to LG, with the four spun-off companies as the first-tier affiliates and Pantos under LG International Corp. as the second-tier affiliate. With the spin-off, LG Group will have a structure where chairman Koo Kwang-mo becomes the sole top leader. The existing company LG Corp. will focus its capabilities and resources on core businesses of electronics, chemicals, and telecommunications.

## [ LG Group Before and After Spin-off ]



Source: LG Group IR Presentation, Details on the Spin-off

In the domestic market, there is not yet any negative sentiment against the spin-off plan. Attention is still drawn to how much support the plan will attract in the upcoming general shareholder meeting.

#### 4) Hankook & Company (formerly Hankook Technology Group)

Chairman of Hankook & Company Cho Yang-rai handed over his entire stake in the business group (23.59%) to his second son Cho Hyun-bum, the CEO of Hankook Tire & Technology, making him the de-facto heir apparent of the business group with a total of 42.9% stake, including his existing holding of 19.31%. With the stock transfer, Cho Hyun-bum is now put into a family feud over management control. Cho Hee-kyung, chairman of Hankook Tire Welfare Foundation and the elder daughter of Cho Yang-rai, filed a petition to start an adult guardianship, raising doubts about whether chairman Cho was able to make a rational decision citing his health condition. Then, the elder son Cho Hyun-sik, vice chairman of the holding company, announced that he would join the petition lodged by his sister.

Amid the management dispute raging on, Cho Hyun-bum was appointed as a co-CEO of Hankook & Company (then-Hankook Technology Group), and there came a disclosure that the holding company would have a dual leadership structure led by Cho Hyun-bum

and his brother Cho Hyun-sik, who was already steering the company as the CEO<sup>7</sup>. While the elder son Hyun-sik maintains the positions of the CEO and the chairman of the board of directors, disputes with his brother seem inevitable.

With the dispute between controlling shareholders looming, the company is expected to make proposals to fill the two soon-to-expire outside director seats, either by re-electing existing directors or nominating new candidates. Whoever is nominated needs to be more independent and equipped with more knowledge and skills. Earlier, Cho Hyun-bum was arrested on charges of taking about KRW600 million in total, millions every month, unfairly from a supplier and embezzling around KRW200 million from affiliates regularly in a separate case. In April 2020, Cho was sentenced to three-year imprisonment and four years of suspension, and in June the same year, he stepped down from the CEO of Hankook Tire & Technology Co. Later in an appeal trial held in November 2020, he received the same sentencing of the original trial.<sup>8</sup>

Moreover, Hankook & Company has been sanctioned three times by the Financial Supervisory Service during the ongoing merger process with Hankook AtlasBX. An issue was raised over the merger ratio and the push for a merger with potentially conflicting interests, which attracted market attention for close monitoring. In response, Value Partners Asset Management is known to have filed a petition for a preliminary injunction of the suspension of the effect along with minority shareholders to deter the merger attempt.<sup>9</sup> Under these circumstances, difficulties are foreseen whether an extraordinary meeting of shareholders can be called to decide on the merger.

Over Hankook & Company, monitoring is necessary to track how the board's decision of appointing a disqualified person to the CEO right after the sentencing influences the corporate value. Shareholders of this company are advised to continue monitoring critical issues coming up in the February special meeting of shareholders - the merger approval - and in the annual general meeting – appointment of outside directors having independence and expertise.

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<sup>7</sup> Change of Chief Executive Officer (Disclosure), Hankook & Company, 2020.11.26.

<sup>8</sup> Confirmation of embezzlement & breach of trust, Hankook & Company, DART, 2020.11.23.

<sup>9</sup> Value Partners files a suit against the merger between Hankook & Company and Hankook AtlasBX', The Bell, 2021.01.29.

## 5) Kumho Petrochemical

A management dispute over Kumho Petrochemical is foreseen with the shareholder proposal sent by Park Chul-wan, nephew of the chairman of Kumho Petrochemical Park Chan-koo and shareholder of a 10% stake in the company, calling for increasing dividends and replacing board members. Park Chul-wan, an executive but not a board member, broke up the co-shareholding and special relationship with chairman Park Chan-koo and filed a blockholder disclosure independently.<sup>10</sup> On the disclosure, Park specified that the purpose of holding shares in the company is to potentially exercise the right to submit a shareholder proposal under the Commercial Act and other shareholder rights in the ways and scope allowed by relevant laws. It is interpreted that Park filed the disclosure to make clear his intention to participate in the management of Kumho Petrochemical by breaking out of the special relationship with the owner family (23.9% stake) and becoming the largest individual shareholder owning a 10% stake. With this, Kumho Petrochemical is anticipated to get embroiled in a family feud over management control once again after the dispute between siblings over the former Kumho Group.

Since the company has four out of seven outside directors reaching the end of the term, a proxy war seems inevitable in the March annual general meeting. Park Chul-wan is known to have demanded an inside director seat for himself and the replacement of four existing outside directors.<sup>11</sup> If the shareholder proposal is approved, Park will be able to secure a majority of the board on his side in the ten-member board comprising three inside directors and seven outside directors, laying the foundation to have a grip on the board. In this fight, the Korean national pension service, another blockholder holding a 9.99% stake, is expected to have the casting vote. Another important variable is IS Dongseo, who is known to have purchased a large sum of the shares over a short time.



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<sup>10</sup> [Amended] Blockholder Disclosure, Park Chul-wan, DART, 2021.01.28.

<sup>11</sup> "Park Chul-Wan from Kumho Petrochemical calls for replacing 5 outside directors", The Bell, 2021.02.03.

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