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# Acquisition Finance 2023

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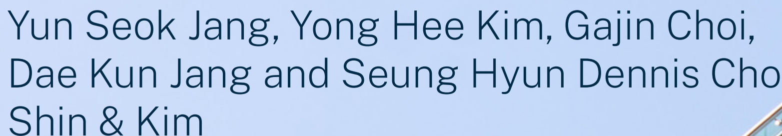
**South Korea: Trends and Developments**



Yun Seok Jang, Yong Hee Kim, Gajin Choi,
Dae Kun Jang and Seung Hyun Dennis Cho
Shin & Kim

# Trends and Developments

**Contributed by:**
Yun Seok Jang, Yong Hee Kim, Gajin Choi, Dae Kun Jang and Seung Hyun Dennis Cho
**Shin & Kim**

**Shin & Kim** is a leading Korean law firm providing comprehensive legal, accounting, tax, compliance and regulatory services. Its clients include multinational companies, conglomerates, global financial institutions and government agencies. Shin & Kim's finance team regularly advises its clients on the most complex and significant M&A transactions, and has the expertise and experience to advise on loan financings, notes issuance, financings of leveraged buyouts and public takeovers, asset-backed financings and customised financing structures. It has been dominant in the acquisition financing market, which has recently become the most active sector due to its importance for high-profile M&A. In recent years, Shin & Kim were advisers to some of the largest acquisition financings in Korea, including: KRW4.3 trillion (USD3.2 billion) financing for MBK's acquisition of Homeplus; KRW3 trillion (USD2.7 billion) financing extended to SK Hynix for its acquisition of Intel's SSD business and Dalian NAND's flash facility; and KRW1.2 trillion (USD1 billion) refinancing provided to Centroid Investment Partners' acquisition of Taylormade.

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## Authors

**Yun Seok Jang** is a partner at Shin & Kim with unparalleled experience in the securities and finance sectors, and currently leads Shin & Kim's corporate finance group. He has experience in advising on landmark acquisition financing transactions, including Taylormade, Job Korea, SK Lubricants and CJ Olive Young, and has also acted as the lenders' counsel for the acquisition of Home Plus, Momentive, Linde Korea, Daesung Industrial Gas, Twosome Place and Burger King, among others. His practice also focuses on a wide range of matters including alternative investments and private equity transactions.

**Yong Hee Kim** is a partner at Shin & Kim. Mr Kim primarily focuses his practice on representing domestic and foreign financial institutions and corporate and sponsor borrowers in financing transactions, including acquisition finance, real estate project finance, structured finance and other financing transactions. Mr Kim also advises domestic and foreign clients on Korean banking and securities laws, and on other general matters. He is a member of the Korean Bar Association.

**Gajin Choi** is a partner of Shin & Kim and is admitted to the Korean Bar Association. She has extensive experience in various domestic and cross-border financial transactions, including acquisition financing, credit financing and corporate financing. She also has experience in advising clients on many landmark acquisition financing transactions and has extensive knowledge in related legal issues and trends. She represents a broad range of domestic and international banks, securities companies and other financial institutions, and also provides advice for private equity firms in connection with financing.

**Dae Kun Jang** is a partner at Shin & Kim and is active in providing legal advice in a wide range of financial transactions. His main areas of practice include acquisition financing, project financing, SOC and infrastructure financing, data privacy and fintech. He has also been involved in asset management, IPO, PEF and a variety of M&A of financial institutions. He is a member of the Korean Bar Association.

**Seung Hyun Dennis Cho** is a senior foreign attorney at Shin & Kim and has extensive experience in advising investors, sponsors, lenders and borrowers in a wide range of banking and finance transactions. His practice concentrates on corporate finance, acquisition finance, asset-backed finance and shipping finance. Mr Cho began his career as a credit analyst at an investment banking arm of a leading commercial bank in Korea and, more recently, served as an executive director at a global zinc smelter, where he headed the risk and operations teams. He is a member of the New York Bar.

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**Shin & Kim**

## Shin & Kim LLC

D-Tower (D2)
17 Jongno 3-gil
Jongno-gu
Seoul 03155
Korea

Tel: +82 2 316 4114
Fax: +82 2 756 6226
Email: shinkim@shinkim.com
Web: www.shinkim.com

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### Acquisition Finance in South Korea: an Introduction

Korea's M&A market saw a dramatic increase in M&A activities in 2021 due to abundance of liquidity in the market, followed by a steep decline by the end of 2022. Korea was not immune from being affected by uncertainties created by interest rate hikes and geo-political tensions which led to a global economic downturn. A significant pick up in the M&A activities in Korea is currently not expected if the general economic outlook in the latter half of 2023 does not improve.

Given the current state of the M&A market, acquisition finance activities have also slowed since the third quarter of 2022. Lenders and borrowers alike have focused on rolling over existing facilities rather than negotiating new loans or refinancing existing facilities.

As for deal terms, lenders are taking a conservative approach, and under the current market climate borrowers are less likely to be successful in asking for terms that are off the norm or have not been tested in the market.

In terms of market players, domestic private equity firms will likely continue to play a significant role as borrowers in the Korean M&A market, along with Korean conglomerates as strategic buyers of businesses. On the lenders' side, Korean domestic banks and securities houses are likely to remain as the most active lender group in the acquisition finance sector. However, overseas private equity firms and international banks are showing increased interest in filling the liquidity gap created by the domestic financial institutions, taking a more conservative approach to underwriting new loans. The challenge for these institutions will be to find effective means to comply with and navigate through various regulatory requirements, including those found under the foreign exchange regulations, to provide credit to borrowers in Korea.

### Financing Structure

For acquisition loans, generally a special purpose vehicle (SPV) is newly established by a sponsor as the borrower of the acquisition loan and the acquirer of the target. Upon consummation of the acquisition, the target will become the subsidiary of the borrower. The acquisition loan is usually repaid in one lump sum at maturity. The term of the acquisition loan is usually

between two and five years. If the borrower elects to prepay the loan, a prepayment fee will usually apply if the loan is prepaid between 12 and 18 months from the drawdown.

In terms of security, an acquisition facility is generally secured by the target's shares and the borrower's bank accounts. The target assets may not be used as collateral to secure the acquisition loan due to breach of fiduciary duty concerns, discussed in more detail below. For the same reason, the target may not provide a guarantee to support the payment obligation of the borrower, as such guarantee will constitute an upstream guarantee.

The acquisition loan agreement in Korea typically contains a robust set of representations, warranties and covenants. The most common financial covenants required by the lenders are the ratio of net debt to EBITDA, and the ratio of the loan to the value of the shares provided as a security (generally in respect of publicly traded target companies).

Lenders may consider covenant-lite documentation, if the financing is provided for an acquisition of a minority equity interest in a target. In the case of acquisition of a minority interest in a listed company, the lenders may forego stringent documentation terms in place of a strict loan to value test (the ratio of a loan to the value of the listed shares granted as a security).

### Supreme Court Case on LBOs

Under Korean laws, the directors of every company owe a strict fiduciary duty to their company. In the context of a leveraged buyout (LBO), therefore, the target pledging its assets to support the acquisition loan being obtained by its acquirer gives rise to the question of a breach of fiduciary duty by the target's directors. To avoid this issue, it is generally accepted that so long as the borrower remains as the parent of the target company, the acquisition loan may not be secured by the target's assets and the target may not issue a guarantee in favour of the borrower's lenders regarding the acquisition loan.

The Supreme Court of Korea, however, has taken the position that if the borrower and the target merge after the acquisition and the target becomes the surviving company, the acquisition loan may be transferred to the target without the target's directors breaching their fiduciary duty. The Court distinguished this type of LBO (a merger-type LBO) from a structure where the target's assets are provided as collateral to the borrower's acquisition loans and further went on to hold that the target could not be considered damaged by the merger in such case.

However, a potential buyer in an acquisition should carefully approach the merger-type LBO. In 2021, the Supreme Court of Korea found a target's directors guilty of breach of fiduciary duty in respect of certain merger-type LBO transactions. The Court held that the target provided its assets to secure the borrower's debt financing without obtaining any profits, and further emphasised that the mortgage established on the target's real estate could be viewed as also securing the borrower's debt financing. The Court also held that the borrower did not engage in any business other than serving as a special purpose vehicle, whereas the target owned tangible and intangible assets with substantial monetary value and generated actual operating profits.

Transaction parties to an acquisition financing will need to stay current on the evolving issue of fiduciary duty obligations in structuring the financing. Korean courts will likely consider all the facts and circumstances of the financing to

determine whether a particular LBO involves a violation of such duty.

### Syndicated Facilities and Interest Rates

A financing institution may choose to underwrite the entire acquisition loan facility and engage in multiple sell-downs after the closing or invite other lenders to form a syndicate in order to finance the acquisition. Although syndicated acquisition loans are common in the market, there has been an increasing trend towards a single leader or a small group of arrangers fully committing to the entire facility followed by post-closing sell-downs.

In order to facilitate sell-downs, the lead arranger may offer interest rate options in the financing terms which allow a loan transferee to select either a fixed rate or floating rate of interest within a certain designated period of time after the initial utilisation of the loan.

Floor rate and market flex provisions were seldom included in acquisition financing terms prior to 2022. However, due to the recent interest hikes and liquidity crunch, more lenders prefer to have these interest rate protection options reflected in the financing terms for increased chance of successful syndication.

### Bridge Loans

A bridge loan is one of the popular ways to finance large M&A. Bridge loans are generally put in place to bridge the gap between the initial funding of the acquisition and the borrower obtaining the longer-term funding of the acquisition. There are various types of bridge financing depending on the types or the value of the collateral provided by the borrower or the sponsor.

One of the most common bridge loan types is a short-term bridge loan where a private equity buyer incurs a financing to bridge the gap between the acquisition closing until the buyer can secure equity financing from its limited partner (LP) investors. Such bridge loans are temporary loans with a maturity of one year or less.

These bridge loans are secured by the equity commitment issued by the general partner (GP) investor or the private equity (PE) sponsor, which provides that the GP investor or the PE sponsor is responsible for repayment of the loans should there be a default. Such equity commitment usually provides that at maturity or upon acceleration of the bridge loan due to an event of default:

- the PE sponsor is required to make an equity contribution to the borrower in an amount equal to or exceeding the respective bridge loan principal and interest amount; and
- the GP investor is required to make capital calls to its LP investors for the purpose of enabling the PE sponsor to repay the loan.

Prior to the amendment of the Financial Investment Services and Capital Markets Act in 2021, it was unclear whether a PE fund could issue an equity commitment under the Act in connection with a financing. However, the amendment clarified that a PE fund is able to issue an equity commitment in connection with a loan, so long as a certain leverage ratio limit is complied with.

### Tender Offers

Obtaining an acquisition financing to fund tender offers has become a trend in the Korean market. A tender offer made for Ostem Implants in the earlier part of 2023 is an example of such trend, where the sponsor contemplated using the acquisition loan proceeds to partially fund the tender offer.

Under the Financial Investment Services and Capital Markets Act, a tender offer report must be filed with the Financial Supervisory Service and the Korea Exchange before a tender offer is made. The filing must be accompanied by documents evidencing that the funds necessary for the tender purchase have been secured.

Until recently, Korean financial regulators required the potential tender offeror to deposit cash in a tender purchase account and submit documents relating to the account as evidence of secured funds. Such cash deposit requirement meant that the mechanism of securing and releasing loan proceeds for the tender offer had to be carefully negotiated and documented to ensure that the transaction could proceed without any hiccups.

However, in recent years, regulators have been willing to take a more flexible approach to securing tender purchase funds before filing a tender offer report. More recently, financial regulators have announced that a letter of commitment issued by financial institutions may be recognised, under certain circumstances, as evidence that the tender offer funds have been secured. Given such announcement, the authors expect that potential offerors will more frequently use a letter of commitment to evidence that funds needed for tender purchases have been secured in the future.

### The Act on Protection of Financial Consumers

With the implementation of the Act on Protection of Financial Consumers in 2021, the majority of financial institutions participating in domestic acquisition financing have also become subject to the provisions of the Act.

In light of the Act, the factors below should be considered in the context of acquisition loan documents.

- The Act limits the scope of parties that may provide personal guarantees to those who have a certain relationship with the borrower (ie, CEO, largest shareholder, etc). Therefore, a third party who provides a personal guarantee for a borrower should be a person who is allowed to provide a guarantee under the Act.
- The Act places certain restrictions on prepayment charges. In particular, a prepayment fee can be charged if prepayment is made within three years from the utilisation. A prepayment fee cannot be imposed if the prepayment is made after the three-year period.
- Under the Act, demanding additional collateral or guarantees, which exceed the scope of collateral or guarantees customarily required to consummate the relevant transaction, is prohibited. Financial regulators have not yet provided a clear guideline regarding this requirement, but in the acquisition finance context, being granted additional collateral (ie, when the borrower's shareholders are asked to provide both personal guarantees and a pledge on the shares issued by the borrower as security) may violate this requirement. Further regulatory developments should be monitored to ensure that a security package for an acquisition financing does not result in breach of the Act.

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