

Amendments to the Commercial Building Lease Protection Act

Amendments to the Commercial Building Lease Protection Act (the “Act”, and as amended, the “Amended Act”) were promulgated on August 13, 2013. The purpose of the amendments is to further protect commercial tenants (i.e., through provisions for renewal rights for large tenants, limitation on landlord’s right to refuse renewal requests, preservation of priority in assigned lease deposit repayment claims, increased maximum repayment to small tenants, and new rate for conversion of lease deposit into monthly rent). The Amended Act will be applicable to a lease agreement newly entered into or renewed after August 13, 2013 (with certain exceptions).

1. Large Tenant’s Renewal Rights

The Amended Act recognizes a tenant’s right to renewal of its lease agreement, even if such tenant’s lease deposit exceeds the amount prescribed by Presidential Decree. In addition, the Amended Act includes a new provision that allows a tenant to request an increase or decrease of rent or lease deposit at the time of renewal, taking into account various factors, such as the tax and public utilities for that building, rents and lease deposits of the surrounding commercial buildings and other economic circumstances (Articles 2(3) and 10-2).

Under the former provisions of the Act, such right of renewal was not available to tenants whose lease deposits exceed the amount prescribed by Presidential Decree (e.g., KRW 300 million for Seoul). However, the Amended Act now recognizes a tenant’s right to renewal, regardless of the amount of lease deposit, to the extent that the entire term (as extended) does not exceed five years.

For renewal of a lease under which the lease deposit is lower than the amount prescribed by Presidential Decree, it is not possible to increase the rent or lease deposit by more than 9%. However, under the Amended Act, for large tenants, there is no specific limit on an increase of rents or deposits, although the tenant has the right to request an increase or decrease of the rents or lease deposits at the time of renewal, considering taxes or other changes in economic circumstance (Article 10-2). Given the

foregoing, it is anticipated that rent increase issues will arise when a large tenant exercises its right to renew based on this new provision.

2. Limitation on Landlord's Right to Refuse Tenant's Renewal Request

Under the Act, when a tenant requests renewal of a lease agreement, the landlord may only refuse to renew for justifiable reasons (e.g., if tenant defaults on rent payments for three payment periods (Article 10(1))). However, landlords had been broadly relying on the general provisions of Article 10(1)7 as a basis to refuse tenants' renewal requests on grounds that the building is scheduled for demolition or reconstruction. To better protect tenants, the Amended Act now provides that the landlord can only refuse the tenant's request for renewal in cases where the relevant construction plan was specifically notified to the tenant at the time of execution of the lease agreement, where there is a risk of accidents, or where the building is required by law to be demolished or reconstructed (newly added clauses (a) through (c) of Article 10(1)7).

3. Preservation of Priority in Assigned Lease Deposit Repayment Claims

Under the Amended Act (newly added clauses (7) through (9) of Article 5), if a financial institution (e.g., a bank) takes assignment of a claim for lease deposit return from a tenant who acquired the preferential right for such lease deposit repayment through fixed-date stamped or leasehold interest registration, such financial institution can succeed to the tenant's preferential rights to the extent of the amount of the assumed claim.

Under the former provisions of the Act, as there was no legal basis to permit financial institutions taking over a claim for lease deposit return to succeed to the preferential right of repayment enjoyed by a tenant, financial institutions were reluctant to grant loans secured by such claims for deposit return. However, as the Amended Act now allows such succession rights, it is anticipated that loans secured by deposit return claims will increase. To ensure tenants remain protected, however, the Amended Act prohibits a financial institution from terminating a lease agreement on behalf of the tenant (Article 5(9)) where such financial institution has assumed the tenant's deposit return claim.

4. Increase of Maximum Repayment to Small Tenants

Under the current provisions of the Act, if a commercial building is to be foreclosed, a small tenant with a secured leasehold interest and lease deposit is entitled to receive, in priority to any other persons with mortgage rights or other interests in such building, an amount determined by Presidential Decree based on the economic conditions of the relevant region, to the extent that such amount does not exceed 1/3 of the price of the building. To better protect small tenants, the Amended Act has increased

the upper limit from 1/3 to 1/2 of the price of a building (Amended Article 14(3)). This amended provision will come into effect as of January 1, 2014.

5. New Rate for Conversion of Deposit into Monthly Rent

Under the current Act, if a part or all of a lease deposit is converted into monthly rent, the monthly rent is not permitted to exceed an amount determined by multiplying the lease deposit by a rate designated by Presidential Decree based on loan interest rates and other economic circumstances of the relevant region (which is currently 15%). However, under the Amended Act, the monthly rent will not be permitted to exceed an amount determined by multiplying the lease deposit by the lower of (i) the rate designated by Presidential Decree based on loan interest rates and other economic circumstances of the relevant region, and (ii) the base interest rate announced by the Bank of Korea multiplied by a multiple decided by Presidential Decree (Amended Article 12). Given the foregoing, permissible monthly rental rates may be linked to the Bank of Korea's base interest rate, going forward. This amended provision will come into effect as of January 1, 2014.

Should you have any questions regarding any of the foregoing, please feel free to contact us at any time.

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