

Criminal Breach of Duty (*Bae-im*) under Korean Law

Criminal breach of duty, or *bae-im* in Korean, is a typical crime on which owners, directors, officers or managers of corporations and businesses in Korea are frequently indicted. A person commits *bae-im* when he or she, in dealing with the affairs of another person, breaches his or her duty and obtains, or enables a third person to obtain, a pecuniary advantage through such breach, thereby causing a loss to the person to whom the duty is owed. *Bae-im* is similar to the concept of *Untreue* under German law, while *bae-im* is broader in scope than *Untreue* in that a mere attempt to commit *bae-im* is also punishable in Korea.

Examples

While owners, directors and officers of Korean companies have been the subjects of most *bae-im* prosecutions, non-Korean corporations doing business in Korea are not immune from being charged with *bae-im*. Recent *bae-im* cases include the following:

- Chairman of a Korean conglomerate was indicted on the charge of *bae-im* for providing the conglomerate's buildings as security and instructing the conglomerate to provide joint and several guarantee for the purchase of a building for his own account;
- Chairman of a Korean conglomerate was prosecuted for *bae-im* for paying too high a price when investing in a venture company and for investing in a venture company without proper consideration of the business and financial risks; and
- Chairman of a Korean conglomerate was prosecuted for causing a loss to an affiliate by transferring shares of the affiliate to his children at below market price.

Acquisition of a company through a leveraged buyout (“LBO”) can give rise to *bae-im* in Korea. In a landmark case, a person established a special purpose company in order to acquire a target company and the target company’s real estate and other assets were provided as collateral for the loan taken out to finance the acquisition of the target company. The Korean Supreme Court ruled that the target company’s director committed *bae-im* since no consideration was paid or provided by the acquirer to the target company for the use of the target company’s assets as collateral for the loan. The Court found that the target company suffered losses by providing the collateral without receiving an adequate quid pro quo, because it exposed itself to the risk of losing its assets upon default of the loan (Supreme Court, Nov. 9, 2006, Case No.2004Do7027). In a series of rulings following the seminal case, the Court has taken a position that not all LBO transactions utilizing a target company’s assets for acquisition financing constitute *bae-im* and facts should be analyzed on a case-by-case basis.

Legal Definition of *Bae-im* and Punishment

Bae-im is codified in Articles 355(2) and 356 of the Korean Criminal Code (the “Criminal Code”).

The elements of *bae-im* are: (i) a person owing a duty to another person or an entity or in a position within an entity to administer the business of the entity (ii) gains, or enables a third party to gain, a pecuniary advantage, which results in a loss to the entity to whom the duty was owed, (iii) in breach of his or her duty.

The Court has interpreted the Criminal Code provisions in core precedents, giving clarity in their application. Among other things, according to the Court, a person can be prosecuted for *bae-im* only if he or she has the duty to administer the affairs of another person or corporate entity. In addition, the Court held that the duties owed and the good-faith administration of those duties must be both typical and essential for the protection and management of the other person or corporate entity. As to the violation of duty, the Court has taken an aggressive approach by holding that inaction or omission to act as well as action can constitute violation of duty in the eyes of the law. Further, the Court made it clear that not only actual loss but also the risk of loss or harm can fall within the definition of “loss” as it pertains to *bae-im*.

Under the Criminal Code, a person who commits *bae-im* is punishable by imprisonment for not more than five years or a criminal fine not exceeding KRW 15 million. However, a person found guilty of *bae-im* for violating the duties of one’s occupation (Occupational Breach of Duty) may be subject to stricter punishment: imprisonment for a maximum of ten years or a criminal fine of up to KRW 30 million.

Moreover, if the value of goods or profits gained through *bae-im* is KRW 500 million or more, but less than KRW 5 billion, the prison term may be three years or more. If, on the other hand, the value of

gains from *bae-im* is KRW 5 billion or more, the minimum prison term is five years and even a lifetime imprisonment can be imposed pursuant to the Aggravated Punishment of Specific Economic Crimes Act.

Business Judgment Rule and *Bae-im*

The crime of *bae-im* is typically committed in cases where (i) a company, without justification, extends a loan to or provides a guarantee in favor of its affiliate or another person without receiving sufficient security, (ii) a company acquires another company at an unjustifiably high price, (iii) a company sells at a low price or purchases at a high price material assets without justification, or (iv) a company makes an investment without fully considering the risk.

The Korean courts have applied the “business judgment rule” as a defense to the charge of *bae-im*. Thus, a business manager would be found not guilty of *bae-im* if he or she can demonstrate that he or she (i) acted in good faith without any intention of obtaining personal advantage, (ii) made an informed decision, (iii) believed that his or her decision was in the interest of the company concerned, and (iv) made a decision in a prudent manner (Supreme Court, July 22, 2004, Case No. 2002Do4229).

Conclusion

Given the far-reaching implications of *bae-im*, directors, officers and other managers of a company in Korea are well-advised to obtain the advice of experienced Korean legal counsel before making an important business decision or administering the company’s business. Also, it is important to employ and follow best practices to benefit from the “business judgment rule” defense.

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