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Corporate Restructuring Through Spin-Off Reorganization Plan: A Korean Case Study

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CORPORATE RESTRUCTURING THROUGH SPIN-OFF REORGANIZATION PLAN: A KOREAN CASE STUDY

Jongho Kim *

ABSTRACT

Since the corporate spin-off was adopted in Korean business corporation law in 1998, many Korean exchange-listed and KOSDAQ-registered firms have applied this system. Especially, the Korean bankruptcy court realized that the spin-off is a very useful tool for reorganizing firms and rescuing them from financial distress. The actual benefits of corporate spin-offs include the (i) enhancement of management efficiency, (ii) improvement of the sound structure of corporate governance, and (iii) alleviation of information asymmetry by dividing a well-diversified business in the market, among others. This article analyzes two reorganizing firms' division cases, which successfully completed a turnaround from insolvency by applying spin-offs.

Corporate spin-off, as a legal process, is controversial. The most critical disputes involve creditor and shareholder interest protection and the subject of division. This article examines many practical issues with a focus on spin-off procedures. This article covers the following topics: (i) the significance, need, and legal nature of a spin-off; (ii) the various ways of creating a company spin-off such as simple division, merger by split, merger through a newly incorporated division, merger by split, and *in rem* division; (iii) the divided firm's scope, asset, and debts; (iv) spin-off procedure for reorganizing a company; and (v) the effects of a spin-off and status of reorganizing a company.

Since 1999, many Korean firms have begun to implement spin-offs for their own purposes, but there has been limited academic research on them. Therefore, Germany and France have been used as other jurisdictional sources for explanation. This article conducts an in-depth analysis of the spin-off process at two reorganizing Korean companies and it will provide understanding as to why corporate spin-offs have been used since the Korean economy's collapse in 1998.

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I. INTRODUCTION

Spin-off occurs when corporate divisions within a company's legal structure, including its material assets, are divided into two or more units.¹ Corporate division is the opposite concept to corporate merger, with the former making two or more independent companies out of one company, while the latter creates a single company by combining two or more companies.

This corporate division system originating in the laws of France, Germany, and England was introduced to Korea when the Korean Commercial Act ("KCA") was amended in 1998. Even though in the United States, the Internal Revenue Code² deals with much the same content, the Korean legislature has taken after the above countries' legal traditions.

Under the current Korean law, the Fair Trade Commission ("KFTC") can approve a company's spin-off only if the company completes the sale of all stakes owned by affiliates.³

Until the KCA was adopted, the phrase "*ex post facto* incorporation" was generally used for corporate division, but now "spin-off" is considered the term for this convenient corporate division device for corporate reorganization and/or restructuring.

The spin-offs could be implemented by the means of existing mechanisms, which could inflict discomfort and disadvantage accordingly. Thus, the corporate division is not a positive and logical inevitability, but also a procedure taking into account physical and personnel factors.

This research was aimed to clarify the benefits of the division by reviewing the spin-off within corporate reorganization proceedings. The scope of this article is confined to the failed company's spin-offs only

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¹ What is a spin-off? "A spin-off is a transaction where corporate assets, usually in the form of the stock of a subsidiary, are distributed to shareholders. . . . This leaves the shareholders with direct ownership of the former subsidiary." See Mark L. Reinstra & Jeffrey R. Vetter, *Alternatives to Traditional Public Offerings*, in UNDERSTANDING THE SECURITIES LAWS 2008 HANDBOOK 301, 317-18 (2008).

² 21 U.S.C. § 355 (2006).

³ See Dokjeom gyuje mit gongjeong georaeae gwanhan beobyul [Monopoly Regulation and Fair Trade Act], Act. No. 3320, Dec. 31, 1980, art. 7(1)(5)(ii) (S. Kor.), available at <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN011494.pdf>.

amongst various kinds of corporate restructuring.

This article examines various issues that occur generally when reorganizing companies undergo corporate division as part of their corporate reorganization process.

This study consists of several parts as discussed below. Division cases of two reorganizing firms will be analyzed in Part I. The article discusses the significance and need for spin-off in Part II. Part III addresses the methods of a reorganizing company's spin-off. In Part IV, the divided firm's scope, assets, and debt-related issues will be examined. The spin-off procedure for reorganizing companies is described in Part V. In Part VI, the effects of spin-off and the status of reorganized companies is examined. Additionally, the nullification of spin-off and reorganization plan execution is discussed in this part. Korean case experiences and lessons are summarized in the conclusion.

II. REORGANIZING FIRM'S DIVISION CASES

To date, the Seoul Central District Court has handled several reorganizing company division cases.⁴ Here, however, only two typical cases will be discussed. One is an *in rem* division and the other is a shareholder level division.⁵

A. *In re Hanshingongyeong Inc.*

Hanshingongyeong was executing its reorganization plan after it was approved by the Seoul District Court on June 30, 1998, but it could not find enough financial resources to repay its debts.⁶ After determining

⁴ There are approximately 2,000 listed companies in KOSDAQ and the Korea Exchange market. Recent year corporate division filing cases of listed company at the Korea Exchange are reported as follows: 9 in 2003, 12 in 2004, 14 in 2005, 23 in 2006, 21 in 2007, 31 in 2008, and 6 in the first half year of 2009. See Dongho Bae, *Current Trend of Listed Company Merger and Division*, FNTIMES, May 14, 2009, available at <http://www.fn-times.com/sub/list-view.asp?num=032009051401302&kind=40>.

⁵ In contrast, spin-offs occur when the equity owners of the parent company receive equity stakes in the newly spun-off company. For example, when Agilent Technologies was spun out of Hewlett-Packard in 1999, the stockholders of HP received stock in Agilent. On March 2, 1999, HP announced its intention to launch a new company, subsequently named Agilent Technologies, through a distribution of Agilent Technologies common stock to HP's stockholders in the form of a tax-free spin-off. See HEWLETT PACKARD CO., FORM 10-Q QUARTERLY REPORT 7 (June 13, 2001), available at <http://www.sec.gov/Archives/edgar/data/47217/000091205701519769/a2050788z10-q.txt>.

⁶ Seoul District Court [Seoul Dist. Ct.], 97Pa4374, Nov. 21, 2002 (S. Kor.).

its operating income would be insufficient, it decided to divide the company based on the principles of fairness and equity to provide the best benefits to its creditors, shareholders, employees, and other interested persons. This was also done for the purpose of promoting the company's reorganization and revival. Below certain provisions of that reorganization plan as related to the division are briefly introduced.

Hanshingongyeong decided to divide the corporation at the shareholder level to establish a new company according to Article 225-2 of the KCRA (current Article 212 of the Debtor Rehabilitation and Bankruptcy Act ("DRBA")) and Articles 530-2 through 530-12 of the KCA. The existing reorganizing company was divided into construction and retail distribution divisions, with the construction division remaining in the existing company and a new company being established within the retail distribution division. The continuing company's shareholders became the new company's shareholders, and both the continuing and new companies became reorganizing companies to be controlled by the finalized reorganization plan.⁷ This company's division standards included:

(i) Assets that directly related to each business division would be kept in the designated division while the continuing company would retain common assets whose application to the division standards was uncertain.⁸

(ii) The new company would repay common benefit claims occurring in the distribution division, with the continuing company repaying common benefit claims occurring in the construction division. Common benefit claims (administrative claims) whose basis for occurrence was unclear would be divided based on the ratio of assets. The continuing company and the new company would be bound to the joint and several liability of repaying common benefit claims.⁹

(iii) Categorization of secured claims would be based on the categorization of the underlying collateral (whether it was to be transferred to the new company or remain with the existing company).¹⁰

(iv) Unsecured claims would apply the asset ratio (distribution proportion) of the construction and retail distribution divisions, but unspecified debts such as indemnification claims and suretyship claims were given to the continuing company in full.¹¹

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

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(v) The new company's capital and total number of shares to be issued was decided as follows: the reorganizing company's existing capital was divided into two based on the net asset value ratio between the existing and new company and the number of shares were distributed accordingly.¹²

The shares were then distributed to the existing company's shareholders and the continuing company decreased its capital to exclude what was given to the new company. The date of division was the continuing company's date of capital deduction by stock consolidation with the division ratio being set to 65.31:34.69, the asset ratio of the construction and retail distribution divisions (as of December 31, 2001).¹³

Table 1. Contents of Company Division

Category	Company	Business Division
Continuing Company	Hanshingongyeong Inc.	Construction
New Company	Ures Corporation	Retail Distribution

The following explains this company's provisions concerning the new company. The reorganization plan introduced the new company as URES Corporation, Seoul.¹⁴ The reorganization process was publicly noticed via Seoul's *Korea Economic Newspaper*.¹⁵

The new company's type and class of shares included registered common stock and registered preferred stock. The total number of shares issued was 4,000,000. The par value of one share was KRW 5,000; thus, the total value of shares for paid-in capital was KRW 20 billion. Other provisions were identified in its bylaws.¹⁶

As for the transfer of assets after corporate division, current assets transferred to the new company from the reorganizing company's former division were KRW 15,351,586,442 with fixed assets being KRW 200,382,441,823, for total assets of KRW 215,734,028,265. The list of

¹² *Id.*

¹³ *Id.*

¹⁴ "A new legal entity is . . . created in a standard spin-off." PATRICK A. GAUGHAN, *MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS* 397 (1996).

¹⁵ Seoul District Court [Seoul Dist. Ct.], 97Pa4374, Nov. 21, 2002 (S. Kor.).

¹⁶ *Id.*

transferred assets was as shown in the reorganization plan.¹⁷

The modification of rights with the transfer of secured and unsecured claims was as stated in the reorganization plan, and the amount of common benefit claims, which were to be paid by the new company, was KRW 54,178,461,935 out of the former division's common benefit claims. The continuing company was exempt from joint and several liability for the final common benefit claims of the new company.¹⁸

The new company received KRW 76,247,102,149 as a reserve fund from the reorganizing company's former division and provided subscription rights to its new shares in a capital increase (according to Chapter 7 Section 2 Clause 11-B-2 of its finalized reorganization plan) to Save Zone Inc. Consortium (Save Zone), its acquirer.¹⁹

As for the capital increase to Save Zone, the new company issued 7,000,000 registered common shares at KRW 5,000 par value for Save Zone with the payment date being the first upcoming sales date after the re-enlistment of the new company on the Korea Exchange. The new shares were to be validated the day after the payment.²⁰

The reorganization plan stated the new company's increase in capital and the convertible bonds available for acquisition by third-parties.²¹

The new company borrowed KRW 45,166,796,573 from Save Zone to repay its claims. The reorganization plan stated how secured and unsecured claims would be changed and repaid. Shareholders did not receive dividends during the reorganization process. The shareholders' meeting was not held and the shareholders' voting rights were not in force during the reorganization process.²²

The new company issued 1,161,466 shares of common stock and 4,567 shares of preferred stock in accordance with the net asset value ratio of the divided, and new companies, by dividing the former division's paid-in capital. New shares were allotted to the existing shareholders at the rate of 0.56113 per share as of the division date with odd shares less than one being discarded. However, if the company was not enlisted, the shareholders had to receive odd shares multiplied by KRW 5,000. The new shares were validated on the day of division and the receiver had to

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

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issue and distributes them with the bankruptcy court's approval.²³

Unsecured creditors did not pay any additional subscription price under the altered reorganization plan conditions. At the time a debt-for-equity swap is carried out, their claims are converted to shares.²⁴ Thus, it is considered that the company's debts have been repaid on the day of the swap.²⁵

The following provisions in the division plans and reorganization plans involved the company's division.²⁶

First, the continuing company's final assets were the remainder of assets within the former division after transferring assets to the new company.²⁷ These constituted KRW 315,614,106,890, with fixed assets being KRW 90,610,848,401 for total assets of KRW 406,224,955,291. The existing company's secured and unsecured claims were the remainder after transferring the designated former division's secured claims and unsecured claims to the new company.²⁸

The new company was not exempt from joint and several liability for the continuing company's final common benefit claims, and the amount of final common benefit claims which the existing company was ultimately left with was KTW 2,204,157,538,229 out of the former division's common benefit claims. The existing company's reserve funds after the division were KRW 59,633,403,428.²⁹

The total number of shares to be issued by the existing company did not decrease. The division made no additional changes to the rights of secured or unsecured claims, and the method of repayment followed the methods that were finally established before the division. Secured claims with no collateral were repaid in installments. Claims stemming from commercial transactions were fully repaid on June 30, 2002 in cash. The existing company did not have any joint and several liability for the new company's secured and unsecured claims.³⁰

²³ *Id.*

²⁴ In this fashion, the surety obligations can be altered, with the result being that a debt-for-equity swap is often favored. *See* LARRY D. SODERQUIST ET AL., *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS* 172 (4th ed. 1997).

²⁵ Seoul District Court, 97Pa4374.

²⁶ *Id.*

²⁷ There is no non-competing covenant in this case but generally these kinds of obligations are transferred by corporate division. *See* Jongho Kim, *A Study on the Corporate Division* 137 n.474 (Feb. 1999) (unpublished Masters thesis, SungKyunKwan University) (on file with author).

²⁸ Seoul District Court, 97Pa4374.

²⁹ *Id.*

³⁰ *Id.*

The reorganizing company's existing capital was determined by dividing the reorganizing company's paid-in capital in accordance with the net asset value ratio of the continuing and the new company. The reorganizing company's existing registered common stock and registered preferred stock were consolidated at KRW 5,000 par value one share per 0.43887 to decrease the capital as the day of capital deduction effected by the former division's old stock certificate consolidation.³¹

As a result of the stock consolidation, odd shares less than one were sold with the bankruptcy court's approval on the first day of enlistment with the proceeds being distributed under the number of odd shares. After stock consolidation, the existing company's capital was KRW 5,000 multiplied by 908,390 registered shares of common stock and 3,573 registered shares of preferred stock with the total value being KRW 4,559,815,000.³²

The former division's holders of secured claims converted their liabilities into shares rather than making an additional investment. This was done in accordance with reorganization plan provisions stating that secured claims shall be converted into stock in lieu of payment if the debt-for-equity swap was carried out within the former division of the reorganizing company.³³

B. In re Hunex Inc.

Hunex Inc. (hereinafter referred to as "the divided company") decided to process an *in rem* division based on Article 225-2 of the KCRA (current Article 212 of the DRBA) and Articles 530-2 through 530-12 of the KCA to establish a new company (hereinafter referred to as "the new company").³⁴

The purpose of the corporate division was to improve the divided company's financial structure. This was accomplished by changing the reorganization plan's payment conditions to overcome its difficulties in repaying secured claims and debts, which were caused by inactivity of business standing and delay in sales of nonessential property.³⁵

The company's assets and debts relating to Freya Mall, one of its major assets, were divided to establish the new company, and the contin-

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ Seoul District Court [Seoul Dist. Ct.], 98Pa4302, June 28, 2002 (S. Kor.).

³⁵ *Id.*

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uing company specializing in each business division, was to quickly stabilize the sales division. In addition, each business division was made independent in order to provide for more professional decision making in its field for the purposes of maximizing business performance and shareholder value.³⁶

The new company concentrated on leasing lots within Freya Mall to simplify and specialize its business structure. The company formed a new growth engine by transforming itself into a market-friendly company and recreating a stable profit structure.³⁷

The company used Article 225-2 of the KCRA (current Article 212 of the DRBA) and Articles 530-2 through 530-12 of the KCA to divide its assets and debts as shown below, establish a new company in *in rem* division, and continue its business with the existing company.³⁸

Table 2. Category and Subjects of Division

Category	Company	Subjects
Divided Company	Hunex Inc.	Assets and Debts excluding the New Company
New Company	Freya World Inc.	Freya Mall-related Assets and Debts

The division was put into effect when the amended reorganization plan was approved by the bankruptcy court. The new company was responsible for the secured claims and debts that related to Freya Mall, but did not hold joint and several liability for the continuing company's secured claims, debts, or contingent liabilities (unspecified debts such as indemnification and suretyship claims). Likewise, the continuing company was free of any joint and several liability for the new company's secured claims and debts. Common benefit claims and common contingent liabilities related to Freya Mall's building and land were given to the new company with the continuing company being responsible for any remaining common benefit claims; however, both companies have joint and

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*; New shares are issued, but here they are not distributed to shareholders on a pro rata basis. In the standard spin-off, "[t]he proportional distribution of shares, the shareholder base in the new company is the same as that of the old company." See GAUGHAN, *supra* note 14, at 397-98.

several liability on the common benefit claims.³⁹

The company followed these procedures for the division:

(i) *Continuing Company*: The continuing company had no decrease in capital after the establishment of the new company.

a. The following lists show the assets transferred by the corporate division and Freya Mall-related current assets and fixed assets at the mall's location in Seoul:

Table 3. Asset for the Division
(Unit: KRW 1,000, equals USD 1)

Category		Before Division	Remarks
Assets	Current Assets	134,684,083	
	Fixed Assets	67,553,224,467	
Total		67,687,908,550	

b. The following lists show the total number of shares issued after division.⁴⁰

Table 4. Change of Number of Shares

Category	Before	Changes	After	Remarks
Registered Common Stock	4,023,712	0	4,023,712	
Total	4,023,712	0	4,023,712	

c. In this case, the company's total number of shares issued did not decrease, and the number and the type or classes of stock to be decreased were not considered.⁴¹

d. The bylaws were not changed.⁴²

(ii) *New Company*: The new company was called Freya World, Inc. The new company's purpose included leasing real estate and engaging in

³⁹ Seoul District Court, 98Pa4302.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

entertainment, culture, and sports businesses, wholesale and retail, warehouse and logistics management, children's facilities, domestic and foreign trading, architecture and housing construction, and others listed in the bylaws.⁴³

The main office of the company was located at 17-2 Euljiro 6-ga Junggu, Seoul, and its incorporation was publicly noticed via Seoul's *Korea Economic Newspaper*.⁴⁴

The total number of shares to be issued was 50,000,000, with each share worth KRW 500. The total number of shares to be issued at the time of incorporation was 100,000 with all of them being registered common stock. The capital of the new company would be KRW 50,000,000 and the reserve fund KRW 309,812. As the new company did not issue corporate bonds, Article 223 of the KCRA (current Article 209 of the DRBA) was not applicable.⁴⁵

As for the new company's assets and the remainder, the assets and debts that related to Freya Mall were transferred from the continuing company to the new company through the corporate division. All details following the estimated list of assets transferred to the new company were based on the split financial statement from March 11, 2001.

The price of assets to be transferred⁴⁶ followed the book value⁴⁷ proven by a certified accountant, with all tangible fixed assets following an official appraised amount.⁴⁸

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ The above summary of the financial statement was quoted from the Division Balance Sheet Report.

⁴⁷ Generally, it is the value at which an asset is carried on a balance sheet. One law dictionary states that:

Determination of price by book value appears to have been used more often than any other method. It is simple and certain and reflects, in part at least, annual changes in the value of the shareholder's equity. It seldom reflects actual value: fixed assets are usually carried at their cost, less depreciation...

If book value is used, it should be recognized that it is likely to be lower than actual value.

See BLACK'S LAW DICTIONARY 177 (7th ed. 1999); see also William C. Childs, *Control of Transfer of Business Interests*, 1958 U. ILL. L.F. 79, 91 (1958) ("However, nowadays there are more complex and delicate methodologies applied in valuations."). See TIM KOLLER, MARC GOEDHART & DAVID WESSELS, VALUATION 101 (4th ed. 2005). See PABLO FERNANDEZ, VALUATION METHODS AND SHAREHOLDER VALUE CREATION 22 (2002) (explaining the modernized valuation skills and techniques).

⁴⁸ Seoul District Court, 98Pa4302.

Table 5. Balance Sheet Before and After Spin-off
(Unit: KRW 1,000,000)

Category		Before	After	
			Continuing Company	New Company
Asset	Current	11,023	10,889	135
	Fixed	102,936	45,383	67,553
Total Assets		113,959	56,272	67,688
Debt	Current	21,465	21,432	33
	Fixed	143,939	30,085	57,655
Total Liabilities		165,404	51,517	57,688
Capital	Capital	20,118	19,648	50
	Earned Surplus	(71,563)	(14,893)	9,950
Total Capital		(51,444)	4,755	10,000
Liabilities and Total Capital		113,959	56,272	67,688

The new company was not responsible for the continuing company's debts that were invested, nor was it to provide certain third persons with subscription rights or old shareholders' preemptive rights to the new shares. The total number and type or class of shares to be issued to secured and unsecured creditors or shareholders, the allotment of newly issued shares, and the consolidation or split of the old stock followed provisions are set forth below.⁴⁹

None of the provisions specify allotment, consolidation, or splitting of new shares. As for the total number, type or class, and allotment of new shares to be issued for secured and unsecured creditors, the following provisions were set forth: (i) the total number of shares to be issued was 100,000, (ii) all of the newly issued shares were registered common stock (KRW 500 per share), and (iii) 100% of the newly issued shares were allotted to the continuing company. The corporate division did not cause any loss or burden to any old shareholder.⁵⁰

The new company was not a reorganizing company, but followed

⁴⁹ *Id.*

⁵⁰ *Id.*

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the rights and obligations stated in the final reorganization plan.⁵¹ The continuing company and the new company were to register the corporate division and incorporation within 14 days from the day of division. The new company was also required to register the alteration of debtors in relation to the debts such as the mortgage and lease that were transferred to the new company from the continuing company. No provisions explained the use of appraisal rights, but rather simply stated that the company division was needed to protect investors and that the division in this case would be finalized with the bankruptcy court's approval.⁵²

III. SIGNIFICANCE AND NEED FOR SPIN-OFF

In corporate division, division plans and/or merger by split agreements based on a special resolution made at the shareholders' meeting are followed by providing information regarding the division, procedures to protect creditors, consolidation or split of stocks, an inaugural general meeting, a general meeting for reporting or a board of director's public notice in lieu of a report to the general shareholders' meeting, registration for division, and the maintenance and perusal of documents.

The spin-off, in economic terms, helps increase market opportunities, improve business efficiency, and better meets the needs of the market.⁵³

A. *Significance of a Spin-off*

Before the system of corporate division was introduced in the KCA, Korea had some similar methods of creating spin-offs such as (i) establishing a new company using investment-in-kind by business including all or important assets,⁵⁴ (ii) issuing new stocks using investment-in-kind by business including operating asset after a new company was estab-

⁵¹ See Kim, *supra* note 27, at 137-38 (stating the effect of corporate division by quoting French cases).

⁵² Seoul District Court, 98Pa4302.

⁵³ James R. Hagan, *Corporate Spin-offs and Federal Securities Law*, THE HAGAN LAW FIRM, INC. (June 16, 2004, 11:26 AM), <http://www.hagan-law.com/docs/Spin-Offs.pdf>. Historically, "spin-offs were used by established corporations to divest themselves of an underperforming division or a part of the business which was incompatible with the core focus of the parent."

⁵⁴ Sangbeob [Commercial Act], Act No. 1000, Jan. 20, 1962, art. 290(2) (S. Kor.) [hereinafter KCA], available at <http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan011485.pdf>.

lished,⁵⁵ (iii) transferring business as an acquisition of assets,⁵⁶ and (iv) transferring business as *ex post facto* incorporation.⁵⁷ However, although the methods (i) to (iii) required investigation by a court-appointed investigator, auditor, or appraiser,⁵⁸ method (iv) (transferring part of the business to the new company after establishing the company by cash investment) did not require any investigation. Thus, the fourth method was generally used for corporate division in Korea. When a company transfers an important and substantial part of its business and invests, it needs to obtain a special resolution at a general meeting of shareholders,⁵⁹ which applies to methods (i) through (iii).

In the case of an *ex post facto* incorporation⁶⁰ under the statute, most new companies require special resolutions from a shareholders' meeting,⁶¹ but these requirements are formal and special resolutions were simply made for the new company because it is a complete subsidiary or a joint stock company of the transferor company, which wants to invest in its business.

The *ex post facto* incorporation can be the best way to achieve the economic effect of corporate division by transferring an existing business within two years after establishing a new company. In Korea, this method was used to avoid strict application of the law of investment-in-kind or asset acquisition because for most companies in Korea, the special resolutions at shareholders' meetings are not strongly enforced since the company is usually controlled by a single person, who owns all or most of the outstanding shares.

B. Need for Spin-offs

The economic purpose of corporate division is twofold. First, it is

⁵⁵ *Id.* art. 422.

⁵⁶ *Id.* art. 290(3).

⁵⁷ *Id.* art. 375. This kind of method is also used in Japan. See TAKEO SUZUKI, SHINBAN KAISHAHŌ ZENTEI DAINIHAN (Corporation Law) 319-20 (2d ed. Year?); see also Ken'ichirō Ōsumi, *Kaisha No Bunaktsu Ni Tsuite* (In regarding Corporation Division), Vol.26 No.1 Hōsōjihō (Jan. 1974).

⁵⁸ KCA art. 299(1) to (2), 422(1).

⁵⁹ *Id.* art. 374(1.1).

⁶⁰ This resolution must be passed by the affirmative votes of no less than two-thirds of the voting rights of the shareholders present at the general meeting and by at least one-third of the total issued and outstanding shares to a contract a company acquires, within two years from its incorporation, a certain property which existed prior to its incorporation and are to be continuously used for purposes of its business, for a value of no less than 5/100 of the capital.

⁶¹ KCA art. 375.

often needed for effective corporate restructuring.⁶² Examples include when a large conglomerate company under multi-business management intends to detach one of its divisions or establish a joint venture company with another company through a particular business segment. The latter includes corporate division and new company establishment through a merger. For instance, if Company A transfers a part of its business to Company B, to Company A, this constitutes a corporate division, but for Company B it actually is a merger.⁶³ Corporate division is thus often a part of corporate combinations. Second, the Monopoly Regulation and Fair Trade Act (“MRFTA”) restricts “participation in new company establishment” for companies governed by antitrust law because they are market dominance enterprise groups and may constitute monopolies, but permits new company establishment through corporate division or merger through spin-off.⁶⁴ Therefore, corporate division can be used in the establishment of the new company.

Corporate division in the KCA is particularly meaningful when it comes to dividing the status of shareholders. This is very similar to what would be considered the opposite of a merger. This is specified in the KCA because an entity can first divide shareholders without undergoing the second step, which includes company establishment, capital decrease, and corporate dissolution. Even in merger by split, all procedures can be completed at once without dividing the company first and undergoing a merger afterwards. A merger is characterized by inclusive succession of shareholder status and corporate assets, with such succession also being seen in the corporate divisions that occur on the opposite side of a merger.⁶⁵

However, the corporate division of a reorganizing company aims at reviving the company and turning around its insolvent operations. If a reorganizing company includes various business divisions such as construction, distribution, and manufacture, and certain divisions are normally operated and profitable, it is important for the company to separate and revive its competent divisions by preventing them from also becoming insolvent.

⁶² See Stephen B. Cohen, *Reconciling Business Purpose with Bail-out Prevention: Federal Tax Policy and Corporate Divisions*, 28 STAN. L. REV. 1100 (1975-76).

⁶³ See HONGGUINE RHIM, CORPORATION LAW 808 (2001).

⁶⁴ Dokjeom gyuje mit gongjeong georaeae gwanhan beobyul [Monopoly Regulation and Fair Trade Act], Act. No. 3320, Dec. 31, 1980, art. 7(1)(5)(ii) (S. Kor.), available at <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN011494.pdf>.

⁶⁵ See RHIM, *supra* note 63, at 809.

C. *Legal Nature of a Spin-off*

Corporate division results for economic and business reasons that are contrary to those of a merger.⁶⁶ Although corporate division is an opposing concept to merger, corporate division and merger share many similar legal aspects. For instance, a divided company's active and passive assets are partially transferred to the new incorporated company, the existing acquirer or are extinguished without a liquidation process. Also, a resolution at the shareholders' meeting is essential for the division process, with the divided company's shareholders receiving shares from the newly incorporated company or the existing acquirer in exchange for the partially inclusive succession of its assets.⁶⁷

Like merger, there are conflicting theories concerning the legal characteristics of corporate division. Some commentators argue that it is a deformation of merger, while others argue that it is a combination of merger and partial investment of assets.⁶⁸ An additional issue is whether corporate division can be a succession of the divided company's juristic personality or a transfer of assets. However, it would be reasonable to identify corporate division as an independent system that differs from a merger.⁶⁹ Thus, division of a reorganizing company is also different from a merger.

IV. METHODS OF A REORGANIZING COMPANY'S SPIN-OFF

The methods of corporate division vary considerably and are classified in various ways. This article examines the division model of reorganizing companies and various legal problems that occur in corporate division processes based on the KCA.

⁶⁶ See Johan F. Bales, *The Business Purpose of Corporations Separation*, 56 VA. L. REV. 1242, 1270 (1970).

⁶⁷ See generally, G. Ripert Par R. Roblot, *Traité élémentaire de droit commercial* (tome I) [Commercial Law Vol. I], 790 (1996); see generally J. Hémar, F. Terré & P. Mabilat, *Sociétés Commerciales* §§ 880-1063 (1974); see also Répertoire des sociétés (tome II), fusion et scission, n° 8-12 (1984). This is a special system through which a company is divided into two or more companies, with the assets of the existing company partially succeeding to the newly incorporated company, with its legal rights and obligations being extinguished without a liquidation process, and the existing shareholders receiving shares of the newly incorporated company.

⁶⁸ RHIM, *supra* note 63, at 809-10. See also GIBEOM KWON, *Division of Stock Company*, in ISSUES OF COMMERCIAL LAW 225 (1998); Umwandlungsgesetz [UmwG][Corporate Reorganization Act], Oct. 28, 1994, BUNDESGESETZBLATT [BGBL. I] at vol I, § 123(1)-(3). (Ger.); Debtor Rehabilitation and Bankruptcy Act [DRBA], Act. No. 7895, Mar. 24, 2006, art. 274(7) (S. Kor.), available at <http://elaw.klri.re.kr/>.

⁶⁹ See RHIM, *supra* note 63, at 809-10; see also KWON, *supra* note 68.

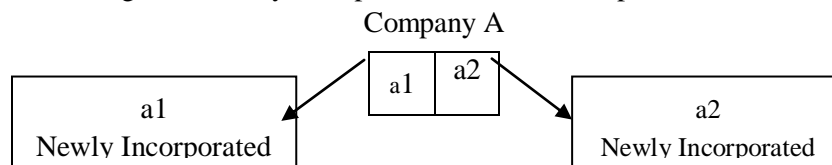
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A. *Simple Division, Merger by Split, Merger through a Newly Incorporated Division*

According to Article 530-2, clause 1 of the KCA, a company may be divided to form one or several new companies. This means a company can establish one or several companies through its division, which is called simple division.⁷⁰ Numerous scholars refer to simple division as: (i) new incorporated division; (ii) complete division; or (iii) extinguished division, since it has such diverse legal characteristics.⁷¹ In this case, the divided company's assets are partially transferred to the continuing company or the newly incorporated company with a comprehensive succession of assets without liquidation.

One company may divide to extinguish the existing "Company A" and newly establish "Company B" and "Company C" [Figure 1], while another company may divide to remain "Company A" and newly establish "Company B" with the detached part [Figure 2]. The former is different from consolidation or newly incorporated merger; it is also called a "simple division," "complete division," "extinguished division," or "new incorporated division."⁷² The latter is similar to an absorption merger; it is also called a "surviving division" or "incomplete division."⁷³ In both cases, the assets of the divided company are transferred to the newly incorporated company with there being a comprehensive succession of assets. Both parties must agree how much of a share the divided company shareholders shall acquire in return for transfer of the assets.⁷⁴

[Figure 1] Newly Incorporated Division; Complete Division



⁷⁰ In the United States, the use of a simple division form of corporate reorganization is the easiest and most direct method of creating a new corporation for purpose of taking over the unwanted assets of the parent corporation. See Howell C. Mette, *Spin-off Reorganization and the Revenue Act of 1951*, 8 TAX L. REV. 338 (1952-53).

⁷¹ See Jongho Kim, *A Study on the Type of Corporate Reorganization Plan* 172 (2003) (unpublished Ph.D. Dissertation, SungKyunKwan University) (on file with author).

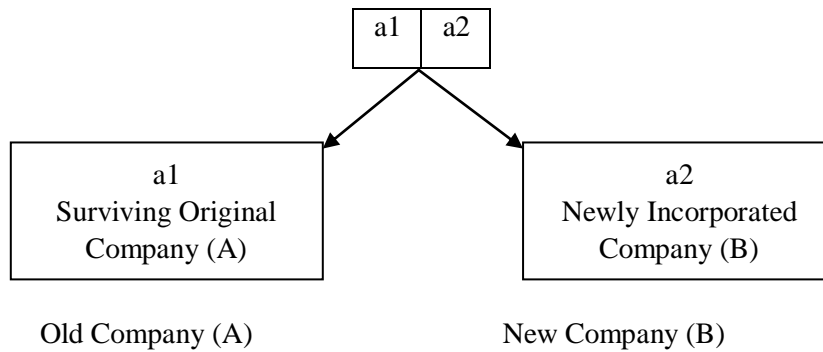
⁷² *Id.*

⁷³ *Id.*

⁷⁴ See RHIM, *supra* note 63, at 810.

New Company (B) New Company (C)

[Figure 2] Survival Division; Incomplete Division
Company A

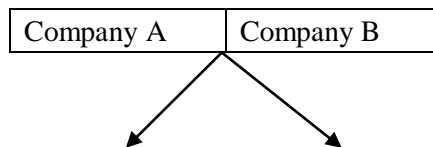


B. Merger by Split

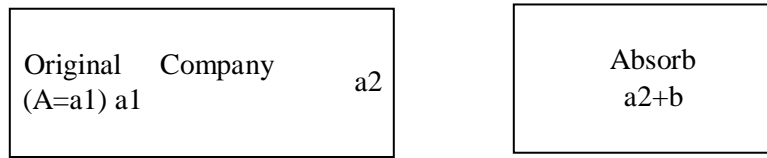
In a merger by split, the detached segment merges with another company or a part of another company to establish a new company. Article 530-2, clause 2 of the KCA provides that a company may merge with one or several existing companies through its division. This means that a company can merge and, at the same time, establish one or several companies through division, thus constituting a merger by split. Two models fall into this method of merger by split.

First, “Company A” with two business divisions, a1 and a2, divides to keep division a1, but transfer division a2 to “Company B.” In this case, Company A’s business division a2 merges with Company B [Figure 3].

[Figure 3] Merger by Split (Type I)



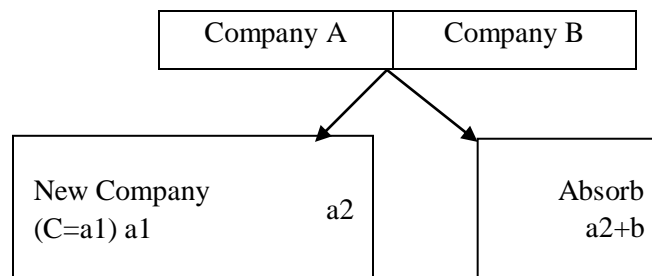
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Second, "Company A" with two business divisions, a1 and a2, divides to establish a new "Company C" from division a1 while having Company B absorb Company A's business division a2. In this case, Company A's business division a2 merges with Company B [Figure 4].

These two models are the same in that business division a2 is detached and merges with another Company B, but differ in that division a1 remains in the former [Figure 3] whereas it becomes new Company C in the latter [Figure 4].

[Figure 4] Merger by Split (Type II)

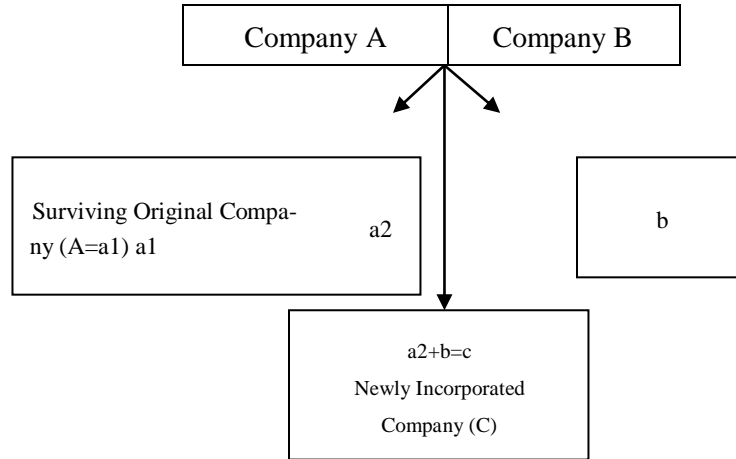


C. *Merger through Newly Incorporated Division*

According to Article 530-2, clause 3 of the KCA, a company may be divided to form one or several new companies, which, in succession, may merge with other existing companies. This means that a company can establish one or several new companies and undergo merger by split at the same time, which is called merger through newly incorporated division. In fact, this provision is the combination of Article 530-2, clauses 1 and 2 of the KCA. Three models fall into the category of merger through newly incorporated division.

First, "Company A" with two business divisions, a1 and a2, divides to remain division a1 and have division a2 join "Company B" to establish new "Company C" [Figure 5].

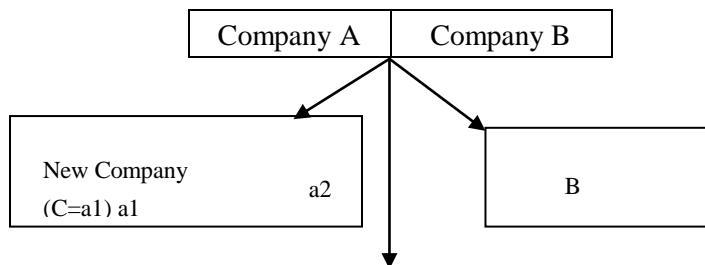
[Figure 5] Merger through Newly Incorporated Division (Type I)



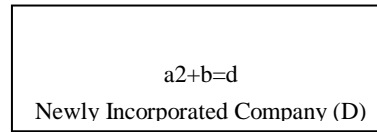
Second, "Company A" with two business divisions, a1 and a2, divides to establish new "Company C" from division a1 while division a2 joins "Company B" to establish new "Company D" [Figure 6].

In these two models, division a2 of "Company A" divides and joins (but is not absorbed by) "Company B" to establish "Company C" or "Company D." However, business a1 of "Company A" remains in the former, whereas it becomes "Company C" in the latter.

[Figure 6] Merger through Newly Incorporated Division (Type II)

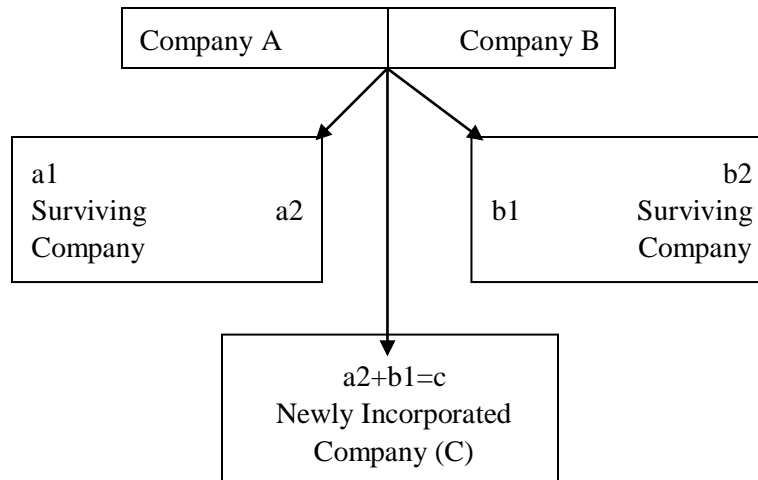


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Third, “Company A” with two business divisions, a1 and a2, divides to remain division a1 while division a2 joins division b1 of “Company B” with two business divisions, b1 and b2, to establish new “Company C.” In this case, division b2 of “Company B” remains in “Company B” as division a1 in surviving “Company A” after division [Figure 7].

[Figure 7] Merger through Newly Incorporated Division
(Type III)



D. *In Rem* Division

In *in rem* division under the KCA, the divided company acquires the total number of the new company’s shares due to a division or a merger by split.⁷⁵

The basic structure of *in rem* division is the same as if the the divided company continued to exist, but the shares of the new company are transferred directly to the divided company, rather than to its shareholders, as consideration for the division.⁷⁶ In this respect, *in rem* division is

⁷⁵ KCA art. 530-12.

⁷⁶ See Kim, *supra* note 27, at 82.

very similar to investment-in-kind or a business transfer that provides the newly incorporated company's shares to the transferor as consideration for the transfer.⁷⁷ However, it is quite different from either of them because: (i) it uses shares as consideration; (ii) a comprehensive partial succession for divided assets is natural under the law; and (iii) the successor of the divided assets must be a newly incorporated company.⁷⁸

V. DIVIDED FIRM'S SCOPE, ASSETS, AND DEBTS

Article 174, clause 1 of the KCA provides that "a merger of companies shall be permissible" and Chapter 4, section 11 of Part 3 of the KCA provides for "regulations for company division" based on the freedom of corporate division.⁷⁹ The KCA also specifies corporate division for stock companies and requires all companies (including divided companies, surviving companies, and newly incorporated companies) to be stock companies. The Corporate Reorganization Act ("KCRA") was applied only to stock companies,⁸⁰ but now under the DRBA the type of company is never a big issue in corporate division because any business organization can file a corporate reorganization proceeding, regardless of its type.⁸¹

A. Target Firm for a Spin-off

An issue is whether the target for a spin-off should be limited to stock companies or extended to other types of firms, such as a limited liability, partnership, or limited partnership company.⁸² The amended KCA from 1998 only considers stock companies. However, all companies, regardless of their legal nature (including individual merchants) also can be divided. It is acceptable to allow limited liability companies to divide in the same way as stock companies, so long as the general prin-

⁷⁷ See HUECK GÖTZ, GESELLSCHAFTSRECHT: EIN STUDIENBUCH 179 (18th ed. 1983). See also FRIEDRICH KÜBLER, GESELLSCHAFTSRECHT 179 (2d ed. 1985); see also KARSTEN SCHMIDT, GESELLSCHAFTSRECHT 303, 603 (4th ed. 2002).

⁷⁸ See RHIM, *supra* note 63, at 812.

⁷⁹ KCA art. 530(2)-(12).

⁸⁰ See Corporate Reorganization Act [KCRA], Act. No. 6627, Jan. 26, 2002, art. 1 (S. Kor.), available at <http://elaw.klri.re.kr/> (repealed March 31, 2006 and substituted by DRBA which took effect April 1, 2006).

⁸¹ See Debtor Rehabilitation and Bankruptcy Act [DRBA], Act. No. 7895, Mar. 24, 2006, art. 34(2) (S. Kor.), available at <http://elaw.klri.re.kr/>.

⁸² Germany's UmwG does not limit the spin-off's target firms to stock companies and refers to the target firms as an "entity of the right holder" or "receiver of the right holder" (*Rechtsträger*), not of the companies (*Unternehmen*).

principles in regard to stock corporate division are applied to them. When there are general partners who have unlimited liability in a partnership company and limited partnership company, the partner's liabilities become issues in these two types of company division.

If the partnership and limited partnership are divided into the same kinds of companies as their original nature, such issues can easily be solved. In reality, however, this is very unlikely in Korea. Thus, companies that are not stock companies do not often find it necessary to undergo division, and we may consider enacting new legislation solely for closely-held private partnerships and limited partnerships.⁸³ Accordingly, this article was limited to the division of stock companies.

B. *Assets to Be Divided*

The law provides that "assets" are the answer to dividing a company.⁸⁴ As specified by Germany's *Umwandlungsgesetz* ("UmwG") (Corporate Reorganization Act),⁸⁵ the subject of division basically includes all active and passive assets of the divided company, or all rights and obligations.⁸⁶ In reality, more companies would need to make investments using debts or passive assets for certain business divisions.⁸⁷ However, in a profit-earning organization, the subjects of corporate division include goods, rights, business relations, know-how, and intangible assets and it should be able to support the business management with itself.⁸⁸

According to Article 530-6, clause 1(6) and (7) of the KCA, Article 212, clauses 1(6), 2(3), and Article 213, clause 1(6) of the DRBA, the subjects of division are specified as: "property and the value thereof to be transferred by the company to be divided to the other party to merger by split." In this case, it seems as if a company shall divide its active assets

⁸³ See Bokki Hong, *Introduction of Corporate Division Regulations to the Commercial Law*, 17 COM. L. STUD. 347 (1998). Professor Hong argues that partnership and limited partnership companies should be excluded from corporate division as they are rarely used in the Korean economy.

⁸⁴ KCA art. 225-2(1.7), (2.3), 225-3(6).

⁸⁵ *Umwandlungsgesetz* [UmwG] [Corporate Reorganization Act], Oct. 28, 1994, BUNDESGESETZBLATT [BGBl. I] at vol I, § 126(1)9 (Ger.).

⁸⁶ See Hong, *supra* note 83, at 360 (commentator argues that "business assets" shall be the subjects of division as it is necessary to admit corporate division solely with the transfer of business assets).

⁸⁷ Division of certain active assets is also allowed. This would be seen particularly frequently in *in rem* division. See SCHMIDT, *supra* note 77, at 408-09.

⁸⁸ See ERNST GEBLER, WOLFGANG HEFERMEHL, ULRICH ECKARDT & BRUNO KROPFF, KOMMENTAR ZUM AKTIENGESETZ 113 (1973) (commentary on the German Stock Corporation Act).

and its liabilities, including debts. The “assets” in Article 530-6, clause 1(6) of the KCA shall be interpreted as an upper dimensional concept that includes all passive assets, including liabilities and obligations.

Here, the important point is that the main purpose is to specify the assets that are the subject of a partially and comprehensively transferred to the surviving or newly incorporated company by the reorganizing corporate division in the plan of reorganization. Therefore, the issue is not whether active and passive assets can be stated on a balance sheet.⁸⁹ Thus, intangible assets⁹⁰ including other companies’ shares and patent rights become subject to division as long as they are transferable, with continuous contract relationships and immovable legal relations, such as employment contract, may also be included.⁹¹ Legal rights and obligations under the public law such as tax law are also included as long as they are transferable.⁹² The following are specific issues that are apt to arise in reorganizing company division.

1. Rights of Trade Name

The firm’s trade name is an indication of its merchant status.⁹³ In reality, however, it works as the name or brand name of the company.⁹⁴ The trade name is usually used for a long period of time and represents the company’s reputation. The trade name is not only an indication of the company’s reputation,⁹⁵ but also represents a certain standard of quality and reliability for the consumer⁹⁶ that distinguishes a company’s prod-

⁸⁹ See PRIESTER, in LUTTER (Hrsg.), UmwG, §126 n.33; see also HANS DEHMER, UmwG, §126 n. 60.

⁹⁰ See 3 JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ A3.07 (1992) (Intangible property rights, patent rights, trademarks etc. are validated and designated by law and will be returned to a joint asset after the protection period has passed. In case of a corporate division, intangible property rights whose protection period has not expired become the subject of division.).

⁹¹ See DEHMER, *supra* note 89, at UmwG §126 n.61.

⁹² *Id.* §126 n.96.

⁹³ KCC art. 18 (“[A] merchant may use his full name or any other denomination as his trade name.”).

⁹⁴ *Id.* art. 19 (“The word ‘partnership company’, ‘limited partnership company’, ‘stock company’ or ‘limited liability company’ shall be contained in the trade name of a company according to its nature.”). *Id.* art. 20 (“No person other than a company may use, in the trade name, any word which is suggestive of a company. This shall apply even in cases where the business of a company has been acquired by transfer.”).

⁹⁵ *Id.* art. 23(1) (“No person shall, for unfair purpose, use any trade name which is likely to induce others to believe that it represents the business of another person.”).

⁹⁶ *Id.* art. 24 (“A person, who has allowed another person to carry on business using his name or trade name, shall be liable jointly and severally with such other person to ef-

ucts and services from those of other companies.

In a complete corporate division, the divided company and its trade name are abolished because the original company is extinguished. However, the trade name holds economic value as property and can be adopted by the new company.

In *In re Haitai Confectionary Inc.*, the company's trade name was transferred along with the business rights of the confectionary division to Haitai Confectionary & Foods Co., Ltd.⁹⁷ Although this was not a division of a reorganizing company, the same issues arise here as to which company shall succeed to the trade name when a company is divided into several companies and what amount of consideration should be given for a trade name.

The KCA provides that a trade name may be transferred only in cases where the business is discontinued or the name is transferred together with the business.⁹⁸ However, this rule cannot be applied to corporate division as it differs from a business transfer.⁹⁹ In a complete division or merger by split, because the divided companies' businesses are closed, the newly incorporated companies can adopt the extinguished company's name with no difficulty.

Germany's UmwG section 133(1) provides that Article 25 of the Handelsgesetzbuch ("HGB") (German Commercial Act) specify that the liability of a business transferee who succeeded to the transferor's trade name and business is still applicable to corporate division and that the newly incorporated company may be responsible for such liability.¹⁰⁰

fect performance in respect of any obligation arising from a transaction in favor of a third person who has effected such transaction in the belief that such other person was the proprietor of the business.").

⁹⁷ *In re Haitai Confectionery & Food, Co., Ltd.*, Bankruptcy Seoul Central District Court [Bankr. Seoul Central Dist. Ct.], 2001Hoi5., Aug. 29, 2001 (S. Kor.). At that time, Haitai Confectionary Inc. transferred its title and Confectionary Division to Haitai Confectionary & Foods Co., Ltd.

⁹⁸ KCC art. 25(1).

⁹⁹ Xuan-Thao Nguyen, *Selling it First, Stealing it Later: The Trouble with Trademarks in Corporate Transactions in Bankruptcy*, 44 GONZ. L. REV. 1, 27 (2008) ("Under the use grant, the purchaser had no right to use the trademark outside of the defined scope and the seller could not use the trademark within the field of use The seller retained ownership and right to the trademark and could continue to use the trademark in other businesses outside the spin-off division.").

¹⁰⁰ See UmwG at vol I, § 133(1) (This section regulates the creditor and owner protection from the shareholder right (Schutz der Gläubiger und der Inhaber von Sonderrechten)).

2. Lease

When a company intends to invest its lease rights in another's real estate in the course of a division, it needs approval from the lessor because the Korean Civil Code ("KCC") requires that companies obtain lessor approval when they assign or sublease their rental rights.¹⁰¹

With an approval, the lease rights in the lessor-owned property can be used and acquired by the newly incorporated company,¹⁰² but the divided company cannot be divided because it cannot invest those rights without the lessor's approval.

In France, the divided company's lease rights in its real property are succeeded to by the newly incorporated acquiring company without alteration.¹⁰³ In this case, however, the lessee can object to the division as a creditor in a corporate division.¹⁰⁴ It is, however, uncertain whether this rationale can be inferred from the Korean Civil Code.

3. Mortgage

It is obvious that company-owned real property constitutes a business asset and becomes the subject of investment in a corporate division.¹⁰⁵ However, the issue is the relationship between a mortgagor and mortgagee when real property is seized by a mortgage holder (mortgagee). The mortgagee of a reorganizing company becomes a secured creditor.

A mortgagee is entitled to obtain satisfaction of its claim out of the collateral that has been furnished by the debtor or by a third person guarantor as security ahead of other creditors without transferring its possession.¹⁰⁶ Accordingly, a company may be divided without the consent of a mortgagee. However, when a secured right is succeeded to by another company via corporate division, the mortgage follows because a common trait of a secured right is that the mortgage accompanies its related

¹⁰¹ KCC art. 629(1).

¹⁰² See MICHEL DE JUGLART, *COURS DE DROIT COMMERCIAL* [Commercial Law] 163 (2d ed. 1967).

¹⁰³ *Id.* at 167.

¹⁰⁴ See France *Cours de Droit Commercial* § 262. Décret § 68-857 (Oct. 3, 1968) [hereinafter Decree].

¹⁰⁵ ARTHUR SULLIVAN & STEVEN M. SHEFFRIN, *ECONOMICS: PRINCIPLES IN ACTION* 272 (2d ed. 2003) (In accounting, business assets are listed on the firm's balance sheet as items of ownership and can be easily converted into cash.).

¹⁰⁶ KCC art. 356.

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liability.¹⁰⁷

A reorganization plan that provides for corporate division shall include a statement regarding the survival and treatment of the mortgagee's claim as a secured claim. In the case of corporate division, payments of the investments for the divided company's shareholders are preceded by issuing new shares and distribution of dividends are only made to shares.¹⁰⁸

When conveying real property in a business transfer that is economically equivalent to a corporate division, the acquiring company can make installment payments, along with the payment of operational income, on an installment basis. In this respect, a business transfer can sometimes be equivalent to an undisclosed association.¹⁰⁹ In the case of corporate division, however, a disguised lease or undisclosed business association never occurs.

4. Business Rights

Many businesses can begin operations only after they receive government or other permission in the form of a license or certificate, which constitutes a business right. These business rights are an element of a company's business assets and are treated in accounting as an intangible fixed asset.¹¹⁰ However, when a company spins-off its business department and requires the business license or certificate be transferred to others, the issue of whether the acquiring company must obtain a new license or certificate becomes an important issue. Thus, it is recommended that a reorganizing company spinning off a corporate division should state this issue in the reorganization plan along with how this will be handled.

¹⁰⁷ This principle is called "Akzessorietät" in Germany. Even though there is no precise English equivalent, one may translate the German term "Akzessorietät" in English as "accessoriness."

¹⁰⁸ See Seoul District Court [Seoul Dist. Ct.], 98Pa4302, June 28, 2002 (S. Kor.) (However, in the case of an *in rem* division, the divided company, not its shareholders, acquires the newly incorporated company's issued shares. *In re Hunex Inc.*, Seoul District Court followed this process.).

¹⁰⁹ KCA art. 78 ("An undisclosed business association is formed when the parties agree that one of them shall make a contribution toward the business of the other and they shall divide any profits accruing from such business.").

¹¹⁰ The International Accounting Standards Board (IASB) offers some guidance as to how intangible assets should be accounted for in financial statements. See DELOITTE GLOBAL SERVICES LIMITED (2010), International Accounting Standard (IASB) 38, <http://www.iasplus.com/standard/ias38.htm>.

5. Rights and Obligations Including a No-Conveyance Covenant

An issue also exists as to how to treat a divided company's rights and obligations that are prohibited or restricted by statute from free transfer or other disposal.¹¹¹ These rights and obligations can be seen in the case of a limited liability company's membership share conveyance,¹¹² assignment of nominative claims,¹¹³ assignment of lease or sublease,¹¹⁴ and transfer of employment contracts.¹¹⁵

If a divided company owned shares in a limited liability company or otherwise restricted stock and intends to transfer them to the acquiring company as a part of its division of assets, it must acquire approval from the limited liability companies' general members' meeting or a resolution from a board of director's meeting.¹¹⁶ The theory of merger cannot be directly applied to corporate division because divided companies may survive in an incomplete division. Also, even though the divided company is extinguished in a complete division, the acquiring company may succeed to their rights and obligations by split. Thus, this is quite different from merger in that the surviving or new company succeeds to all the dissolved company's rights and obligations.

Germany's UmwG §132 provides that general prohibitions and restrictions under the statute apply to most corporate division cases, except those in which the divided company is extinguished, whereas Article 17, clause 1(a) of the EC Corporate Division Guidelines specifies that a partial comprehensive succession applies in corporate division, but that these kinds of restrictions are not applied to corporate division.¹¹⁷

Germany's UmwG, which applies the general statute's restrictions to corporate division, also includes an exception in that the restrictions are not applied to restrict certain transfers, such as allowed transfers according to nature of its subject or agreed transfers by both parties when a

¹¹¹ It was a mistake of the legislation that the drafters relied on interpretations rather than specifying these issues concerning corporate division. Some insist that the partially inclusive succession of EC Corporate Division Guidelines shall be applied to businesses that do not require a license or certificate. See GIBEOM KWON, CORPORATE RESTRUCTURING LAW 333-34 (2d ed. 1999).

¹¹² KCA art. 556.

¹¹³ KCC art. 449.

¹¹⁴ KCC art. 629.

¹¹⁵ *Id.* art. 657.

¹¹⁶ KCA art. 556, 335(1).

¹¹⁷ See Council Directive 82/891, art. 17(1)(a), 1982 O.J. (L 378) 47-54 (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31982L0891:EN:NOT>.

divided company is extinguished.¹¹⁸ Furthermore, many scholars severely condemn these restrictions¹¹⁹ imposed by the legislative process as they interfere with corporate division.¹²⁰ To actively utilize the corporate division system that is grounded on the comprehensive succession of a divided company's assets, regardless of the divided company's extinguishment or continuation, related restrictions in the laws shall specify that these prohibitions and restrictions are not applicable. Division or merger by split agreements or division reorganization plans should clearly state all related issues to prevent misunderstandings.¹²¹

6. Credit Transaction Relation

A credit transaction relationship is the outcome of business operating activities. It is a factual relationship with others (i.e., goodwill) with established property value, but it is neither a right nor an obligation. The credit relationship brings more profit as compared to competitors with the elements of business as an organizational unit including number of clients or customers, quality of clerks, know-how (techniques or business strategies), years since incorporation, leadership and management quality of the CEO, quality of subsidiary company or suppliers, and quality of sales agencies. Eventually the credit relationship corresponds to the number of customers.

Each company can create its own elements or acquire them from other companies by payment or through a merger. The KCA provides that the value of business rights shall be admitted in both types of acquisition and must be repaid within five years.¹²²

People debate the question of whether the credit transaction relationship, which is only an abstract one, should be called a business right,¹²³ or whether, their overall value should be measured when corporate assets are comprehensively transferred in a merger, including each individual property and credit relationship. In case of corporate division, credit transaction relationships can be considered a subject of investment through an appropriate evaluation.

¹¹⁸ See UmwG at vol I, § 132.

¹¹⁹ See DEHMER, *supra* note 89, §132 n.1; See also KWON, *supra* note 111, at 333.

¹²⁰ See ARNDT TEICHMANN, in LUTTER (Hrsg.), UmwG, §132 n.12.

¹²¹ See KWON, *supra* note 111, at 333-34 (however, Professor Kwon argues that these restrictions are not applied to mergers and divisions).

¹²² See KCA art. 452(6).

¹²³ See Kim, *supra* note 71, at 180.

7. Non-Substitute Obligations

Non-substitute obligations include the obligation that a divided company respond to warrant holders' exercise of their rights if the divided company issued bonds with warrants to subscribe to new shares¹²⁴ along with a divided company's obligations to respond to stock-option holders' (for example, optionees such as directors, auditors, or other employees who will be able to contribute to the promotion of its incorporation and management, technological innovation, etc.) exercise of their option rights.¹²⁵

The acquiring company can succeed to these non-substitute obligations as stated in the division or merger by split agreement or reorganization plan when a corporate division is based on comprehensive succession. This is because it is beneficial for rights holders to say the acquiring company succeeds to non-substitute obligations instead of those obligations being extinguished by a division. Thus, it is reasonable to have this type of specification in the legislation.

Germany's UmwG and EC Corporate Division Guidelines guarantee the same rights to special rights holders against the acquiring company who also charged non-substitute obligations other than stock.¹²⁶

C. *Divided Company's Debts*

In case of corporate division, debts as well as assets become the subject of division and the issue arises as to how the acquiring company shall succeed to them.¹²⁷

It is necessary to state in the division plans the list of passive property that is transferred to the acquiring company and its appraised value. Article 254, clause 2(3) of France's Commercial Corporation Law Enforcement Decree¹²⁸ refers to the decision of the original division plan and its required items when describing "assets, debts, and its appraised values that are transferred to merged company (merger), acquiring company (division), or new incorporate company (merger or division)."¹²⁹

¹²⁴ KCA art. 516-5(1).

¹²⁵ *Id.* art. 340-4.

¹²⁶ UmwG at vol I, § 125; *see also* Council Directive 82/891, art. 17(1)(a), 1982 O.J. (L 378) 47-54 (EC).

¹²⁷ *See* Stanley Siegel, *When Corporations Divide: A Study and Financial Analysis*, 79 HARV. L. REV. 534-35 (1965-66) (in the United States, the transfer of debts from the divided company to another business sector is prohibited).

¹²⁸ Decree § 67-236.

¹²⁹ Decree § 1468-25 (short-term liabilities or secured claims as well as debts not

Another question is whether it is acceptable to leave the transfer of debts to the agreement of the two companies. In corporate division, this issue differs from what happens in a merger. In the case of a merger, the rights and obligations are always transferred to one company; in a corporate division, they are distributed to several companies. Therefore, it is necessary in the division plan or in additional specifications to state which part of the debts are transferred to which company.

Article 254, clause 2(3) of the France Commercial Corporation Law Enforcement Decree requires that only the company that is divided furnish specifics on transferred debts. However, when dividing a company, transfer of debts shall be consistently stated for both the divided and acquiring companies in order to protect the shareholders and claim holders of the related companies.

When interpreting the KCA, the question of whether divided companies' active assets or debts can only be the subject of division or merger by split is often raised. This is a bigger issue in case of *in rem* division, where a company to be divided acquires the total number of shares of a company to be incorporated due to a division or a merger by split. Although the division system essentially involves only a partially comprehensive succession, it should be permitted as the KCA does not prohibit individual division of active assets. However, division of individual debts is not permitted under the doctrine of capital adequacy.¹³⁰

In *In re Hanshingongyeong Inc.*, the reorganizing company's unsecured claims were divided using the construction and distribution divisions' asset ratio (division ratio).¹³¹ Only unspecified debts and guarantee claims remained with the other part of the company.

The draft of the German UmwG had prohibited the split of individual assets, but eventually deleted this provision in the legislation.¹³²

specified in the balance sheet shall be stated in the division plans or additional specifications.).

¹³⁰ If one has planned to divide the firm, but wanted to apply an extremely unbalanced ratio of individual debts division, it will be against the doctrine of capital adequacy. In the U.S., one industry leader argues that "capital adequacy is one of the most important but by no means the only important prudential rule." However, "it is clear that the application of the Basel II capital-adequacy rules by the SEC - which allowed 40 to 1 leverage, and accordingly, extremely low capital requirements for investment banks - was seriously wrong." See Eugene A. Ludwig, *Smart Regulation for Financial Markets* (Jan. 15, 2009), <http://www.ppionline.org/ndol/print.cfm?content-id=254854>.

¹³¹ See Kim, *supra* note 27, at 137-38 (stating the effect of corporate division by quoting French cases).

¹³² See KWON, *supra* note 111, at 312; see also Teichmann, *supra* note 120, § 123 n. 8.

However, Article 15, clause 1, paragraph 1, and Article 11 through 13 of the German Umwandlungssteuergesetz (“UmwStG”) (Corporate Reorganization Taxation Act) offers tax deferral benefits only when at least a “business division” is divided and the division of individual assets is quite restricted.¹³³

VI. SPIN-OFF PROCEDURE FOR A REORGANIZING COMPANY

A company after dissolution may be divided or merged through division only when an existing company becomes the surviving company or a new company is to be incorporated by such division or merger by split.¹³⁴ Considering that a company is not extinguished even after dissolution, but may continue its business for purposes of liquidation or otherwise, in the case of dissolution, the company may continue to exist with the consent of all or even some of the members. However, after its dissolution, a company may be involved in a merger only if it is merged into an existing company and the latter company survives the merger. Thus, in those cases, the KCA allows division or merger by split.¹³⁵ Accordingly, the KCA’s application of *mutatis mutandis* to merger regulation is often used for corporate division.¹³⁶

In the case of business division in a corporate reorganization proceeding, the KCA’s articles on corporate division are applicable. However, regulations regarding public disclosure regarding the balance sheet in division,¹³⁷ dissenting shareholders’ appraisal rights,¹³⁸ creditor protection procedures,¹³⁹ actions for nullification of division,¹⁴⁰ bondholders’ objections to capital reduction,¹⁴¹ and protection of creditors under the

¹³³ See PRIESTER (Hrsg.), *supra* note 89, at n.34 (Business division in the UmwStG is not a sales agency in the KCA, but a concept in the Labor Act. It is a unit through which an entrepreneur can pursue a certain purpose through tangible and intangible facilities).

¹³⁴ KCA art. 530-2(4).

¹³⁵ *Id.* art. 174(3).

¹³⁶ *Id.* art. 530-11.

¹³⁷ *Id.* art. 530-7 (When a reorganizing company divides, the one who file the plan of reorganization must include provisions concerning corporate division and merger by split with the court, then provide public notification of the date of the meeting of interested persons in a daily newspaper, and serve the letter of convocation to major secured and unsecured creditors, etc.).

¹³⁸ See Securities and Exchange Act, Act No. 972, Jan. 15, 1962, art. 191 (S. Kor.); KCA art. 274-2, 522-3.

¹³⁹ KCA art. 530-9(4).

¹⁴⁰ *Id.* art. 237-40, 374(2), 529.

¹⁴¹ *Id.* art. 439(3).

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KCA are not applicable for the same reasons that apply to merger.¹⁴² Nevertheless, regulations concerning the other party to a merger by split are not affected.

A. *Procedure for Reorganizing a Firm's Division and Merger by Split*

1. Schedule of Division and Merger by Split

When scheduling a division or merger by split in a corporate reorganization proceeding, various time periods designated by law shall be met and the company is permitted only a certain length of time to accomplish its objective. However, scheduling within the maximum or minimum length of a given time is not restricted.

According to the KCA, creditors can take more than a month to submit objections or stock certificates.¹⁴³ The notice for convocation of a general meeting shall be communicated in writing or electronically to each shareholder at least two weeks prior to the day set for such meeting at which the division plans or merger by split agreements will be approved.¹⁴⁴

The DRBA does not specify anything about the scheduling of division or merger by split. Therefore, when a reorganizing company divides, it must go through a special process under the DRBA. In other words, a reorganization plan on corporate division can process a division with an examination and resolution from the meeting of interested persons and the bankruptcy court's approval. In this case, creditors (including secured and unsecured creditors, common benefit claim holders, etc.) and shareholders, who think their interests or rights are being impaired, may object to the division and merger by split at the meeting of interested persons or file a petition objecting to approval of the reorganization.¹⁴⁵

2. Drafting of Division or Merger by Split Memorandum and Approval of Division or Merger by Split Plans

When a company divides, it needs to prepare a division or merger by split plan. New companies and merger by split companies often exchange a memorandum after preparing the division plan. This document

¹⁴² *Id.* art. 527-5.

¹⁴³ *Id.* art. 530-11, 527-5(1), 440.

¹⁴⁴ *Id.* art. 530-3(3).

¹⁴⁵ It should be noted that “[s]mall, as well as large, corporations can use spin-offs to create additional value for shareholders.” See Hagan, *supra* note 53, at 1.

contains basic provisions concerning division or merger by split or important matters that are not specified in the division or merger by split agreement.¹⁴⁶

Exchange of a memorandum of division or merger by split is not mandatorily required, and whether any memorandum shall bind the receiver or the representative directors of related companies or at least have ethical implications, shall be decided by the related parties and circumstances. However, the forum court handles a reorganizing company's division and the receiver is authorized to manage all procedures with the court's approval.

An ordinary company needs approval from the shareholders' meeting in order to validate a division plan or merger by split agreement.¹⁴⁷ However, when a reorganizing company divides, the division plan or merger by split agreement shall be approved by the bankruptcy court instead and reflected in the reorganization plan.

3. Preparation of Division Plan

Article 530, Clause 5 of the KCA provides for the preparation of two kinds of division plans: establishment of a new company¹⁴⁸ and continuation of business.¹⁴⁹

4. Privileges of Incorporation through Corporate Division

Article 530-2 of the KCA specifies two types of incorporation: establishing a new company through corporate division (incorporation by split) and creating a merger by split through the establishment of a new company (incorporation merger by split). When a new company is incorporated, Chapter 4, Section 1 of Part 3 of the KCA's doctrine of *mutatis mutandis* applies.¹⁵⁰

¹⁴⁶ It must contain: purpose of the division or merger by split, method of division or merger by split (i.e., will the company be absorbed or a new company established?), trade name of the new company, cost of division, division and transfer of unsecured claims and secured claims, grant to merger by split, executive personnel and their rewards, succession of employees, initiation of a general meeting for the approval of division or merger by split, and the date of division or merger by split.

¹⁴⁷ KCA art. 530-3(1).

¹⁴⁸ *Id.* art. 530-5(1).

¹⁴⁹ *Id.* art. 530-5(2); *see also* Debtor Rehabilitation and Bankruptcy Act [DRBA], Act. No. 7895, Mar. 24, 2006, art. 225(2), 213 to 215 (S. Kor.) [hereinafter DRBA], available at <http://elaw.klri.re.kr/>. (regarding for the division of the reorganizing company, merger by split, *in rem* division, and establishing a new company).

¹⁵⁰ KCA art. 530-4(1).

When a company is established by division, it falls into a type of investment-in-kind. Therefore, the company must undergo an investigation and the investigators must produce a report pursuant to Article 299 of the KCA. As court intervention is also required in the division process, the procedure can become complex; however, this investigation is omitted when the divided company distributes new shares according to the previous ratio of shares.¹⁵¹

When a reorganizing company divides, the bankruptcy court supervises and instructs the process. It arranges for the bankruptcy investigators' onsite investigation and guarantees interested persons' rights even without a private investigator. In this respect, the DRBA exempts application of the Article 299 of the KCA concerning the investigation and report of investigators for a reorganizing company's division or merger by split.¹⁵²

B. Shareholder Meeting and Interested Persons' Resolution for Spin-off

When a reorganizing company divides, its reorganization plan requires an examination and vote and a meeting of interested persons shall be held.¹⁵³ In this case, secured and unsecured creditors and shareholders can vote for the approval of the reorganization plan and its provisions on corporate division. Unlike the division of an ordinary company, however, shareholders cannot exercise their voting rights if the company's debts exceed its assets.

Executive directors of the company that merges by split with a reorganizing company must submit division plans and the merger by split agreement as well as obtain approval at the shareholders' meeting.¹⁵⁴ The other party must obtain approval at the shareholders' meeting via a resolution by supermajority.¹⁵⁵ In the special resolution meeting, even shares that do not normally have voting rights are given special ones.¹⁵⁶ If the other party's shareholders are unduly burdened by the reorganizing company's merger by split, then the other party must obtain approval from all such shareholders in addition to a resolution.¹⁵⁷

¹⁵¹ *Id.* art. 530-4 (2).

¹⁵² DRBA art. 274(1) to (2).

¹⁵³ *Id.* art. 224, 232.

¹⁵⁴ KCA art. 530-3(1).

¹⁵⁵ *Id.* art. 530-3(2), 434.

¹⁵⁶ *Id.* art. 530-3(3), 370(1).

¹⁵⁷ *Id.* art. 530-3(6).

Where a company, which issued several classes of shares, inflicts a loss to a class of shareholders due to division or a merger through division, the division or merger through division must be approved by such shareholders at a general meeting pursuant to Article 435 of the KCA.¹⁵⁸ Where the shareholders' liability of each company involved in the reorganizing company's division or merger by split is to be increased due to such division or merger by split, such division or merger by split shall be approved by all of such shareholders in addition to a resolution.¹⁵⁹

C. Protection of Dissenting Creditors and Shareholders to a Spin-off

1. Creditor Protection

In the case of an ordinary company, those companies that are incorporated or continue to exist due to a division or merger through division shall be jointly and severally liable to satisfy the debts of the company existing before the division or merger through division.¹⁶⁰ The purpose of joint and several liability is to prevent damaging the creditors' rights after a division or merger by split.

This is more similar to §133 of Germany's UmwG than to the EC Corporate Division Guidelines' Article 12, Clause 6. The subject of joint and several liability is the divided or newly incorporated company. Accordingly, the newly incorporated company has responsibility without liability for the debts that are transferred to it. This is similar to the status of a guarantor who pledges property or a third party who acquires real property subject to a mortgage because the new company holds a liability for payment, but no liability for the underlying debt. Thus debts and liabilities are separated in this case and a party other than the debtor holds the liability.

There are two cases in which joint and several liability of a new or continuing company is exempt from the regulations. First, where a company to be divided incorporates another company by means of division, upon a resolution at a general shareholders' meeting, it may be determined that the incorporated company bears only the debts related to the property invested in it. The general meeting shall be adopted by the affirmative vote of no less than two-thirds of the voting rights of the shareholders present at the general meeting and of at least one-third of the to-

¹⁵⁸ *Id.* art. 530-3(5).

¹⁵⁹ *Id.* art. 530-3(6).

¹⁶⁰ *Id.* art. 530-9(1).

tal issued and outstanding shares. In this case, if the company to be divided continues to exist after the division, the company shall bear only the debts, which the company incorporated due to the division's failure to repay.¹⁶¹ Although it is problematic because only shareholders have the right to decide this matter as they do not need the consent of secured and unsecured creditors, it could be a very useful exemption method.

Second, in the case of a merger by split, a company to be divided may, upon a special resolution of shareholders, determine that it bears only the debts related to property, which an existing company financed, due to it being invested in it by the merger by split. In this case, if the company to be divided continues to exist after the division, the company shall bear only the debts, which the company fails to repay.¹⁶²

The issue of whether the divided company shall be responsible for the debts that are transferred to the new company with joint and several liability depends upon whether it continues its business. The divided company is not responsible for the debts it takes over even if it continues the business because it is in essence a corporate division. Thus, the divided company is solely responsible for what remains within it. If not, division is too burdensome and it does not balance to the case when the divided company is extinguished.¹⁶³

The debts of the divided company are transferred to the continuing or new company as specified in the merger by split agreement or division plan, and the new company becomes the principal debtor of the transferred debts. Therefore, the major debts of the divided company should decrease even if it survives. However, if this is so, for which debts shall the new company bear joint and several liability? Article 530-9, Clause 1 of the KCA states that joint and several liability shall be established for "the debts of the company before the division or merger by split."¹⁶⁴

If we conclude that all acquiring companies shall bear joint and several liability for the debts of the continuing company by division, the

¹⁶¹ *Id.* art. 530-9(2).

¹⁶² *Id.* art. 530-9(2) to (3).

¹⁶³ See KWON, *supra* note 111, at 366-67 ("Article 530-2 Clause 2 Paragraph 2 of the KCA which provides that if the company to be divided continues to exist after the division, the company shall bear only the debts which the company incorporated due to the division fails to repay) causes unnecessary misunderstandings.").

¹⁶⁴ See KCA, art. 530-9(1) (This provision is also very unclear and may cause arguments. It can be interpreted in three ways: (i) a divided company's existing debts that remain with the company; (ii) a divided company's existing debts that remain with the company and debts that are succeeded to the acquiring company after a division; or (iii) existing debts of acquiring companies. Interpretations (i) and (ii) are logically persuasive and valid, with (i) being the closest to the core of the provision.)

new company shall bear joint and several liability for “the whole debts of all divided companies that invested in it” in the case where several companies are divided at once. If the divided company is extinguished, it holds no responsibility for its own debts and other new companies’ debts, regardless of whether those debts were succeeded from the divided company or were already held.

There is no limitation with regard to the divided company’s debts that are subject to joint and several liability. Moreover, the underlying basis on which the debt was incurred is a factor, and debts are not always limited to monetary ones.¹⁶⁵

In this respect, §133 of Germany’s UmwG uses the term *obligation* (*Verbindlichkeit*) instead of *debt* (*Schuld*). However, obligations and debts are more or less equal concepts under the KCA. The subject of joint and several liability eventually includes the obligation to compensate for unlawful acts and misfeasance, return unjust enrichment, and pay taxes. It should not matter whether debts were to be repaid at the time of division or whether they were principal debts, surety obligations, or secured claims on notes.¹⁶⁶ As for repayment, offers of security, or trust obligations for which a divided company must take responsibility in case its creditors make an objection, these become the subjects of joint and several liability if they remain with the divided company after division.

This issue becomes more complicated for non-substitute obligations. As mentioned above, these obligations include those involving forbearance such as observing a covenant not to compete or affirmative ones such as to respond to a warrant holder’s exercise of its right,¹⁶⁷ to perform on contracts when shareholders practice their stock option rights,¹⁶⁸ or to deliver specific request. In particular, a company in these situations never succeeds to a covenant not to compete because of its nature. What happens in case of a comprehensive succession such as a corporate division? If the divided company continues its business, it is responsible for observing the negative covenant.

Some commentators argue it is unnecessary to distinguish these obligations from general obligations,¹⁶⁹ but if they are unmet, the new company bears joint and several liability to compensate for any losses.¹⁷⁰

¹⁶⁵ See DEHMER, *supra* note 89, § 133 n.3.

¹⁶⁶ See *id.* § 133 nn. 7-8.

¹⁶⁷ KCA art. 516-5(1).

¹⁶⁸ Korean Stock Exchange Act, art. 189-4(3)1-5. Act No. 8985 (Mar. 21, 2008).

¹⁶⁹ See DEHMER, *supra* note 89, § 133 n.4.

¹⁷⁰ See Hommelhoff, *in*: Lutter (Hrsg.), *UmwG*, § 133 n. 25. (acquiring companies

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However, a divided company's debts, which require joint and several liabilities, must exist before the registration of the division. Requiring the new company to bear joint and several liability for debts arising after registration would be excessive protection of the divided company's creditors and is decidedly against the principle of equity. However, as to debts created before registration, no dispute arises as to whether the debt was due for repayment at the time of registration or whether the new company knew about it.

The new company's joint and several liabilities for the remaining debts of the divided company can be exempted under the agreements. When this joint and several liability is waived, the new company is only responsible for the debts to which it comprehensively succeeded from the divided company. If the shareholders' meeting approves the merger by split agreement or division plan, which states that the new company is responsible only for these debts to which it succeeded, the new company is exempt from any joint and several liability.¹⁷¹

However, when this exemption is applicable, it is more important to protect the divided company's creditors. In this matter, the KCA allows creditors the right to submit objections in cases of both simple division and merger by split.¹⁷²

In the corporate reorganization process, the exception for joint and several liability can be made valid by specification in the division or merger by split agreement, by being reflected in the corporate reorganization plan, by being examined and resolved at the meeting of interested persons, and by being approved by the court.

2. Dissenting Shareholders' Appraisal Rights

Generally, the appraisal right is the original right of shareholders who opposed certain resolutions that would change a company's legal foundation or cause critical economic impact to the corporation. Therefore, even the bylaws cannot take this right away. While shareholders of a reorganizing company do not hold appraisal rights in the corporate di-

cannot have responsibilities that are equal to a divided company's non-substituted obligation, such as responding to its employees' stock option rights, they shall hold a joint and several liabilities to provide compensation via the difference of share price.). *See also* KWON, *supra* note 111, at 371.

¹⁷¹ KCA art. 530-9(2) to (3).

¹⁷² *See id.* art. 530-9(4), 530-11(2) (Even in a simple division, the divided company's creditor has an exception to submit objections.).

vision process in Korea,¹⁷³ if the other party to the merger by split is an ordinary company, shareholders who oppose its division and merger can exercise their appraisal rights.

Conflicting opinions exist regarding the appraisal right in Korea. The appraisal right is given to shareholders, who meet certain qualifications and can be exercised without the company's consent. It is called a formative right that stems from the right-holder's notice.¹⁷⁴ Therefore, when a shareholder intends to use an appraisal right, he or she automatically builds a legal relationship that is equal to purchasing stocks from the company of minority shareholders who dissent to a merger by split.¹⁷⁵ Some commentators have argued that this system was created from the viewpoint of fairness rather than the legality of division and merger,¹⁷⁶ while others contend it is uncertain whether this legislation serves to protect minorities or to comply with the given law based on existing data.¹⁷⁷

In Korea, the purpose of this system is to protect the minority from the majority shareholder's oppression.¹⁷⁸ Some also argue that shareholders' appraisal rights for minority must always be the normative model in the process of corporate's final decision making when a closely-held corporation, which has generally no freedom of stock transfer, intends to divide because of internal troubles among shareholders.¹⁷⁹

In reality however, appraisal rights are never admitted when a reorganizing company includes a division in its reorganization plan. In most bankruptcy reorganization cases in Korea, the rights of the minority shareholders are completely ignored. For example, in *In re Hanshingongyeong Inc.*¹⁸⁰ and *In re Hunex Inc.*, both corporate division cases,¹⁸¹ the appraisal right is not even mentioned in either the division or reorganiza-

¹⁷³ This statement is authenticated by the fact that after payments are made for the shares, the value of the corporate assets of the divided corporation would not equal the total amount of the secured claims and unsecured registration liabilities of the corporation.

¹⁷⁴ See KIWON CHOI, *THEORY OF COMMERCIAL LAW* 522 (1998).

¹⁷⁵ See TAERO LEE & CHEOLSONG LEE, *CORPORATIONS* 543 (5th ed. 1997). See also SITORI EISONU & HOSHIKAWA CHOSHICHI, *CORPORATION LAW I* 203 (1984).

¹⁷⁶ See MELVIN ARON EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* 75 (Beard Books 2006) (1976).

¹⁷⁷ See *id.*

¹⁷⁸ See SCHMIDT, *supra* note 77, at 350 (One German commentator argues that it is not a system but a legal program because the Corporation Law does not always systematically protect the minority.).

¹⁷⁹ See EISENBERG, *supra* note 178, at 79.

¹⁸⁰ Seoul District Court [Seoul Dist. Ct.], 97Pa4374, Nov. 21, 2002 (S. Kor.).

¹⁸¹ Seoul District Court [Seoul Dist. Ct.], 98Pa4302, June 8, 2002 (S. Kor.).

tion plans.

D. Reduction of Capital, Stock Consolidation, and Stock Splits

If a divided company is not extinguished after a division, but its net assets clearly fall short of capital as a result of the division, it needs a decrease in capital. The KCA does not have any specific provisions concerning the process of decreasing capital, except that it must be stated in the division plan or merger by split agreement.¹⁸²

Even in a division, a stock consolidation or split can be necessary for allotment of new shares. The Korean law has certain provisions concerning this matter.¹⁸³ Article 272, Clause 4 of the DRBA also has special provisions concerning the application of the KCA to division or merger by split, but has no provision to exempt the application for the divided company's capital decrease, stock consolidation, or stock splits. Therefore, such special provisions could be applied to the corporate reorganization proceeding.

E. Surviving or New Company's General Meeting for Reporting and Inaugural General Meeting

In case of a company's division or merger by split, the new or existing company is required to hold its inaugural general meeting or general meeting to report to its shareholders the progress of division or merger by split. However, the board of directors may make a public notice in lieu of a report to the general shareholders' meeting.¹⁸⁴ A member of the organizing committee at the inaugural general meeting shall be the representative director.¹⁸⁵

Unlike a merger, a division or merger by split of a reorganizing company does not bring new members, and its newly incorporated company by the division becomes a reorganizing company. Thus, its shareholders' general meeting for reporting and the inaugural general meeting can be replaced by the meeting of interested persons. In the event a reorganizing company undergoes a division or a merger by split, the receiver becomes the member of the organizing committee.

¹⁸² See KCA art. 530-11(1) (Articles 440 through 444 usually apply *mutatis mutandis*).

¹⁸³ See *id.* art. 530-11, 329-2, 440, 441, 442, 443, 444.

¹⁸⁴ *Id.* art. 530-11(1), 526, 527.

¹⁸⁵ *Id.* art. 530-11(1), 527(1).

F. Registration of Division and Efficacy

In case of a reorganizing company's division or merger by split, secured and unsecured creditors, or the third company that are allotted the new company's shares from the continuing company, become subscribers as soon as the reorganization plan is approved, and shareholders as soon as the merger by split becomes valid (i.e., when it is completely registered). Registration is made with the court's charge.

In case of a division or a merger by split, the registration of alteration by the surviving company, the registration of the dissolution by the company, which ceases to exist in consequence of the merger, and the registration of incorporation set forth in Article 317 of the KCA shall be made on the public record.¹⁸⁶ Article 317 states that the company that is newly incorporated by division or merger by split come into effect within two weeks at the place of the principal office and within three weeks at the place of each branch office from the date of the closing of the general shareholders' meeting or the date of a public notice in lieu of a report under Article 526 of the KCA, or from the date of the closing of the inaugural general meeting or the date of a public notice in lieu of a report under Article 527 of the KCA, as the case may be.¹⁸⁷ Corporate division is validated by the registration process.¹⁸⁸

A written commission, an application for the dissolution registration, or the alteration registration of a company that has been dissolved

¹⁸⁶ *Id.* art. 317. For instance, (i) Purpose; (ii) Trade name; (iii) Total number of shares authorized to be issued; (iv) Par value per share; (v) Number of shares to be issued at the time of incorporation; (vi) Place of principal office; (vii) Method of public notice; (viii) Total amount of the capital; (ix) Total number and class of the issued and outstanding shares and contents and number of each class of shares; (x) Provision that the transfer of shares shall be subject to the approval of the board of director, if so determined; (xi) Provision under which stock option is granted, if so decided; (xii) Places of branch offices; (xiii) Duration or reasons for dissolution of the company, if determined; (xiv) Dividend of interest prior to the commencement of business, if so determined; Redemption of shares out of profits to be distributed to shareholders, if so determined; (xv) Matters set forth in Article 347 [i.e., (1) A statement to the effect that the shares concerned may be converted into shares of another class; (2) Conditions of conversion; (3) Contents of the shares to be issued in consequence of the conversion; and (4) Period within which the conversion may be demanded], if convertible shares are issued; (xvi) Name and resident registration number of each director and auditor; (xvii) Name, resident registration number, and address of the representative director; (xviii) Provision that two or more representing directors shall jointly represent the company, if so determined; (xix) Trade name and the principal office of a transfer agent, if any; and (xx) Name and resident registration number of each auditor of the audit committee, if such committee has been set up.

¹⁸⁷ *See id.* art. 528(1), 530-11(1).

¹⁸⁸ *See id.* art. 234, 530-11(1).

by a split shall be accompanied by a certified copy or abstract of a letter of decision with respect to the approval of the reorganization plan concerned, while a written commission, an application for the dissolution registration, or the alteration registration of a company that has been dissolved by a merger by split shall be accompanied by a merger by split contract in addition to a certified copy or abstract of a letter of decision with respect to the approval of the reorganization plan concerned.¹⁸⁹

Furthermore, a written commission or an application for the incorporation registration of a company that has been incorporated by a merger by split shall be accompanied by a merger by split contract, the certificate of incorporation, the minutes of an inauguration general meeting, and the minutes of a meeting of the board of directors with respect to the representative director, in addition to a certified copy or abstract of a letter of decision with respect to the authorization of the reorganization plan concerned.¹⁹⁰

If a reorganization plan provides that a company should incorporate a new company after splitting itself, or that a company should incorporate a new company without going through the process of any merger, split, or split-merger, such company may perform the incorporation according to the provisions of such reorganization plan.¹⁹¹

VII. EFFECTS OF A SPIN-OFF AND STATUS OF THE REORGANIZING COMPANY

According to Article 530-10 of the KCA, a company that is incorporated or continues to exist due to a division or a merger by split shall succeed to the rights and duties of the company to be divided under the conditions prescribed by a division plan or written agreement of the merger by split.¹⁹²

¹⁸⁹ See DRBA art. 272(7).

¹⁹⁰ See *id.* art. 272(8).

¹⁹¹ See *id.* art. 274(7). In this case, the written commission for registration of the establishment of the new company shall be accompanied by documents (i) attesting to the subscription for and acceptance of shares; (ii) reporting on the investigation by the directors and auditors and its annexed documents; (iii) containing the minutes of the inaugural general meeting; (iv) involving certificates of banking or other financial institutions in which the payments are deposited; (v) evidencing appointment of the director, auditor, or election of the representative director if the certificate of incorporation or the plan provides a method for such appointment or election; and (vi) if there is a transfer agent, attesting to this fact, in addition to a certified copy or abstract of the written decision for the approval of the plan.

¹⁹² In this regard, the issue is whether the active and passive assets or rights and obligations that are unspecified in the division plans and the reorganization plan are com-

A. *Succession of Assets and Shareholders*

When a division is complete, the divided company is either extinguished or it continues. Liquidation is not required when the divided company is extinguished because all rights and obligations of the dissolved company are automatically taken over by each continuing company.

Even when a divided company survives the division, its capital and other important matters are often changed. Thus, such changes should be stated in the division plans or merger by split agreement. If required, changes are also registered.¹⁹³

As soon as the division is effected, if it is not a *in rem* division under Article 530-12 of the KCA, shareholders of the divided company receive new shares from the new or continuing company and become new shareholders.¹⁹⁴ In this case, they are not obliged to pay any consideration for the new shares except for their investment assets as stated in the merger by split agreement. This is because the legal nature of division does not allow additional investment for new shares.

If a new company from a division or a merger by split or the other party of a merger by split acquires the right of business constituting goodwill, what it paid for the acquisition value can be included on the balance sheet under assets. In this case, an equivalent amount or more shall be amortized at each settlement within five years after the registration of incorporation or merger by split is effected.¹⁹⁵

B. *Minority Protection*

Minority shareholders' status can be violated by corporate division as in other types of fundamental corporate restructuring. The minority shareholder protection issue in the spin-off process generally arises with regard to share allotment.

prehensively succeeded to the new or existing company. See Martin Heidenhein & Burkhardt W. Meister, in *MMEDS THE Vertragshandbuch*, Bd.1, Gesellschaftsrecht 1234 (1996); See also Gibeom Kwon, *Few Issues of Corporate Division under the Draft of Commercial Law*, 9 *BUS. & L.* 43 (1999).

¹⁹³ See KCA art. 40.

¹⁹⁴ Gary M. Brown, *Reach of Securities Act Regulation*, in *UNDERSTANDING THE SECURITIES LAWS* 2009 107, 134 (2009) (In America, for example, when Agilent Technologies was spun out of Hewlett-Packard in 1999, the stock holders of HP received stock in Agilent. In a spin-off, "a corporation takes stock that it owns in another corporation and distributes that stock to its shareholders as a dividend.").

¹⁹⁵ See KCA art. 530-8.

One of the most difficult issues of distributing new shares is called disproportionate distribution.¹⁹⁶ Germany's UmwG requires all shareholders to agree with the unproportionate distribution of new shares to minority shareholders,¹⁹⁷ and the EC Corporate Division Guidelines provide for minority shareholders' appraisal rights.¹⁹⁸

From the shareholders' point of view, fairness means at least the preservation of their existing equity value guaranteed by the allotment. When shareholder *A* is reassigned to Company *C* and shareholder *B* to Company *D* by a complete division plan, the property value of shareholder *A*'s shares from Company *C* shall be equal to those of shareholder *B*'s shares from Company *D*.¹⁹⁹ The distribution of disproportionate new shares in a general corporate division usually means that the minority shareholders' ratio of shares after the division is less than what they held in the previous company.²⁰⁰ For instance, assuming that the ratio of shares of shareholders *A* and *B* in the previous company was 4:6, and Companies *C* and *D* were newly incorporated after the division, a disproportionate distribution occurs when Company *C* decides to provide 3:7 of shares and Company *D* decides to provide 8:2 of shares for shareholders *A* and *B*. An extreme example would be distributing stocks of two different new companies (acquiring company) to two conflicting shareholders *A* and *B* and extinguishing the divided company.²⁰¹

The rationale of the disproportionate stock distribution basically assumes that it is allowable to arrange each group of shareholders with similar interests in relationship to each new (acquiring) company. However, all shareholder consents as specified under German law are based on dissenting shareholders' compensation²⁰² and have no great impact as compared to the economic effect of the EC Corporate Division Guide-

¹⁹⁶ See Hagan, *supra* note 53, at 2 (In U.S., there is an issue whether is a spin-off a sale of share. The answer is that "[i]n most cases, a spin-off is not a sale" if it occurs as a dividend to the shareholders of the parent. "In order not to be a sale, the spin-off shares must be distributed on a pro rata basis to all shareholders of the parent without any consideration.").

¹⁹⁷ See Umwandlungsgesetz [UmwG][Corporate Reorganization Act], Oct. 28, 1994, BUNDESGESETZBLATT [BGBL. I] at vol I, § 128 (Ger.).

¹⁹⁸ Council Directive 82/891/EEC, art. 5, 1982 O.J. (L 378) 47 (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:3198-2L0891:EN:NOT>.

¹⁹⁹ See KWON, *supra* note 111, at 325-26 (As shareholder *A* loses rights in the division without a liquidation process, shareholder *A*'s shares are abolished as soon as the division is effected.).

²⁰⁰ See DEHMER, *supra* note 89, § 128 n.5.

²⁰¹ See PRIESTER, *supra* note 89, § 128 n.10.

²⁰² See DEHMER, *supra* note 89, § 128 n.18.

lines. Germany's UmwG §125 and §29 protects minority shareholders and has similar appraisal rights compared to Korea's KCA.²⁰³

The KCA does not have any provisions concerning this matter. In case of merger by split, the statute does not force acquiring companies (new companies) to allot their shares under the shareholder's previous ratio. Considering that Article 299 of the KCA does not apply when a company to be incorporated through division follows the existing proportion in distributing new shares and allows examination by an investigator to be omitted, distribution of disproportionate shares is also possible. This is the principle of freedom of share allotment.

In *In re Hunex Inc.*, the reorganizing company chose *in rem* division with the continuing divided company, coming to possess 100% of the new company's issued shares.²⁰⁴ Thus, the issue of a disproportionate allotment of shares was not raised.

In *In re Hanshingongyeong Inc.*, the reorganizing company chose a shareholder level division, with a disproportionate allotment of shares not being necessary because only one new company was incorporated.²⁰⁵ In this case, however, the divided company's secured claims were split under the contracts and succeeded to by the existing company and the newly incorporated company under the property conveyance, which were subject to the reorganization secured and unsecured claims being divided into construction division and retail distribution division by a ratio of 65.31:34.69.²⁰⁶ The existing company's shareholders from the corporate division received new shares in proportion to their existing holdings (0.56113 per share).²⁰⁷

C. Nullification of a Spin-Off and Reorganization Plan Execution

Even when a corporate division is carried out by registration, a division or merger by split can be nullified for various reasons. Just as general principles of the Civil Code may interfere with safe trading, the KCA

²⁰³ A disproportionate corporate division is difficult to perform, but is realistically necessary. Some commentators argue that it is better to provide shareholders who dissent in a disproportionate division with appraisal rights rather than requiring all shareholders to agree, as Germany's UmwG provides. See KWON, *supra* note 111, at 326. However, dissenting opinions exist on this matter. *But see* Hong, *supra* note 83, at 361.

²⁰⁴ Seoul District Court [Seoul Dist. Ct.], 98Pa4302, June 8, 2002 (S.Kor.).

²⁰⁵ Seoul District Court [Seoul Dist. Ct.], 97Pa4374, Nov. 21, 2002 (S. Kor.).

²⁰⁶ *Id.*

²⁰⁷ *Id.*

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allows for the filing of a nullification action.²⁰⁸ However, the action is restricted as to the corporate division nullification to the greatest extent possible and denies the retroactive effect of a nullification decree even when the nullification is done to stabilize the legal process of corporate division or merger by split.

The KCA does not directly state the possible causes for nullification, which are determined by the court by comparing causes to the purpose of the division or merger by split and considering the stability of legal procedures and the protection of safe trading. This includes cases in which: (i) there are no division plans or merger by split agreements, or certain legal provisions required by statutes are omitted; (ii) reasons for cancellation, nullification, or termination are given in the division plans or merger by split agreement which required shareholders' meeting; (iii) reasons for cancellation or nullification emerge in the examination and resolution of meetings of interested persons; or (iv) creditors rights are not being protected. Another reason may arise when a merger by split results in an unfair merger proportion (i.e. stock exchange ratio).

Under the KCA, the nullification of a corporate division or merger by split can be alleged only by action.²⁰⁹ However, since Article 272, Clause 4 of the DRBA does not contain any provision regarding nullification actions, the nullification of a corporate division must be disputed in some other way. In other words, a reorganizing company's division plan must be stated in the reorganization plan, which then needs to be approved by the court through examination and resolution of issues by vote at the general meeting of interested persons. Thus, anyone who wants to nullify a corporate division should file a petition with the bankruptcy court objecting to approval of the reorganization plan. The procedure is the same if nullification of a merger is sought.

VIII. CONCLUSION

In theory, as long as mergers are acknowledged as legal in business, spin-offs, which can be considered the opposite of a merger, are also allowable as such. At this time, spin-offs are no longer matters of pure theory at all, but it has become frequently requested as permanent statutory devices by the actual players of business arena.²¹⁰ In short, means of

²⁰⁸ See KCA art. 529, 530-11(1).

²⁰⁹ See *id.* art. 529(1), 530-11(1).

²¹⁰ See Hagan, *supra* note 53, at 1 (introducing recent five spin-off cases) (One practitioner states that "[p]arent companies are carving out high profile divisions eager to have ... spin-outs independently valued by the marketplace and in an effort to exploit

corporate division are keenly wanted as much as mergers.²¹¹

Nowadays, many corporations in Korea, regardless of health or insolvency, wish to take advantage of spin-offs for increased efficiency. Free and flexible alternation of business entity is seriously wanted through the rationalization of management and maximum profit return could be expected by means of restructuring.

The insolvent enterprises are being liquidated to reconstruct the entities by means of different methods that are supported by statute.²¹² Under the given circumstances, it is preferable to save the corporation's viability in such a way than to take the shareholder's investment and the creditor's claims. Accordingly, a new frame of corporate restructuring ought to be arranged so that the pertinent corporation can be viable in any situation.

While the motive for corporate division is contrary to the merger, there is commonality in terms of legal phenomenon. Obviously, more similar is asset succession by means of stocks and the maintenance of the business identification itself. As a matter of fact, spin-offs can be made by utilizing the established system. However, it is not only a complicated procedure, but also presents many disadvantages and inconveniences to corporations.

Stipulations concerning mergers are set up in favor of the simplicity in procedure and the advantages of the concerned parties, although mergers can be made by the other established systems in spite of the lack of particular stipulations concerning them. In the same manner, particular stipulations concerning spin-offs are considered necessary in the reorganization procedure.

While mergers have occurred frequently, spin-offs have rarely been done thus far.²¹³ This is why the secondary effect was undisclosed obviously from the merger, and the irksome matter of division was required to be somehow solved eventually. Quite expectedly, however, reorganizing enterprises or corporations encounter frequent situations that necessi-

current market conditions." "[I]nternet and tech spin-offs create an independent company with an independent stock which may be publicly traded and which creates wealth for the parent company shareholders.").

²¹¹ See GAUGHAN, *supra* note 14, at 377 (Spin-offs can be classified as either voluntary or involuntary. In the United States, the classic example of an involuntary spin-off was the breakup of AT&T in 1984.).

²¹² See Kim, *supra* note 71, at 109-14.

²¹³ See *id.* at 197 (there are only two cases reported from the bankruptcy department at the Seoul Central District Court).

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tate corporation spin-offs parallel with mergers.²¹⁴

In this article, corporate division was compared and analyzed with a focus on the reorganization plan. Advanced countries' spin-off system regulations were examined and compared with the DRBA as well as with corporate law in other parts of the world. The context and the concept of current Korean law on corporate division were analyzed and spin-off methods were investigated. The spin-off process as well as division in relation to the essential factor, object, and proceedings within the reorganization procedure were surveyed.

Other countries' systems are now being studied and compared to Korea in terms of logical adjustment between the shareholders, creditors, and other parties concerned, for the sake of protection of the shareholder and the creditor. The important issues are how to tie over the inclusive succession process of the corporation being divided on assets and the lack of efficient settlement between the shareholders and the creditors. Another obstacle in how to prepare the plan includes protection measures for secured and unsecured creditors and other interested parties concerned with the corporate reorganization.

The benefits given to the shareholders of the divided corporation, creditors, receiver, officers, employees, and other concerned parties were studied. As a hypothesis, total invalidity of the divisions were studied as well. It is predicted that the same type of spin-off cases presented in this article will likely reappear and will help revitalize failing corporations.

²¹⁴ See *id.* at 168-70.