

THE PRIVATE EQUITY
REVIEW

ELEVENTH EDITION

Editor
Stephen L Ritchie

THE LAWREVIEWS

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REVIEW

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CONTENTS

PREFACE.....	vii
<i>Stephen L Ritchie</i>	
PART I FUNDRAISING	
Chapter 1 AUSTRIA.....	1
<i>Martin Abram and Clemens Philipp Schindler</i>	
Chapter 2 CANADA.....	10
<i>Jonathan Halwagi, Tracy Hooley, Anabel Quessy and Ryan Rabinovitch</i>	
Chapter 3 CHINA.....	18
<i>James Yong Wang</i>	
Chapter 4 GERMANY.....	34
<i>Felix von der Planitz, Natalie Bär and Maxi Wilkowski</i>	
Chapter 5 HONG KONG	48
<i>Lorna Chen, Anil Motwani and Ji Zhang</i>	
Chapter 6 INDIA.....	56
<i>Raghubir Menon, Shiladitya Banerjee, Rooha Khurshid and Palak Dubey</i>	
Chapter 7 ITALY	78
<i>Enzo Schiavello and Marco Graziani</i>	
Chapter 8 JAPAN.....	96
<i>Mikito Ishida</i>	
Chapter 9 NORWAY.....	106
<i>Peter Hammerich and Markus Heistad</i>	

Chapter 10	SOUTH KOREA	116
	<i>Chris Chang-Hyun Song, Tae-Yong Seo and Sang-Yeon Eom</i>	
Chapter 11	SPAIN.....	123
	<i>Carlos de Cárdenas, Alejandra Font and Manuel García-Riestra</i>	
Chapter 12	SWITZERLAND	132
	<i>Phidias Ferrari and Pierre-Yves Vuagniaux</i>	
Chapter 13	UNITED KINGDOM	144
	<i>Jeremy Leggate, Prem Mohan and Ian Ferreira</i>	
Chapter 14	UNITED STATES	165
	<i>Joseph A Smith, Tarik M Shah and Ruchi Sharma</i>	
PART II	INVESTING	
Chapter 15	AUSTRIA.....	184
	<i>Florian Cvak and Clemens Philipp Schindler</i>	
Chapter 16	CHINA.....	193
	<i>Rongjing Zhao and Bryan Jin</i>	
Chapter 17	INDIA.....	232
	<i>Raghubir Menon, Taranjeet Singh and Niharika Sharma</i>	
Chapter 18	JAPAN	262
	<i>Shubei Uchida</i>	
Chapter 19	NORWAY.....	270
	<i>Peter Hammerich and Markus Heistad</i>	
Chapter 20	PORTUGAL	281
	<i>Mariana Norton dos Reis and Miguel Lencastre Monteiro</i>	
Chapter 21	SOUTH KOREA	293
	<i>Chris Chang-Hyun Song, Tong-Gun Lee, Brandon Ryu and Dong Il Shin</i>	
Chapter 22	SWITZERLAND	304
	<i>Phidias Ferrari and Pierre-Yves Vuagniaux</i>	

Chapter 23	UNITED STATES	316
	<i>Aisha P Lavinier and Melanie B Harmon</i>	
Appendix 1	ABOUT THE AUTHORS.....	330
Appendix 2	CONTRIBUTORS' CONTACT DETAILS.....	346

PREFACE

The 11th edition of *The Private Equity Review* comes on the heels of a record-breaking year for dealmakers in 2021. Despite the continued impact of the global covid-19 pandemic, the volume and value of both US and global buyouts soared to all-time highs in 2021, with more than US\$1 trillion of global activity attributed to private equity sponsors – at roughly 25 per cent of global deal value, the highest share ever. Deal activity was propelled by a confluence of factors, including favourable macroeconomic conditions leading to increased confidence in boardrooms, accommodating central bank policies, an abundance of cheap financing, robust stock markets, substantial corporate cash and the pace of innovation across industries. IPO and merger and acquisition activity by special purpose acquisition corporations (SPACs), skyrocketed to unprecedented levels, with more than 300 de-SPAC transactions announced in 2021 for a total of over US\$600 billion. Private equity (PE) sponsors also sought out larger public targets in record numbers, with overall take-private value eclipsing that of previous years. In keeping with the theme, sponsor-backed leveraged buyouts above US\$1 billion peaked in 2021, as did exits above US\$1 billion, in part due to more public exits with higher multiples fuelled by the boom in de-SPAC transactions and IPOs. With continued confidence in the performance of PE as an asset class, fundraising activity remained strong, with PE funds amassing aggregate capital of over US\$1.3 trillion raised and record amounts of available capital ('dry powder') (one estimate puts the latter at over US\$1.6 trillion).

In 2021, PE's enormous impact and the continuing creativity of PE dealmakers was demonstrated. Given PE funds' success, creativity and available capital, we are confident that PE's role in the global economy will continue to grow, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa, notwithstanding ongoing and potential political, regulatory and economic challenges.

PE professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. *The Private Equity Review* has been prepared with this need in mind. It contains contributions from leading PE practitioners in 16 different countries, with observations and advice on PE deal-making and fundraising in each.

As PE has grown, it has also faced increased regulatory scrutiny throughout the world. Adding to this complexity, regulation of PE is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this 11th edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their scarce and valuable time to share their expertise.

Stephen L Ritchie

Kirkland & Ellis LLP

Chicago, Illinois

March 2022

Part II

INVESTING

SOUTH KOREA

Chris Chang-Hyun Song, Tong-Gun Lee, Brandon Ryu and Dong Il Shin¹

I OVERVIEW

i Deal activity²

Although the growth trend of the South Korean M&A market has been dampened somewhat by the covid-19 pandemic in 2020, the market witnessed a large expansion in 2021, driven by significant increases in both domestic and cross-border M&A transactions. In particular, with respect to the first quarter of 2021, inbound M&A transactions increased by around 4,595 per cent and outbound M&A transactions increased by 22 per cent as compared with 2020. This demonstrates the importance of cross-border M&A transactions to South Korean companies and private equity houses in the M&A market.

The number of outbound M&A transactions fell in 2020 to 56 transactions from 80 in 2019, despite the combined value of 2020's transactions has increased to US\$17.2 billion from US\$14.57 billion in 2019. Inbound M&A transaction volumes in 2020 reduced by 42 per cent year on year to 29 transactions, with a corresponding decrease in overall transaction value of 66.9 per cent to US\$4.8 billion from US\$14.5 billion in 2019. As for domestic M&A transactions, 362 transactions for a total value of US\$39.6 billion were recorded in 2020, which is at a similar level as in 2019 with 408 transactions for a total value of US\$39.63 billion. The key takeaway is that, although the growth of the South Korean cross-border M&A market has been disrupted by the covid-19 pandemic in 2020, the South Korean domestic M&A market has shown resilience and recorded a level similar to that of 2019 despite the covid-19 pandemic.

For the first quarter of 2021, the number of outbound M&A transactions decreased to 11 transactions from 19 in the first quarter of 2020, but the value of 2021 quarter 1's transactions has increased by 22.3 per cent to US\$3.34 billion from US\$2.73 billion in the first quarter of 2020. There was an increase in the volume of inbound transactions in the first quarter of 2021 to 12 transactions from four in the first quarter of 2020, and an increase in value of 4,699 per cent from US\$0.103 billion to US\$4.84 billion. In addition,

1 Chris Chang-Hyun Song and Tong-Gun Lee are partners, Brandon Ryu is a senior foreign attorney and Dong Il Shin is an associate at Shin & Kim LLC.

2 All statistics on the value and volume of M&A deals in Korea involving private equity funds were retrieved from Mergermarket. They are based on M&A deals announced for the given year or certain period (the announcement is based on the signing date), some of which have not disclosed the size of investment; the statistics take into account only direct investments by private equity funds and not those done through special purpose vehicles.

the domestic M&A transaction volume of the first quarter of 2021 increased to 94 from 79 in the first quarter of 2020, with an increase in value of 54.5 per cent to US\$7.72 billion from US\$5 billion.

In the first quarter of 2021, there were 106 M&A transactions with a total deal value of US\$12.56 billion. This represents the highest recorded volume of transactions, with a dramatic increase compared to the first quarter of 2020's 83 deals worth US\$5.1 billion. The Korean inbound M&A transaction space especially drew attention in 2021, of which notable transactions include KKR's acquisition of an 8.11 per cent stake in SK E&S for US\$2.04 billion, Match Group's acquisition of Hyperconnect for US\$1.725 billion, SoftBank Vision Fund's acquisition of an 24.75 per cent stake in Yanolja for US\$1.7 billion, CBC Group-led consortium's acquisition of a 46.85 per cent stake in Hugel for US\$1.48 billion, and GIC and E-mart's joint acquisition of a 50 per cent stake in Starbucks Coffee Korea for US\$1.3 billion. Also, there were several notable domestic transactions such as DTR Automotive's acquisition of Doosan Machine Tools for US\$2.44 billion and IMM Private Equity's acquisition of a 40 per cent stake in SK Lubricant for US\$984 million.

Overview of private equity fund activity

Offshore private equity funds (foreign PEFs) became active in Korea during the immediate aftermath of the Asian financial crisis of 1997. They were followed by the emergence of onshore private equity funds (Korean PEFs) a decade later, with the introduction of the Financial Investment Services and Capital Markets Act (FSCMA) in 2007. Currently, all aspects of PEF activities, ranging from fundraising and investment to exits, demonstrate that PEFs have a robust presence in Korea that is continuing to grow. In addition, the FSCMA has been amended in 2021 to alleviate the regulatory burden of PEF registration procedures and mandatory investment requirements applicable to PEFs. And a significant amount of fresh, policy-driven capital in the form of the Growth Ladder Fund as well as the Corporate Structure Innovation Fund promises to further fuel PEF activities. Based on these factors, the growth trend of PEF activity in South Korea is expected to continue in the coming years.

There were 55 acquisition deals sponsored by PEFs worth US\$22.72 billion in value, and 50 exit deals by PEFs worth US\$12.27 billion in 2021. The table below shows the annual aggregate deal volume and deal count for acquisitions and exits by PEFs in 2020 and 2021, as compared with 2007.

Year	Acquisitions		Exits (excluding IPOs)	
	Deal value (US\$ billion)	Deal volume	Deal value (US\$ billion)	Deal volume
2021	22.72	55	12.27	50
2020	11.24	34	7.10	46
2007	4.86	13	4.33	17

A breakdown of PEF-driven acquisitions by transaction volume according to price bracket shows that in 2020 there were 27 acquisitions in the US\$100 million to US\$500 million range, accounting for 79.4 per cent of all PEF-driven acquisitions; seven acquisitions in the US\$500 million to US\$1 billion range, reflecting 20.6 per cent of all PEF-driven acquisitions; 39 acquisitions in the US\$100 million to US\$500 million range, accounting for 71 per cent of all PEF-driven acquisitions; 11 acquisitions in the US\$500 million to US\$1 billion range, reflecting 20 per cent of all PEF-driven acquisitions, and five acquisitions at or above US\$1 billion, thus accounting for 9 per cent of all PEF-driven acquisitions in 2021.

As for PEF-driven exits (excluding IPOs) by transaction number in 2020, there were 11 exits in the US\$100 million to US\$500 million range, four exits in the US\$500 million to US\$1 billion range, and one exit at or above the US\$1 billion mark. From 2021 Q1 to Q3, there were 14 exits in the US\$100 million to US\$500 million range, three exits in the US\$500 million to US\$1 billion range, and two exits at or above the US\$1 billion mark.

PE fund acquisition trends

Buyout, majority stake and minority stake acquisition deals increased in 2021 compared to 2020 in terms of deal value and deal volume. Both the deal volume and deal value of buyout transactions and minority stake acquisition deals in 2021 surged compared with those of the year 2020. Minority stake acquisition deals in particular increased significantly both in deal volume and deal value, which drove M&A market expansion in 2021.

Year	Buyout (100%)		Majority stake (50% or more)		Minority stake (up to 50%)		Undisclosed	
	Deal value (US\$ billion)	Deal volume	Deal value (US\$ billion)	Deal volume	Deal value (US\$ billion)	Deal volume	Deal value (US\$ billion)	Deal volume
2021	5.67	38	5.53	33	12.67	35	–	12
2020	3.74	28	4.07	27	4.59	29	–	12
2007	0.21	3	1.91	1	2.73	9	–	–

PE fund exit trends

Trade sales have traditionally been the main exit channel for PEFs. However, secondary sale exits are becoming more common, and in 2020 approximately 29 per cent of all PE fund exits took place as secondary sales. There was a decrease of IPO exits in 2020 compared with 2019 and, as in previous years, IPO exits did not constitute a significant exit channel in 2020 compared to trade sales and secondary sales.

Year	Trade sales		Secondary sales		IPO	
	Deal value (US\$ billion)	Deal volume	Deal value (US\$ billion)	Deal volume	Deal value (US\$ billion)	Deal volume
2021	8.29	37	3.99	13	–	–
2020	4.76	28	2.34	18	0.12	2
2007	3.07	11	1.24	4	0.08	2

Trend of public-to-private transactions

There were no public-to-private deals in 2019, 2020 and 2021, following a single public-to-private transaction worth US\$360 million consummated in 2017. In general, public-to-private deals are not common in Korea, with only four public-to-private transactions recorded from 2007 to 2021.

Registered private equity funds

As at September 2021, a total of 981 PEFs were registered with the Financial Supervisory Service (FSS).³ In 2020, there were 218 newly registered PEFs, which is 12 more than that of 2019. The combined value of capital anchored in these PEFs (i.e., the total commitment amount) amounted to 17.9 trillion won in 2020, which is 2.3 trillion won more than the equivalent figure of 2019, and the total commitment amount newly invested for the first three quarters of 2021 amounted to 10.9 trillion won.

Year	2021	2020	2019	2018	2017
Newly registered PEFs	214	218	206	198	135

Registered general partners of private equity funds

As at December 2020, a total of 337 general partners (GPs) were registered with the FSS, 245 of which being full-time GPs. The remaining 92 GPs comprise existing financial institutions, start-up investment companies and new technology companies. Full-time GPs account for 100 per cent of all newly registered GPs (69.1 per cent in the case of 2019), which shows an increase in the proportion of full-time GPs, and financial institution GPs had decreased in number by two.

Year	2020	2019	2018	2017
Full-time GPs	245	210	170	138
Financial institution GPs	36	38	37	35
Start-up GPs	56	56	49	36
Total GPs	337	304	256	209
Newly registered GPs	35	50	15	19
Newly registered full-time GPs	35	42	32	23

The largest private equity funds set up by leading PE houses in Korea in terms of committed capital are as follows: a 3.018 trillion won fund set up by MBK Partners called MBK V; a 2.540 trillion won fund set up by MBK Partners called MBK III; a 1.827 trillion won fund set up by Hahn & Company called Hahn & Company III-1; and a 1.581 trillion won fund set up by IMM Private Equity called IMM Rose Gold IV.

ii Operation of the market

Market-standard management equity incentive arrangements

There are certain precedents wherein a PEF with a controlling stake grants stock options or a small percentage of shares (either through transfer or issuance of new shares) to management with the aim of aligning the interests of the PEF with management. However, sophisticated forms of management equity incentive arrangements remain relatively uncommon in South Korea.

3 The vast majority of these were registered under the FSCMA, but the total number includes those registered under the Industrial Development Act and the Overseas Resources Development Business Act, Financial Supervisory Service, Status of Private Equity Funds in September 2021 (30 September 2021).

Standard sales process

As is the case in other jurisdictions, the investment process for private equity funds in South Korea usually takes place across the following stages: (1) deal structuring; (2) due diligence checks of investment target; (3) negotiation of deal terms; and (4) closing. In a standard share purchase transaction, the parties would first determine a due diligence cut-off date or valuation date, followed by the buyer conducting due diligence on the target. After due diligence, the parties would negotiate the terms and execute a share purchase agreement reflecting such terms. Subject to the fulfilment of conditions precedent to the closing date, the buyer would pay the purchase price to the seller and the seller would transfer its shares to the buyer. The final step usually involves a shareholders' meeting or a board meeting to effect the replacement of the existing directors and officers of the target.

The overall process can take around six to seven months on average. However, this timeline can vary depending on the particular nature and complexity of each deal. If regulatory authorisations are required to complete the deal (e.g., because of foreign capital investment, industry-specific licensing requirements, or market dominance or competition-related issues), the process can be further delayed. Generally, these regulatory authorisations are not especially onerous or far-reaching in terms of scope and depth of regulatory review, and are therefore not considered significant obstacles in most South Korean M&A deals.

II LEGAL FRAMEWORK

i Acquisition of control and minority interests

Prior to the amendment of the FSCMA in October 2021, Korean PEFs were required to either acquire de facto control over the target company or otherwise acquire a minimum of 10 per cent or more of the target company's voting shares. Because of these regulatory restrictions, Korean PEFs had to either engage in a buyout, acquire a majority stake in the target company, or otherwise acquire a minority stake of 10 per cent or higher.⁴ In contrast, unlike Korean PEFs, foreign PEFs were not subject to the 'minimum 10 per cent stake rule'. However, the aforementioned regulatory restrictions on the Korean PEFs were removed starting from 21 October 2021, and accordingly Korean PEFs have now secured a level playing field with foreign PEFs and it is anticipated that they will be able to engage in minority stake investments of various forms.

⁴ In the event a Korean PEF acquires a minority stake in a company, it could still influence the management or governance of the target company by means of a shareholders' agreement with the controlling shareholder or major shareholders.

ii Fiduciary duties and liabilities

Subject of fiduciary duties

The Korean Commercial Code does not impose fiduciary duties on a shareholder towards the company. Furthermore, a shareholder is not liable for the debts of the company aside from the shareholder's investment contribution.⁵ Therefore, a PEF (or its GP) shareholder does not owe any fiduciary duty towards the company and is not liable for the company's debts beyond its investment contribution.

Directors do owe fiduciary duties towards the company under the Korean Commercial Code (KCC) and can be held both civilly and criminally liable for actions that result in harm to the company. These fiduciary duties and liabilities apply to all directors of the company, whether inside or outside directors, as well as to non-executive directors. Furthermore, individuals who do not officially hold director titles but nonetheless exert control over the company's management can be treated as 'de facto directors' pursuant to the KCC and will be subject to the same fiduciary duties and liabilities as directors. It is common practice for personnel from a PEF investor to serve on the board of directors of a target company. Therefore, by extension, the PEF-nominated director would also be subject to fiduciary duties and liabilities to the target company.

Fiduciary duties in leveraged buyout transactions

Another point of note regarding fiduciary duties concerns leveraged buyout transactions (LBOs). Currently, there are differing opinions as to whether company directors can be held civilly and criminally liable for LBOs. The court precedents from the Korean judiciary distinguish between 'collateralised LBOs' and 'merger LBOs'. In relation to the former, where the target company's assets are used as collateral to obtain acquisition financing without giving any benefit to a target company, the Korean courts have ruled that the directors responsible are in criminal breach of their fiduciary duties. In contrast, in merger-LBO scenarios, where the acquiring party sets up a special purpose company (SPC) and merges the target company with the SPC (thereby having the target company succeed to the liabilities of the SPC), the South Korean courts have not found any criminal breach of fiduciary duties by the directors involved in debt push-down mergers of this type, as long as the merger ratio is reasonably set and the merger procedures are taken in accordance with statutory requirements. Note, however, that these court rulings do not necessarily imply a bright-line rule with regard to criminal breach of fiduciary duties in an LBO context; for each transaction, the courts will decide based on the totality of circumstances (e.g., whether the LBO will enhance managerial efficiency, financial conditions and company value).

Korean courts will consider the factual matrix to determine whether any particular LBO constitutes a collateralised LBO or a merger LBO, and whether directors of a target have complied with their fiduciary duties will depend on this distinction. In October 2020, in a case concerning potential fiduciary breaches in the LBO of Himart, an electronics distribution company, the Korean Supreme Court found that the Seoul High Court's

5 As an exception, a majority shareholder holding 51 per cent or more of a company's total issued shares can be subject to secondary tax liability. Additionally, the court may pierce the corporate veil in rare cases when the corporate entity is only used for avoidance of shareholder's debt or liability, in which case the shareholder will also be subject to liability with regard to the company.

interpretation of the factual matrix was incorrect.⁶ The Seoul High Court had held that the transaction constituted a merger LBO, and accordingly the directors of Himart had not breached their fiduciary duties. The Korean Supreme Court overruled this judgment to find that the transaction was in fact a collateralised LBO, after considering factors such as the transaction agreement and the fact that the purchaser of Himart intended to use Himart's assets as collateral for its acquisition financing.⁷ The Korean Supreme Court accordingly found the Himart directors guilty of breach of fiduciary duty. Prospective investors must therefore be aware of the potential liability of target company directors resulting from M&A transactions that utilise LBOs.

III YEAR IN REVIEW

i Recent deal activity

The year 2021 saw a diverse range of M&A deals in South Korea in terms of deal size, ranging from small and medium-sized deals to mega deals worth US\$1 billion and above. SoftBank Vision Fund's acquisition of a 24.75 per cent stake in Yanolja for US\$1.7 billion is one such mega-sized, cross-border acquisition deal. The acquisition of a 46.85 per cent stake in Hugel by CBC Group-led consortium for US\$1.48 billion represents another significant cross-border deal.

Notable past transactions

Notable M&A deals led by PEFs in recent years are as follows.

- a* In October 2021, KKR acquired an 8.11 per cent stake in SK E&S, with a deal value of approximately US\$2.04 billion.
- b* In September 2020, Baring Private Equity and Affinity Private Equity acquired a 7.33 per cent stake in Shinhan Financial Group, with a deal value of approximately US\$970 million.
- c* In April 2019, IMM Private Equity acquired a 100 per cent stake in Linde Korea, with a deal value of approximately US\$1.17 billion.
- d* In February 2017, MBK Partners acquired a 100 per cent stake in DaeSung Industrial Gases, with a deal value of approximately US\$1.5 billion.
- e* In December 2016, the consortium of Hanhwa Life Insurance, Korea Investment & Securities, TongYang Life Insurance, Kiwoom Securities, Mirae Asset Global Investment, IMM Private Equity and Eugene Asset Management acquired a 29.7 per cent stake in Woori Bank, the fourth-largest commercial bank in Korea, with a deal value exceeding US\$2 billion.

The above shows a trend of PEFs participating in large M&A deals as co-investors or consortium partners.

⁶ Seoul High Court decision on 24 July 2016, case number 15No478 (S. Kor.).

⁷ Korean Supreme Court decision on 15 October 2020, case number 16Do10654 (S. Kor.).

ii Financing

As mentioned in Section II.ii, there is uncertainty as to whether obtaining acquisition financing through LBOs constitutes a breach of directors' fiduciary duties. Because of this restriction on LBOs, PEFs in South Korea tend to raise acquisition financing through loans from financial institutions. The amount and terms of such loans are determined based on the financial health and business operations of the target company. If a target company holds existing liabilities, it is market practice for PEFs to have the target company pay off the existing liabilities through refinancing from the financial institution simultaneously with the completion of the acquisition of the target company by PEFs. In large M&A deals, a syndicate of financial institutions provides loans often consisting of term loans and revolving facilities. Though it is not common, vendor financing has been provided in some M&A deals.

iii Key terms of recent control transactions

Closing certainty and clean-exit mechanisms

In acquisition transactions, certainty of closing and break-up (termination) flexibility are key concerns for PEFs, so they tend to request strict representations and warranties, indemnification obligations and material adverse change (MAC) clauses from the seller, while objecting to contractual language that undermines closing certainty or restricts their break-up flexibility. In recent years, insolvent companies have started to comprise a significant portion of M&A targets in Korea. Because sales and purchases of insolvent companies are supervised by the courts, the courts will sometimes impose various restrictions or conditions, such as purchase price adjustment restrictions and MAC clause prohibitions, from the onset of the bid process.

The covid-19 pandemic prompted interest in interpretation of definitions of MAC clauses in M&A agreements. Sellers are incentivised to reducing the scope of a MAC clause to the greatest extent possible to ensure closing certainty and push for covid-19-related matters to be explicitly carved out from the definition of a MAC. Contrastingly, purchasers attempt to expand MAC definitions as broadly as possible and include the occurrence of a MAC as a ground to terminate the agreement. A relevant dispute involved the aborted acquisition of Asiana Airlines by HDC Hyundai Development, because of the financial deterioration of Asiana Airlines caused by business environment and economic changes in the aftermath of the covid-19 pandemic. The parties are still in a dispute in the Korean court as to whether Asiana Airlines' financial deterioration constituted a MAC entitling termination of the agreement. There are few historical instances of Korean courts enforcing MAC clauses, and prospective investors would be wise to monitor the development of this case as to whether Korean courts are agreeable to covid-19-induced financial distress entitling cancellation under MAC clauses.

Additionally, with the rising popularity of representations and warranties insurance, an increasing number of transaction documents include provisions to the effect that damages incurred as a result of a breach of representations and warranties shall be handled by the coverage amount of the relevant representations and warranties insurance policy. The use of representations and warranties insurance is increasing among PEFs, who require a clean exit when divesting portfolio companies that transfers all liability for damages away from the seller. This is also increasingly common in tender sales, which are often used for large-scale M&A deals, as bidders can enhance their bids by including in their offer a representations and warranties insurance policy that guarantees the seller a clean exit.

Purchase price adjustment mechanisms

Purchase price adjustment mechanisms are fairly common in Korea, with the following options available: (1) a price adjustment mechanism based on net working capital, whereby the risk of value fluctuation between the valuation date and the closing date is borne by the seller;⁸ (2) the ‘locked-box’ method, whereby the risk of value fluctuation between the valuation date and the closing date is borne by the buyer;⁹ and (3) the earn-out method, whereby the buyer potentially pays an additional purchase price amount based on the target company’s earnings before interest, tax, depreciation and amortisation, business profits, net profits, cash flow, turnover, etc.¹⁰ In South Korea, it is common for parties to either opt for the locked-box method or forgo a purchase price adjustment mechanism altogether.

Validity of investor protection arrangements

Recently, there was a lower court precedent that held that a shareholders’ agreement that grants consent rights only to specific shareholders and allows such shareholders to claim certain rights (such as early redemption and the right to claim penalty) in case of a breach of such consent right shall be invalid. In this case, the court reasoned that granting an early redemption right and penalty right exercisable upon a breach of the investor’s consent right will allow the investor to receive an amount exceeding more than twice its original investment amount regardless of whether the company has distributable profits in priority to other shareholders and even creditors, and the aforementioned rights granted only to certain shareholders are against the principle of shareholder equality, thus those rights are invalid. Accordingly, prospective investors would be wise to monitor the development of this case in the appeals court, as it could have a profound impact on the protection mechanism regarding the consent right of investors.

Confidentiality

Before proceeding with a transaction, it is usual practice for PEFs to impose confidentiality obligations on the counterparties with regard to the transaction by way of a non-disclosure agreement. Such confidentiality obligations are particularly important with regard to publicly listed companies, as news of a potential acquisition may have a substantial effect on share prices and, by extension, result in a higher acquisition price. A related issue is that publicly listed companies may have limited capacity to enter into confidentiality obligations because of disclosure requirements. When faced with a disclosure request from the Korea Exchange, parties sometimes opt to disclose that a potential acquisition is being contemplated.

8 A potential downside of this option is that the parties have to come to an agreement on which accounts should be included to determine net working capital.

9 Under this option, the buyer will pay interest on the purchase price accumulated from the locked-box date up until the closing date, provided, however, that the transaction document clearly states that certain leakage from the target company is prohibited, and if leakage should occur, the buyer shall be indemnified accordingly.

10 The earn-out period is usually set at two to three years; a potential downside is that the buyer must continue to closely monitor the operations and earnings of the target company during this period.

iv Exits

Recent notable exits

The joint sale of Oriental Brewery by KKR and Affinity Equity Partners with a deal value of approximately US\$6.2 billion was both the largest and the most highly publicised exit by a PEF in Korea. In 2021, MBK Partners exited its investment in Doosan Machine Tools by selling its 100 per cent equity interest in Doosan Machine Tools to DTR Automotive Corporation for around US\$2.44 billion. In 2019, KKR successfully exited by selling 100 per cent of its shares in KCF Technologies to SKC for approximately US\$1.02 billion. The 2012 sale by Lone Star of its 51.02 per cent stake in Korea Exchange Bank with a deal value of approximately US\$3.4 billion remains the second-largest private equity fund exit transaction in Korea. In 2018, the Carlyle Group sold its 100 per cent stake in Siren Holdings, a company engaged in security solutions through its subsidiary ADT Caps, to a consortium of SK Telecom, Daishin PE and Keystone Partners with a value of approximately US\$2.7 billion. In 2017, Goldman Sachs and Bain Capital sold a 95.39 per cent stake in Carver Korea, a cosmetic manufacturer, to Unilever, with a value of approximately US\$2.5 billion.

Drag-along rights

PEFs divesting investments through the exercise of drag-along rights to compel other shareholders to sell all shares in a company is fairly common practice. The usage of drag-along rights was put under the spotlight by the Korean Supreme Court in January 2021.¹¹ In that case, IMM and a number of other investors purchased shares in Doosan Infracore China Corporation (DICC). The investors entered into a shareholders' agreement with Doosan Infracore (Doosan), the largest shareholder of DICC, which provided that if DICC did not complete an IPO within a specified period, the investors would be entitled to exercise a drag-along right against Doosan. This drag-along provision contained an option that Doosan may opt to purchase all shares of the company at the same price as offered by a third party rather than being forced to sell.

DICC failed to complete an IPO within the required time period, and the investors exercised their drag-along right. However, Doosan and DICC did not cooperate with the investors in the drag-along sales process including due diligence, claiming confidentiality concerns prevented them from disclosing this information until a certain buyer was located. As a result, all prospective purchasers declined to commit to a purchase of DICC. The investors asserted (1) this constituted a breach of the Doosan's obligation to act in good faith; (2) Doosan was therefore deemed to have exercised its option to purchase the investors' shares at the price offered by the highest prospective purchaser; and (3) a corresponding sale and purchase agreement between Doosan and the investors was deemed to exist. The investors demanded payment of the sale price for their shares pursuant to the purported sale and purchase agreement.

The Korean Supreme Court ruled in favour of Doosan and held that in order for an agreement to be deemed to exist pursuant to the drag-along clause, the initial prospective purchaser needed to have been specified at the time of exercise of the drag-along right, and that the investors had no right to compel Doosan to purchase their shares.

This demonstrates the importance of setting out in clear language the procedure for exercise of a drag-along right, and expressly stating that both parties must do all things

11 Korea Supreme Court decision on 14 January 2021, case number 18Da223054 (S. Kor.)

necessary to procure successful completion of the drag-along transaction. The parties must also clearly state the penalties for non-cooperation. Failure to include this clear language may result in a drag-along right being legally or practically unenforceable in Korea.

IV REGULATORY DEVELOPMENTS

Following the entry of foreign PEFs into the South Korean M&A market, the South Korean legislature took prompt action to provide a legal framework to help foster onshore private equity funds (Korean PEFs) by implementing the Indirect Investment Asset Management Business Act of 2004 and its successor, the FSCMA. Recently, there has been a reform of the FSCMA, which took effect as of 21 October 2021, and it is anticipated that the overhaul of the legal framework will facilitate investment activity by PEFs within the Korean market, as it provides for (1) removal of the minimum 10 per cent stake rule that previously governed Korean PEFs; (2) removal of the distinction between PEFs and hedge funds, with both instead being re-categorised as general PEFs (PEFs that raise financing from retail, professional and institutional investors) and institutional PEFs (PEFs that raise financing exclusively from institutional investors), pursuant to which only qualified institutional investors will be permitted to make investments as limited partners to institutional PEFs; and (3) permitting PEFs to have up to 100 investors, an increase from the previous limit of 49 investors. Separately, like in the past, the 2021 reform of FSCMA still requires all Korean PEFs to be registered with the FSS.

There is no general legal framework that governs PEF M&A transactions. Similarly, M&A transactions by PEFs are not subject to approval by a designated regulatory body. Nonetheless, each transaction can have different regulatory requirements depending on the nature of the target company's business and industry.

V OUTLOOK

The South Korean M&A market has seen varying degrees of ups and downs in the past few years. Nonetheless, the South Korean M&A market continues to show resilient deal-making and continued growth. Despite the covid-19 pandemic, positive factors such as the market trend to discover future growth engines through active business reorganisation and investment in new businesses, the upward trend of the government's pro-M&A regulatory stance, various pre-emptive restructuring attempts by South Korean companies, and the ongoing development of PEFs have helped the South Korean M&A market to witness a strong bounce back in 2021 and the growth trend is expected to continue throughout 2022.

In terms of challenges in 2022, PEFs will have to grapple with the ever-changing economic situation in South Korea, as well as with competition from strategic investors. Uncertainties arising from the ongoing covid-19 pandemic and the related social and economic disruption and the continuous trade war between the United States and China are also projected to impact South Korea's M&A market in 2022. Nonetheless, the positive factors noted above may offset these negative influences, and considering the financial constraints of corporate and strategic investors at this juncture, there is significant deal-making potential for both domestic and foreign PEFs in 2022.

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