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INTERNATIONAL FINANCIAL LAW REVIEW

CROSS-BORDER FINANCING REPORT 2013



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Milbank

South Korea

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Section 1 – Bank licences

1.1 What licences/approvals do lenders need to have if lending to a borrower in this jurisdiction if a) the lender is a bank or b) the lender is not a bank? Describe any mitigants typically employed to structure around any such requirements.

Any entity wishing to engage in the lending business in Korea must be appropriately licensed. Foreign banks and non-banking institutions must obtain a licence to engage in the lending business under the Act on Registration of Lending Businesses and Protection of Finance Customers.

Whether a lender engages in the ‘business’ of lending requires factual analysis of the lender’s activities. In order to minimise the licensing requirement risk, foreign lenders should refrain from activities that might be characterised as carrying on a lending business in Korea, such as negotiating the terms of the loan or related documents in Korea.

Section 2 – Taxes

2.1 Are there any requirements to make deductions or withhold tax from payments made to domestic or foreign lenders in this jurisdiction? Describe any mitigants typically employed to structure around any such requirements.

Interest paid to a domestic corporate lender is generally subject to Korean withholding tax at the rate of 14%. For a foreign lender (without a permanent establishment in Korea), the withholding tax rate is generally 22%, subject to reductions and exemptions that may be available under an applicable tax treaty.

There is no Korean withholding tax on foreign currency denominated bonds issued outside of Korea to a non-resident (in each case, without a permanent establishment in Korea). As such, the issuance of bonds may be an alternative source of financing if withholding tax is a concern.

2.2 Is interest on debt tax deductible for borrowers incorporated in your jurisdiction?

Yes.

2.3 Are there any thin capitalisation rules in effect in this jurisdiction which would impact the amount of debt that can be borrowed/guaranteed by entities incorporated there?

There are thin capitalisation rules for (i) borrowings from certain foreign-controlled shareholders (FCS) or (ii) borrowings from unrelated third parties that are guaranteed by an FCS.

If a Korean company borrows from (i) its FCS or, (ii) an unrelated third party with a guarantee (or grant of security) from the FCS in an amount exceeding 300% (600%, in the case of financial institutions) of its equity, interest on the excess of (x) the amount of such borrowings over (y) 300% (or 600%, as the case may be) of such equity will not be tax-deductible.

2.4 Are there any other important tax concerns that lenders to borrowers incorporated in this jurisdiction should be aware of?

In order to obtain exemption under a tax treaty, a foreign lender should provide the withholding agent (usually the borrower) with an application for exemption (together with a certificate of residence issued by a tax authority of its jurisdiction) before receiving payments of interest.

Section 3 – Security interests

3.1 Please confirm that viable security is available over the following asset classes, with reference to the documentation or formalities or costs required to create, perfect and maintain such security and confirm whether or not a universal security agreement which grants security over all assets can be utilised.

- a) shares
- b) bank accounts
- c) receivables (including intercompany, shareholder and trade receivables)
- d) contractual rights other than receivables
- e) insurance policies
- f) real property
- g) plant, machinery, equipment and other movables
- h) intellectual property
- i) debt securities
- j) future/after acquired property

There is no concept of a universal security agreement under Korean law.

Depending on the type of assets offered as collateral, one of the following three types of security interest may be created: mortgage, pledge or *yangdo dambo* (an assignment for security purposes). There is also a newly-legislated security regime under the Act on Security Over Movables and Receivables which came into force in June 2012 (the New Act), which provides an alternative means for creating security interests in movable properties and receivables (other than intellectual property).

Mortgage

Security over real property and certain registrable personal/movable property, such as motor vehicles, may be constituted by a mortgage.

To create and perfect a mortgage, the mortgagor and the mortgagee must execute a mortgage agreement and register the mortgage with the relevant registry.

Pledge

A pledge may be granted over movable properties (that are not registrable), claims or rights against third party obligors (*chae-kwon*) or shares.

To create and perfect a pledge, (i) the pledgor and the pledgee must enter into a pledge agreement, (ii) the pledgee must have actual (or deemed) possession of the collateral and (iii) in the case of a pledge of *chae-kwon*, a notice of pledge is given to, or the consent to pledge is obtained from, the obligor. Notices and consents must be affixed with a fixed-date stamp, which may be obtained at post offices, local government offices and at public notaries’ offices. There is no registration requirement for creation or perfection of a pledge.

The requirement of actual physical possession may not be practicable or possible for certain movable goods such as inventory or equipment. In such cases, creditors often resort to the method of creating and perfecting a security interest by way of *yangdo dambo*, which is discussed below.

Yangdo Dambo

This is a type of security constituted by way of transferring legal title to the collateral to the creditor for security purposes. Typically, the physical possession of the asset is left with the debtor and the creditor is regarded as hav-

ing 'constructive' possession of the asset. This form of security is a non-statutory right which has developed through custom and is now recognised by Korean courts as a valid form of security. There is no registration requirement for creation or perfection of *yangdo dambo*.

In order to create a valid *yangdo dambo* security interest, the transferor and the transferee must enter into a *yangdo dambo* agreement. The perfection of *yangdo dambo* is the same as for a pledge, except that constructive possession is allowed in the case of *yangdo dambo*.

Act on Security Over Movables and Receivables

The New Act came into force in June 2012 and allows the creation and perfection of security interests in movable properties and receivables by registration of the security interests in these assets with a newly-established registry.

a) Shares

Security over shares may be taken by way of pledge or *yangdo dambo*.

A pledge over shares may be perfected by the delivery of share certificate(s) to the pledgee (the practice is also to endorse the share certificate(s) in favour of the pledgee). For book-entry shares, actual possession of share certificates is not necessary and perfection is achieved by noting the pledge in the books of the share registrar or the share custodian. In addition, in the case of certificated shares, the details of the pledge are recorded in the issuer's shareholders' registry. This recording is not a condition to perfection of the pledge, but it is done to enable the pledgee to assert rights associated with the pledged shares directly against the issuer.

Yangdo dambo of shares may be perfected by the assignor delivering the share certificate(s) to the assignee, with such share certificate(s) endorsed in favour of the assignee.

b) Bank accounts

Security over cash deposits is usually created by way of pledge of bank accounts.

In order to perfect the pledge, a fixed-date stamped notice of the pledge is sent by the pledgor to the account bank, or the account bank provides a fixed-date stamped consent to such pledge (but, typically, both notice is given and consent obtained). The pledgee must also receive the document(s), if any, evidencing the rights over the account (for example, an account passbook) to establish possession of the account.

c) Receivables (including intercompany, shareholder and trade receivables)

Receivables constitute a right or claims against third parties (*chae-kuon*). Either a pledge or *yangdo dambo* may be created with respect to receivables.

d) Contractual rights other than receivables

Please see our response to c) above, but usually *yangdo dambo* is taken with respect to contractual rights.

e) Insurance policies

Please see our response to c) above.

f) Real property

Security over real property is constituted by a mortgage. As a building is treated as a property interest separate from land, a mortgage of a building would need to cover both the building and the underlying land. A mortgage of real property is perfected by filing the mortgage with the relevant real estate registry.

The mortgage filing requires a payment of registration tax, which is 0.2% of the maximum secured amount in the case of a *kun-mortgage* (a *kun-mortgage* permits the amount of secured obligation to vary from time to time within a maximum secured amount limit specified in the mortgage) and 0.2% of the secured amount in the case of a mortgage.

g) Plant, machinery, equipment and other movables

Security over plants and equipment may be taken by way of a comprehensive factory mortgage (*gongjang jeodang*). This type of mortgage creates a security interest in all of the real property, the plant (including fixtures) and equipment constituting a factory property as set out in the registered list.

The perfection of the comprehensive factory mortgage is the same as perfecting a mortgage with respect to any real property.

The filing of a comprehensive factory mortgage requires a payment of registration tax, which is 0.2% of the maximum secured amount specified in the mortgage.

Title to certain heavy machinery used for construction requires registration with separate registries, and security over such machinery may be taken by way of mortgage.

A security interest over non-registrable movable goods may typically be taken by way of pledge, together with actual possession of the underlying asset, or by way of *yangdo dambo* if actual possession is not practicable.

h) Intellectual property

Security interests in patent, trademark and design rights and copyrights may be effected by way of pledge. Pledges over patent, trademark and design rights are registered with the Korea Intellectual Property Office for perfection; a pledge of copyright is registered with the Copyright Commission of Korea.

i) Debt securities

Please see our response to a) above.

j) Future/after acquired property

Security interests may be granted in future or after acquired property, but perfection can only be achieved once the pledgor actually obtains title to such property.

Under *yangdo dambo*, it is possible to take security over a fluctuating pool of assets.

3.2 Highlight any issues with securing obligations that may arise in the future.

As a general matter, Korean law allows obligations that may arise in the future to be secured only if such obligations can be identified with a degree of specificity.

3.3 Can security trustee or security agent structures be used in this jurisdiction to secure obligations that are owed to fluctuating creditor classes? If not can parallel debt or joint and several creditor structures or similar techniques be employed to similar effect?

The generally accepted view in Korea is that a parallel debt structure may be used to allow a security agent or trustee to hold a security interest in connection with a debt facility with fluctuating creditor classes. However, in such cases, the debt owing to the security agent/trustee must be established as an independent and separate obligation owed by the debtor to such person, apart from its obligations to the creditor classes.

3.4 Briefly outline any issues that need to be considered when transferring loans and accompanying security interests between lenders.

In the event that a parallel debt structure is not used, the relevant security agreements (and registration of security interests) will need to be amended to reflect any change in secured parties.

3.5 Can security be granted by an entity which is neither a borrower nor a guarantor? Are there any rights of contribution, subrogation or similar that might arise as a result of granting/enforcing purely third party security that ought to be/can be waived?

Security can be granted by a third party. The third party has contribution and subrogation rights against a borrower after the third party security is enforced. Such rights may be waived.

3.6 Briefly outline the registration requirements, if any, applicable to security interests in this jurisdiction including any practical considerations such as the time/expense associated with registration.

Registration is required for security interests in registrable assets such as real property.

Time and expense associated with registration depend on the type of assets concerned. For instance, the major cost associated with establishing a mortgage over real property is registration tax, which is 0.2% of the maximum secured amount. Under the New Act, the following registration fees and taxes apply:

- registration licence fee: secured amount x 1/1000
- local education tax: registration licence fee x 20%
- stamp tax (supreme court): \$14.00

3.7 Briefly outline any regulatory or similar consents that are required to create security over a local company's assets.

Loans and certain other transactions between a non-resident and a resident require a filing of a report under the Foreign Exchange Transactions Act. Once such filing is made and accepted by the relevant governmental authority, further consents or filings are not necessary.

3.8 Briefly explain the rules governing the priority of competing security interests.

The priority of competing security interests is determined by order of perfection. For mortgages, the date of registration will determine priority. In the case of a pledge or *yangdo dambo*, priority is determined in the order of the date a notice or consent with fixed date stamp is given or obtained, except that with respect to shares, the creditor who possesses the certificates will have priority.

Section 4 – Guarantees

4.1 Briefly explain any formalities required for guarantees to be enforceable.

None.

4.2 Briefly explain the downstream (parent to subsidiary), upstream (subsidiary to parent) and cross-stream (between sister companies within one group) guarantees available, with reference to any particular restrictions or limitations. Are there any techniques typically employed to enhance credit support/guarantees that might otherwise be limited?

In general, a company is restricted from providing a guarantee to an affiliate without receiving a corporate benefit. Such restriction makes upstream guarantees difficult. Further, if a company is a member of a Korean conglomerate which falls within a 'designated corporate group' under the Monopoly Regulation and Fair Trade Act (Monopoly Act), it is prohibited from providing any type of downstream, upstream or cross-stream guarantees to another group member.

4.3 What regulatory or other consents are required for the granting of downstream, upstream and cross-stream guarantees (aside from board/shareholder approvals)?

The granting of such guarantees does not itself require governmental approval or consents.

4.4 Briefly outline any enforceability concerns associated with the granting of downstream, upstream and cross-stream guarantees that lenders should be aware of, including reference to any exchange controls or similar obstacles.

Other than the restrictions discussed above, none.

Section 5 – Enforcement

5.1 Do the local courts generally recognise and enforce foreign-law governed contracts?

Yes, except with respect to matters that involve (i) the mandatory laws of Korea, which are required to be applied irrespective of the governing law, (ii) Korean laws regarding the capacity of the party incorporated or established in Korea to enter into contracts and, (iii) Korean laws requiring governmental approvals, authorisations or consents.

5.2 Will the local courts generally recognise and enforce a foreign judgment that is given against a domestic company in foreign courts (particularly the New York or English courts) without re-examining the merits of the decision?

The Korean courts will enforce a judgment without re-examining the merits of the case if the following factors are satisfied:

- such judgment was finally and conclusively given by a court having valid jurisdiction;
- a defendant, who has lost a case, received service of process, other than by publication or similar means, in sufficient time to enable such party to prepare its defence in conformity with the laws of the relevant foreign jurisdiction (or in conformity with the laws of Korea, if service of process was made on the defendant in Korea) or responded to the action without being served with process;
- such judgment is not contrary to the public policy of Korea; and,
- judgments of the courts of Korea are accorded reciprocal treatment under the laws of the relevant foreign jurisdiction.

5.3 Will the local courts recognise and enforce an arbitral award given against the company without re-examining the merits of the decision?

If the country where the seat of the arbitration lies is a signatory to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (the New York Convention), the award would be recognised and enforced so long as it meets the requirements under the New York Convention.

If the New York Convention does not apply, the Civil Procedures Code of Korea regulates the recognition and enforcement of foreign court decisions. The additional requirements under the Civil Procedures Code (as compared with the New York Convention) are that the application for arbitration and other summons have been duly served and there is reciprocity of enforcement between the relevant countries.

5.4 When enforcing security, what factors significantly impact the time such enforcement takes and the value of the proceeds received from such enforcement? For example, are there any statutory requirements such as (a) holding a public auction; (b) court involvement; or (c) obtaining regulatory consents?

A secured creditor is not prescribed by law to enforce its security interest in any particular manner and may elect from remedies specified in the relevant security agreement.

5.5 Briefly comment on the likely cost of any enforcement process.

The cost of the enforcement process depends on the type of collateral and the security interests involved. For instance, the fees and expenses to commence a court auction based on a mortgage over real estate consist of the following:

- registration tax (0.2% of the claim amount);
- educational surtax (20% of the registration tax); and,
- other fees and expenses relating to the auction (which generally amount to two to three percent of the real estate's appraised value).

5.6 Are there any restrictions that apply specifically to foreign lenders when taking enforcement action?

No.

Section 6 – Bankruptcy and insolvency proceedings

6.1 Briefly outline the main bankruptcy/insolvency processes in your jurisdiction, with reference to any control or influence that creditors can exert on the process, the timeframes usually involved and any mandatory filing requirements.

The Debtor Rehabilitation and Bankruptcy Act (the Act) provides for two different types of insolvency proceedings. These proceedings consist of (i) bankruptcy proceedings and (ii) corporate rehabilitation proceedings.

A bankruptcy proceeding may be initiated by the insolvent debtor, any director of the debtor company or the creditors of the debtor. The filing for bankruptcy may be made if (i) the debtor is not able to pay all of its debts or (ii) the total debts of the debtor exceed its total assets. The adjudication of bankruptcy is usually made within one month of filing of a bankruptcy petition. The unsecured creditors must file their claims within the court-determined filing period, which varies between two weeks to three months after the adjudication of bankruptcy.

A corporate rehabilitation proceeding may be initiated by any creditor that holds claims of an aggregate amount that is at least 10% of the debtor's stated capital or by any shareholder controlling 10% or more of the total issued and outstanding shares of the debtor. A filing for a rehabilitation proceeding may be made if (i) the debtor is reasonably likely to become eligible to file for bankruptcy or (ii) the debtor is unable to pay its debts as they become due without significantly harming the continuity of its business.

Upon commencement of the rehabilitation proceeding, there is a statutorily prescribed period during which (i) creditors may object to the list of creditors and claims filed by the receiver by filing a proof of claim, (ii) the receiver and other interested parties may dispute claims filed by a creditor and (iii) a creditor may file for a review of claim and initiate a claim allowance proceeding.

The rehabilitation plan is generally prepared and submitted to the court by the receiver. The plan must be approved by each group of interested persons

(secured creditors, unsecured creditors and shareholders). For a secured creditor group, generally not less than three-quarters of the total voting rights held by such persons must consent to the plan. For an unsecured creditor group, not less than two-thirds of the voting rights held by such persons must consent to the plan.

The interested persons must vote on the plan within two months of their initial meeting (subject to one month's extension by the court). If the plan is not adopted within a year of the commencement of the proceeding (which may be extended for an additional six months by the court), the court may exercise its discretion to terminate the proceeding or modify the plan for its approval.

Once the plan is ratified by interested persons, the court makes a determination as to whether the plan should be accepted.

6.2 Are there any preference, fraudulent conveyance, claw-back, hardening periods or similar issues or preferential creditor rights that lenders should be aware of?

The Act allows a trustee or a receiver in insolvency proceedings to avoid or set aside transactions that are deemed to harm the interests of the creditors.

Other creditors may raise fraudulent conveyance claims regardless of a commencement of bankruptcy or rehabilitation proceedings. Under the Korean Civil Code, if a debtor commits an act with the knowledge that such action would harm its creditors, any creditor of the debtor may petition a court to set aside such action.

6.3 Do bankruptcy/insolvency processes provide for any kind of stay/moratorium on enforcement of lender claims? If so, does the stay/moratorium apply to the enforcement of security interests?

Secured creditors remain free to exercise their security interests in a bankruptcy proceeding. In a corporate rehabilitation proceeding, however, creditors may be stayed from exercising their creditors' rights, including enforcement of security interests.

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David Bernstein, corporate partner, K&L Gates

Section 7 – Other matters

Financial assistance

7.1 Are there any restrictions in place on locally incorporated companies in assisting the acquisition of shares in itself, its sister companies or in its holding companies? Do these prohibitions apply to all forms of company, to companies being acquired which are incorporated outside this jurisdiction and indirect holding companies?

A company may acquire its own shares up to an amount equal to its distributable income. Accordingly, a company may assist such acquisition to the extent it has distributable income.

A company may not acquire shares in its parent company (a company which owns at least 50% of the shares in the subsidiary). If a company is a member of a certain designated Korean conglomerate under the Monopoly Act, the company may not acquire the shares in its sister companies or holding companies that already own shares in the company. Further, there are general

restrictions under law regarding fiduciary duties of directors and specific restrictions under the Monopoly Act that would prohibit a company from providing financial assistance in connection with the acquisition of shares in its sister companies or in its holding companies in the absence of sufficient corporate benefit.

7.2 Are there any exceptions to these restrictions? Are there any structuring techniques that can be employed in order to achieve target collateral support?

Certain structuring techniques, such as merger of target and bidco, may be employed depending on the specific facts underlying a financing. However, Korean laws relating to financial assistance are generally strictly applied, and a careful consideration of the overall circumstances of the financing is necessary in using any structuring technique.



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