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Joint ventures

South Korea

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A NORTON ROSE GROUP GUIDE

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South Korea

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Making the investment

Foreign ownership and control

Foreigners can freely make investments in the Republic of Korea (Korea) and in practice they have actively invested. The Foreign Exchange Transactions Act (FETA) regulates transactions in Korea involving foreign exchange, including the acquisition of shares of a Korean company by foreigners. The Foreign Investment Promotion Act (FIPA) was enacted to stimulate foreign investment which meets certain requirements. Under the FIPA, the procedures for such foreign investment are simplified and when certain requirements are met, various benefits such as tax exemptions or reductions are given to the foreign investor.

However, in some industry sectors, certain specified restrictions are placed on foreign investment or governmental approval is required. For example, foreign ownership restrictions (concerning voting shares) are applicable in some cases – eg, in the energy industry (eg, power business), transportation (eg, air transportation), telecommunications and broadcasting industry (eg, newspaper and cable TV businesses); and in other cases, such as the national defence industry, prior approval from the competent authority is required for a foreigner to acquire shares of a Korean company above a prescribed shareholding ratio. In other words, although in principle freedom of foreign investment is ensured in Korea, due to the possibility of applicable restrictions depending on the industry sectors, it would be advisable to check relevant procedures and requirements in advance of making a contemplated investment.

The following is a summary explanation of foreign investment in a Chusik Hoesa (a joint stock company, the most typical form of company in Korea) that is privately-held, unless otherwise specified.

Bilateral investment treaties

As of December 2011, Korea has entered into bilateral investment treaties (BITs) with 93 countries, of which the BITs with 85 countries (consisting of 31 are in Europe, 21 in Middle East/Africa, 16 in Asia, and 17 in America) are in effect.

BITs are very similar to one another in substance, including, among others, the most-favoured-nation-treatment clause and a national-treatment clause applicable to investors, guarantee against investment loss caused by war, civil war and so on, guarantee of remittance of returns on investment, resolution of disputes between an investor and the country in which investment is made, and compensation in the case of nationalisation and expropriation.

Statutory minority protection and conflicts with shareholder agreements

The meeting of shareholders of a Chusik Hoesa (Shareholders Meeting) has the highest decision-making authority of the corporation on such matters as prescribed by law or its articles of incorporation (AOI).

A general resolution such as for the appointment of directors/statutory auditors, approval of financial statements, requires the affirmative vote of a simple majority of voting shares present or represented at the Shareholders Meeting. On the other hand, a special resolution (eg, for dismissal of directors/statutory auditors, capital reduction and merger) requires the affirmative vote of two-thirds of voting shares present or represented at the Shareholders Meeting. Thus, control over a matter can be ensured by securing one share plus 50 per cent of all voting shares, if it requires a general resolution, and two-thirds of all voting shares, if it requires a special resolution.

As the principle, “one vote for one voting share” is applicable. But, according to the amendment to the Commercial Code which will come into force on April 15, 2012, a company may issue class of

shares with no voting rights or limited voting rights for certain resolution provided by the articles of incorporation. Still, shares with weighted voting rights or a casting vote is not permissible. However, since in practice most of material decisions are made at a meeting of the board of directors (Board), it would be important to control the Board in order to exercise management control effectively. The representative director of a corporation has the authority to represent it and conduct all businesses on its behalf. Generally, the representative director is appointed at the Board meeting while the AOI confers such authority on the Shareholders Meeting.

The requirement for a quorum at a Board meeting is satisfied by the presence of a majority of all directors of the company and a Board resolution requires the affirmative vote of a simple majority of all directors present at the meeting. It is permissible for shareholders to agree in a shareholders' agreement higher requirements for a Board resolution than prescribed by law, and to impose sanctions (eg, compensation for damages) for violation of the shareholders' agreement.

The Korean Commercial Code (KCC) guarantees certain rights of minority shareholders. Some of such statutory minority protections are as follows:

- a shareholder holding one share of a company may exercise his right against the company to inspect and copy corporate documents (eg, the AOI, minutes of Shareholders Meetings, etc) and bring a claim in a court against the company for rescission of a resolution adopted at the Shareholders Meeting, or to seek court's confirmation that a resolution adopted at the Shareholders Meeting is invalid

- shareholders holding one per cent or more of all issued and outstanding shares of a company may demand the suspension of illegal action by a director of the company and

- shareholders holding three per cent or more of all issued and outstanding shares of a company may call for a Shareholder Meeting, propose an agenda thereof, request the dismissal of a director/statutory auditor and exercise his right against the company to inspect and copy accounting books of the company

- minor shareholders may request controlling shareholders owning at least 95 per cent of the stock of a company to purchase the shares owned by him, and the controlling shareholder shall purchase the shares of minor shareholders within 2 months after receiving the request.

Issues commonly encountered by a foreign or domestic minority shareholder

Employment

Korea has an enhanced legal system for the protection of employees. The Labour Standard Act (LSA) and other employment-related laws and regulations provide for strict standards for labour conditions and reasons for termination of employment, to protect employees.

Tax

In Korea, corporate tax is imposed with respect to income of a corporation, while income tax is imposed with respect to income of an individual. In addition, in relation to transactions involving stock, capital gains tax and securities transaction tax can be imposed, and in the case of acquisition/registration of specific properties (most typically, real properties), acquisition/registration tax may also be imposed.

Competition law and merger control

Under the Monopoly Regulation and Fair Trade Act, certain business combinations involving joint ventures may be subject to mandatory pre-merger (ie, before the closing of the business combination) or post-merger (ie, after the closing of the business combination) clearance by Korea's Fair Trade Commission (KFTC). These merger clearance requirements apply to a variety of business combinations, including minority share acquisitions.

The following transactions constitute "business combinations" under the Act:

- the acquisition of the shares of another company, when such acquisition leads to the holding of at least 20 per cent of total shares, or 15 per cent in the case of listed companies

- the transfer of the whole or a substantial part of the business of another company; or the transfer of the whole or a substantial part of the fixed operating assets of another company

- participating in the establishment of a new company and becoming the largest shareholder thereof
- mergers or
- the establishment of an interlocking directorate of a large-scaled company (ie, company with a total revenue or assets exceeding KRW2 trillion).

A situation where a joint venture is formed through the acquisition of shares of an existing company or the participation in the establishment of a new company would fall within the first type of business combination listed above if the equity thresholds are met, irrespective of whether the joint venture constitutes an autonomous business in economic terms.

Business combinations are subject to post-merger clearance by the KFTC if all of the following conditions are met:

- one party to the transaction had total worldwide assets or annual sales of at least KRW200 billion during the last financial year
- another party to the transaction had total worldwide assets or annual sales of at least KRW20 billion during the last financial year
- in the case of business combinations between foreign businesses, each of the foreign entities achieved turnover within South Korea of at least KRW20 billion during the last financial year.

Business combinations that meet the above thresholds are subject to pre-merger clearance by the KFTC if one of the parties to the business combination had total assets or achieved annual sales over KRW2 trillion during the last financial year (except for the establishment of an interlocking directorship, which is subject to a post-closing notification).

Certain companies and investment funds are exempt from notification requirements if they fall within specific exemption conditions.

Post-merger notifications must be made within 30 days after the business combination is formed. The starting date for the 30-day period differs depending on the type of business combinations. Pre-merger notifications can be made at any time after the signing of the transaction documentation but before the closing of the business combination.

The KFTC has 30 days to decide whether or not to approve the business combination, but may shorten or extend this review period by an additional 90 days.

Objectives and termination

A Chusik Hoesa may have a finite term of existence. In such case, the term of its existence must be registered with the commercial registry, and expiry of the term serves as a reason for dissolution of the corporation. However, in practice a corporation seldom pre-sets its life term.

In addition, a corporation may be dissolved:

- upon occurrence of any event provided in the AOI
- upon merger or bankruptcy
- upon spin-off
- pursuant to a court's order or decision for dissolution of the company or
- by special resolution adopted at the Shareholders Meeting.

Thus, it is permissible to provide for special reasons for dissolution in the AOI. Once a corporation is subject to dissolution, the procedures for its liquidation will begin to wind up all of its rights and obligations.

The KCC does not provide for a deadlock, which thus needs to be resolved under a shareholders' agreement. The parties may agree how to handle the occurrence of a deadlock – for example, it is possible to allow a party to exercise a put or call option (ie, right to sell its shares to another shareholder or purchase shares of another shareholder) upon the occurrence of a deadlock.

In many cases, the exercise price of a put or call option is calculated based on a fair market value of underlying shares. However, controversy often arises from how to calculate the exercise price, it would be advisable to have a shareholders' agreement expressly and specifically provide for the procedures and method of evaluation of the stock in the case of exercise of a put/call option.

In principle a shareholder may freely transfer stock held by him. However, it is also possible to require approval from the Board in the case of transfer of stock if so provided in the AOI. No statutory right of first refusal is recognised. However, it is permissible to grant a right of first refusal, tag-along rights and the drag-along rights to shareholders under a shareholders' agreement. It should be noted that such rights are just contractual rights to the parties to a shareholders' agreement and cannot be enforced against a third party. Thus, transfer of stock in violation of a shareholder agreement itself cannot be invalidated but there only remains an issue of compensation for damages against a party to the contract for the violation thereof.

Governing law

Parties to a joint venture agreement and a shareholders' agreement can freely agree to the governing law, the method of dispute resolution, jurisdiction and venue. However, regardless of which law is agreed to be the governing law, the mandatory laws of Korea – eg, the MRFTA, the LSA, tax laws, etc – will apply, where applicable. Though separate review would be required on a case-by-case basis, in many cases the foreign arbitration awards and decisions are enforceable in Korea – because Korea is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and because the Korean court takes a very generous stance in this respect.

Offshore structures

While in the past special purpose companies (SPC) were formed in tax havens, such as the Cayman Islands, to reduce taxes arising from investment in Korea, the regulatory framework of the tax law of Korea now covers foreign investment through SPCs in tax havens, mainly by looking through the SPCs to find the real investors (the beneficial owners of the shares held by SPCs). Accordingly, investment through SPCs in tax havens may not enjoy the benefits previously available.

Managing the investment

Veto rights, reserved matters and weighted voting

The KCC provides for the principle of "one vote per voting share" and no veto right or weighted voting is recognised by operation of law. However, it is permissible to enhance the requirements for a resolution adopted at the Shareholder Meeting on certain matters, if so reflected in the AOI in advance. As for to what extent it is permissible to enhance the requirements, there still is controversy among legal scholars and commentators and there is no precedent. In practice, occasionally a veto right is in substance granted to a particular shareholder or director by enhancing the requirement for a resolution adopted at the Shareholder Meeting or by the Board on certain specified matters.

Governance

The Shareholders Meeting of a Chusik Hoesa has the highest decision-making authority of the corporation on such matters as are prescribed by law or its articles of incorporation (AOI). A company must hold an ordinary general meeting of shareholders (Ordinary Meeting) once a year, and may hold extraordinary general meetings of shareholders (Extraordinary Meetings) when necessary. Matters requiring a general resolution by shareholders require the affirmative vote of a simple majority of shares present or represented at the Shareholders Meeting, and one-fourth of all issued and outstanding shares of the corporation. Thus, a shareholder holding one share plus 50 per cent of all issued and outstanding shares of the corporation may alone adopt a general resolution for the appointment of directors/statutory auditors, the approval of financial statements, and the like.

A special resolution requires the affirmative vote of two-thirds of voting shares present or represented at the Shareholders Meeting, and one-third of all issued and outstanding shares of the corporation. Thus, in general, a shareholder holding two-thirds of all voting shares of the corporation may alone adopt a special resolution for the dismissal of directors/

statutory auditors prior to expiry of their respective terms, capital reduction, merger, and so on.

Directors are appointed by a general resolution at a Shareholders Meeting, while material decisions of the company are made by the Board. The quorum of the Board meeting is satisfied by the presence of a majority of all directors of the company and a Board resolution requires the affirmative vote of a majority of all directors present at the meeting. Under the KCC, it is permissible to have more stringent requirements for a Board resolution, if so provided in the AOI. However, it is still controversial and there is no precedent, as to what extent the requirements can be enhanced. Though there are commentaries that requiring unanimous affirmative votes or granting a veto right to a certain director is invalid, due to lack of precedents expressly on the point it would be difficult to render a definitive conclusion on this issue. However, under the principle of "freedom of contract" it is permissible for shareholders to agree to set (a) higher requirements for a Board resolution than prescribed by law and further (b) the effects of violation of the shareholders' agreement. On the other hand, it is not permissible under the KCC to grant any weighted voting right (eg, multiple voting rights) to a particular director.

There is no restriction on the nationality or residence of a director of a corporation. The KCC recognises three categories of directors, namely "inside directors", "outside directors" and "non-standing directors" (who are inside directors but are not involved in the daily affairs of the company). Thus, the KCC categorises directors first into inside directors and outside directors, and then further categorises inside directors into ordinary inside directors (who engage in the daily affairs of the company) and non-standing directors (who do not engage in the daily affairs of the company). Outside directors are similar to independent directors under U.S. corporate law.

Under the KCC, certain requirements need to be met in order to qualify as an outside director and to maintain their independence from management. For example, persons who fall under any of the following categories (among others) may not be an outside director of a company:

- a director or employee of the company currently engaged in the daily affairs of the company, or a director, statutory auditor or employee of the company who has engaged in the daily affairs of the company during the previous two year period
- if the largest shareholder is a natural person, that person, his/her spouse, parent or child
- if the largest shareholder is a company, a director, statutory auditor or employee of such company.

Each director of a company has a duty of care as a good manager owed to the company. If a director violates any law, regulation or AOI intentionally or by negligence or neglected to perform his duties, he is liable for damages to the company. This liability of director may be released by the consent of all shareholders. Also under the amendment to the Commercial Code, the company may exempt the liability of directors in accordance with the provisions of the articles of incorporation where the amount exceeds more than six times the director's recent one year's remuneration. However, this does not apply in case where the directors have caused damage to the company intentionally or by gross negligence, or violated the prohibition of competing with the company, involved in self dealing or used corporate opportunity which is prohibited by the Commercial Code. Shareholders holding one per cent or more may demand that the company brings a lawsuit against a director for his liabilities. If a director of a company neglects his duties intentionally or by gross negligence, the director is personally liable for damages to any third parties.

A director must submit a financial statement to the statutory auditor of the company at least six weeks prior to the Ordinary Meeting, and submit the audited financial statement to the Ordinary Meeting for approval. Minority shareholders may exercise their right to inspect and copy accounting books of the company, they can inspect certain accounting books with due cause, so that they can monitor major issues concerning corporate management.

Capital calls and pre-emption rights

A corporation may raise new funds by way of a capital increase. In principle, the KCC ensures

that shareholders of a Chusik Hoesa are entitled to pre-emptive rights to new shares on a pro rata basis based on their respective shareholding ratios, whenever it increases its paid-in capital with consideration. However, the corporation may issue new shares to a third party by Board resolution, if:

- permitted under the AOI and
- also required for management reasons.

The allocation and issuance of new shares to a third party (Third Party Allocation) is often utilised as a means of diluting shareholding ratios of the other shareholders and increase management control of the incumbent Board, and thus in many of such cases, the validity of capital increase by the Third Party Allocation is challenged and disputed.

The KCC originally did not allow a majority shareholder to compel minority shareholders to sell their shares, or otherwise squeeze them out. Thus, if there are minority shareholders, it was very difficult for a majority shareholder to acquire a 100 per cent equity interest in the corporation. Although indirect routes could be taken – such as a tender offer, merger, comprehensive stock exchange or transfer, capital reduction, business transfer, and reverse split (consolidation of shares) – none of the foregoing were perfectly straight forward, from a legal perspective, as a method for squeezing out the minority shareholders.

However, according to the amendment to the Commercial Code, a shareholder owning at least 95 per cent of the stock of a company can buy out the stock owned by minor shareholder for the achievement of the company's operational objectives.

In addition, a corporation may be financed through borrowing funds from a financial institution. In practice, in many cases, a financial institution in Korea requires a debtor to provide either security interests (eg, mortgage over real property) of which value is equivalent to at least 130 per cent of the principal of a loan, or a personal guarantee of payment under which the representative director or the majority shareholder of a company is jointly and severally liable for the debt owed by the company.

In addition, a company may take another route of debt or equity financing – eg, issuing bonds, special types of debentures (eg, CB, BW, EB) or preferred stock without voting rights, or otherwise.

Non-compete undertakings

Generally, Korean law does not have provisions prohibiting competition in the context of joint ventures. However, under the principle of "freedom of contract" parties to a joint venture contract may agree to non-compete undertakings, which will in principle be effective unless violating any mandatory laws of Korea.

On the other hand, a director of a company cannot, without the approval of the Board, be engaged in any business competing with the company's business, or serve as a director of its competitor. In respect of non-compete undertakings by an employee whose employment with the company is terminated, if the scope of prohibition is too broad or if the term of the non-compete undertakings is too long, the undertakings may be found to be invalid, for unfairly infringing the employee's interests. Thus, it would be advisable to check in advance whether the substance and term of such undertakings are appropriate under Korean law.

Realising the investment

Deriving income

Korean law does not place any restriction on transferring dividends earned in Korea to recipients outside Korea. A Chusik Hoesa can distribute its distributable profits to shareholders by a general resolution adopted at the Shareholders Meeting, under the KCC. Further, under the amended Commercial Code, a company may decide to pay dividends by a resolution of board of directors if the articles of incorporation provide so. It is also permissible to return investment, through a capital reduction approved by a special resolution adopted at a Shareholders Meeting. Moreover, it is permissible to dissolve a company to return remaining assets to the shareholders through liquidation procedures.

Further, under the KCC, it is permissible to issue preferred stock, of which holders may be entitled to such preferential right to dividends or distribution of remaining assets as are set out in the AOI.

Realising capital (transfer restrictions)

There is no restriction on realising investments by way of a transfer of shares held by a foreign investor to any other person. However, filing of a business combination report may be required in relation to such transfer, or government approval may be required in some cases such as transfer of stock issued by a financial institution.

In relation to transfers of stock, it is permissible for the parties to agree to the right of first refusal or a put/call option, and such agreement is recognised as being valid in Korea. However, in some cases, prior reporting of such agreement to the Bank of Korea would be required. The Bank of Korea would rarely refuse to accept such a report.

Deadlock and termination provisions

The KCC does not specifically provide for a deadlock. Parties are free to agree what steps are to follow on the occurrence of a deadlock. Parties can also have freedom to agree to the termination or cancellation of a joint venture agreement in such manner as is agreed by them.

Further, an agreement to grant drag-along rights (rights to sell shares held by a shareholder together with shares held by another shareholder when the former intends to sell his shares to a third party) and an agreement to grant tag-along rights (rights to sell one's shares together with another shareholder when the latter intends to sell his shares to a third party) are recognised as being valid under Korea law. However, those rights are just contractual rights, binding upon and enforceable against the parties to the agreement only. Thus, even if the AOI of the company, reflecting such agreement, provide for tag-along or drag-along rights (as the case may be), such restrictions on transfer of stock cannot have any legal effect binding upon or be enforceable as against a third party.

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