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2011 Modularization of Korea's Development Experience:

Legal Infrastructure for Foreign Investment

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MINISTRY OF JUSTICE
REPUBLIC OF KOREA

Korean Association of Civil Law

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Preface

The study of Korea's economic and social transformation offers a unique opportunity to better understand the factors that drive development. Within one generation, Korea had transformed itself from a poor agrarian society to a modern industrial nation, a feat never seen before. What makes Korea's experience so unique is that its rapid economic development was relatively broad-based, meaning that the fruits of Korea's rapid growth were shared by many. The challenge of course is unlocking the secrets behind Korea's rapid and broad-based development, which can offer invaluable insights and lessons and knowledge that can be shared with the rest of the international community.

Recognizing this, the Korean Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI) launched the Knowledge Sharing Program (KSP) in 2004 to share Korea's development experience and to assist its developing country partners. The body of work presented in this volume is part of a greater initiative launched in 2007 to systemically research and document Korea's development experience and to deliver standardized content as case studies. The goal of this undertaking is to offer a deeper and wider understanding of Korea's development experience with the hope that Korea's past can offer lessons for developing countries in search of sustainable and broad-based development. This is a continuation of a multi-year undertaking to study and document Korea's development experience, and it builds on the 20 case studies completed in 2010. Here, we present 40 new studies that explore various development-oriented themes such as industrialization, energy, human capital development, government administration, Information and Communication Technology (ICT), agricultural development, land development and environment.

In presenting these new studies, I would like to take this opportunity to express my gratitude to all those involved in this great undertaking. It was through their hard work and commitment that made this possible. Foremost, I would like to thank the Ministry of Strategy and Finance for their encouragement and full support of this project. I especially would like to thank the KSP Executive Committee, composed of related ministries/departments, and the various Korean research institutes, for their involvement and the invaluable role they played in bringing this project together. I would also like to thank all the former public officials and senior practitioners for lending their time and keen insights and expertise in preparation of the case studies.

Indeed, the successful completion of the case studies was made possible by the dedication of the researchers from the public sector and academia involved in conducting the studies, which I believe will go a long way in advancing knowledge on not only Korea's own development but also development in general. Lastly, I would like to express my gratitude to Professor Joon-Kyung Kim for his stewardship of this enterprise, and to his team including Professor Jin Park at the KDI School of Public Policy and Management, for their hard work and dedication in successfully managing and completing this project.

As always, the views and opinions expressed by the authors in the body of work presented here do not necessary represent those of KDI School of Public Policy and Management.

May 2012

Oh-Seok Hyun

President

KDI School of Public Policy and Management

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Summary

A legal Infrastructure plays a significant role in investment. Investors risk their financial resources as they involve themselves with investment-related activities. To minimize risks, investors check the soundness of the legal infrastructure that governs their economic activities. Therefore, a sound legal infrastructure is a prerequisite in attracting investment. The need for a more reasonable legal infrastructure becomes even more eminent when it comes to the matter of foreign investment. Since foreign investors are not familiar with investment environment of the nation they seek to invest in, they heed more to the wholesomeness of the legal infrastructure of the nation. This shows the close inter-relationship between a legal infrastructure and investment. Given the importance of a legal infrastructure for investment, this paper aims to examine the legal infrastructure for foreign investment in Korea.

As can be inferred by the term "infrastructure," this paper mainly concentrates on basic and fundamental legal frameworks rather than specific legal details relating to foreign investment. Civil law and commercial law have been chosen as main areas of law to be addressed in this paper. Considering the wide scope of these laws, this paper narrowed down the subject matters to issues pertaining to real estate investment and corporate system. Other relevant statutory laws concerning these issues will also be reviewed when necessary. Further, the very first part of the paper will be devoted to a brief overview of the foreign-investment regulatory scheme in Korea in order to give a general idea of how foreign investment is viewed and treated in Korea.

Against this backdrop, we will first explain how the foreign-related regulatory regime has evolved and works in Korea (chapter 2). Then, we will proceed to elaborate on two notable features of Korean legal infrastructure relating to investment in the field of civil law and commercial law – the very cores of Korean private law. One is the legal infrastructure for real estate investment (chapter 3), and another is the legal infrastructure for corporate system (chapter 4). Then, the summary will be given (chapter 5) in conclusion.

Below is a brief summary of chapter 2, 3 and 4.

1. Regulatory Structure for Foreign Investment in Korea

As Korea desperately needed to secure financial resources in order to establish the foundation of the nation's economy, Korean government strived to induce the influx of foreign capital. The initial legislative steps were taken mostly during 1960s. However, it was not completely open-ended legal frameworks. Rather, there were still abundant regulatory elements based on the fear that local industry will be taken away and controlled by the foreign entities.

Closely monitoring of foreign investment policy continued through 1980s. For this reason, foreign loan-which might not lead to take-over of Korean domestic industry-was the main channel through which foreign financial resources were provided to the Korean economy, while foreign direct investment remained a subsidiary tool. During the 1990s, the liberalization process was stimulated by the desire to attract foreign investment along with the external pressure, notably from Organization for Economic Cooperation and Development (OECD) members that demanded that Korea reduce barriers to foreign direct investment. With Korea's accession to the OECD in 1996, and in particular with the IMF crisis beginning in 1997, Korea was pushed to reform the legal regime to actively attract foreign investment. However, the movement also had voluntary motive to diversify and expand the financial sources on which Korean economy could thrive. Most notably, the Foreign Investment Promotion Act was enacted in 1998 to accomplish this policy goal. With this change taking place, foreign direct investments began to increase.

Foreign portfolio investment-or foreign indirect investment-also increased with the advancement of the capital market.

In January 1981, Korean government announced "A Long-Term Plan for Liberalization of the Capital Market" in order to induce foreign capital and enhance the financing by Korean companies. According to the plan, foreign investment has been allowed step by step.

At first, an indirect investment through domestic securities investment trust was allowed with a specific license per each trust from the Minister of Finance pursuant the Securities Investment Trust Business Act and the Foreign Exchange Control Act of Korea, beginning in 1981.

Then, an indirect investment through offshore funds established for investment exclusively in Korean securities was allowed with a specific license per each fund from the Minister of Finance pursuant the Securities and Exchange Act and the Foreign Exchange Control Act of Korea, beginning in 1984.

Then, financing by Korean companies through overseas offerings of equity related securities was allowed with a specific approval per each offering from the Minister of Finance pursuant the Securities and Exchange Act and the Foreign Exchange Control Act of Korea, beginning in 1985.

In December 1988, Korean government announced “A Plan to Pursue Liberalization of Capital Market on an Enlarged Scale” in order to provide a specific schedule to push forward with the aforementioned 1981 plan. Following the 1988 plan, foreign investments in Korean stocks listed on the Korea Stock Exchange (KSE) subject to certain limitations pursuant the Securities and Exchange Act and the Foreign Exchange Control Act of Korea, beginning January 1, 1992.

In July 1993, Korean government announced “A Blue Print on Mid-term Plan for Liberalization of Financial Market” to further the opening of stock market and to provide for a schedule for gradual opening of bond market and securities industry. In 1994, foreign investment in Korean bonds listed on the KSE began to be permitted gradually.

In December 1996, Korean government joined the OECD and provided an overall plan to liberalize the transfer of capital and open its financial market. In 1998, the limitations on the type of financial products available for foreign investment were lifted. Now that foreigners are allowed to invest in any Korean securities including stocks and equities listed or not, corporate bonds listed or not, mutual funds and trusts, listed derivatives, CPs and warrants, under certain procedural limitations pursuant the Capital Market and Financial Investment Business Act and the Foreign Exchange Management Act of Korea.

2. Legal Infrastructure for Real Estate Investment

The most general legal infrastructure for real estate investment is Korean Civil Code (KCC). It is the lengthiest and perhaps the most influential of all Korean statutory laws, and it includes the law of right in rem, that is the most relevant part to real estate investment. In particular, transfer of real estate ownership and the real estate secured transaction are two major components that affect real estate investment. As for the transfer of real estate ownership, the KCC as well as Real Estate Registration Act provides ample rules and procedures by which transfer of ownership takes place in a secure and efficient way. As for the real estate secured transaction, the KCC and other related statutes provide the way by which the real estate owner can make use of the financial value of the real estate, including a mortgage or issuing asset-backed securities.

Another noteworthy statute that may be classified as a part of the general legal infrastructure is the Trust Act. The trust is one of the most frequently used legal institutions in the context of real estate investment. It is generally understood that the trust is a relationship between three parties where one party (trustor) transfers property to another party (trustee) for the benefit of a third party (beneficiaries). Although the trustee holds the title of the property, he or she only does so for the benefit of beneficiaries. With its insolvency insulation and high flexibility, the trust is frequently used in various different forms in real estate investment. The Trust Act offers a vast number of provisions regulating the complicated legal relationships arising out of trust. Dispute-resolution is also one of the important factors to be taken into consideration when investment is made. The Korean

Civil Procedure Act provides a general mechanism by which a dispute is resolved by the judiciary.

Further, there are some special legal infrastructures that have come into being in the wake of the so-called IMF (International Monetary Fund) crisis of 1997. This crisis strongly called for more open and transparent system in order to attract foreign investment, which was then necessity to overcome this unprecedented national tribulation. Confronted by this crisis, Korean government actively reformed the legal and financial system to make it even more investment-friendly. There are various statutes including 『Financial Investment Services and Capital Markets Act』, 『Real Estate Investment Company Act』, and 『Act concerning Asset-Backed Securitization』 that are all aimed at facilitating acquisition, financing and developing real estate.

3. Legal Infrastructure for Corporate System

At an earlier stage of planning for economic developments, Korean government had directly intervened to induce foreign capital through various methods including direct or indirect government guarantee and legislation that provides benefits and privileges (including tax incentives) toward foreign lenders and foreign direct investment. As a result of such an approach, Korea could pile up primitive capital it needed for economic developments as planned. With the IMF crisis in 1997 as a momentum, Korean government determined that the fundamental soundness and competitiveness of individual Korean companies will ultimately become a prominent factor that could induce foreign capital.

From this perspective, it has persistently endeavored to make circumstances that would improve the transparency and competitiveness of Korean companies. Korean government has pursued this policy through the transformation of legal structure on corporate system. The most general legal infrastructure for corporations in Korea is the Commercial Code. Also, securities law (the Capital Market and Financial Investment Business Act, and formerly the Securities and Exchange Act) provides for the disclosure rules applicable to corporations and certain fiscal aspects of listed corporations. The Korean government's efforts have been materialized by the legislations regarding the Commercial Code and the securities law.

Among others, we describe the government's efforts in two aspects: (i) mandatory enforcement of good corporate governance practice, and (ii) provision of the facilities for active corporate restructuring and revitalization of corporate control market.

With respect to the mandatory enforcement of good corporate governance practice, the government has taken a number of measures including the following:

(i) That a listed corporation must appoint minimum number of qualified independent directors in due course as mandated by statute;

(ii) That a large listed corporation must have an audit committee, in place of traditional statutory auditor, that meets stringent requirements and a medium-sized listed

corporation must appoint qualified standing auditor(s), while non-listed corporation or small-sized listed corporation may, at its option, choose either standing or non-standing auditor(s) or a lenient audit committee;

(iii) That minority shareholders rights must be strengthened: that is, newly introducing rights to place an agenda for the general shareholders meeting and cumulative voting rule, and mitigating the threshold percentage requirements;

(iv) That certain related party transactions involving a listed corporation must be strictly regulated so that managers, controlling shareholders and specially-related persons be prohibited from exploiting their position at the cost of the corporation or the shareholders in general;

(v) That 'de facto' or shadow directors (typically controlling shareholders or their specially-related persons) must be subject to the same liabilities as those of directors, in cases where they participate in or influence the management of a corporation and, as a result thereof, incur damages to the corporation;

(vi) That class actions are for the first time permitted with respect to certain securities transactions by virtue of a special statute, so that investors may efficiently seek a relief for collective injuries caused in the course of securities trading.

With respect to the provision of the facilities for active corporate restructuring and revitalization of corporate control market, the government has taken a number of measures including the following:

(i) That workout programs, that were used to be arranged through private contracts among lending institutions and a borrowing company with financial difficulty, must be subject to a special statute that formalizes and supplements the past practices, while the agreements among the related parties still have a key role in the restructuring process;

(ii) That a corporate division, a reverse of a merger, becomes available as a means for corporate restructuring;

(iii) That a short form merger, small-scale merger, cash merger, triangular merger have been permitted, to enable easier corporate reorganization transactions and to respond to the IMF crisis;

(iv) That an exchange or transfer of all outstanding shares of a corporation has been permitted, in order to provide a device to create a holding company and 100% subsidiary structure;

(v) That there have been deregulations to encourage M&A transactions; that is, abrogation of the 25% mandatory tender offer rule, changes from prior filing to ex post facto filing system regarding tender offer, and relaxation of limitations on both the raider side and the target side while balancing the interests of both sides.

2011 Modularization of Korea's Development Experience
Legal Infrastructure for Foreign Investment

Chapter 1

Introduction

Introduction

Korea has experienced continuous ups and downs throughout its modern history, and has made considerable efforts to respond to each and every challenge in a timely manner. This has resulted in Korea's high level of dynamism. It can be seen in the dramatic changes that have occurred in the Korean economy and politics. Korea was once one of the poorest nations in the world after the devastating Korean War (1950-1953). Yet, the nation miraculously grew up to be one of the major economies in the world. Investment, both from domestic and foreign investors, has surely played an essential role in establishing Korean economy.

Although the Korean economy has been facing numerous crises, including the so-called IMF (International Monetary Fund) crisis of 1997 that impacted not only Korea but also other Asian countries, and the global financial crisis of 2007 which originated from the U.S. liquidity crisis, Korea successfully maintained its status as an 'economic miracle'. During the last few decades, Korea also has experienced dramatic changes in the political realm. There was a time when Korea regressed in terms of democracy, yet on the whole, the nation has made a gradual progress toward a democratic society, and it is now quite safe to say that democracy has broadened and deepened more than ever before in the history of Korea. With success in both its economic and democratic reforms, Korea is often mentioned as a model for other developing countries.

At the same time, one cannot overlook the significant role played by relevant legal infrastructures for economic development. Drawing on the experiences of other nations and creatively adapting these lessons to the Korean context, Korea developed a stable and sound legal system Despite numerous difficulties, it has responded to the demand of the people and economy in a highly pertinent way. The same can be said of investment. In general, investment refers to the activity of putting money into something with the expectation of future gain. The notion of investment is characteristic in that it calls for a thorough analysis on the security of its return. In this regard, investment is clearly differentiated from mere speculation or gambling. Speculation or gambling does not require a sophisticated analysis

on security, although it may accompany rough estimate of its profitability and risks. To minimize risks, they tend to examine the soundness of the relevant legal infrastructure. Legal infrastructure is not a legally defined terminology. An infrastructure generally refers to the basic systems and services that are necessary for a nation. In line with that, a legal structure may be defined as a basic legal system supporting a nation's economy. A sound and reasonable legal infrastructure is the prerequisite to the investment. The need for more reasonable legal infrastructure becomes even more eminent when it comes to the matter of foreign investment. Since foreign investors are not familiar with investment environment of the nation they seek to invest in, they heed more to the wholesomeness of the legal infrastructure of the nation. Given the close relationship between legal infrastructure and investment, examination of Korea's legal infrastructure development may provide at least part of the reasons for the miraculous economic accomplishment of Korea.

Against this backdrop, this paper is structured as follows. Chapter 2, titled 『Regulatory Structure for Foreign Investment in Korea』, introduces how Korean legal regime, before the large scale open-up of the capital market to foreign investors, has dealt with the issue of foreign investment. Chapter 3, titled 『Legal Infrastructure for Real Estate Investment』, details the basic legal foundations that support real estate investment. Chapter 4, titled 『Legal Infrastructure for Corporate System』, addresses the corporate system in Korea, centering around relevant provisions in the Korean Commercial Code. Finally, Chapter 5, the conclusion of this paper, provides the basic summary of the paper.

Chapter 2

Regulatory Structure for Foreign Investment in Korea

1. Loans and Foreign Direct Investment (FDI)

2. Foreign Portfolio Investment

Regulatory Structure for Foreign Investment in Korea

1. Loans and Foreign Direct Investment (FDI)

1.1 Overview

Devastated by the Korean War in the 1950s, Korea desperately strived to rebuild its economy in a short period of time. There were no sufficient natural resources on which the country could depend on. Moreover, educated and well-trained manpower was in shortage. Lacking both natural and human resources, it was difficult for the country to accumulate sufficient economic resources on which the economy could be built.

Therefore, drawing foreign economic resources was significant to the country's recovery. Korea was benefitting from the foreign aid from the United State, but it was not permanently reliable. Thus, Korean government strived to induce the influx of foreign capital. The initial legislative steps to facilitate this policy goal were taken mostly during 1960s. However, the legal regime for foreign investment was carefully planned and controlled by the government, thereby reducing the foreign control on the Korean industry to a manageable degree. This policy was based on the keen concern on the protection of local industrial groups.

A rapid inflow of investment based on the above legal regime followed until 1973. Beginning in the late 1970s, the government gradually began to remove restrictions as domestic industries began to grow and needed to be strengthened to cope with international competition. But until the early 1980s, Korea still relied heavily on borrowing and maintained a somewhat restrictive policy towards foreign direct investment. Restrictions on foreign direct investment were eased in 1984 and 1985. Korean government changed its control policy on foreign investment from a "positive list" to a "negative list" basis, which meant that any activity not specifically restricted or prohibited was open to investment. An automatic approval system was introduced under which all projects meeting certain requirements were to be immediately and automatically approved by the Ministry of Finance. In December 1987, Korean government announced a policy to liberalize the

domestic capital market by 1992. The program called for liberalizing foreigners' investment funds, offering domestic enterprises rights on overseas stock markets, and consolidating fair transaction orders.

However, in 1980's, foreign loan was the main channel through which foreign financial resources were provided to the Korean economy, while foreign direct investment remained as a subsidiary tool.

During the 1990s, the liberalization process was stimulated by the desire to attract foreign investment as well as by the external pressure, notably from Organization for Economic Cooperation and Development (OECD) members who demanded Korea to reduce barriers to foreign direct investment. With Korea's accession to the OECD in 1996, and in particular with the IMF crisis that began in 1997, Korea was pushed to reform the legal regime to actively attract foreign investment. Most notably, Foreign Investment Promotion Act was enacted in 1998 to accomplish this policy goal. The foreign investment began to flourish based on a new legal regime.

We will briefly touch on the initial-stage foreign investment policy as reflected on the relevant legislations such as the Foreign Capital Inducement Act, and the representative legislations that are currently enforced such as the Foreign Investment Promotion Act and the Foreigners' Land Acquisition Act. More minute details regarding the change of Korean foreign investment policy will be delineated in terms of foreign portfolio investment.

1.2 Foreign Capital Inducement Act

1.2.1 Background of the Legislation

Korea began to implement a five-year plan targeted at boosting devastated Korean economy. The first plan was implemented as of 1962, and the subsequent plans continued on a five-year basis. To ensure the success of this plan, drawing foreign financial resource was essential. Korea had to mobilize external sources as well as internal sources to make the plan work. The drawing of the financial resources was implemented in two different forms. One form was to make a loan contract with foreign entities. This loan came from either public entities including the foreign government (public loan) or private entities such as foreign banks (private loan). Another form was to attract foreign investment. The investment can take place either directly (foreign direct investment) or indirectly (foreign portfolio investment). With the latter form, which is called the foreign portfolio investment, will be elaborated on in details in the later part of this paper.

In order for developing countries to attract foreign capital, they need to reduce political, economical and social risks to give certain degree of assurance to foreign investors that their investments will pay off. Establishing reliable and reasonable legal frameworks is one of the good ways to achieve this.

Korea was no exception. From 1960 to 1962, Korea promulgated three different legislations concerning the influx of foreign investment. However, confusions and contradictions arose

in the course of enforcing these different laws. Therefore, the comprehensive and consistent legislation was constantly called for.

As a result, Foreign Capital Inducement Act (hereinafter, "FCIA") was drafted and enacted as of August 3rd, 1966. This Act consolidated the three different laws into a single one. This Act was meant to be applicable to three forms of foreign capital: direct investment, loans, and technology transfer.

The Act was amended several times, including the massive one that took place in 1983 when it consolidated the 『Act for the Inducement and the Management of the Public Loan』 and the 『Foreign Capital Management Act』. The title of this Act changed to 『Foreign Investment and Foreign Capital Inducement Act』. This Act later became a part of the 『Foreign Investment Promotion Act』, which will be dealt with later in this paper. Though the Act itself does not exist anymore, it shows us how Korean government strived to manage the foreign investment policy. Below are the main contents of the Act.

1.2.2 The Contents of the Act

The basic aim of the Act was to encourage the flow of foreign capital into Korea that will contribute to Korea's long-term economic development and help improve Korea's balance of payment situations.

The first principle that was declared by the FCIA was to guarantee the investment-related activities by foreigners in accordance with the law and decree of the Korea, thereby allowing them the necessary liberty for economic activities. Once a proposal for foreign direct investment was authorized by the Ministry of Finance, the repatriation of equity investment was not subject to government intervention. Foreign investors could sell their stocks or shares. When the buyer of the stock was a foreigner, the new investor was not required to obtain authorization because the FCIA presumed that the authorization had been granted. However, the seller and buyer were required to report the sale to the Ministry of Finance.

The FCIA expressly declared that the property rights of foreign investors and foreign-invested enterprises shall be guaranteed in accordance with the law, thereby assuring foreign investors that their property as a result of their investments will remain secure. Foreign-invested enterprises and foreign investors were, with few exceptions, entitled to receive the same treatment as Korean nationals. All property of foreign-invested enterprises was guaranteed by acts and decrees. Foreign investors were entitled to the same legal protection and access to judicial remedies as Korean citizens.

The FCIA took a relatively liberal attitude toward remittance of dividends and capital subscription. The government guaranteed the remittance of profit dividends justly accrued from the stocks or shares owned by foreign investors. However, a foreign investor who intended to make remittance of dividends was required to apply for permission for such

remittance to the Ministry of Finance. The Ministry of Finance was then obliged to give permission unless the application is in violation of any condition of law.

The FCIA also induced foreign investment by offering benefits such as tax incentives or other forms of incentives that were not provided to domestic investors. For instance, foreign-invested companies authorized under FCIA were exempt from income tax, corporate tax, and acquisition tax for five years after they are registered as foreign-invested enterprises. A foreign investor, as an equity participant in the foreign-invested enterprise, would not be subject to any Korean taxes except taxes on dividends to be paid to foreign investors by the foreign-invested enterprise.

Foreign personnel who were working for a foreign-invested enterprise authorized under FCIA or rendering services under a technology inducement contract approved under FCIA were exempt from personal income tax on their salary income for five years. Foreign personnel working in foreign-invested enterprises were exempt from tax from the date that the enterprise is registered with the Ministry of Finance. Foreign personnel under a technology inducement contract were exempt from the date of government approval of the technology inducement agreement.

Though there were many legal devices to attract foreign investment, the FCIA also had strong sentiment of regulation law. In many facets of investment-related activities, foreign investors were required to get permission and approval from the Ministry of Finance.

1.3 Foreign Investment Promotion Act

1.3.1 Background of the Legislation

Foreign Investment Promotion Act (hereinafter “FIPA”) is designed to facilitate foreign investment by supporting foreign investment and increasing investor convenience. The FIPA serves as the basic law for foreign investment, and its subordinate statutes include Enforcement Decree of the Foreign Investment Promotion Act and Enforcement Rule of the Foreign Investment Promotion Act, which prescribe matters delegated by the FIPA and matters necessary for the enforcement thereof, and Regulations on Foreign Investment and Technology Introduction.

The FIPA was first enacted in Korea in 1998 for the purpose of encouraging foreign direct investment, after the 1997 IMF crisis swept the country. The Korean government also opened its market and liberalized foreign direct investment as part of the effort. This Act repealed the previously enforced Foreign Investment and Foreign Capital Inducement Act, in order to widely ease the regulations and restrictions on investment by foreigners and expand the tax incentives, and to reorganize from all sides the systems related with foreign investment such as designation of foreign investment zones.

Recently, the FIPA was amended in order to improve the existing foreign investment system and promote foreign investment in the service sector. Foreign investment zone,

which refers to a geographical area designated exclusively for the purpose of leasing or transferring lands to foreign-invested companies, has been expanded to allow foreign-invested companies in the high value-added service industries to move into the zone. The amended Act also stipulates high value-added industries which are allowed to move into a foreign investment zone.

1.3.2 The Contents of the Act

This Act intends to promote investment by foreigners. This principle is well described in the Art 4-① of the Act, where it states that a foreigner in principle may conduct, without restraint, various activities of foreign investment in Korea. Based on this spirit, no foreigner shall be restricted from any foreign investment unless ① it threatens the maintenance of national safety and public order or ② it has harmful effects on public hygiene or the environmental preservation or is against Korean morals and customs, or ③ it violates the Acts and subordinate statutes of Korea (§4 ②).

To mobilize and organize governmental efforts to draw foreign investment, the Minister of Knowledge Economy sets up a plan to stimulate foreign investment including basic direction, analysis of circumstances of foreign investment, plan of attracting foreign investment, and plan of assisting agencies conducting activities of inviting foreign investment (§4-2).

As incentives for foreign investment, taxes such as corporate tax, income tax, acquisition tax, registration tax, property tax and aggregate land tax may be abated or exempted under conditions as prescribed by the Restriction of Special Taxation Act. Besides, there are multiple measures throughout the Act aimed at inducing foreign investment.

1.4 Foreigners' Land Acquisition Act

1.4.1 Background of the Legislation

Traditionally, uneasiness existed regarding foreign investment on the land of a sovereign nation. Land forms the physical infrastructure for sovereignty. For this reason, a prevalent sentiment was that giving away land to foreigners might undermine the sovereignty. Yet, after IMF crisis, the attitude toward foreign investment on real estate has changed. Though some restrictions are inevitable, the Korean legal regime now largely opens the way for foreigners to acquire land in Korea. The Foreigners' Land Acquisition Act (hereinafter "FLAA") provides such legal framework.

The purpose of the FLAA is to prescribe matters necessary for land acquisition, etc. of foreigners in Korea. Although the FLAA requires some administrative procedure for the acquisition of the land, it strives to keep regulation at a minimal level. The term "foreigner" in this Act includes not only an individual, but also a juristic person or an organization such as companies.

The FLAA declares the principle of reciprocity (§3). Therefore, a foreigner from nations where acquisition or transfer of land by Koreans are prohibited or restricted may be subject to same prohibition or restriction. Otherwise, a foreigner is free to acquire or transfer land as long as she follows certain procedures and regulations set forth in the FLAA. This stance implies that the FLAA intends to keep the gateway wide open for foreigners' alnd acquisition.

1.4.2 Contents of the Act

According to the FLAA, a foreigner should make a report of the land acquisition to administrative authorities stipulated in the Act within 60 days from the conclusion date of the contract (§4 ①). The two types of reports include the land acquisition report and the continued land possession report.

In purchasing some specific types of land, such as military base, designated cultural assets, ecology and scenery conservation areas or special reservations for wild animals and plants, a foreigner need to obtain permission from relevant authorities before concluding a contract for land acquisition (§4 ②).

If a foreigner has acquired land by means of inheritance, auction or any cause other than contract prescribed by Presidential Decree, the foreigner should make a report to the authorities within 6 months after the date of land acquisition (§5).

The FLAA stipulates that acquisition of domestic land by a foreign national be reported or permitted. The Foreigner's Land Acquisition Act only covers land ownership, hence acquisition of real estate other than land (buildings) and real estate related rights (right to lease on a deposit basis or mortgage) is not required to be reported under the FLAA. However, one must beware that under the Foreign Exchange Transactions Act, the land acquisition report should include the acquisition of real estate other than land (buildings) and real estate related rights (right to lease on a deposit basis or mortgage).

2. Foreign Portfolio Investment

2.1 Overview

Prior to 1981, no foreign investment in Korean capital market was permitted, except for the loan transactions and foreign direct investments pursuant to the FCIA and the FECA. However cumulated burden to repay the debt financing and higher interest rates led the Korean government to induce foreign capital through securities market that does not raise such concerns.

On January 14th, 1981, Korean government announced "A Long-Term Plan for Liberalization of the Capital Market" in order to induce foreign capital and enhance the financing by Korean companies. According to the plan, foreign investment was to be

allowed step by step. At first, an indirect investment through domestic securities investment trust was allowed beginning in 1981. Secondly an indirect investment through offshore funds established for investment in Korean securities was allowed beginning in 1984. Third step was financing by Korean companies through overseas offerings of equity related securities beginning in 1985.[1]

In December 1988, Korean government announced “A Plan to Pursue Liberalization of Capital Market on an Enlarged Scale” in order to provide a specific schedule to push forward with the aforementioned 1981 plan. Following the 1988 plan, foreign investments in Korean stocks listed on the Korea Stock Exchange (KSE) subject to certain limitations, beginning on January 1st, 1992.

In July 1993, Korean government announced “A Blue Print on Mid-term Plan for Liberalization of Financial Market” to further the opening of stock market and to provide for a schedule for gradual opening of bond market and securities industry.[2] In 1994, foreign investment in Korean bonds listed on the KSE began to be permitted gradually.

In December 1996, Korean government has joined the OECD and provided an overall plan to liberalize the transfer of capital and to open financial market. In 1998, the limitations on the type of financial products available for foreign investment were lifted. Today, foreigners are allowed to invest in any Korean securities including stocks and equities listed or not, corporate bonds listed or not, mutual funds and trusts, listed derivatives, CPs and warrants.

2.2 Investment via Domestic CIVs

2.2.1 Legal structure

a. Securities Investment Trust Business Act of Korea (SITBA)

The Korean securities investment trust (SIT) was the first vehicle through which foreign investors could access the Korean stock market. The SIT is a collective investment vehicle (CIV) for investment in securities, which is governed by the SITBA (Act No. 2956).[3] The SIT is a contractual type CIV that is formed though a trust contract between an asset management company and a trustee bank. Each of the asset management company and the trustee bank must first obtain the relevant license from the Minister of Finance of Korea (MOF). For formation of each SIT and issuance of certificates evidencing beneficial interests in the SIT, there must be a prior approval from the MOF. Execution, revision and termination of a trust contract for an SIT must be also subject to the approval of the MOF. The assets of an SIT must be invested primarily in listed securities subject to certain

1 Shin, Young-Moo, Securities and Exchange Law, Seoul National University Press, 1988, pp.148-149.

2 Jeon, Hong-Yeol, A Commentary on Securities and Exchange Law, Nexus Publishers, 1997, p.679.

3 The SITBA was repealed and replaced by the Indirect Investment Asset Management Act (Act No. 6987) in October 2003, which was again repealed and incorporated into the Capital Market and Financial Investment Business Act (Act No. 8635) in February 2009.

investment limitations per an issuer and per a class of securities.[4] When the MOF grants an approval, it may put such terms and conditions as deemed necessary.

Under the SITBA, an SIT that was exclusively offered to foreign investors (so called "international SIT") must be approved by the MOF. An international SIT is managed by a Korean asset management company that is licensed by the MOF. Its assets are held in the name and custody of a Korean trustee bank that is licensed by the MOF. Under the MOF approval, an international SIT is subject to certain investment limitations; that is, it must invest primarily in Korean listed stocks, and may not invest in shares of an issuer in excess of 5% of its all shares and in a class of securities in excess of 10% of the amount of its assets.

b. Foreign Exchange Regulations

Under Articles 24 and 26 of the old Foreign Exchange Control Act (Act No. 1920, the FECA) and Article 35 of the Presidential Decree thereunder (Decree No. 9886, the FECA Decree), any capital transactions involving non-residents or cross border offering of securities by residents must be first authorized by the MOF. A Korean asset management company having a license from the MOF under the SITBA may issue beneficial certificates representing beneficial interests in an international SIT (the beneficiaries thereof are confined to non-residents and its offering proceeds are to be invested in Korea) pursuant to, and subject to, the Foreign Exchange Control Regulations promulgated by the MOF (FECR) pursuant to the FECA and the FECA Decree. An issuer of an international SIT may, subject to a permit of a designated Class A foreign exchange bank, repatriate abroad in foreign currencies distribution or repurchase amounts. The MOF had a power to set investment ceilings on international SITs or have an issuer to offer an international SIT if and when it deems necessary considering the balance of international payments. An issuer of an international SIT must file a quarterly report on the status of issuance and repurchase of the SIT and repatriation records with the Governor of the Bank of Korea (BOK).

2.2.2 Evaluations

The international SIT was a CIV through which foreign investors could invest indirectly in the Korean stock market for the first time. Given the small size of the Korean stock market, Korean government was concerned about the risk of Korean companies' losing their corporate controls in cases where foreign institutions heavily invest in a target company and the risk of influxes into Korea of speculative funds.[5] The international SITs that are subject to the strict supervision of the MOF at every stage of their formation, operation and termination were the vehicles through which the government's concerns were resolved. In November 1981, the first international SIT, the Korea International Trust (KIT), was

4 Under the SITBA, an SIT may invest in shares of an issuer up to 20% of its all shares, and in a class of securities up to 10% of the amount of the fund assets.

5 Shin, Young-Moo, op. cit., p.151.

launched by the Korea Investment Trust Co., LTD, a Korean investment management company. The KIT in an amount of USD 15 million was offered in the Euro market. Credit Suisse First Boston was the lead manager. Also, the Korea Trust (KT) was launched by the Daehan Investment Trust Co., LTD, a Korean investment management company, in an amount of USD 15 million. The KIT and the KT had additionally offered their beneficial interests abroad several times. In 1985, the Korean Growth Trust, Seoul International Trust and Seoul Trust, each in an amount of USD 30 million, were launched for the investment in Korean bonds as well as Korean stocks. In late 1985 and early 1986, two international SITs investing in non-listed stocks of Korean venture companies were launched abroad.[6] Afterwards, there followed a number of international SITs were successfully offered and operated for foreign investors.

2.3 Investment via Offshore CIV

2.3.1 Legal structure

a. Securities Regulations

Encouraged by the successful offering of Korean CIVs for foreign investment in Korean securities (international SITs), Korean government permitted offshore CIVs for foreign investment in Korean securities in 1984. While an offshore CIV was formed and operated pursuant to laws of its incorporation instead of Korean laws, its investment activities in Korean securities were subject to Korean laws and regulations because such offshore CIV itself is a foreign investor.

Far earlier than the time when the Korean government permitted direct or indirect foreign investment in Korean securities market directly or indirectly, it had formed a legal structure for foreign investment in the perspectives of the securities regulations. In Korea, the basic statute that governs the securities market and industry had been the Securities and Exchange Act (SEA) that was first legislated in 1962 (Act No. 972) and thereafter amended from time to time.[7] In 1976, for the first time, the SEA (Act No. 2920) provided for a legal ground for regulation on foreign investment in Korean securities (Article 203). In 1982, Presidential Decree to the SEA (SEA Decree, Decree No. 10823) was amended to newly insert the Article 87-2 that provides for limitations on foreign investment under the auspices of the Article 203 of the SEA. Under the Article 87-2 of the SEA Decree, the Securities and Exchange Commission (SEC) was empowered to put limitations on foreign investment in securities issued by listed or registered companies, per kind of securities, per class or per industry. Unless authorized by the SEC, foreign investors must trade listed securities

6 Korea Small Companies Trust (1985) by Korea Investment Trust Co., Ltd. and Korea Emerging Market Companies Trust (19860 by Daehan Investment Trust Co., Ltd. Shin, Young-Moo, op.cit., pp.151-154 and p.520.

7 In February 2009, the SEA was repealed and the main contents of which were incorporated into the Capital Market and Financial Investment Business Act (Act No. 8635).

through the securities market (KSE). Any securities company that broke foreign investment in securities must report the details to the SEC.

In 1984, under Article 203 of the SEA and Article 87-2 of the SEA Decree, the SEC promulgated the Regulations on Securities Transactions by Foreign Investment Companies, to provide for limitations on investment in Korean securities market by offshore CIVs that non-residents established with the proceeds from offshore offering for the purpose of investment in Korean securities ("the foreign exclusive investment companies"). Under the Regulations, a foreign exclusive investment company may not invest in Korean securities (i) in an industry in excess of 25% of the total assets of the investment company and (ii) in a class of securities of an issuer in excess of 5% of the total number of the shares of the class, provided however that the total foreign holdings in the class shall not exceed 10%. Also, it may not invest in Korean bonds in excess of 10% of its total assets. It must trade listed securities through the securities market (KSE) with certain exceptions. Such companies must also keep any securities they purchased under the custody of the Korean central depository (KSD) or designated Class A foreign exchange bank and, are subject to regular reporting requirements. The Regulations had been amended from time to time to respond to ever changing market environment and liberalization process.

b. Foreign Exchange Regulations

Under Article 24 of the old FECA and Article 35 of the FECA Decree, any capital transactions involving non-residents must be first authorized by the MOF. Under the FECR, the foreign exclusive investment companies must be first approved by the MOF. The MOF had the power to set investment ceilings on the foreign exclusive investment companies and change them from time to time, if and when it deems necessary considering the balance of international payments. Funds in Korean Won obtained by a foreign exclusive investment company must be kept at its Non-resident Won Currency Account with a designated Class A foreign exchange bank in Korea. A foreign exclusive investment company may, subject to a permit of a designated Class A foreign exchange bank, repatriate abroad in foreign currencies all or any part of its income and, only upon its termination, investment principal. A foreign exclusive investment company must first obtain an approval from the Governor of the Bank of Korea in order to enter into a service contract with a resident of Korea.

2.3.2 Evaluations

The foreign exclusive investment company has in common with the international SIT in that it is also a CIV through which foreign investors could invest indirectly in the Korean securities market. However, the foreign exclusive investment company is a more advanced vehicle from the perspectives of the foreign investors because it is formed and operated pursuant to non-Korean laws unlike the cases of the international SITs, even though it would be subject to limitations under the Korean laws and regulations.

The MOF has granted approvals for three foreign exclusive investment companies only, that is, The Korea Fund, Inc., The Korea-Europe Fund Limited and The Korea Asia

Fund Limited. In 1984, The Korea Fund, Inc. was organized under Maryland law, and was registered under and regulated by, the United States Company Act of 1940. It is managed by Scudder, Stevens and Clark, the U.S. investment advisory firm with the advice of Daewoo Research Institute, a Korean advisory company. Its shares are listed on the NYSE. Generally speaking, the Korea Fund, Inc. is the U.S. fund that invests in Korean securities market with the privileges and limitations under the license from the MOF. In 1987, The Korea-Europe Fund Limited and in 1990, the Korea Asia Fund Limited obtained MOF licenses to invest in Korean securities market. As the liberalization process went on, the exclusive edge given to the licensed offshore funds had eroded. However, by virtue of amendments to their MOF licenses, they could invest in Korean securities at least on an equal footing as the other foreign investors without such licenses.

2.4 Overseas Offering by Korean Companies

2.4.1 Legal structure

a. Securities Regulations

In November 1985, Korean government announced a plan for an overseas issuance of securities by Korean companies. The Commercial Code of Korea is generally applicable to such issuance because the issuer is incorporated pursuant to the Commercial Code even if the issue is made outside of Korea. Also laws of the place of offering (non-Korean law) are applicable. In addition, Korean securities regulations are applicable because on the one hand such issuance would involve foreign investment in Korean securities and on the other hand certain financial activities of listed companies are also regulated.

Under Article 192 of the SEA, the SEC has a power to promulgate regulations regarding financing by and improvement of financial structure of listed companies. Also under Article 203 of the SEA and the Article 87-2 of the SEA Decree, the SEC could provide for limitations on foreign investment in Korean securities. Based upon such authority, in November 1985, the SEC promulgated Regulations on Issuance and Administration of Overseas Securities by Listed Companies (later renamed "Regulations on Issuance of Overseas Securities"). The Regulations provided for the type of eligible securities, eligible issuer, limitations on issue amount and terms and conditions, and procedural requirements. Eligible securities included equity related securities such as convertible bonds, bonds with warrants and depositary receipts[8] that are issued outside of Korea by a listed company[9] ("Overseas Securities"). To become an eligible issuer, a listed company must meet certain qualifications with respect to minimum shareholders equity, net profits, stock price and investment grade. A listed

8 In 1985, only one type of depositary receipts was allowed, that is, the depositary receipts issued under a deposit agreement between the depository and the company that issues new shares to underlie the depositary receipts. However in July 1992, another type was allowed, that is, the depositary receipts being issued by a depository without issuance of new shares by the share issuing company, subject to the prior approval of such share issuing company.

9 In June 1996, exchangeable bonds were added to the list of eligible securities.

company may not issue Overseas Securities in aggregate in excess of 15% of its total number of issued and outstanding shares, assuming that all conversion rights or warrants are exercised in full, unless otherwise approved by the SEC. In addition, one investor may not hold shares of an issuer in excess of 3% of the issuer's total number of issued and outstanding shares in aggregate as a result of an exercise of conversion rights, warrants or withdrawal rights. There were limitations on the minimum conversion price, warrant exercise price and DR issue price, compared to the market price of the relevant shares as of the issue date. Also there were limitations on the minimum period that the Overseas Securities may be converted into the underlying shares, that is, one and half years from the issue date. A listed company must first consult with the SEC prior to the launching of the Overseas Securities and obtain an approval of the SEC regarding its plan for the issuance of the Overseas Securities. Granting such approval, the SEC may adjust or limit the issuance plan if and when it deems necessary for the purpose of financial management of the issuer, stabilization of domestic securities market and investor protection. From time to time, the SEC had eased restrictions on the issuance of the Overseas Securities. In August 1989, the SEC promulgated the Regulations on the Acquisition and Administration of Shares related to Overseas Securities, in order to provide for limitations on the foreigners' acquisition of Korean securities via the Overseas Securities.[10] By November 1991, foreign investors that acquired Korean shares as a result of an exercise of conversion rights, warrants or withdrawal rights could dispose of such Korean shares in the Korean stock market, and then reinvest such sales proceeds into another Korean stock.

b. Foreign Exchange Regulations

Under Article 26 of the FECA and Article 35 of the FECA Decree, any capital transactions involving non-residents or cross border offering of securities by residents must be first authorized by the MOF. In November 1985, the MOF promulgated the Rules on the Issuance of Securities Denominated in Foreign Currencies ("Foreign Currency Securities") under the auspices of the FECA and the FECA Decree, which were later incorporated into the FECR. The Rules (or later the FECR) provided for the eligible Foreign Currency Securities, eligible issuer, maximum issue amount, limitations on the usage of the issue proceeds and procedural requirements. Among others, the issue proceeds were restricted for use abroad such as purchase price for importing capital goods and funds for investment outside of Korea. To secure such usage, the offering proceeds must be deposited to resident's account with its primary bank in Korea and any withdrawal of such funds must be made in accordance with the pre-set schedule with a confirmation from such bank. The shares underlying DRs must be kept under the custody of the KSD. Foreigners in aggregate may not hold shares of a Korean company in excess of 50% of the total number of shares of such company not only through the conversion or exercise of Overseas Securities but also pursuant to

10 In the wake of the Financial Crisis, in June 1998, the two Regulations aforementioned were all repealed. Now that, in connection with the issuance of securities abroad by a Korean company, the only issue remains is an extra-territorial application of Korean securities law regarding the disclosure requirement involving a public offering.

other laws and regulations. A listed company must first consult with the MOF prior to the launching of the Overseas Securities, and obtain an approval of the MOF regarding its negotiation plan for the issuance of the Overseas Securities. During the process of such consultation or authorization, the MOF may adjust the issue terms, timing or managers, or recommend suspension of the issue, if and when it deems necessary considering its impact on the international financial market and Korean capital market, its influences on a specific industry in Korea and other general public policies. From time to time, the MOF had eased restrictions on the issuance of the Overseas Securities.[11]

2.4.2 Evaluations

Prior to 1985, a few Korean financial institutions or governmental agencies had issued straight bonds and notes abroad, but no Korean company in general was permitted to raise funds through overseas offering of its debt or equity securities. In December 1985, Samsung Electronics for the first time launched USD 20 million of convertible bonds in the Eurobond market. Stimulated by the successful financing by Samsung Electronics, other Korean companies began to get interested in overseas financing. In November 1989, Sami Steel issued the first Korean overseas bonds with warrants (USD 50 million), and in December 1990, Samsung C&T Corporation (former Samsung Corporation) issued the first Korean depositary receipts (USD 40 million) in the Euro market. In October 1994, POSCO issued American depositary receipts (USD 300 million) that were listed in the NYSE for the first time as a Korean company. In November 1996, Daewoo Corporation issued the first bonds overseas exchangeable into shares of Daewoo Heavy Industries (SFr. 107 million). A number of Korean companies have financed substantial amounts from foreign investors by way of offshore offering of debt and equity securities.[12]

2.5 Direct Investment in Korean Market

2.5.1 Legal Structure

a. Securities Regulations

Under Article 203 of the SEA and the Article 87-2 of the SEA Decree, the SEC could provide for limitations on foreign investment in Korean securities. Based upon such authority,

11 Under the current foreign exchange regulations, a Korean company may issue Overseas Securities without obtaining the MOF approval. Only a report to its designated foreign exchange bank if the issue amount is not exceeding USD 30million, and a report to the Minister of Finance and Economy (MOFE) via such bank if the issue amount exceeds USD 30 million, is required (Article 7-22(2) of the Foreign Exchange Transaction Regulations).

12 Up until October 1998, 121 Korean companies have launched 175 convertible bonds issues abroad in an amount of USD 6.4 billion; 10 Korean companies have offered offshore 10 bonds with warrants in an amount of USD 360 million; 28 Korean companies have issued overseas depositary receipts in an amount of USD 4.1 billion; and 4 exchangeable bonds have been offered to foreign investors in an amount of USD 180 million. 25 Years History of The Korea Securities Depository, Korea Securities Depository, 1999, pp. 326-327.

effective on January 1, 1992, the SEC promulgated Regulations on Trading of Securities by Foreigners to provide for limitations on foreign portfolio investment in Korean securities, not through international SITs, the MOF licensed offshore CIVs, or Overseas Securities, but outright into Korean securities market. The Regulations provided for, among others, the type of securities eligible for foreign investment, investment ceilings per person and foreigners in aggregate, restrictions on trading and custody and procedural requirements.

Step by step, restrictions on foreign investment have been gradually lifted by amending the Regulations. For instances, the scope of eligible securities has been enlarged and the investment ceilings were raised. In 1992, the only eligible category was shares listed on the Korea Stock Exchange subject to investment ceilings of 3% per a single foreign investor and 10% for foreigners in aggregate with respect to a class of listed shares. As a result of liberalization of Korean capital market, now that there remains no restriction on the type of the eligible securities nor investment ceilings beginning in 1998. Investment ceilings for listed stocks were raised gradually[13] and in May 1998 they were lifted as a whole.[14] Beginning July 1998, foreign investment in non-listed stocks of Korean companies and in equity primary market has been permitted. Also beginning in 1994 foreign investment in debt securities of Korean companies have been permitted step by step, in 1994 convertible bonds issued by small or medium sized Korean companies, in October 1997 corporate bonds with maturity not shorter than 5 years, in December 1997 corporate bonds with maturity not shorter than 3 years, and in January 1998 all corporate bonds. In 1998, foreign investment in government securities, money market instruments such as MMF, CP, CD and RP have been permitted. Beginning in 1995, foreign investment in exchange-traded derivatives has been permitted, with an investment ceiling per person and for foreigners in aggregate. In 1998, all such investment ceilings were lifted.

In 2009, the SEA was repealed and largely replaced by the Capital Market and Financial Investment Business Act (CMFIBA) which became a basic law that provides for ground for regulating foreign investment. Article 168 of the CMFIBA provides that foreign investment in Korean securities or derivatives listed on the Korea Exchange (KRX) may be regulated pursuant to the standards and methods as set forth by the Presidential Decree to enforce the CMFIB (CMFIBA Decree). In addition, foreign investment in shares of certain public-purpose corporations may be limited as determined by articles of incorporations of such corporations.[15] With respect to the shares acquired by a foreigner in violation of

13 The investment ceiling for foreigners in aggregate per class of shares of a listed company was increased from 10% to 12% in Dec. 1994, to 15% in Jul. 1995, to 18% in Apr. 1996, to 20% in Oct. 1996, to 23% in May 1997, to 26% in Nov. 1997, to 50% in Dec. 11, 1997 and 55% in Dec. 30, 1997. Also the investment ceiling for a single foreigner per class of shares of a listed company was increased from 3%, to 4% in Apr. 1996, to 5% in Oct. 1996, to 7% in Nov. 1997, and to 50% in Dec. 1997.

14 However, there exist investment ceilings with respect to foreign investment in shares of public-purpose corporations.

15 Under Article 187(1) of the CMFIBA Decree, foreigners may not acquire equity securities of a public-purpose corporation in excess of (i) the limit on acquisition by a foreigner per issue or per person as stipulated by the articles of incorporation of the public-purpose corporation; and (ii) 40% of the total number of the class of equity securities by foreigners in aggregate.

such investment limitations, voting rights would be deprived of. The Financial Services Commission (FSC) may issue an order to a foreigner to correct his trading of securities or exchange-traded derivatives in violation of the regulations. Under Article 187 of the CMFIBA Decree, if it is deemed necessary for stabilizing the securities market or the derivatives market or protecting investors, the FSC may prescribe and publicly notify the limits on acquisition of securities or exchange-traded derivatives (limited to those traded in the derivatives market) by type of business, by type or issue, and by item of securities and exchange-traded derivatives, under Article 188 of the CMFIBA Decree, a foreigner shall, when he or she intends to acquire or dispose of securities listed securities, register his/her personal data and other information (investor registration) in advance with the FSC. A foreigner, shall, when trading listed securities, trade them through the KRX unless otherwise allowed by the FSC. Based upon empowerment under the CMFIBA and its Decree, the FSC has promulgated the Regulations on Financial Investment Business which, among others, regulate foreign investment in terms of investment limits on shares of public-purpose corporations, electronic investment registration system, opening of trading accounts, custody of purchased securities, appointment of a standing proxy, reporting on details of trading with respect to foreign investment in Korean securities and exchange-traded derivatives, and supervision and sanction by the FSS with respect to foreign investment in Korean securities.

b. Foreign Exchange Regulations

Under Article 24 of the old FECA and Article 35 of the FECA Decree, any capital transactions involving non-residents must be first authorized by the MOF. However, beginning 1992, such capital transactions permitted from time to time pursuant to the Korean government's liberalization plan had not been subject to the MOF authorization restriction. Effective from September 1st, 1992, the FECA was repealed and replaced by the Foreign Exchange Management Act (Act No. 4447, the FEMA). The Article 23 of the FEMA provided that the MOF approval would not be required for any securities transaction between a resident and a non-resident of Korea if such type of transaction is generally recognized by the MOF. Under such authority, the MOF promulgated the Foreign Exchange Management Regulations (FEMA) and has amended the FEMA from time to time to recognize such securities transactions as being permitted pursuant to the Korean government's liberalization plan. Under the current FEMR, foreign portfolio investment in Korean securities is not subject to any approval requirement in general. However, for such investment, a foreign investor must open with its own name both a foreign currency account exclusively for investment and a Non-resident's Won currency account exclusively for investment at a foreign exchange bank in Korea. Any foreign currency remittance into Korea, foreign currency repatriation out of Korea and deposit and withdrawal of Korean Won in connection with the purchase and sale of Korean securities must go through those accounts.

2.5.2 Evaluations

As of the end of 1998 when foreign investment in Korean capital market was fully liberalized, 8,480 foreign investors from 66 countries invested in Korea, an increase from 1,572 foreign investors from 37 countries in 1992 when Korea for the first time permitted direct foreign investment in Korean stock market. By the end of 1998, foreign investors held 18.5% of the market capitalization of the Korean stock market and net worth of foreign capital into Korea amounted USD 4.7 billion in 1998 and USD 22.1 billion in aggregate during the period from 1992 to 1998.[16] Since the Korean capital market was fully liberalized in 1998, foreign investment in Korea has substantially increased and contributed significantly in inducement of foreign capital into Korea. As of the end of September 2011, foreigners had 30.7% of the Korean stock market and 7.2% of debt market. The regulatory structures have been modified from time to time to adapt swiftly to the government's liberalization schedule and at the same time to take precautionary measures in order to prevent or minimize the possible side effects thereof.

16 "Results and Analysis of the Opening of Capital Market in 1998", Financial Supervisory Service, 1999. 2. http://www.fss.or.kr/fss/kr/bbs/view.jsp?page=17&url=/fss/kr/1207397030605&bbsid=1207397030605&idx=240000000013&num=1

Chapter 3

Legal Infrastructure for Real Estate Investment

1. Background
2. General Legal Infrastructure for Real Estate Investment
3. Specific Legal Infrastructure for Real Estate Investment

Legal Infrastructure for Real Estate Investment

1. Background

Real estate is the major backbone of a nation's economy and Korea is no exception. Korea has a population of over 48 million people in a territory of just 100,032 square kilometers, which is similar to the size of Portugal. With two-thirds of the lands composed of mountains, Korea is one of the most densely populated countries in the World. With scarcity of land and buildings, coupled with extreme density of population, real estate has always been at the center of concern in Korean economy. With insufficient supply of real estate along with the large amount of available capital and relatively low interest rate, Korean real estate market has been a lucrative target of a large number of investors seeking large returns. This has led to the increase in the volume of real estate transaction. Since an efficient and transparent legal framework is required to back up such economic structure, the legal infrastructure surrounding real estate has been of great significance within the whole picture of Korean legal regime.

However, real estate investment market was largely available only for domestic investors. Like many other countries, there were various regulations against foreign investors. These regulations deterred foreign investors from putting their money in the market. Furthermore, it may be helpful to note that there was a strong tendency among Korean people to that real estate market is something that should not be open to global players for investment purposes, an idea based on the popular sentiment that real estate forms the very foundation of the nation in terms of its physical territory and economy.

Yet, this long-standing sentiment has finally yielded to a tremendous and abrupt changes incurred during the so-called IMF (International Monetary Fund) crisis of 1997. The IMF bailout in the wake of a Korean financial analysis was indeed a humiliating incident to Korean people who had achieved a miraculous economic development over the past couple of decades. This crisis strongly called for more open and transparent system in order to

attract foreign investment, which was then necessary to overcoming the unprecedented national crisis. In the wake of this, Korean government actively reformed the legal and financial system to make it even more investment-friendly. Although the phase was a painful national experience for the Korean people, it was also a precious stepping-stone for Korean economy. Korea began to ease restrictions for foreign investors in real estate, only requiring a simple procedure for administrative purpose. Ironically enough, foreign investment in Korean real estate was initiated by the IMF crisis which gave such hard time to the nation, and the demand for the country's commercial real estate among global asset managers has been ever growing since then. Now Korea is deemed one of the most prime investment locations in Asia both in terms of its market size and growth potential.

Against the backdrop, Korean legal infrastructure for real estate investment is described in this part of the paper. Before proceeding to the details of this topic, defining each terminology seems necessary in order to clarify the scope of coming discussions. For the above reason, the meaning 「investment」, 「real estate」, and 「legal infrastructure」 is explained below.

1.1 Investment

As stated in the outset of this paper, investment refers to the activity of putting money into something with the expectation of future gain. Since prudent investors are ordinarily concerned with the security of investment along with its profitability, they strive to scrutinize the soundness of legal infrastructure to find out how well it supports the certainty and security of investment-related transactions. This alludes to the correlation of investment and a legal infrastructure. The more solid the legal infrastructure is, the more likely investment will incur.

Meanwhile, investment requires putting money into "something". Technically speaking, everything has potential of turning into "something" in this context. To put it another way, the object of the investment is not limited to a specific type of assets as long as it stays within the boundary of legal framework. Yet, there are some typical objects such as real estate, securities, bonds, or gold that draw most of investment. Among these objects, this part of the paper focuses on real estate investment. It takes us to the next issue of what real estate is.

1.2 Real Estate

The term 「real estate」 is frequently and routinely used in our daily lives as well as in business. This term also has a legal definition. Among various laws in Korea, the Korean Civil Code (hereinafter "KCC") legally defines this concept. Since we will be dealing with this term repeatedly throughout this paper, it would be pertinent to define this term at this point.

In the first place, it should be noted that real estate is the type of a「thing」in the legal sense. Thus, a「thing」needs to be defined first. A「thing」is any corporal object and manageable natural power (KCC §98). There are a great number of things existing in the world. An umbrella, a mobile phone, an automobile, a ship, and a piece of land are all labeled as a「thing」in the realm of private law. They are all objects of the rights in rem.

These things are subsequently categorized into either a real estate (or immovable) or a chattel (or movable). A real estate refers to the land, and other independent things-representatively a building-that is attached to the land (KCC §99 ①).

One peculiar feature of Korean private law is that land and buildings are treated as separate and independent thing, unlike in many other Western jurisdictions. Therefore, ownership of the land and the building standing thereon can belong to different owners respectively. Accordingly, if A owns land and B owns a building on that land, it is necessary that B lease the land or obtain the superficies in order to secure the ownership of the building. Every other thing than real estate is deemed a chattel (KCC §99 ②).

This distinction is relevant with respect to the modes of acquisition and the types of rights in rem available. Most importantly, the acquisition, transfer and extinction of rights in rem over real estate are subject to registration (KCC §186), as we will describe later.

1.3 Legal Infrastructure

Unlike real estate, legal infrastructure is not a legally defined terminology. As stated in the outset of this paper, a legal structure may be defined as a basic legal system supporting a nation's economy.

Then, specifically, what comprises the legal system in Korea? That boils down to the issue of the source of law. In Korea, the source of law is in principle a written law as opposed to customary law. As with most jurisdictions drawing from the continental legal tradition, written law in Korea has its own hierarchy. The Constitution is at the top and provides guiding principles for all forms of law. Statutory law made by the National Assembly gives detailed shape and substance under the guidance of the Constitution. A treaty is also considered a part of statutory law once it acquires domestic effect. Besides exercising its law-making power, the National Assembly delegates a certain portion of its legislative power to the executive and judicial branches to supplement statutory law. As a result, decrees and regulations set forth by the Presidents, Ministers, the Supreme Court, and the Constitutional Court. At the local government level, there are ordinances passed by local assemblies which have application only for that locality.

Each element of this grand hierarchy comprises what we call legal infrastructure. Due to its vastness and diversity, it would be nearly impossible to sketch every step of legal infrastructure, the Constitution from the top all the way down to the local ordinances at the bottom, concerning real estate investment. Therefore, this paper only focuses on major statutory laws closely related to real estate and investment.

1.4 Chapter Structure

Based on the elements described above, the real estate investment part is structured as follows.

To begin with, the general legal infrastructure for real estate investment will be covered (3.2. General Legal Infrastructure). Much ink will be spilt on the Korean Civil Code (3.2.1. Civil Code), since it is the corner stone of private law and offers fundamental legal framework for property law as well. General overview on the Civil Code will be followed by the explanation of two distinctive features of Korean property law that has special connotation to real estate investment – real estate transfer system and real estate secured transaction. Then, Trust Act, which is frequently used as a legal source in real estate investment, will also be explained (3.2.2. Trust Act). Since real estate transactions are always vulnerable to disputes, the basic dispute-resolution mechanism stipulated in the Korean Civil Procedure Act will be briefly touched on along with some relevant statistics (3.2.3. Civil Procedure Act).

Following explanation on the general legal infrastructure, the special legal infrastructure for real estate investment will be presented (3.3. Special Legal Infrastructure). Although the somewhat vague, the special legal infrastructure in this paper means special legislation directly aimed at fostering investment or investment-related financing. The acquisition-related legal infrastructure, such as laws governing REITs and real estate funds, will be introduced first (3.3.1. Acquisition-related Legal Infrastructure). It will be followed by the account of financial-related legal infrastructure, such as laws governing ABS (Asset-backed Securities), MBS (Mortgage-backed Securities), and trust for encumbrance (3.3.2. Financing-related Legal Infrastructure). Finally, a legal framework regulating real-estate development will be explained (3.3.3. Development-related Legal Infrastructure).

On the basis of legal regime on the real estate investment, we will see how foreign investment, as opposed to domestic investment, is treated and fostered through special legislation (3.4. The Treatment of Foreign Investment).

2. General Legal Infrastructure for Real Estate Investment

2.1 Civil Code

2.1.1 Overview

a. Historical Background

The KCC is the lengthiest and perhaps the most influential of all Korean statutory laws. This law is a comprehensive and fundamental norm that covers the entire area of private law. Most private transactions and familial matters are governed by the principles and doctrines provided by the KCC.

In order to understand the overall system and principles of the KCC, one needs to understand historical background of the KCC as well as some background knowledge on Korean law in general.

Korea has been developing its own peculiar tradition of the rule of law throughout its history. For instance, the first dynasty, Kojoseon (2333-108 B.C), already established its own statutory law consisting of eight articles. This legal tradition developed with time. However, Korean legal tradition and framework significantly differed from those in Western laws. Though introduction of Western ideas of law began as early as the 17th century, they initially faced opposition and criticism in Korea. It was due to the deeply rooted Confucianism that prevailed Korean society. However, at the turn of the 20th century, Korea finally geared up for the reform of legal system patterned after the Western model The reform came to an abrupt halt in 1910 when Japan forcefully annexed Korea to colonize the country. From then, until the end of the Second World War in 1945, Japanese law functioned as the primary source of law in Korean territory. Since Japanese law had already been heavily influenced by the Western legal tradition, Korea was somewhat involuntarily exposed to the full-scale and indirect influx of Western laws. In 1912, the colonial government promulgated a decree titled 「Decree on Civil Matters on Joseon」 in which enforcement of Japanese law concerning civil matters to the colony was declared. By virtue of this decree, Japanese Civil Code and Civil Procedure Code became the governing norms in Korea in the area of private legal relationship and litigation arising there from.

Japanese colonial rule ceased with the end of the Second World War, and the Republic of Korea was formally established on August 15th, 1948. A modern legal system began to develope. The process of making a draft for the Civil Code took considerable efforts and time. The breakout of the Korean War (1950-1953) made this task even more challenging. Despite all the difficulties, drafts of the KCC was prepared and finally enacted. The KCC took effect as of January 1, 1960.

The KCC, except for the part on family law, has remained almost unchanged. However, the KCC is currently in the process of amendment. The goals of this reform are to reflect case laws, to adjust the law to changed market situations, and to cope with issues caused by the globalization of law. Besides building coherent norms that work best for Korean society, another significant mission of Korean civil law is to constantly harmonize itself with global trends. The recent legislative movement to re-codify the KCC is noteworthy in this respect. In early 2009, the Ministry of Justice announced its ambitious four-year plan to push for the comprehensive amendment of KCC. This plan is currently being executed. It is too early to tell at this time what this committee will bring forth. However, significant changes are definitely in store. In terms of this paper, we might have to concentrate on the current Civil Code as it is. However, it should be noted that some features of the Civil Code that are being introduced in this paper may have different forms and substances in the future when the above amendment project is completed.

b. The Relevance of the Civil Code to Real Estate Investment

The KCC does not aim to govern investment-related legal relationships in a direct and specific manner. Rather, it aims to govern legal relationships between private entities in a more general way. Yet, legal relationship concerning investment, after all, is largely based on general principles and doctrines set forth in the KCC. Therefore, the KCC is a foundation on which real estate investment stands. Therefore, understandingthe KCC is essential in understanding real estate investment in Korea.

We will particularly focus on property law. The basic concepts of rights in rem, transfer of ownership by way of registration, and secured transaction using real estates, are all applicable to real estate investment, which we will deal with in more details below. The soundness of property law regime strongly affects the soundness of investment environment. In that regard, understanding the above elements of Korean property law is highly pertinent in understanding legal infrastructure for investment in real estate.

c. Main Features of the KCC

On the whole, the KCC was deeply influenced by the tradition of continental law as opposed to common law, thus making it appear quite similar to German or Japanese law. For this reason, jurists and lawyers trained in the common law tradition may find it unfamiliar. In contrast, those who are comfortable with continental law may find it very familiar.

It bears much resemblance to the overall structure of the Bürgerliches Gesetzbuch (BGB), the Civil Code of Germany, in that it follows a Pandekten system. The hallmark of this system is the placement of the general principles at the very front, and the provision of clauses containing concrete doctrines concerning particular areas of the subject matter subsequently. The KCC shares this pattern.

The KCC is divided into five books-General provisions (Book 1), the law of rights in rem (Book 2), the law of obligations (Book 3), the law of family (Book 4), and the law of inheritance (Book 5). The law of contracts, torts, and unjust enrichment are governed by the law of obligations (Book 3) along with some part of general provisions (Book 1), whereas the law of property and the law of security rights are governed by the law of rights in rem (Book 2) along with some other part of general provisions (Book 1).

d. Right in rem

At this point, one needs to understand the concept of right in rem. The right in rem is a concept that stems from continental law, in particular German law. It is the right directly exercised on a thing, and has absolute effect against anybody. The absolute and monopolistic aspect of the right makes it clearly different from the right in personam primarily governed by book 3 of the KCC. Due to the absolute effect of the right in rem that imposes a duty to respect the right holder on general public, defining and publicizing the type and contents of the right in rem so as to provide certainty and security becomes imperative. In this regard, numerus Clausus principle is provided (§185). The KCC enumerates eight types of the

right in rem; possessory rights, ownership, superficies, servitude, Chonsegwon, right of retention, pledge, and mortgage.

For reference, further provisions regarding real estate law are contained in different statutes. Real estate registration is mainly governed by 「Real Estate Registration Act」. Rules on the common ownership of apartments are dealt with by the 「Act on the Ownership and Management of Aggregate Buildings」.

2.1.2 Types of the right in rem in the KCC

a. Possessory Right

The possessory right is a concept used to describe the legally protected status of someone who possesses or occupies a thing. The possessor does not necessarily have ownership or other proper legal grounds in order to have possessory right. Extreme case would be a thief who has no legal ground at all to claim ownership over the thing she has stolen, but who still enjoys possessory right. In that sense, possession is essentially different in that it is a mere fact with legal consequences.

Possession is characterized by mere physical, not necessarily legally legitimate control over a thing (§192). The underlying rationale of possessory right is to give a certain legal status to a possessor so that rampant self-help of the alleged owners does not savage social stability. The KCC endows a possessor with certain benefits and authorities to ensure this goal. For instance, possession as such is legally protected by claims against infringements by means of distraction (§204) or interference (§205, 206). In addition, the possessor may physically defend his position against attempts to dispossess him or interfere with his possession (§209). However although these rights arise from possession, possession as such does not grant a right to use the thing or to acquire its fruits, nor does it provide a sufficient defense against the owner's claim for restitution or damages. These may arise from an underlying contractual obligation or a right in rem.

b. Ownership

Ownership is deemed the most complete right among all types of rights in rem. It includes the right to use, enjoy, and dispose of things in the most absolute way unless it is prohibited or restrained by relevant laws or regulations. Consequently, ownership includes all the relevant power to exclude others from the use, enjoyment or disposal of one's thing without owner's consent (§211).

The continental concept of ownership is different from the common law concept of estates. In common law, no one "owns" real property. People own estates. This is often compared to a "bundle of sticks", where all the sticks of estates add up to fee simple absolute. If an estate holder parts with some of the sticks, he is left with a lesser estate. The concept of ownership in Korean law is roughly comparable, though not exactly identical, to fee simple absolute in common law countries.

In reality, however, ownership is regulated by various laws. Due to scarcity of real estate and its importance to national economy, ownership over real estate is subject to many regulations. In this context, the absoluteness of the ownership is called into a question in favor of various social interests, such as city planning, environmental protection and the economy in general.

There are no legal restrictions on the ownership of real estate by particular classes of persons. However, it should be noted that under 「Foreigner's Land Acquisition Act」, foreigners and foreign entities are required to report to the relevant governmental entity after a land purchase contract has been closed (§4).

Ownership can be held by multiple persons as well. The KCC stipulates three forms of joint-ownership; co-ownership, partnership-ownership, and collective ownership. Co-ownership is the most loose form of joint-ownership where joint-owners can freely dispose of their shares (§263). Partnership-ownership is the form of ownership of a partner in a partnership relations (§271). This is more restricted than co-ownership in that each partner should obtain the consent of other partners when disposing the share or altering the property (§272). Collective-ownership is a distinctive form of joint-ownership when a piece of property is owned collectively by the members of the association which is not a juristic person (§275). Each member of the association is entitled to make use of the property and take the profits from it, but the administration and disposition of property is determined by resolutions from a general meeting of the members (§276).

Another important legislation in this regard is 「Act on the Ownership and Management of Aggregate Buildings」 in which sectional ownership of the building is addressed.

c. Superficies

Superficies is a right in rem to use another person's land for the purpose of owning the buildings or other structures thereon (KCC §279). Superficies can also be created for using the underground part of the land or the space above the land (§289-2). This right is created by agreement between relevant parties, in principle. Yet, it is very rarely seen since most land owners do not prefer to see this right established against her land due to its long-lasting period. The duration of a superficies should not be less than fifteen or thirty years if the superficies is for owning buildings (§280,281), while there is no such provision for a lease. Rather, this right is sometimes used for a mortgagee over the land to prevent the land owner from constructing a building which will eventually lower the value of the mortgaged land.

Another form of superficies frequently used is a superficies by virtue of customary law. This form of superficies is created when the ownership of the land and the building which belonged to the same person are transferred, respectively, to different persons. Unless there is an agreement to demolish the building, the owner of the building automatically acquires superficies by virtue of customary law.

d. Servitude

Servitude is defined as a right in rem to use the land of another person for the convenience and benefit of one's own land (§291). In most cases, servitude concerns a right of way, a

right to have a cable or a pipeline, water rights, or limitations on the way the site may be used by the owner. Unlike Germany or Japan, the KCC does not recognize "personal servitudes"-servitudes in favor of specific persons.

e. Chonsegwon (Right to registered lease on deposit basis)

Chonsegwon is a peculiar right in rem that entitles a right-holder to use the real estate owned by another person by paying the deposit money (§303). Although the amount of deposit money is settled between parties, it generally hovers between 30% and 70% of the value of the real estate. Unlike a lease, no rent is paid on a regular basis. The settler of Chonsegwon receives deposit money in full and benefits the interest arising there from during the duration of this right. The right-holder enjoys absolute and monopolistic effects, has the right to request auction when the settler of Chonsegwon delays the return of the deposit money, and has priority over the deposit money when the real estate is subject to civil execution. This is in principle clearly differentiated from lease, which only confers a right in personam to the lessee. However, the line has become blurred due to several special legislations protecting a certain group of lessees of the house or commercial buildings 「Housing Lease Protection Act」 and 「Commercial Building Lease Protection Act」 by extending strong protection for the lessee as is shown in Chonsegwon.

f. Right of Retention

If the possessor of property or a negotiable instrument belonging to another person has any claim arising from such property or instrument, and if payment of the claim is due, one may retain possession of the property or the instrument until the claim is satisfied unless the possession has originated in an unlawful act (§320). In practice, this right is widely used in securing a claim arising from construction project against the owner of the building, by retaining possession of the building until the payment is made in full. This may be a powerful tool for the creditor since it can be claimed against anybody including a new purchaser or a mortgagee of the building. However, there is also strong concern that it is creating legal uncertainty since this right is not registered in the public registry. Therefore, the third party has trouble figuring out the existence and scope of the right. Consequently, the abolition of this right over immovables while leaving it available merely for the sake of movables is currently under in-depth discussion in the Civil Code Amendment Committee.

g. Pledge

A pledge under the KCC requires the delivery of possession or control over the pledged movables or rights to the secured creditor until payment (§329,345). In practice, a pledge over movables is rarely used in commercial contexts. Since pledged movables need to be physically delivered to the pledgee, it creates problems for the ledger who might need them to carry out its business or daily life, and often to the pledgee as well who takes the risk of liability from possessing them. A pledge over certain rights is used relatively frequently in commercial contexts. In this type of a pledge, control over pledged rights is transferred to the pledgee. The way of transferring the control differs based on what kind of right it is.

A pledgee who has either possession or control over pledged assets can satisfy his claim by selling the assets by auction (§338) or exercising the pledged right directly (§353). However, a pledge is incomplete in terms of publicity. Although the transfer of possession or control over the pledged assets may carry out some degree of publicity function, it is not always clear from the third party's point of view whether or not a pledge has been created.

h. Mortgage

A mortgage is the most frequently used security right of all. It is a non-possessory right-in rem against real estate (§356). Unlike the right of retention or a pledge, a mortgage is perfected upon its registration in principle. Thus, this is highly recognizable, satisfying the demand for publicity. A mortgage is established and transferred in accordance with the general rules on rights in real estate. Therefore, it is created by agreement and corresponding registration, though with some exceptions (§649).

A mortgagee does not possess or control the real estate, but only secures the portion of its value for the purpose of securing the underlying claim. On account of its absolute effects, a mortgagee can assert this right against anybody. Therefore, the new owner of the mortgaged real estate is subject to the right of the mortgagee. In the case of default, a mortgagee may sell the mortgaged property by auction to obtain satisfaction of the claim (§363).

A mortgage cannot be assigned separately from its secured claim (§361). This represents that the mortgage is inseparably connected with the underlying claim. As a result of this principle, the total or partial absence of a secured claim results in total or partial nullification of the mortgage. As an exception to this principle, fluctuating obligation can be secured by a mortgage in the form of floating sum mortgage (§357). Here, a mortgage can be created by settling only the maximum amount of the debt to be secured and reserving the determination of the debt in the future. In such case the extinction or transfer of the debt which occurred before the debt is determined does not render mortgage null and void. In practice, this form of a mortgage is much more frequently used than the general form.

「Factory and Mining Estate Mortgage Act」 also provides the special forms of mortgage, which allows a mortgage over the entire estate of a factory or mining business, including land, buildings, equipment and intangible property. 「Act on Mortgage on Automobiles and Other Special Movables」 provides for the creation of security interests in the form of a mortgage on registrable movables such as automobiles, heavy construction equipment, vessels and aircraft.

2.1.3 Transfer of Real Estate Ownership

a. Significance of Transfer System

Transfer of real estate ownership is the mechanism through which the value of real estate becomes concrete. Transfer enables total capitalization of the value in real estate. It also offers data for the estimation of the objective value of the property.

Transfer system is closely related with real estate investment. Investment is, after all, transactional activity. Just to name one, the most typical of real estate investment is to purchase real estate from someone, either directly or indirectly, to enjoy the benefit from the value of that estate. Needless to say, purchase takes place in the form of transaction, which is carried out by the transfer system offered by a certain national legal system.

Since investment, which accompanies transactional activities, requires a certain degree of security, investors heed to the security and transparency of the transfer system. In that sense, transfer system is a significant building block of the legal infrastructure for investment.

b. The Status of Registration in the Transfer of Real Estate

In order to specify how registration functions in the whole picture of real estate transfer process, let us consider a simple transaction to buy a house.

In the first phase, a seller and a buyer makes a purchase contract over a house usually preceded by pre-contractual bargaining process. Typically, they are assisted by a real estate broker or a realtor. Although lawyers may be involved in this transactional process, individuals rarely seek for professional legal assistance. This is partly due to the limited number of lawyers, but also partly due to the well-settled transfer system along with various informational sources that make costly legal assistance by lawyers unnecessary. However, purchase of real estate for the purpose of large-scale real estate investment is assisted by law firms. When they make a contract, they can either use a standard paper form or create a contract of their own specifically addressing their needs. If the real estate transaction is done on an individual basis, a standard form contract offered by the above middlemen is widely used.

In the second phase, the balance of the price is paid and the documents necessary for registration are delivered. Usually, the physical delivery of the real estate also occurs at this stage. In some jurisdictions, either a notary (civil law jurisdictions) or a conveyancer (common law jurisdictions) examines the documents that are necessary to ensure the validity of the title and notarize them. This is not the case in Korea. There is no legal requirement forcing the parties to have the documents such as contract form notarized by a public notary or any other certified professionals. Although real estate brokers and paralegals typically examine possible risks of the transfer as they carry out their jobs, this is not a legal prerequisite to the transfer of real estate.

In the third phase, registration takes place at the registry. However, the legal significance of the registration differs between a tradition system and a consensual system. In a consensual system, transfer of title only requires a valid contract between the buyer and the seller. Additional transfer act such as delivery or registration is optional and may only bring about the effect of the conveyance against a third party. However, the meaning of this "third party effect" is often ambiguous. In a tradition system, transfer of title requires both a valid contract and the act of additional transfer. The additional act is mandatory. While the registration requirement usually applies to land and delivery requirement to movables, there are jurisdictions extending registration duty to specific types of movables.

During the colonial period when the Japanese Civil Code was in effect, a consensual system was implemented. The transfer took effect when both parties agreed upon the transfer of right in rem, and the registration was only a requirement for its third-party effect. However, transfer of title in the KCC follows the pattern of tradition system as opposed to consensual system. As has been mentioned, the tradition system requires not only a valid juridical act but also an additional requirement such as delivery in movable and registration in immovable. The KCC §186 makes it clear that the registration, besides a valid juridical act, is needed to complete the transfer of title in immovable. Further, the KCC §188 also states that the delivery is required for the transfer of title in movable. These two provisions characterize Korean system as a tradition system.

c. How Real Estate Registration System works in Korea

The bulk of registration-related rules are provided in the 「Real Estate Registration Act」. Below is the brief account of how registration system actually works in Korea under this law.

When contracting parties involved in the transfer of rights in rem over real estate wish to finalize the transfer, they need to register the transfer. In principle, a transferor and transferee, or their representative/agents are required to show up together for the registration. This is to ensure that both parties are still willing to implement the registration in accordance with the contract. This mechanism functions as a substitute for notarization typically taking place in other jurisdictions.

The registration is done in the registry offices. Registry offices are maintained and overseen by the Supreme Court, and are located in each district court. The registries are staffed by registrars who have received years of specialized legal training and who work under the overall supervision of the court. They review each application for real estate registration only for formal requirements. They do not verify identities or legal capacity of parties other than those identified by IDs or documents that have been submitted. They do not determine compliance with any sales conditions or payment either.

When the applicants file for the registration, registrars type in necessary information in the registry. In the past, this work was mostly done in the paper-form registry. Yet, Korea has been turning paper-based registry into the electronic one to promote cost effectiveness and swiftness of the registration system. As of now, the public registries in Korea are entirely digitalized. Further, they are publicly accessible on the internet. The public has the access to a certified copy or abridged copy of any real estate registration record in any registration office as well as access to registered information on the internet. In particular, the internet registration system drastically improved public access and reduced economic costs. It enables people to acquire information and to obtain copy of any real estate registration record regardless of the location.

The following information is contained in the registry:

- Factual information on real estate, including the location, administrative number, structure, size of the real estate.

- Legal information on real estate, including current owner, history of title transfer, dates and grounds for title transfer.

- Encumbrances, including mortgages, servitudes, superficies, registered leases, trusts, and judicially-ordered attachments and injunctions.

d. Indefeasibility of Title

Another issue regarding a real estate registration system is whether or not to recognize indefeasibility of title. Indefeasibility of title presupposes a following case. Let's say that A has acquired a piece of land from B, who had a title on the registry as an owner. According to the registry, B has purchased it from the previous owner, C. A believed that B was a true owner of the real estate. Yet, it turned out that the contract between B and C was invalid. According to the property law in Korea, B did not acquire ownership since the contract was invalid from the beginning. Is A, a good faith purchaser, entitled to title?

Korean property law does not extend general protection for a good faith purchaser of real estate. To put it another way, indefeasibility of title is not recognized in Korea. In the midst of drafting the KCC in 1950's, whether or not to introduce this doctrine into the KCC was a controversial issue. Although a tradition system usually accompanies the protection of good faith purchaser of immovable, the drafters were not certain if the registration system was credible enough to accommodate this new doctrine. Korea had no experience of running the registration system of its own. Korea had no public notary system that would increase the credibility of the registration. Further, the protection of the good faith purchaser of real estate was not a part of Japanese law that was in practice. Thus, implementing the protection measures would have caused much confusion. Assessing these factors, the KCC has adopted a tradition system, but not the indefeasibility of title.

However, the third parties who rely on the title registration are not without protection. There are numerous provisions in the KCC designed to protect a good faith purchaser. To name some, a false declaration (KCC §107), a sham transaction (KCC §108), a mistake (KCC §109), fraud and duress (KCC §110), and the rescission of the contract (KCC §543-548) are all equipped with third-party protection clauses. For instance, the third party purchaser who relied on the title of certain land, which was in fact invalid due to a sham transaction, would acquire the title so long as she purchased it in good faith. Yet, this protection with individual provisions is not as comprehensive as it is under German or England legal regime where good faith purchaser of immovable is generally protected.

From the investor's point of view, recognizing indefeasibility of title provides higher degree of security. If indefeasibility of title is not acknowledged, the purchaser of the real estate needs to either thoroughly examine the validity of title beforehand or avoid possible risks by purchasing costly insurance policy covering potential loss, in case the title turns out to be a null and void one. This generally increases transaction costs, consequently leading to inefficiency of the transaction. In that regard, Korean registration system is not fully in tune with investment-friendly setting. Although this issue is being discussed in the process

of amendment of the KCC, it remains to be seen whether or not the dramatic change will actually take place.

2.1.4 Real Estate Secured Transaction

a. General Secured Transaction Regime

An effective and sound secured transaction regime is an essential component in any financial system. Investment is related to financing in two aspects. Firstly, investors are frequently in need of financing. Secondly, investors have stronger incentive for investment if the object of investment can easily be capitalized by way of securitization. Therefore, an effective and sound secured transaction regime is essential in fostering investment.

In principle, taking security can be classified into two categories: one over movables, securities or receivables; and the other over real estate or special movables such as vehicles, ships and factory machinery that are registered as real estate. Both categories of securitization require an agreement to create security. Further requirements to complete the securitization differ among types of objects. In case of ordinary movables or securities, taking possession is required. In case of receivables, notice to or consent from the debtor is required. In case of real estate or registered assets, registration of the creation of the security interest in the relevant registry is needed.

Another noteworthy change that will take place is the new security right regime over movables and receivables. On June 10, 2010, Korea promulgated「Act on Security Rights in Movables and Receivables」. This Act will take effect as of 11 June 2012. This provides the framework for the registration system for security rights in movables and receivables. However, it does not completely replace the current security right system in this field. Rather, this is intended to leave it untouched, while providing people another option that is more secure and predictable.

b. Secured Transaction using Real Estate

The most typical secured transaction using real estate is a mortgage. A mortgage has already been explained above when we covered the rights in rem stipulated in the KCC. There are other forms of security rights than mortgage. They have been created either by customary or statutory laws. The typical example of security right by customary law is a “Yangdo-dambo", a form of non-possessory security right outside the scope of the KCC. A debtor transfers title to its property while the possession of the property is retained by the debtor. The title comes back to the debtor upon the full payment of the secured debt. This right covers both immovables and movables, yet is widely used in movables due to the convenience of not having to deliver the possession of the property to the creditor.

In terms of corporate financing, asset-backed securitization is broadly used in practice.「Asset-backed Securitization Act」governs the procedural and some substantive aspects of the securitization. According to this Act, the originator gets financing by selling the pool of

assets to a SPC (Special Purpose Company), which in turn issues asset backed securities to investors. The pool of assets being securitized typically consists of small and illiquid assets that are unable to be sold individually, such as payments from credit cards, auto loans, and mortgage loans. Along with these types of assets, real estate itself can be the asset for the securitization.

2.2 Trust Act

2.2.1 Overview

Trust is one of the most frequently used legal institutions in terms of real estate investment. As the purpose of this part of the paper is to sketch legal framework that is used in real estate investment, giving an outline of the Korean trust law is indubitably necessary.

It is generally understood that the trust is a relationship between three parties where one party (trustor) transfers property to another party (trustee) for the benefit of a third party (beneficiaries). Although the trustee holds the title of the property, she only does so for the benefit of beneficiaries. Thus, it is different from pure ownership where the owner does not have such legal restriction to protect or promote the benefit of someone else. Although the beneficiary is conceptually differentiated from the trustor, trustor herself can be a beneficiary. In practice, this self-beneficiary is prevalent in Korea, especially in the investment context.

The trust is created by the contract between trustor and trustee unless otherwise stipulated in the law. Thus, the trust relationship is basically governed by the terms of the contract. The trust is also governed by law. The law governing legal issues arising from these relationships is a trust law.

Historically speaking, a trust law has been considered ‘common law product’. Trust law had mainly developed in England as early as the time of the Crusades during the 12th and 13th century. For this reason, most jurisdictions that have the trust law generally belong to the common law tradition. On the other hand, it is much less prevalent in continental jurisdictions. For example, Germany and France, the two super-powers in the area of continental law, do not have statutory law on trust. Several accounts for the absence of trust law in continental law tradition may be provided. Above all, some typical principles and doctrines inherent in the trust law, such as dual ownership, equitable tracing, and the powerful status of the beneficiary without holding the right in rem. are definitely foreign to traditional continental law regime.

However, there are several jurisdictions with statutory trust law outside the common law tradition. In Europe, Switzerland and Liechtenstein have statutory trust law. In Asia, Japan, China, Taiwan and Korea do. Korea has enacted 「Trust Act」 in December 1961, and is awaiting the enactment of comprehensively amended Trust Act next year (The new Trust Act will be in effect as of July 26th, 2012. The below explanation is based on the current Act) after years of efforts to modernize trust law. However, debates still continue as to the nature of the trust and its compatibility with indigenous legal concepts in continental law.

In the past, this Act was not extensively used. It was due to the fact that Korean companies and individuals were not familiar with this legal area. In addition, investment environment was not as complex as it is today to require some sophisticated legal tool such as trust. Recently, the importance of trust law has been on the sharp rise. In particular, trust law is a vehicle frequently used for purpose of real estate financing. For example, Real Estate Investment Trusts (REITs), as its name strongly indicates, is based on trust law. In that sense, understanding the basic structure of trust law is essential in understanding the basic structure of real estate financing.

2.2.2 Benefits of Trust in terms of Real Estate Investment

Trust has a number of benefits in real estate investment. Realizing these merits might help readers understand why trust is widely used in a real estate investment setting.

Firstly, trusting real estate to a trust company enhances the security of the transaction, thereby increasing the volume of transaction. Most of the times, the trustee in the real estate is a trust company established on the ground of capital market law. The company has to meet the financial requirements set forth by the law. It is also supervised by the relevant authority on a regular basis. It has sufficient expertise to handle the responsibility of the trustee.

Secondly, trust offers a formidable firewall against insolvency. This is called the principle of asset protection. Even when a trustor goes insolvent, the creditors of the trustor cannot go after asset that has been set apart as trust property. Legally speaking, the trustee, not the trustor has legal title over that property. This makes the trust assets safe from the creditors of the trustor. Moreover, it is also safe from the creditors of the trustee. Here, the segregation of trust assets from other assets of the trustee takes place. The segregation of trust assets from other assets of the trustee enables this. Therefore, this is a highly secure way to protect asset for a certain purpose without being threatened by the claims of the creditors.

Thirdly, trust is a highly flexible means to design legal relationship according to the wish of the trustor. Ownership, in contrast, is strictly bound to the provisions of the Civil Code. Parties cannot alter or change the contents of ownership at their wills, due to numerus clausus principle that limits property rights in their number and content. Yet, trust is created by an agreement between the trustor and the trustee. This enables the parties to create more customized and flexible rights and duties accustomed to their own circumstances and needs. This trait of the trust makes it highly appropriate for ever-changing business environment.

2.2.3 Outline of Korean Trust Act

a. How Trust is Created

Under Korean Trust Act, trusts may be created by a contract between the trustor and the trustee, or by the will of the trustor (§2). Exceptionally, the trust is created by operation of

law. In the real estate investment, it is mostly a contract that creates trust relationship. For this reason, trust accompanies a various contract-related issues. The distinctive point that shows the continental legal trait here is that it is the contract, not merely a declaration as in the common law, which constitutes the ground for the trust.

Since any transfer of the right in rem in real estate is subject to registration, transfer of ownership by trust over real estate needs registration to take effect. By trust, the trustee acquires complete ownership over real estate, but is subject to terms and conditions set forth by the trust contract. These restrictions are made public by registration. Otherwise, the third parties are not able to distinguish it from ordinary transfer of ownership. Hence, trust is only opposable to the third party by registration (§3 ①).

There are several limitations as to the creation of trust. The trust may not be created with a purpose contrary to the good customs and other social order (§5 ①). The trust shall be null and void if its object is illegal and impossible (§5 ②). Trust aimed at evasion of the law or aimed at creating lawsuits are also prohibited (§6, 7). Fraudulent trust – a trust settled by an obligor knowing that it would be prejudicial to the obligee – can be cancelled and restored to the original state as prescribed in the KCC §406 ①, even when the trustee has acted in good faith (§8 ①).

b. The Legal Status of the Trustor

The trustor does not have any legal title over trust property once the transfer of property to the trustee takes place. From the third party's perspective, the trustee is the sole right-holder. For instance, if the trustor trusts real estate to the trustee, the trustor does not have right to use and benefit from the property any more. However, the trustor frequently uses and benefits from the real estate that she already has trusted to the trustee. This may be explained as follows. In the first place, it is often the case that the trustor herself is a beneficiary. If this is the case, the trustor using and benefitting from the real estate can be explained as the trustor exercising her right in the position of beneficiary. If the trustor is not the beneficiary, then there should be agreement, either explicit or implicit, between the trustor and the trustee within the boundary of the purpose of the trust.

Even though the trustor no longer has legal title, he or she still possesses certain statutory rights provided by the Trust Act. These rights include the following rights.

The trustor may file an objection against any compulsory execution or public auction rendered in contravention of the relevant provisions prohibiting compulsory execution (§21 ②). The trustor may request to the court the change of the trust property management method (§36 ①). The trustor may claim any compensation for damages or a restoration of the trust property to the original state if the trustee destroys, loses or reduces the trust property, or inflicts any loss on it, through inadequate management, or he disposes of the trust property in contravention of the principal objective of the trust (§38). The trustor may demand an inspection of the documents pertaining to the management of the trust affairs, or an explanation on the handling of the trust affairs (§34).

c. The Legal Status of the Trustee

The trustee acquires the ownership of the trust assets along with some restrictions set forth either by law or contract. The trustee needs to gain certain degree of control over trust assets in order to manage them effectively. At the same time, the trustee should be deterred from taking opportunistic measures for her own benefit by abusing control she has. For this purpose, stringent duties are imposed on the trustee. These include: the duty to abide by the terms of the trust; the duty to account; the duty of good faith and honesty; the duty of care or reasonable prudence; and fiduciary duties of loyalty.

d. The Legal Status of the Beneficiary

According to the common law, the beneficiary gets the equitable ownership over trust assets, while the trustee holds the legal ownership. This is premised on the concept of dual ownership. However, continental legal tradition does not incorporate this concept. Neither does Korean law. Subsequently, the Korean Trust Act does not envisage the picture of the beneficiary holding equitable ownership. Rather, it is construed that the beneficiary merely holds the right in personam, as opposed to the right in rem. Yet, the right in personam held by the beneficiary is exceedingly fortified one. In order to accomplish the purpose of the trust, that is to protect and promote the interests of the beneficiary, the Trust Act prevents various legal devices to enhance the status of the beneficiary.

e. The Legal Status of Trust Assets

As mentioned above, one of the merits of the trust is the segregation of the trust assets from other assets of the trustors or trustees. This entails that the trust assets are free from the claims of the trustor or trustee's creditors. This becomes highly significant in the event of insolvency. Unless the claims are related to the trust, the trust assets are separated from insolvent assets.

Another aspect of the legal status of the trust assets is its traceability. In common law, tracing is an evidentiary process that allows beneficiaries to identify current assets held in the hands of someone – including a third party – as representing the trust assets originally held in the hands of the trustee, even though the property has been exchanged into a new form, and passed through several hands. In the Korean Trust Act, this sort of tracing is not allowed.

2.3 Civil Procedure Code

2.3.1 Relevance to the Real Estate Investment

Investment involves a variety of transactions. Transactions pose potential risks of disputes. Disputes are ultimately handled in the civil procedure. Therefore, a credibility of a nation's civil procedure is highly influential in making investment decisions. If civil procedure is not trustworthy enough, potential investors might hesitate to put their money in for fear of not being able to deal with potential disputes in an appropriate way.

Besides substantive law regarding investment, Korea also has a well-organized civil procedure law and a reliable judiciary running the procedure. Below is an overall account on Korean civil procedure and the judiciary.

2.3.2 Overview of the Korean Civil Procedure Code

The civil procedure in Korea is governed by the Korean Civil Procedure Code (hereinafter 'KCPC'). In addition to this Code, Rules of Civil Procedure was promulgated by the Supreme Court of Korea, and is serving as a supplemental norm to the KCPC. Besides these two main body of norms, there are adjacent statutory laws such as 「Civil Execution Act」 and 「Family Litigation Act」.

The KCPC is comprised of 7 chapters and 502 provisions. The first four chapters account for the most part of the KCPC. The first chapter sets forth general provisions on courts, parties, litigation costs, and litigation procedure in general. The second chapter provides various provisions concerning litigation procedure of the court of first instance. The third chapter is a chapter on appeals, while the fourth chapter deals with a re-trial. Case law in the area of civil procedure also plays an important role.

2.3.3 How Disputes are Resolved through Trial

a. File of Complaint & Pre-Trial Proceedings

When one wishes to file a complaint concerning legal disputes, he or she must specify (1) name of parties and (2) facts, legal grounds, demand for relief. When the complaint satisfies the designated format, it is then sent to the court; the court is said to serve the complaint, in which the court summons the defendant as written in the complaint.

Pre-trial Proceeding is a type of meeting between the parties of the dispute and the court. The purpose of this procedure is to clarify the main issues, so as to encourage an accurate and concentrated oral argument in the main trial proceedings. This procedure is not mandatory. When it is deemed appropriate in the pre-trial stage, the case may be transferred to a separate settlement conference, leaving room for the possibility of alternative dispute resolution in favour of expediency and cost-efficiency.

b. Trial Proceedings

The trial proceeding in Korean civil procedure is mainly based on an Adversary system. While there is also a provision authorizing the judge to conduct its own investigation under certain conditions, this discretionary power of the judge is seldom used in practice.

The trial proceedings are based on oral hearings, in which the parties exchange verbal arguments concerning the dispute at hand. The relevant provisions on civil procedure reflect this principle of oral proceeding in its promulgation of specific rules for arguments,

examination of evidence and judgments. However, in examining evidence, there has been a tendency in the courts to favour evidence in written form.

When the dispute in question relates to highly technical matter that requires specialized expertise, the parties and the court may rely upon the Expert Commissioner System, where they can receive expert opinions with respect to certain issues. Examples are skilled professional and technical disputes involving construction, medical, intellectual property rights. In such cases, an expert can be called upon in accordance to the request of the party involved or by a court decision. This system facilitates the trial proceedings even in disputes of a complicated and technical nature.

After the oral hearings the court closes the hearing, followed by subsequent deliberation and judgment.

c. Appeal Proceedings

After the judgment is rendered, any party who wishes to challenge the court's judgment to a higher court must appeal within 14 days counting from the date of judgment. Provisions relating to cross-appeal are also included in the KCPC.

Although there is a tendency toward appeal in many civil cases, as shown by the rate of appeal, only 19.3% of appeals from the court of first instance are reversed and remanded, while 35.5% of the appeals are dismissed.

The Final Appeal is made when parties attempt to challenge the judgments of the High Courts, which are the appellate courts in Korea. Final Appeal must also be made within 14 days from the date of judgment, and cannot be lodged with the Supreme Court unless (1) the judgment of the High Court erred in conclusion of law or (2) the appeal proceedings were in grave contravention of law.

The principle of stare decisis does not apply with respect to the judgments given by the Supreme Court; Supreme Court judgments, however, hold de facto binding force as a persuasive source of law. Among the entire number of final appeals, 89.5% are dismissed, and 7.7% are reversed and remanded.

3. Specific Legal Infrastructure for Real Estate Investment

3.1 Taxonomy

Acquisition, financing, and development are three key words to real estate investment. They have specific corresponding legislation. We intend to use these three elements as tools to describe specific legal infrastructure for real estate investment.

3.1.1 Acquisition

The first step in real estate investment is to acquire certain right over real estate. By exercising the acquired right, the investor reaps the benefit.

The typical form of the acquisition is to gain ownership over real estate. Once the investor becomes the owner of the property, she now has a myriad of possibilities of gaining monetary return by utilizing that property. She may resell it and take the difference. She may lease it and receive the rent. She may borrow money by furnishing the property as security. Given that acquisition is the indispensible part of real estate investment, providing a legal framework backing up acquisition is necessary. We have already covered basic framework at the Korean Civil Code part. In addition, there are some peculiar ways of acquiring real estate, particularly focused on enabling greater number of investors to participate with lesser money and risks.

Korea has two types of such real estate investment vehicles. One is a real estate fund governed by 『Financial Investment Services and Capital Markets Act』. Another is a real estate investment company, known as a REITs, governed by 『Real Estate Investment Company Act』. These are what we wish to address in 『3.3.2 Acquisition-related Legal Infrastructure』.

3.1.2 Financing

Financing refers to the act of providing funds for business activities, making purchases or investing. Financial institutions and banks engage in the business of financing as they provide capital to businesses, consumers and investors to help them achieve their goals. Since the value of real estate is considerably high in general, investors frequently need to find a way to procure necessary funds. The most typical and traditional way of accessing the financial resource is to apply for a loan at the bank. The easier and cheaper the loan is, the more likely it is that investment will occur. Other than a regular bank loan, there are various ways of financing techniques. In this paper, we will focus on relatively new securitization techniques such as asset-backed securities (ABS) or mortgage-backed securities (MBS). Korea has 『Asset-Backed Securitization Act』 governing ABS, and 『Special Purpose Companies for Mortgage-backed Bonds Act』 governing MBS. These are what we will address in 『3.3.3 Financing-related Legal Infrastructure』.

Project financing (PF), which is keenly related to real estate investment in the form of development, is also another way of financing. Yet, this will be covered with respect to the development issue that we wish to address below.

3.1.3 Development

Another way of real estate investment is to develop it. Real estate development refers to activities aimed at creating or improving the value of real estate by organizing necessary resources and talents. Real estate development commonly accompanies construction work. In a big-scale real estate development project, the developer and the constructor are separated. The developer has expertise in planning, financing, marketing and selling, whereas the constructor has expertise in constructing and engineering. However, understanding construction law is highly pertinent in understanding real estate development since the construction plays a core role in the whole development plan.

Against this backdrop, we wish to address briefly Korean construction law regime, and then proceed to explain one of the key factors in the real estate development plan – Project Financing (PF) in『3.3.4 Development-related Legal Infrastructure』.

3.2 Acquisition-related Legal Infrastructure

3.2.1 The Integration of Real Estate Market and Capital Market

Acquisition-related legal infrastructure since the IMF crisis can be characterized in a single catchy word; the integration of real estate market and capital market.

Real estate market has its peculiar traits. Real estate is fixed location-wise. Therefore, real estate market tends to be local in its nature. Korean real estate market has interested Koreans, not foreigners. On top of this, Korean real estate market was not wide open to foreign investors. There are some other traits worth noting. The substitutability of real estate is considerably low, compared to capital which is highly replaceable. This implies that liquidity of real estate is lower than capital. With lower liquidity, price-setting of real estate is not as flexible and accurate as that of capital.

By contrast, capital market has contrasting features. Capital is not bound to certain location. It flows cross the national border, therefore making it truly international. Korean capital market was relatively more open to the foreign investors. For all these reasons, capital market tends to follow a global standard. The price of the capital is determined in a market which resembles a perfect market, and information is more publicly disclosed to ensure its trustworthiness.

After the IMF crisis, Korea needed to adopt an open-door policy to attract foreign capital. Opening of the real estate market, and adopting global standard by integrating regional real estate market with global capital market was necessary. It was against this backdrop that Korea fostered real estate fund (REF) and real estate investment trusts (REITs).

3.2.2 Real Estate Fund (REF)

a. Overview of the Real Estate Fund (REF)

Real estate fund (or in short, REF) is a type of collective investment vehicle that pools money from many investors to buy real estate or its related rights.

The object of real estate investment is, in general, a large sized and high priced real estate. However, purchasing such real estate is burdensome and risky. This may cause chilling effects on real estate investment. Instead of a single investor paying for whole amount of money for the acquisition of real estate, involving more investors reduces risks and financial burden. REF is an appropriate way of involving many investors. In this sense, fund is a useful means of collective investment.

This also makes it feasible for small investors to invest in a large-sized real estate investment that would be impossible to invest in otherwise. In stock investment, even small investors can easily purchase stocks since they are divisible in small sums. Real estate does not offer this sort of flexibility when it comes to investment. REF overcomes this obstacle by securitizing real estate. With this collective investment scheme, the investors can also take part in real estate investment without having gross sum of money.

Furthermore, REF can also be characterized as indirect investment. Investors only finance acquisition of real estate, but do not involve themselves in a business decision-making process. The purchase and management of real estate in the process of investment is handled by professionals. By separating financing and business, investment becomes even more reliable and efficient.

Lastly, most REFs are insulated from other assets. Fund takes a form of a trust or a company which sets the fund apart from other assets. For this reason, fund is protected from other claims than the claims regarding fund itself even when other investors or a management company go bankrupt.

b. Applicable Law

In Korea, REF is regulated by 『Financial Investment Services and Capital Markets Act』 (hereinafter, "Capital Markets Act").

This is relatively a new legislation. It was promulgated on August 3rd, 2007, and took effect as of February 4th, 2009. The purpose of the Act is to provide better-suited regulation on the Korean capital market. To provide comprehensive legal framework for the market, this Act consolidated a number of individual statutes that were in force on financial regulation.

The distinctive feature of this Act is that it adopts a comprehensive approach by defining financial investment products in a broad manner. It also adopts a functional approach by categorizing regulations by the substance of the activity, not by type of the industry or institution. In the past, statutes applied on an institution-basis. Thus, even the same financial service performed by different institutions was regulated by separate statutes.

The most noteworthy aspect of this Act is that it provides investors with enhanced and customized investor protection mechanism by introducing the suitability principle and the duty of risk disclosure and explanation. Investors are classified into professional and non-professional investors depending on their capability of taking risks in light of the expertise they possess (§ 9(5)). Since professional investors are considered capable of assuming and managing investment risks, the Act is designed to protect non-professional investors who are more vulnerable to risks, while loosening unnecessary regulation on the transaction between the financial institution and professional investors. For example, financial institutions must explain the investment risks and recommend appropriate financial investment products to non-professional investors, but professional investors are not required to do so. Based on the framework explained above, there are some distinctive features of the law concerning REF. For instance, § 229 (2) of the Act defines the concept of REF. According to this provision, REF is a collective investment scheme that invests the collective investment property in real estate (including investment in derivatives based on underlying assets consisting of real estate, loans to corporations related to the development of real estate, and other investment in real estate in a manner prescribed by Presidential Decree and in securities related to real estate as prescribed by Presidential Decree) in excess of the ratio prescribed by Presidential Decree, which shall be no less than 40/100 of the collective investment property. When investing the collective investment property in real estate in the form of a real estate development project, disposal of real estate within a period of time prescribed by Presidential Decree not exceeding five years after the acquisition of real estate is prohibited to ensure stability of investment (§81 ①-2).

3.2.3 Real Estate Investment Trusts (REITs)

a. Overview of the Real Estate Investment Trusts (REITs)

Real Estate Investment Trusts (or in short, REITs) is another form of real estate investment vehicle. It is similar to REF in that it aims at drawing many investors' money for the purpose of real estate investment while providing safer and securer protection for the asset. Often, the difference between REITs and REF is contested. At least in Korea, the difference is relatively minor. The first difference to be noted is that REITs is supposed to be a stock company, whereas REF can take various forms such as a stock company, a limited company, a partnership, and a trust. Further, they are governed by different laws. While REITs is governed by 『Real Estate Investment Company Act』, REF is governed by 『Financial Investment Services and Capital Markets Act』.

From this difference, a number of differences as to the process of incorporation and authorization, requirements to be met, and the contents and the scope of supervision exist. REITs and its related law belong to the business of Ministry of Land, Transport and Maritime Affairs, while REF and its related law belong to the business of the Financial Services Commission. Given the similarities REITs and REF share, it could have been consolidated into a single law. However, the difference of the Ministries in charge made mercing difficult.

b. Applicable Law

REITs in Korea is governed by 『Real Estate Investment Company Act』. It was first enacted in Apr. 7. 2001, and has been amended numerously since then. According to the Article 1 of the Act, the purpose of this Act is "to contribute to the development of national economy by prescribing the matters concerning the establishment of real estate investment company, the management methods of assets thereof and the protection of investors therein to provide the citizens with more opportunities to invest in real estate as well as to vitalize the sound investment therein."

The Act presupposes that the REITs is a stock company (§3 (1)). This is different from REITs in other countries, such as the USA or Germany, where REITs can take the form of trust or partnership. It should use the name "real estate investment company" in its trade name to distinguish it from other ordinary companies (§3 (3)). Unlike other companies, REITs company should only be engaged in investing its assets in real estate (§4).

The Act goes on to stipulate various rules and standards by which the company is regulated Rather than going over all the details of these regulations, it would suffice to state that the Act is prescribing the incorporation and authorization of real estate investment company (§5 to §11-2), its organization (§12 to 14-2), issuance of stock (§14-3 to §20-2), investment and management of assets (§21 to §29), limitations on its activities (§30 to §34), entrustment of asset custody (§35 to §36), public notice of information (§37 to §38), supervision (§39 to §42), merger and dissolution (§43 to §44-2), registration (§45 to §46), and so forth.

3.3 Financing-related Legal Infrastructure

3.3.1 Asset-backed Security (ABS)

a. Overview of the Asset-backed Security (ABS)

An ABS is a security backed by a specified pool of underlying assets. The pool of assets is typically a group of small and illiquid assets that are unable to be sold individually. Pooling the assets into financial instruments allows them to be sold to general investors and allows the risk of investing in the underlying assets to be diversified. The pools of underlying assets are broad in range. They typically include common payments from credit cards, auto loans, and mortgage loans, but stretch as far as cash flows from aircraft leases, royalty payments and movie revenues. Even the real estate itself can constitute the asset for securitization.

Here is how ABS actually works. The Originators, who hold the ownership over underlying assets, usually transfer these assets to the special purpose vehicle (SPV). The SPV is created only for the purpose of executing securitization of ABS, selling them, paying back the proceeds to originators. From the perspective of the originators, this is a good way of financing using underlying assets. Unlike mortgage, the originators remove the value of the underlying assets from their balance sheet. Further, their assets are protected from the creditors' claim in case of bankruptcy, since they now belong to the SPC, a bankruptcy

remote entity. They can still receive cash in return as the asset backed securities are sold. From the perspective of investors, ABS is a convenient and safe way to invest their money in various groups of assets. Unlike buying real estate or other assets upfront, investors can choose the total amount of value they wish to purchase as well as the objects of the investment. In case of default, investors can go after the assets that back up securities. In determining the price of securities (or an interest rate), credit rating plays a crucial role. A higher credit rating could allow the SPV, or the originators at the backstage, to pay a lower interest rate. A lower credit rating would yield a different outcome.

b. Applicable Law

"Restructuring" was the key-word for Korean companies at the time of the IMF crisis in the late 1990's. Securitization of the non-performing loans (NPLs) was one of the major tools of restructuring. To facilitate the effective disposal of NPLs, the relevant reform of the legal framework was needed. Against that backdrop, special legislative efforts have been made to enact the statutory law governing asset-backed securities (ABS). As a result, 『Act concerning Asset-Backed Securitization』 took effect as of Sep. 16. 1998. Since then, most of the securitizations in Korea are transacted pursuant to this Act.

The ABS Act presumes roughly two types of ABS; one using a SPV and the other using a trust (§2 (1)). In practice, ABS using a SPV is much more prevalent than the other, although the usage of the ABS trust is on the rise. The Act also specifies the lists of the eligible originators (§2 (2)). Confining the ABS issuance to the enumerated entities is to minimize possible detrimental effects if the issuance is done by entities that are not credible enough.

Under this Act, securitization assets are defined as "claims, real estates and other property rights that are the subject matters of asset-backed securitization."

A securitization plan must be registered with the Financial Services Commission (FSC) by the relevant securitization vehicle as the first step of the ABS issuance (§3 (1)). The FSC may refuse the registration of a plan or demand the changes of the contents under certain circumstances prescribed in the Act (§5 (1)).

The actual ABS starts when the transfer of the assets from the originator to the SPV (or trust company) takes place. This transfer should be qualified as a true sale. The requirements of a true sale is enumerated in the Act (§13). To facilitate transfer of assets, there are special provisions in the Act. The Article 7 concerns the assignment of the claims. According to the Civil Code, a written notice of assignment should be given by the assignor to the obligor or the consent of an obligor should be obtained. Such notice or consent should bear a fixed-date stamp in order to gain effect against third party. However, the ABS Act eases this requirement to facilitate the assignment of assets in the form of claims. It is deemed, according to this Act, that an assignment of a debt claim has been properly perfected against third parties if the assignment of such debt claim is duly registered with FSC. To be effective against the obligor, the notice or the consent is still required. However, the ABS Act provides that the assignor, not only the assignee, can give this notice. Also, if the assignment of mortgage interest on real estate is necessary, the Act simplifies this process by rendering it effective

at the time of registration of such assignment with FSC (§8). In principle, the Civil Code requires that assignment of mortgage interest to be registered with the court where the relevant real estate is located. This is time-consuming and costly. The simplification of the process by the ABS act saves time and money, consequently facilitating the securitization of real-estate related assets.

There are other provisions to secure the asset management. For example, The SPV should entrust the management of the securitization assets to a qualified servicers (§10). The servicers should manage the securitization assets separately from their own assets, and maintain separate books for the administration of the assets (§11). In the event of a bankruptcy of the servicers, the securitization assets do not become a part of the servicers' bankrupt estate (§12).

3.3.2 Mortgage Backed Securities (MBS)

Mortgage backed securities (MBS) is a type of an ABS. The peculiarity of the MBS lies in the fact that claims are backed by mortgage. The above explanation on the ABS basically applies to the MBS as well. The only thing to be noted is that there are special statutes specifically designed for MBS; 『Special Purpose Companies for Mortgage-Backed Bonds Act』 and 『Korea Housing Finance Corporation Act』.

The former statute was first enacted in 1999 under the name of 『Mortgage Backed Claims Securitization Company Act』. Later in 2003, the latter statute was also enacted. The former statute governs general legal relationships and issues arising out of MBS. The latter statute governs specific matters pertaining to MBS issued by Korea Housing Finance Corporation. In practice, most of the MBS are issued by Korea Housing Finance Corporation. Thus, the latter statute is widely applied. However, the legal structure of MBS is largely similar to that of ABS.

3.4 Development-related Legal Infrastructure

3.4.1 Legal Framework for Real Estate Development

Real estate development involves multifaceted legal issues. It concerns general property law, in particular real estate law. It also concerns general construction-related law. This is due to the fact that most of the real estate development projects require architecture and engineering. It also concerns administrative law. In general, various types of permissions and licenses are needed in order to proceed with a development project. Contract law is one of the most frequently applicable laws. Contracts are made at various levels and phases of the development project. Tort law, environment law, and other laws are also at issue.

Therefore, the legal framework for real estate development is very wide in its scope. When a nation has a highly credible and reasonable legal framework on the whole, it is more likely to attract investment in real estate development project.

In the paragraphs below, we will touch upon two features of development-related legal infrastructures-construction-related law and project financing-related law-that were not treated elsewhere in this paper.

3.4.2 Construction-related Laws in Korea

Construction lies at the center of real estate development. The most typical real estate development project is to purchase parcels of land, construct a high-rise building along with adjacent facilities and space, sell or lease them to enterprises or individuals, reap the investment benefits there from.

There is no single statute that governs overall issues of this process. A great number of statutes must be collaborated to regulate these issues. It would not be feasible to go through every single statute and its details in this paper. Instead, the outline of the relevant legal framework will be described.

a. Purchasing Land

The first step of the development project is to secure legitimate power to use the land on which development is made. The most secure way of doing this is to purchase land and become its owner. The owner has all the necessary legal power to use and enjoy the benefits from the land. There are other ways by which the power to use land is acquired. One may acquire servitude. It is a right in rem to use the land of another person for the convenience and benefit of one's own land (§ 291). Another is to acquire this power by contract, such as land lease contract. In the process of acquiring these rights, financing is needed.

In the course of purchasing land, developers usually face a situation in which they have to deal with multiple number of land owners as their counterparts. This is due to the fact that multiple pieces of land are generally needed for a development project. Securing merely a single parcel of land does not guarantee the success of the development plan. Therefore, developers make use of various contractual devices such as a pre-contract agreement or a conditional contract, so that they can either purchase all pieces of land collectively or get out of the contractual relationship more easily in the case they fail to purchase all the necessary lands. Moreover, the 『Urban and Residential Environment Improvement Act』 endows developers the right of eminent domain in the case of a development project that has to do with public interest.

As for the funding, the developers can simply get a loan from the financial institutions, or use some distinct financing techniques such as REF or REITs as we have mentioned above. We will further expound on the Project Financing (PF) below.

b. Complying with Relevant Regulatory Measures

Another step to be taken at the initial stage of the development is to acquire relevant permissions, approvals, authorizations or licenses in accordance with administrative statutory laws and regulations.

The general regulation on land is provided by 『National Land Planning and Utilization Act』. The purpose of this Act is to promote the public welfare and to upgrade the quality of living through provision of matters necessary for a formulation and implementation of plans to utilize, develop and preserve the national land (§ 1). It provides grounds for various regulatory measures to achieve the above purpose.

The general regulation on building is provided by 『Building Act』. The purpose of this Act is to improve the safety, functional, environmental, and aesthetic aspects of buildings, and to promote public welfare by establishing the standard for construction of buildings (§ 1). It also provides grounds for various regulatory measures corresponding to the purpose.

In the case of re-development, the noteworthy statute is 『Urban and Residential Environment Improvement Act』. Massive reconstruction plan is frequently made and executed. This entails a large number of complicated legal issues. There are not only public interest issues but also private interest issues as well. For example, the collective decision by relevant real estate owners should be made in order to proceed with a massive reconstruction project. The Act comprehensively regulates issues and policies concerning an urban and residential environment improvement plan.

c. Constructing a Building by Contract

Entering a contract is one of the most important parts of a development project. In constructing a building, numerous contracts are made. They spell out in detail all the possible contingencies that may be encountered in the course of the project. A contract defines the responsibilities for each participant and the rights and obligations associated with the parties. In Korean contract law, a contract can be as simple as a short verbal agreement, or as complicated as several volumes of documents. Unless otherwise specified, a contract regardless of its value needs no formal requirements. However, most of the construction contracts are made in writing. It is especially the case with the contract where the government becomes the contracting party.

It is customary for a constructor to make subsequent contracts with sub-constructors. To ensure the quality and the safety of the construction work that the developer anticipated, 『Framework Act on the Construction Industry』 prohibits, in principle, subcontracting of the construction works (§ 29(1)). At the same time, protecting subcontractors is important. This is because subcontractors are generally at an inferior status and thus vulnerable to abuse. The protection of subcontractors is realized mainly by 『Fair Transactions in Subcontracting Act』. To name some of the provisions aimed at this goal, the prohibition of fixing unreasonable subcontract payment (§ 4), the prohibition of compelling purchase of goods (§ 5), enabling payment in advance (§ 6), prohibition of unreasonable cancellation of entrustment (§ 8), prohibition of unfair requests for settlement of purchase price (§ 12), prohibition of unfair requests for economic profits (§ 12-2), and direct payment of the principal contractor to the subcontractor (§ 14).

3.4.3 Project Financing (PF)

a. Project Financing in General

Project financing is the method of long-term financing based on the cash flows of the project rather than the balance sheets or collateral. This financing technique is widely used in a large-scale development project. Frequently, this closely functions in conjunction with real estate development, especially with the long-term construction project.

Usually, the monetary source of a project financing comes from a number of equity investors, known as sponsors, as well as a syndicate of banks or other lending institutions that provide loans to the project. Theoretically speaking, the loans are meant to be non-recourse loans, meaning that creditors cannot go after the borrower's personal assets. In order to secure the loan, the lenders exhaustively examine the profitability of the project and expect to be paid entirely from project cash flow and project assets, rather than from the general assets of the borrowers or the sponsors. For the purpose of perfect insulation of project assets from other general assets, a special purpose vehicle (SPV) is created for the project. Since the project financing is a highly complicated and sophisticated financing technique, it calls for a number of experts including attorneys and accountants. In addition, it runs higher risks than a regular secured loan. Besides the fact that the pure form of project financing does not have any collaterals besides project assets and the future cash flow from the project, the fact that the project usually takes lengthy period until its completion, thereby becoming vulnerable to various economic and political risks, exacerbates the risks of the project. Therefore, the interest rate of the project financing tends to be higher as well. Furthermore, a project financing requires more delicate risk identification and resource allocation mechanism.

In Korea, a project financing usually takes place in the transformed way incorporating collateral enhancement and surety provision as to mitigate risks. In that regard, it is a deviation from the pure form of a project financing.

b. Legal Infrastructure concerning a Project Financing

There is no single statute governing a project financing. Rather, the legal infrastructure for the project financing is a set of complex statutory laws governing different legal aspects. Corporate Tax Act and Restriction of Special Taxation Act offer favorable tax benefits for a project financing vehicle to promote project financing, while Trust Act and the Civil Code provide legal basis for transactional activities taking place in the project. There is the Act on Public-Private Partnerships in Infrastructure, specifically aimed at promoting the project financing for social infrastructure such as roads, railroads, harbor and airport facilities, telecommunication and electric power-generators and so forth.

The most peculiar feature of the legal relationships in the Korean Project Financing, as has been described above, is the emphasis on acquiring security interests on various properties to ensure the collection of the investment. These measures are usually taken by the creditors with the help of legal experts. For example, the creditors may establish

the right of pledge on the receivables of the borrower, or secure their credits by acquiring mortgages or settling trusts on the real estates of the borrower. Creditors also tend to make a contract in advance to ensure that the construction companies, which are also creditors for their construction works, do not exercise mechanic's lien so that they can take priority in the event of bankruptcy of the borrower. Another notable contractual clause that is frequently in use for security purpose is the provision that forces the borrower to transfer rights and duties regarding the project if the borrower fails to pay back.

Chapter 4

Legal Infrastructure for Corporate System

1. Overview

2. Improvement of Corporate Governance

3. Corporate Restructuring and Enhancement of Acquisition Laws

Legal Infrastructure for Corporate System

1. Overview

At an earlier stage of planning for economic developments, Korean government had directly intervened to induce foreign capital through various methods including direct or indirect government guarantee and legislation that provides benefits and privileges (including tax advantages) toward foreign lenders and foreign direct investment. As a result of such an approach, Korea could pile up primitive capital it needed for economic developments as planned.

As discussed in Chapter 2, Korea became an OECD member country in 1998 and fully opened its capital market for foreign investment. Ever since foreign investors have been allowed to invest in Korean capital market on an equal footing with Korean investors in general, except for certain procedural limitations and foreign exchange regulations. In this chapter, we will focus on Korean government's recent strategies that have been adopted since the IMF crisis in 1997. With this crisis as a momentum, Korean government determined that the fundamental soundness and competitiveness of individual Korean companies will ultimately become a determinant factor that could induce foreign capital. From this perspective, it has constantly tried to make circumstances that would enhance the fundamental soundness and competitiveness of Korean companies. Korean government has pursued this policy through the transformation of legal structure on corporate system. Among others, we will describe the government's efforts in the following two aspects:

- Mandatory enforcement of good corporate governance practice: that is, enhancement of corporate governance system by way of newly introducing independent director system and audit committee system, strengthening minority shareholders rights, regulating conflict transactions by managers or involving controlling shareholders, imposing liabilities against de facto directors, and permitting class actions on securities transactions;

- Facilitation of active corporate restructuring and corporate control market: that is, enhancement of corporate restructuring and M&A market by way of legislation of workout program, permitting easier merger transactions and providing more structuring options for merger (short form merger, small-scale merger, cash merger and triangular merger), newly introducing devices for creation of a holding company system, and activating the market for corporate control.

Prior to entering into the details on the government's initiatives, let us briefly discuss general legal framework involving Korean corporate system. In Korea, Chapter 3 of the Commercial Code provides a comprehensive regulation of companies that is mandatory unless provided otherwise. There is no independent statute regulating companies. Even though the Commercial Code provides for 4 types of companies, most of the companies that have significance in Korean economy are established in the form of a "chusik-heusa" that is an entity with legal personality, limited liability and transferable shares, having a centralized board of directors that is subject in certain major respects to the general shareholders meeting (in this paper, hereinafter referred to the "corporation"). Separate from the Commercial Code, there is a securities law that governs disclosure of equity holdings, solicitation of proxies, tender offers, public offering of securities, and certain fiscal aspects of listed corporations. Prior to February 2009, the securities law existed in the name of the Securities and Exchange Act (the "SEA"), which was repealed and incorporated as a part of the Capital Market and Financial Investment Business Act (the "CMFIBA") as of February 2009. So, Korean corporate system is largely governed by the Commercial Code and in certain aspects by the CMFIBA (or formerly, the SEA). The Korean government's efforts have been materialized by the legislations regarding the Commercial Code and the CMFIBA (or formerly, the SEA).

2. Improvement of Corporate Governance

2.1 Introduction of Independent Director System

2.1.1 Background

Under Korean law, the management of affairs such as the disposal and transfer of important properties, the borrowing of large-scale assets, the appointment or dismissal of managers and the establishment, transfer or abolition of branch offices shall be made by the resolution of the board of directors (Article 393 (1) of the Commercial Code). Also, the board of directors shall supervise the performance of duties by the directors (Article 393 (2) of the Commercial Code). Directors shall be elected at a general shareholders' meeting (Article 382 (1) of the Commercial Code). The number of directors shall be at least three (Article 383 (1) of the Commercial Code).[17] However, other than the minimum number

17 Due to the amendments to the Commercial Code in 2009 (Act No. 9746), in case of a company of which the total capital is less than ten hundred million Won, the number of the directors may be one or two. In such case there shall be no board of directors. and the role of the BOD shall be performed by individual director(s) or general shareholders meeting depending upon the nature of the matter concerned. (Article 383 of the Commercial Code) .

of directors, there had been no requirement mandating a corporation to have independent director(s). Traditionally, most directors had been senior executives (corporate insiders) and, since Korean companies usually have controlling shareholders and complicated cross ownership ties among affiliated companies are popular, the level of corporate governance in Korea was far below the global standard.

In February 1998, Korean government determined to introduce a mandatory independent director structure with respect to listed corporations, in order to overcome the IMF crisis and enhance transparency of corporate management. Accordingly, listing rules of the stock exchange[18] mandated for the appointment of independent directors with respect to corporations listed on the securities market[19] (the "KOSPI listed corporations"). In 2000, amendments to the SEA (Act No. 6176) required the KOSPI listed corporations to have certain minimum number of independent directors and further, in 2001, amendments to the SEA (Act No. 6423) enlarged the scope of regulation to encompass corporations listed on the KOSDAQ market (the "KOSDAQ listed corporations"). (Article 191-16 of the SEA) Upon repeal of the SEA, the mandatory independent director requirements were incorporated into the Commercial Code through amendments to the Commercial Code (Act No. 9362) in 2009 and, the contents of which are intact in material respect. (Article 542-8 of the Commercial Code).[20]

2.1.2 Details

a. Minimum Number of Independent Directors

Any listed corporation[21] shall have independent directors not less than one fourth of total number of its directors, provided, however, that any listed corporation with assets not less than two trillion KRW as of the end of the most recent business year[22] shall have at least three independent directors and at the same time have the number of such independent

18 In Korea, there has been only one stock exchange, The Korea Exchange. The securities law of Korea authorizes the establishment of The Korea Exchange and prohibits any other entity to open a securities market that performs functions similar to those of The Korea Exchange..

19 In the Korea Exchange (formerly the Korea Stock Exchange up until 2004), there are two sections; one is the "securities market" (so-called "KOSPI market") that is the first league for larger corporations and another is the "KOSDAQ market" that is the second league for small-medium sized corporations and venture companies.

20 While listed corporations are, in general, subject to the mandatory independent director requirements under the Commercial Code, financial institutions are subject to similar or more stringent independent director requirements under special laws that govern the relevant industry (for instances, the CMFBA, Banking Act, Insurance Business Act, Financial Holding Company Act).

21 However certain listed corporations are exempt from this requirement: i.e., KOSDAQ-listed venture companies having assets less than one hundred billion Won, bankrupt companies, corporate restructuring funds under the Real Estate Investment Company Act, dissolving companies (Article 13(1) of the Presidential Decree to the Commercial Code).

22 As of September 2011, 136 KOSPI-listed corporations (18.6%) and 1 KOSDAQ-listed corporation (that is, 7.8% of 1,767 listed corporations) meet this standard.

directors not less than a majority[23] of the total number of its directors (Article 542-8(1) of the Commercial Code and Article 13(2) of the Presidential Decree to the Commercial Code). In case where the number of independent directors of a listed corporation fails to meet the mandatory requirement due to any cause such as resignation or death of any independent director, the corporation must appoint independent director at a general shareholders meeting convened for the first time after such deficiency has occurred, to satisfy the requirement (Article 542-8(3) of the Commercial Code).

b. Qualifications for Independent Directors

By definition, independent directors are directors who are not engaged in regular business of the corporation concerned (Article 382(3) of the Commercial Code). Also, an independent director must meet certain negative qualifications in terms of their competence and integrity as well as their independence from controlling shareholders and management.

Anyone who falls under any of the following is disqualified for an independent director of a corporation:

(i) Directors and employees who are engaged in regular business of the corporation concerned, or directors and employees who have been engaged in regular business of the corporation within the past two years;

(ii) The principal, his spouse, lineal ascendants, and lineal descendants, in cases where the largest shareholder[24] is a natural person;

(iii) Directors, auditors and employees of the corporation, in cases where the largest shareholder is a corporation;

(iv) Spouses, lineal ascendants, and lineal descendants of directors and auditors;

(v) Directors, auditors and employees of a parent company or a subsidiary company of the corporation concerned;

(vi) Directors, auditors and employees of a corporation which has a significant interest in the corporation concerned, such as business relations with the corporation; and

(vii) Directors, auditors and employees of another corporation for which directors, auditors and employees of the corporation concerned work as directors. (Article 382(3) of the Commercial Code)

In addition, anyone who falls in any of the following is disqualified for an independent director of a listed corporation:

(i) A minor, a person of incompetence, or a person of quasi-incompetence;

23 Prior to the amendments to the Commercial Code (Act No. 7025) in December 2003, the requirement was not a majority but one-half of the total number of directors. Unlike the requirement under the Commercial Code, the independent director requirements for financial institutions under special laws are still one-half of the total number of directors.

24 Contrary to the "Largest Shareholder" concept under Article 542-8(2) below, only holdings by himself counts and holdings by specially-related persons do not add up.

(ii) A person who has been adjudicated bankrupt and has not yet had his rights reinstated;

(iii) A person in whose case not more than two years have elapsed since his imprisonment without prison labor or a heavier punishment was completely executed or exempted;

(iv) A person for whom two years have elapsed since he was dismissed or removed from his office after he violated certain financial statutes;

(v) In cases where a shareholder of a listed corporation and certain persons who have a special relationship with the shareholder (the "specially-related person")[25] own the largest number of voting shares of the corporation, the shareholder (the "Largest Shareholder") and his specially-related persons;

(vi) A shareholder who owns 10% or more of voting shares for her own account regardless of the name of the shareholder, or exerts de facto influence on the corporate management in material respect including appointment or dismissal of directors or auditors (the "Major Shareholder") and his spouse, lineal ascendants and lineal descendants; and

(vii) Other person, who has difficulty in faithfully performing his duty as an independent director, who have an influence on the management of the listed corporation concerned. (Article 542-8 (2) of the Commercial Code) Article 13 (5) of the Presidential Decree to the Commercial Code specifically provides for the disqualifications: for instance, directors, auditors and employees of affiliates of the listed corporation concerned, shareholders having not less than 1% shares, lawyers, consultant or outside accountants having contract with the listed corporation concerned, corporations that have significant transactions with the listed corporation concerned. Also a person is not permitted to serve as an independent director for more than two listed corporations.

If an independent director shall fall under any of the foregoing disqualifications after he is elected to his office, he shall be removed from his office.

c. Appointment Procedure

(1) Prior Disclosure Requirement

In cases where a listed corporation convoke a general shareholders meeting, the purpose of which lies in appointment of directors or auditors, the corporation must announce or notify material information on candidates of such directors or auditors (Article 542-4 (2) of the Commercial Code). Directors or auditors must be appointed from among candidates so announced or notified (Article 542-5 of the Commercial Code).

25 Article 13(4) of the Presidential Decree to the Commercial Code enumerates a long list of persons and entities that falls under the category of the specially-related persons. The scope is so sweeping that any person who is likely to be under common control of the Largest Shareholder in a practical sense would be included in the category.

(2) Recommendation Committee

Korean law mandates certain large listed corporation to have a recommendation committee. A listed corporation having assets not less than two trillion Won as of the end of the most recent business year[26] shall establish a recommendation committee within its BOD,[27] and have the number of independent directors not less than one-half[28] of the total number of the recommendation committee members (Article 542-8 (4) of the Commercial Code). Such a large listed corporation must select an independent director (s) only from and among candidates recommended by its recommendation committee at its general shareholders meeting. When a recommendation committee recommends candidate (s) for independent director (s), it must have such nominees included in the list of candidate (s) as recommended 6 weeks prior to the date set for general shareholders meeting by minority shareholders entitled to rights to propose an agenda for general shareholders meeting or to rights to call for general shareholders meeting (Article 542-8(5) of the Commercial Code).

d. Duties and Responsibilities of Independent Directors

Independent directors are subject to the same duties and responsibilities as those of standing or executive directors. However, amendments to the Commercial Code in 2011 (Act No. 10685, to become effective April 15, 2012) have differentiated independent directors from other directors with respect to the upper limit of the amount of their liabilities: that is, a corporation may waive its damage claims[29] against its directors in excess of 6 times (3 times, in cases of independent directors) of the annual compensation amount pursuant to an authorization under its articles of incorporation (the "AOI") (Article 400 (2) of the Commercial Code).

e. Independent Directors of Non-listed Corporations

Under Korean law, a non-listed corporation is not required to appoint an independent director. The amendments to the Commercial Code in 2009 (Act No. 9362) have introduced some provisions for independent directors that are applicable to corporations regardless of their listing. If and when a corporation appoints an independent director, it must disclose such information in its corporate registry; that is, it must make a registration of such independent director separately from other directors in the corporate registry (Article 317 (2) 8. of the Commercial Code). Also if a corporation opts to have an audit committee instead of a statutory auditor, it must have at least two independent directors because an

26 As of September 2011, 136 KOSPI-listed corporations (18.6%) and 1 KOSDAQ-listed corporation (that is, 7.8% of 1,767 listed corporations) meet this standard.

27 A recommendation committee is one of committees established by the BOD to perform some duties of BOD for and on behalf of the BOD. A committee consists of two or more of directors. (Article 393-2 of the Commercial Code)

28 The requirement will be strengthened to majority beginning from April 15, 2012 pursuant to the amendments to the Commercial Code in 2011 (Act No. 10685).

29 Such waiver is not available with respect to damage claims caused by intentional act or gross negligence or an activity in violation of the limitations on self-dealing, anti-competition or corporate opportunity rule (Proviso to Article 400(2) of the Commercial Code).

audit committee must consist of three or more directors and two thirds or more of those directors must be independent directors (Article 415-2 (2) of the Commercial Code). Therefore, to those extents, appointment of independent directors is mandated even in case of non-listed corporations.

2.2 Enhancement of Audit System

2.2.1 Background

Korean law requires a corporation to elect one or more statutory auditor at the general shareholders meeting.[30] There is no limit on the number of auditor (s) and such auditor (s) need not to be a standing position. Any shareholder, who holds more than 3%[31] of voting shares, may not exercise his voting rights in respect of shares exceeding such percentage in election of auditors (Article 409(2) of the Commercial Code). Korean statutory auditor performs both a financial audit of the books and a compliance audit of whether directors are complying with their duties (Articles 412, 412-2 and 413 of the Commercial Code).[32]

In 1997 amendments to the SEA (Act No.5254) tightened limitations on voting rights with respect to election or removal of an auditor of listed corporations and required standing auditor(s) in case of certain large listed corporations.

In the wake of the IMF crisis of 1997 and collapse of major corporate groups, audit system was pointed out as one of the weak areas to be corrected. In 1999, Korean government amended the Commercial Code (Act No. 6086) to introduce an alternative to the statutory auditor system, so that corporations were allowed to choose between the traditional statutory auditor system and an audit committee system which is similar to that of U.S. corporations. (Article 415-2 of the Commercial Code)

Further in 2000, certain large KOSPI-listed corporations became subject to more rigorous regulations. Amendments to the SEA (Act No. 6176) provided for the mandatory audit committee system with respect to large listed corporations. (Article 191-17 of the SEA) In 2001, amendments to the SEA (Act No. 6423) enlarged the scope of regulation to encompass the KOSDAQ listed corporations. (Article 191-17 of the SEA) Upon the repeal of the SEA, the mandatory audit committee requirement and others were incorporated into the Commercial Code through amendments to the Commercial Code (Act No. 9362) in 2009 and, the contents of which are intact in material respect. (Articles 542-10 through 12 of the Commercial Code)

30 According to the amendments to the Commercial Code in 2009 (Act No. 9362), a corporation, the paid-in capital of which is less than one billion Won, may choose not to have statutory auditor(s). In case of a corporation that opts not to elect auditor(s), the functions of auditor(s) shall be performed by the general shareholders meeting. (Article 409(4) and (6) of the Commercial Code)

31 The AOI of the corporation may provide for a lower percentage than 3% (Article 409(3) of the Commercial Code).

32 In addition to the statutory auditor, in case of certain large corporations, an outside accounting auditor must be retained under the Act on Outside Accounting Audit regarding Corporations.

2.2.2 Details

a. Optional Audit Committee

A corporation may choose to have either statutory auditor (s) or an audit committee. In order to have an audit committee, it must opt in with authorization of its AOI.

(1) Establishment of Audit Committee

A corporation may, in accordance with its articles of incorporation, establish an audit committee within its BOD, in place of statutory auditor (s). In the case of the corporation that establishes an audit committee, the corporation shall not appoint any auditors (Article 415-2 (1) of the Commercial Code). The audit committee shall consist of not less than three directors[33] and independent directors shall be two thirds or more of the total members of the committee (Article 415-2(2) of the Commercial Code). Therefore, up to one-third executive directors may participate in audit committee.

(2) Appointment and dismissal of members

A member of the audit committee shall be appointed or dismissed by the BOD (Article 393-2 (2) 2. of the Commercial Code). A resolution of the board of directors for the appointment of a member of the audit committee shall require simple majority vote, but the dismissal of a member of the audit committee requires affirmative votes of two thirds or more of the total members of the board of directors of the audit committee (Article 415-2(3) of the Commercial Code).

(3) Representative of audit committee

The audit committee shall, from among its members, elect a member to represent the committee. In this case more than one member may be elected to jointly represent the committee. (Article 415-2 (4) of the Commercial Code) There is no requirement that the representative should be confined to an independent director.

(4) Duties and responsibilities of audit committee

The audit committee is subject to the same duties and responsibilities as those of statutory auditor(s) (Article 415-2 (7) of the Commercial Code).

(5) Reversal by BOD

Under Article 393-2 (4) of the Commercial Code, a committee of the BOD shall notify each of directors of the resolutions it has adopted and. any of the directors may, upon receipt of the notification, request the convocation of a meeting of the board of directors and the BOD may revisit and reverse the resolutions of the committee. As the audit committee was designed as one of a committee of the BOD (Article 415-2 (1) of the Commercial Code), its resolutions were subject to the review by the BOD. Given the nature of the responsibility

33 Under Article 393-2(3) of the Commercial Code, a committee of a BOD shall consist of two or more directors.

of the audit committee, such rule had no ground. The amendments to the Commercial Code in 2009 (Act No. 9362) have corrected the problem. Now, the BOD may not reverse the resolution of the audit committee (Article 415-2 (6) of the Commercial Code).

(6) Others

The audit committee may use professional assistance at the expense of the corporation (Article 415-2 (5) of the Commercial Code).

b. Mandatory Audit Committee

Certain large listed corporations must establish an audit committee that meets more stringent requirements than those of an optional audit committee mentioned in B.2.1. They are not permitted to have statutory auditor(s) instead.

(1) Corporations subject to the Rule

A listed corporation with assets not less than two trillion Won as of the end of the most recent business year[34] must establish an audit committee (Article 542-11 of the Commercial Code and Article 16 (1) of the Presidential Decree to the Commercial Code). It needs no authorization of AOI.

(2) Composition of audit committee

The audit committee shall consist of not less than three directors[35] and independent directors shall be two thirds or more of the total members of the committee (Articles 542-1 1(2) and 415-2 (2) of the Commercial Code). In addition, one of the members must be an accounting or financial expert. Also, the representative of the audit committee must be an independent director (Article 542-11 (2) of the Commercial Code and Article 16 (2) of the Presidential Decree to the Commercial Code). In case where the number of independent directors of a listed corporation who is a member of the audit committee fails to meet any of the foregoing mandatory requirement due to any cause such as resignation or death of any independent director, the corporation must make it whole at a general shareholders meeting convened for the first time after such non-compliance has occurred, to satisfy the requirement (Article 542-11 (4) of the Commercial Code).

Although up to one-third of the total members of the committee maybe non-independent directors, they must not fall under any of the following:

(i) A minor, a person of incompetence, or a person of quasi-incompetence;

(ii) A person who has been adjudicated bankrupt and has not yet had his rights reinstated;

34 As of September 2011, 136 KOSPI-listed corporations (18.6%) and 1 KOSDAQ-listed corporation (that is, 7.8% of 1,767 listed corporations) meet this standard. Under proviso to Article 16(1) of the Presidential Decree to the Commercial Code, there are exceptions for such companies as real estate investment companies, certain public corporations and rehabilitating companies.

35 Under Article 393-2(3) of the Commercial Code, a committee of a BOD shall consist of two or more directors.

(iii) A person in whose case not more than two years have elapsed since his imprisonment without prison labor or a heavier punishment was completely executed or exempted;

(iv) A person for whom two years have elapsed since he was dismissed or removed from his office after he violated certain financial statutes;

(v) The Major Shareholder and his spouse, lineal ascendants and lineal descendants;

(vi) A full-time director or employee of the corporation concerned or a person who has been a full-time director or employee thereof in the last two years; and

(vii) A person who is capable of having influence on the management of the corporation concerned other than those mentioned above. (Article 542-11 (3) of the Commercial Code) Article 15 (2) of the Presidential Decree to the Commercial Code specifies such persons.

If a non-independent director who is a member of the audit committee shall fall under any of the foregoing disqualifications after he is elected to his office, he shall be removed from his office (Article 542-11 (3) of the Commercial Code).

(3) Appointment and Dismissal of Members

A member of the audit committee shall be appointed or dismissed at the general shareholders meeting (Article 542-12(1) of the Commercial Code). A member of the audit committee shall be appointed from among directors appointed in a general shareholders meeting (Article 542-12 (2) of the Commercial Code).[36]

In cases where the total amount of voting shares held by the largest shareholder, his specially-related person and certain other persons together exceeds 3%[37] of the total voting shares, such shareholder may not exercise voting rights in excess of such percentage, when appointing or dismissing a member of the audit committee who is not an independent director (Article 542-12 (3) of the Commercial Code). Also, any shareholder who has 3%[38] or more of voting shares may not exercise voting rights in excess of such percentage, when appointing a member of the audit committee who is an independent director (Article 542-12 (4) of the Commercial Code).

c. Mandatory Standing Statutory Auditor

Certain large listed corporations must have standing statutory auditor(s), or they may dispense with audit committee that is mandatory to large listed corporations.

(1) Corporations that are Subject to the Rule

A listed corporation with assets not less than one hundred billion KRW as of the end

36 Cumulative voting, unless opt-out, is applicable at the first stage of election of directors, not at the second stage of appointment of the member of audit committee.

37 The AOI of the corporation concerned may lower the percentage.

38 The AOI of the corporation concerned may lower the percentage.

of the most recent business year[39] must have one or more full- time auditors, unless it has established a stringent audit committee applicable to larger listed corporations (Article 542-10 (1) of the Commercial Code and Article 15 (1) of the Presidential Decree to the Commercial Code).

(2) Qualifications to Become a Standing Auditor

Any person who falls under any of the following criteria can not be a standing auditor of a listed corporation:

(i) A minor, a person of incompetence, or a person of quasi-incompetence;

(ii) A person who has been adjudicated bankrupt and has not yet had his rights reinstated;

(iii) A person in whose case not more than two years have elapsed since his imprisonment without prison labor or a heavier punishment was completely executed or exempted;

(iv) A person for whom two years have elapsed since he was dismissed or removed from his office after he violated certain financial statutes;

(v) The Major Shareholder and his spouse, lineal ascendants and lineal descendants;

(vi) A full-time director or employee of the corporation concerned or a person who has been a full-time director or employee thereof in the last two years; and

(vii) A person who is capable of having influence on the management of the corporation concerned other than those mentioned above. (Article 542-10 (2) of the Commercial Code) Article 15 (2) of the Presidential Decree to the Commercial Code specifies such persons.

If a non-independent director who is a member of the audit committee shall fall under any of the foregoing disqualifications after he is elected to his office, he shall be removed from his office (Article 542-11 (3) of the Commercial Code).

d. Strengthen Voting Limit

With respect to listing corporations, there are stronger restrictions as to the controlling shareholders' influencing on audit structure.

In cases where the total amount of voting shares held by the Largest Shareholder, his specially-related person and certain other persons together exceeds 3%[40] of the total voting shares, such shareholder may not exercise voting rights in excess of such percentage, when

39 As of September 2011, 687 KOSPI-listed corporations (94.0%) and 675 KOSDAQ-listed corporations (65.2%) (that is, 77.1% of all 1,767 listed corporations) meet this standard. Excluding the number of corporations that are subject to the mandatory stringent audit committee system mentioned above, 551 KOSPI-listed corporations (75.4%) and 674 KOSDAQ-listed corporations (65.1%) (that is, 69.3% of all 1,767 listed corporations) are subject to this requirement.

40 The AOI of the corporation concerned may lower the percentage.

electing statutory auditor (s) or appointing or dismissing a member of the audit committee who is not an independent director (Article 542-12 (3) of the Commercial Code).

e. Internal Compliance Standards and Compliance Officer

In 2011, amendments to the Commercial Code (Act No. 10685, to become effective April 15, 2012) have introduced an internal compliance rule with respect to certain listed corporations (Article 542-13 of the Commercial Code). The legislation purports to upgrade the level of compliance with laws and ethical management, and to protect shareholders, customers, counterparties of corporations and ultimately investors and the capital market in general.

2.3 Minority Shareholders Rights

2.3.1 Background

Korean government has strengthened minority shareholders rights through a number of amendments to the Commercial Code and other related laws.

In 1997, the amendments to the SEA (Act. No. 5521) were made to enhance the minority shareholders rights with respect to the listed corporations:

(i) To allow minority shareholders to place an agenda of the general shareholders meeting (Article 191-14 of the SEA); and

(ii) To mitigate threshold percentage requirements for the minority shareholders rights (Article 191-13 of the SEA).

In 1998, amendments to the Commercial Code (Act No. 5591) were made to protect the interests of the minority shareholders:

(i) To allow minority shareholders to place an agenda of the general shareholders meeting (Article 363-2 of the Commercial Code);

(ii) To allow cumulative voting (Article 382-2 of the Commercial Code); and

(iii) To mitigate threshold percentage requirements for the minority shareholders rights (Articles 403, etc. of the Commercial Code)

In 2001, amendments to the SEA (Act. No. 6423) were made to enhance the minority shareholders rights with respect to the listed corporations:

(i) To further relax threshold percentage requirements for the minority shareholders rights (Article 191-13 of the SEA); and

(ii) To lower the threshold percentage requirement to demand cumulative voting (Article 191-18 of the SEA).

2.3.2 Details of the Structure

a. Rights to place an Agenda for the General Shareholders Meeting

(1) Background

Commercial Code limits the shareholder voting to a small number of fundamental transactions such as amendments to the AOI or mergers, which must be put in an agenda for the general shareholders meeting by the BOD. Shareholders are barred from directly making any decisions about corporate policy without the initiation of the BOD.

1997 Amendments to the SEA (Act No. 5254) have newly introduced minority shareholders proposal rights with respect to listed corporations so that they can directly participated in formulation of corporate policy (Article 191-14 of the SEA). Further, 1998 Amendments to the Commercial Code (Act No. 5591) grant minority shareholders of any corporation, listed or non-listed, rights to propose agenda for the general shareholders meeting (Article 363-2 of the Commercial Code).

(2) Details of the Proposal Rights

• Minimum Holding Requirements

There are minimum holding requirements for shareholders' rights to propose agenda for general shareholders meeting. Shareholders who hold no less than 3/100 of the total outstanding shares other than non-voting shares may propose a subject matter of a general shareholders meeting (Article 363-2 (1) of the Commercial Code). In case of listed corporations, shareholders who have been holding[41] 10/1000 or more (in case of a corporation whose capital is one hundred billion Won or more, 5/1000 or more) of the total number of issued and outstanding stocks of a listed corporation for six months, may propose to the directors that the directors make certainsubject matters at the general meeting of stockholders (Article 642-6 (2) of the Commercial Code).

• Procedural Requirements

Shareholders must propose to directors in writing or by way of electronic communication at least six weeks prior to the date set for general shareholders meeting (Article 363-2 (1) of the Commercial Code). Shareholders may also request that directors record the summary of the proposal submitted by the shareholders in addition to the subject-matters of the meeting in a notice to all shareholders for convocation of the shareholders meeting (Article 363-2 (2) of the Commercial Code). The shareholders who made the proposal shall, on their request, be given an opportunity to explain the proposal at the general meeting (Article 363-2 (3) of the Commercial Code).

• Limitations on the Contents of the Proposals

Shareholders need not substantiate the fairness or prospects for their proposal. However, in order to check the risk of abuses by shareholders of its rights, the law provides for limits

41 The term "holding" here includes any of the following: (i) owing of shares, (ii) acquiring of a proxy on the exercise of shareholders rights, or (iii) joint exercise of shareholders' rights by 2 or more shareholders. (Article 542-6(8) of the Commercial Code)

on the shareholders proposal rights in terms of the contents of the proposal. BOD is not required to accept the proposal if its contents fall under any of the following:

(i) Where it is in violation of the relevant statutes;

(ii) Where it breaches the corporation's AOI;

(iii) Where a proposed subject matter which is identical in contents with one rejected in the past general shareholder meeting, is proposed again within 3 years from the date on which it was voted down obtaining less than 10% of the votes cast;

(iv) Where it matters personal predicament of a stockholder;

(v) Where it matters the rights of minority shareholders subject to certain threshold percentage holding requirement for their exercise ;

(vi) In case of listed corporations, where it matters the removal of directors and statutory auditors who are under their terms of office;[42]

(vii) Matters which a corporation may not actualize, or of which the reason for proposal is obviously false or impairs a specific person's honor. (Article 363-2 (3) of the Commercial Code, Article 5 of the Presidential Decree to the Commercial Code).

b. Cumulative Voting Rule

(1) Background

In general, Korean Commercial Code provides for a mandatory one-share, one-vote rule (Article 369 (1) of the Commercial Code).[43] Multiple voting rights are not allowed.[44]

1998 Amendments to the Commercial Code (Act No. 5591) has introduced a cumulative voting rule[45] in order for minority shareholders to be able to represent their interests at the BOD and to curb domination of the board room by controlling shareholders. It is not a mandatory, but a default rule permitting minority shareholders to demand cumulative voting.

42 Under Article 385 of the Commercial Code, a director may be dismissed from office at any time by a supermajority vote at a general shareholders meeting, with or without cause. If the dismissal of a director is rejected at a general shareholders meeting notwithstanding the existence of dishonest acts or any grave fact in violation of the relevant acts, subordinate statutes or the articles of incorporation in connection with his duties, any shareholder who holds no less than 3/100 of the total outstanding shares may demand the court to dismiss the director, within one month from the date on which the above resolution of the general meeting was made.

43 However, under Article 370 of current Commercial Code, a corporation with authorization by its AOI may issue non-voting shares with respect to preferred shares having preferential rights as to the dividends, up to 1/4 of its total outstanding shares.

44 2011 Amendments to the Commercial Code have deregulated stringent limitation on voting rights; that is, they provides for classes of shares having no voting rights at all or having limited voting rights in terms of the sort of agenda or time span or subject to certain conditions, regardless of whether the shares having preferential rights as to the dividends (Article 344-3). However, multiple voting rights are still not permitted.

45 The law adopted a cumulative voting rule in the name of "concentrated voting".

(2) Details of the Cumulative Voting Rule

Cumulative voting rule kicks in only if all of the following requirements are met:

(i) When a general shareholders meeting is convened to elect 2 or more directors;

(ii) The corporation

(iii) Corporation elects directors by means of cumulative voting. Such demand must be made in writing or by way of an electronic communication at least 7 days prior to the relevant shareholders meeting. (Article 382-2 (1), (2) of the Commercial Code) In case of listed corporations, shareholders' demand must be made at least 6 weeks prior to the relevant shareholders meeting (Article 542-7 (1) of the CMFBA).

Once cumulative voting rule works, each shareholder shall have voting rights per share in the same number as the number of directors to be elected, with respect to a resolution for election of directors, and the voting rights may be exercised for one or several candidates for directors as she likes (Article 382-2 (3) of the Commercial Code). And the directors shall be elected in the order of candidates who obtain the most votes (Article 382-2 (4) of the Commercial Code).

As mentioned above, a corporation may opt out of the cumulative rule if its AOI prohibits cumulative voting. Under Article 542-7 (3) of the CMFBA, however, there are voting caps for shareholders with holdings over 3% of voting shares in case of listed corporations having assets worth 2 trillion Won or more. In the event that such a large listed corporation intends to preclude the cumulative vote in its AOI or to change the AOI for such preclusion, any stockholder holding stocks in excess of 3/100 (if the percentage is set lower than it by the AOI, such percentage shall be applied) of the total number of voting stocks issued shall be prohibited from exercising her voting rights on the stocks held in excess. So no shareholder, regardless of the size of her holdings, may exercise more than 3% of the votes at the general shareholders meeting with respect to the agenda for opt-out of the cumulative voting rule. Voting caps purport to protect minority shareholders by diluting the voting power of large shareholders.

Because Korean law chose to have an opt-out system, currently many corporations have provisions in their AOIs excluding the application of the cumulative voting.[46] Even major conglomerates such as Samsung Electronics, Hyundai Motors, SK Telecom have opted out. According to the 2010 KLCA Survey, more than 90% of the KOSPI listed corporations opt out of the cumulative voting rule as of the end of March 2010.[47]

46 Kim, Hwa-Jin, Board of Directors (2nd Ed.), Parkyoungsa, 2007.

47 649 companies out of 713 KOSPI listed corporations opt out of the cumulative voting rule as of the end of March 2010. KLCA Survey, p.45.

c. Threshold Percentage Requirements

(1) Background

In order to protect interests of minority shareholders from dominating majority shareholders, the law has acknowledged that shareholders exceeding certain threshold percentage shares may participate or intervene in the corporate management by themselves or with sanction from courts. The area includes rights to call for a general shareholders meeting, rights to demand dismissal of directors, derivative law suits, rights to enjoin corporate action and inspection rights. The threshold percentages differ from rights to rights. Korean government has relaxed such threshold percentages several times.

In 1997, amendments to the SEA (Act No. 5254) provided for special rules for listed corporations so that the threshold percentage requirements are reduced to lower percentage while 6 month continuous holding requirement was additionally imposed (Article 191-13 of the SEA). Those threshold percentage requirements were further lowered through amendments to the SEA in 1998 (Act No. 5521). In late 1998 the Commercial Code was amended so that general percentage thresholds were lowered (Act No. 5591). In 2009 through amendments to the Commercial Code (Act No. 9362), special rules for listed corporations have been incorporated into the Commercial Code (Article 542-6 of the Commercial Code).

(2) Details

As a result of the 1998 amendments to the Commercial Code, the threshold percentage requirements are lowered as follows (reduced threshold percentage requirements for listed corporations are set forth in the parenthesis below).[48]

Article 403 (1) – derivative action by shareholders:[49] 5% to 1% (1/10,000)

Article 366 (1) – shareholders' rights to call for a general shareholders meeting:[50] 5% to 3% (15/1,000)

Article 385 (2) – shareholders' rights to demand dismissal of directors to the court:[51] 5% to 3% (50/10,000, or in case of a corporation whose capital is one hundred billion Won or more, 25/10,000)

48 As mentioned above, in addition to the threshold percentage requirements, 6 month continuous holding requirement is applicable for listed corporations. Also in this context 'holding' includes any of the following: (i) owing of shares, (ii) acquiring of a proxy on the exercise of shareholders rights, or (iii) joint exercise of shareholders' rights by 2 or more shareholders. (Article 542-6(8) of the Commercial Code)

49 Article 403 (1) Any shareholder who holds no less than 1/100 of the total outstanding shares may demand that the company file an action against directors to enforce their liability.

50 Article 366 (1) Shareholders who hold no less than 3/100 of the total outstanding shares may demand the convocation of an extraordinary general meeting, by submitting to the board of directors a written statement of the proposed subject-matters of the meeting together with the reasons for the proposed convocation.

51 Article 385 (2) If the dismissal of a director is rejected at a general shareholders' meeting notwithstanding the existence of dishonest acts or any grave fact in violation of the relevant acts, subordinate statutes or the articles of incorporation in connection with his duties, any shareholder who holds no less than 3/100 of the total outstanding shares may demand the court to dismiss the director, within one month from the date on which the above resolution of the general meeting was made.

Article 402 – shareholders' rights to injunction:[52] 5% to 1% (50/10,000, or in case of a corporation whose capital is one hundred billion Won or more, 25/10,000)

Article 466 (1) – shareholders' rights to inspect books and records of the corporation:[53] 5% to 3% (10/10,000, or in case of a corporation whose capital is one hundred billion Won or more, 25/10,000)

Article 467 (1) – shareholders' rights to inspect affairs and status of the corporation's property:[54] 5% to 3% (15/1,000).

2.4 Related Party Transactions

2.4.1 Background

Since the inception of the Commercial Code in 1962 conflicted transactions by a director has been strictly regulated under the Commercial Code. For instances, directors are prohibited from engaging in businesses competing with the corporation and also from effectuating self-dealing transactions with the corporation, unless they obtain informed authorization of disinterested directors (Articles 397 and 398 of the Commercial Code). But there had been no limitation on the transactions between a corporation and its executive officers or parties affiliated with controlling shareholders of the corporation.

In 2001, amendments to the SEA (Act. No. 6423) introduced a new regulation on significant transactions with affiliates of controlling shareholders with respect to certain large listed corporations (Article 191-19 of the SEA).

In 2004, amendments to the SEA(Act. No. 7025) prohibited listed corporations from engaging in certain corporate loans and credit transactions with their major shareholders and officers (Article 191-19 (1) of the SEA0. In 2009 upon repeal of the SEA and amendments to the Commercial Code (Act. No. 9362) the foregoing regulations on listed corporations were moved into the Commercial Code (Article 542-9 of the Commercial Code), but the contents remain largely the same.

In 2011, the amendments to the Commercial Code (Act No. 10600) have enlarged the coverage of the self-dealing regulations (Article 398 of the Commercial Code). At the

52 Article 402 If a director commits an act in contravention of the relevant acts, subordinate statutes or the articles of incorporation and the act is likely to cause irreparable damage to the company, the auditor or a shareholder who holds no less than 1/100 of the total outstanding shares may demand on behalf of the company that the director stop such act.

53 Article 466 (1) Any shareholder who hold no less than 3/100 of the total outstanding shares may demand, in writing with the reasons therefore specified, to inspect or copy the account books and related documents.

54 Article 467 (1) If there is any reason to suspect of dishonest act or of material fact in contravention of any relevant acts, subordinate statutes or the articles of incorporation in connection with the management of affairs, any shareholder who holds no less than 3/100 of the total outstanding shares may apply to the court for the appointment of an inspector to investigate the affairs of the company and the status of its property.

same time, limitations similar to the U.S. usurpation of corporate opportunity doctrine are introduced into the Commercial Code (Article 397-2 of the Commercial Code).

2.4.2 Details of the Related Party Transaction Rule

a. Self-Dealing Transactions by Managers

Under Article 398 of the Commercial Code, a director (regardless of standing or non-standing) may transact with the corporations for his own account or for the account of a third party only after obtaining a disinterested BOD approval. The law forbids interested directors from voting to approve their own transactions (Article 391(3) of the Commercial Code). The rule is applicable to listed or non-listed corporations, and to all transactions including those that are ordinary and at market conditions. Shareholder approval is not mandated except for directors' compensation (Article 388 of the Commercial Code).

In 2011, amendments to the Commercial Code (Act No. 10600, to become effective April 15, 2012) enlarged the coverage of the regulation on self-dealing transactions and strengthened BOD approval requirement.

(1) Persons or Entities that are Subject to the Rule

Under the amended Article 398 (1) of the Commercial Code, any of the following becomes subject to the self-dealing transaction rule:

(i) A directors or executive officers;

(ii) A shareholder who owns 10% or more of voting shares for her own account, or exerts de facto influence on the corporate management in material respect including appointment or dismissal of directors or auditors (hereinafter referred to as "Major shareholder");

(iii) Spouses, lineal ascendants and lineal descendants of (i) or (ii);

(iv) Lineal ascendants and lineal descendants of spouses of (i) or (ii);

(v) A company of which any of (i) through (iv) alone or together have 50% or more of voting shares, or its subsidiary;

A company of which any of (i) through (iv), together with (v), have 50% or more of voting shares.

(2) BOD Authorization Requirement

Disinterested BOD approval is required for self-dealing transactions. The law requires directors, etc. to disclose their personal interests in corporation-related transactions (including all material information on the proposed transactions) prior to seeking BOD approval. BOD approval must be ex ante and at least two thirds of the directors' consent is required. Prior to the 2011 amendments, only a majority vote was required for BOD approval.

(3) Fairness of the Transaction

The transaction must be fair in terms of its terms and process taken.

b. Transactions involving Interested Persons Including Major Shareholders

(1) Prohibition of Credit Transactions between Listed Corporations and their Interested Persons

Under Article 542-9 (1) of the Commercial Code, listed corporations are prohibited outright from providing loans to, and engaging in certain credit transactions with, their major shareholders and officers.[55]

• Persons or Entities that are Subject to the Rule

Listed corporations are prohibited from providing loans to, and engaging in certain credit transactions with, any of the following:

(i) A Major shareholder or its/his specially- related person;

(ii) A director (including de facto director under Article 401-2 (1) of the Commercial Code) or an executive officer; and

(iii) Statutory auditor.

• Scope of Credit Transactions that are Subject to the Rule

Listed corporations are prohibited from engaging in any of the following transactions with persons or entities enumerated above paragraph a.

(i) Renting any property that carries the economic value such as money, and securities;

(ii) Guaranteeing the fulfillment of an obligation;

(iii) Purchasing securities intended for financial support;

(iv) Engaging in other transactions carrying credit risk, those are provided by Presidential Decree to the Commercial Code. Restricted transactions under Article 14(1) of the Presidential Decree include the following: transactions providing collateral or endorsing a draft bill for security, capital commitment, certain transactions for purposes of an evasion of the rule, assumption of an obligation, credit support transactions such as securitization, and any other transaction that may cause losses against the corporation upon insolvency of the Major Shareholder or Largest Shareholder (including their specially-related persons).

However, there are exceptions from such prohibition:

(i) Lending money to directors, executive officers or auditors within the amount of 100 million won for the purpose of the welfare that includes school fees, housing funds and medical expenses under the conditions as prescribed by the relevant corporation;

55 This limitation is similar to those restrictions appearing under Article 402 of Sarbanes-Oxley Act of the U.S.

(ii) Giving credits, which is permitted in other statutes;

(iii) Giving credits in due course to a Major Shareholder(including its specially-related persons) which is a legal entity for purposes of achieving corporate needs. (Article 542-9 (2) of the Commercial Code, Article 14 (2) and (3) of the Presidential Decree to the Commercial Code)

- A violator of the rule shall be subject to criminal sanctions (Articles 624-2 and 642-3 of the Commercial Code)

(2) Restriction on Significant Transactions between a Large Listed Corporation and its Controlling Shareholders

Under Article 542-9(3) of the Commercial Code, large listed corporations may engage in significant transactions with its controlling shareholders or their affiliates only after obtaining disinterested BOD approval, provided however that they may not engage in such credit transactions as prohibited by the rule mentioned above paragraph D.2.2.1.

- Corporations that are restricted by the Rule

A listed corporation having assets worth 2 trillion Won or more as of the end of recent business year is restricted by the rule (Article 542-9 (3) of the Commercial Code, Article 14 (4) of the Presidential Decree to the Commercial Code). Neither smaller listed corporations nor non-listed corporations are unrestricted by the Rule.

- Persons or entities that are subject to the Rule

A large listed corporation is subject to BOD approval requirement so that it may engage in significant transactions with, any of the following:

(i) The Largest Shareholder (counting together holdings of its specially-related persons);

(ii) A specially-related person of the Largest Shareholder;

(iii) A specially-related person of the corporation. (Article 542-9 (3) of the Commercial Code, Article 14 (5) of the Presidential Decree to the Commercial Code)

- Scope of significant transactions that are subject to the Rule

The “significant transactions” that are subject to the Rule include any of the following:

(i) The scale of the single transaction runs in excess of 1% of the corporation’s total amount of assets or the total amount of sales;

(ii) The aggregate amount of the transactions executed with a specified person during the current business year runs in excess of 5% of the corporation’s total amount of assets or the total amount of sales. (Article 542-9 (3) of the Commercial Code, Article 14 (6) of the Presidential Decree to the Commercial Code).

However, there are exceptions from such restriction. Notwithstanding the foregoing restrictions, any transactions that are taken in the ordinary course of business in connection with the business line of the relevant corporation may be carried out

(i) Without obtaining BOD approval, if those transactions are typical trading executed pursuant to standard contracts under Article 2(1) of the Act on Regulation of Standard Contract;

(ii) Without reporting to the general shareholders meeting, if the transaction is executed within the total amount approved by the board of directors. (Article 542-9 (5) of the Commercial Code, Article 14 (9) of the Presidential Decree to the Commercial Code)

• Procedural requirements for the restricted transactions

A large listed corporation may engage in a significant transaction involving its controlling shareholders or its affiliates,

(i) only after obtaining disinterested BOD approval for such transaction; and

(ii) it must report to a regular general shareholders meeting that is called for the first time after the board of directors resolves on such approval such details of the transaction as the terms, timing, duration and conditions of the transaction and both the aggregate and outstanding amounts of transactions with the same counterparty per each type of transactions. (Article 542-9 (3) and (4) of the Commercial Code, Article 14(8) of the Presidential Decree to the Commercial Code).

• A violator of the rule would be subject to a fine(Article 635 (3) of the Commercial Code).

c. Corporate Opportunity Rule

In 2011, amendments to the Commercial Code (Act No. 10600, to become effective by April 15, 2012) introduced a new rule similar to corporate opportunity doctrine in the U.S. Prior to the 2011 amendments, directors were prohibited from engaging in businesses in which the corporation currently engages but are not restricted from engaging in any business where the corporation might have an opportunity to realize profits in the future. However, under the new Article 397-2 of the Commercial Code, managers should not take advantage of corporate business opportunities that should have been offered to their corporations instead, absent BOD approval.

(1) Persons Subject to the Rule

Director and executive officers are subject to the rule (Articles 397-2 (1) and 408-9 of the Commercial Code). The rule is applicable to both the listed companies and non-listed companies. Also standing or non-standing directors are subject to the rule.

(2) The Scope of the Corporate Business Opportunity

A director or an executive officer should not misappropriate for the benefit of himself or third party any of the following opportunity that might produce profits for the corporation at present or in the future:

(i) A business opportunity which he has recognized during the course of doing his job for the corporation or which takes advantage of the corporate information;

(ii) A business opportunity which is closely related to the business in which the corporation currently engage in or will engage in the future. (Article 397-2 (1) of the Commercial Code)

(3) Procedural Requirement

BOD approval is required for appropriation of corporate opportunity by managers. Disinterested directors only are entitled to vote for the agenda. At least two-thirds of the directors' consent is required. (Article 397-2 (1) of the Commercial Code)

(4) Presumption of Damages

Any manager who has acted in violation of the rule shall be jointly and severally liable for the damages to the corporation. In this regard, it is presumed that the profits that the manager or the third party gains shall be presumed the damages to the corporation. (Article 397-2 (2) of the Commercial Code)

2.5 'De Facto' or 'Shadow' Directors

2.5.1 Background

In 1998, amendments to the Commercial Code (Act No. 5591) have deemed certain 'de facto' or 'shadow' directors as directors with respect to the damage remedies for corporations and third parties, to enhance sound management of corporations (Article 401-2 of the Commercial Code). Controlling shareholders might become liable as 'de facto' or 'shadow' directors if they have been personally active in the management of the corporation even though they do not take directorate positions. The original intent of the legislation was to curb unfair influences of controlling shareholders directed not for the corporation and shareholders as a whole but for the interests of their own, especially in the context of the unique chaebal structure. However, in reality, few lawsuits have been brought under this provision.

2.5.2 Details of the Rule

A person who falls under any of the following subparagraphs shall be deemed to be a director in the application of the liabilities to the corporation or third persons with respect to the duties which he instructs or conducts:

(i) A person who instructs a director to perform duties by using his influence on the company;

(ii) A person who performs duties in person under the name of a director; and

(iii) A person other than a director who performs the duties by using a title which may be recognized as authorized to perform the duties, such as honorary chairman,

chairman, president, vice-president, executive director, managing director, or director. (Article 401-2 (1) of the Commercial Code)

(Article 401-2 (1) of the Commercial Code)A director or an executive officer who is liable for damages to a corporation or third person shall be jointly and severally liable with the person above (Articles 401-2 (2) and 408-9 of the Commercial Code).

2.6 Class Actions on Securities Transactions

2.6.1 Background

In January 2004, Korean government legislated a new law to permit class actions with respect to certain securities transactions; that is, Act on Securities-related Class Actions (Act No. 7074, hereinafter referred to "ASCA"). The law became effective from January 1st, 2005, but for corporations having assets less than 2trillion Won became effective from January 1, 2007 (except for the damage claims involving market manipulation). It has been the first and the only area where class actions are permitted under Korean legal regime.[56] The purpose of the law is to set forth exceptional treatment from the general procedural rules(the Civil Procedure Act) in order to efficiently seek a relief for collective injuries caused in the course of securities trading and ultimately to enhance the transparency of corporate management.

2.6.2 Details of the ASCA

a. Scope of the Application of the ASCA

Class actions are permitted only for damage claims filed in connection with trading of securities issued by listed corporations under any of the following circumstances:

(i) Damage claims involving violations of disclosure rules on the public offerings in the primary markets under Article 125 of the CMFBA;

(ii) Damage claims involving violations of ongoing disclosure requirements in the secondary markets under Article 162 of the CMFBA;

(iii) Damage claims involving violations of regulations on insider trading, market manipulation or other unfair trading under Articles 175, 177 or 179 of the CMFBA;

(iv) Damage claims involving outside auditors liability under Article 170 of the CMFBA (Article 3 of the ASCA).

b. Requirements for Class Actions under the ASCA

Class actions must meet all of the following requirements:

56 To date class actions are not permitted in Korea for any other areas that are popular in the U.S., such as product liability and environmental claims.

(i) The number of the class members[57] shall be 50 or more, and the sum of the securities held by the class members shall be 1/10,000 or more of the total number of the outstanding securities of the defendant company;

(ii) As a claim for compensation for loss, the counts that are material legally or actually shall be common to all members of the class;

(iii) The class action shall be an efficient instrument which is appropriate for the realization of rights of the class and the protection of their interests;

(iv) There shall be no defects in the application and its accompanying documents filed for the class action (Article 12 of the ASCA).

In addition, appointment of lawyers as attorney is required both for the plaintiff and defendant (Article 5 (1) of the ASCA). Any person who has a conflict of interests with the class may not act as a lawyer for the plaintiff (Article 5 (2) of the ASCA).

Also there are requirements for a representative party[58] and attorney. A representative party shall be a class member who is able to represent the interests of the class in a fair and appropriate manner, such as the person who is likely to receive the largest economic benefit from the class action among class members (Article 11 (1) of the ASCA). The attorney of the plaintiff shall be a person who may represent the interests of the class in a fair and appropriate manner (Article 11 (2) of the ASCA). A person who has engaged in more than 3 class actions as a representative party or an attorney during the recent 3 years shall be disqualified from becoming a representative party or an attorney of the plaintiff, unless a court determines otherwise in light of the overall circumstances (Article 11 (3) of the ASCA).

Even though the new law has introduced class actions for the protection of small investors, to date few class actions were filed in reality. One was an action involving false disclosure by a KOSDAQ company of its quarterly performance concealing big losses resulting from certain OTC derivative transaction (KIKO transactions), which was settled in 2010. The other was an action involving market manipulation by a foreign investment bank in connection with trading of underlying stocks of equity-linked securities (ELS). Among others, stringent requirements for a representative party and an attorney have been claimed to be the cause for such unpopularity of the class action.

c. Procedures of Class Actions under the ASCA

Generally speaking, class actions under the ASCA proceed as follows:

(i) First step: a person who wishes to become a representative party files a written complaint and an application for permission of the class action with a court (Article 7 of the ASCA).

57 The term "class" means all of the members who have common interest to claim compensation for loss when any loss arises to numerous persons in the course of trading of securities, and the term "class member" means each victim comprising the class (Article 2, sub-paragraphs 2 and 3 of the ASCA).

58 The term "representative party" means one or more class members who file for a class action for the class after obtaining the approval of a court (Article 2, sub-paragraph 4 of the ASCA).

(ii) Second step: The court publicly notifies the institution of the class action and asks for filing of an application to become a representative party by other class member (Article 10 (1) of the ASCA).

(iii) Third step: The court rules to appoint a representative party (Article 10 (4) of the ASCA).

(iv) Fourth step: Upon substantiation of the grounds for the permission of the class action and examination of the parties to be, the court rules to permit the class action (Articles 13 through 15 of the ASCA).

(v) Fifth step: The court notifies class members and Korea Exchange of the details of the class action and opt-out period, immediately upon its ruling on the permission of the class action (Articles 18 and 19 of the ASCA).

(vi) Sixth step: A class member who intends not to be bound by the class action judgment, if any, reports an opts-out notice to the court (Article 28 (1) of the ASCA).

(vii) Seventh step: Upon completion of the proceedings including investigation, examination, and order to submit relevant documents, the court renders a judgment (Articles 30 through 36 of the ASCA).

(viii) Eighth step: A distribution procedure is handled by a distribution administrator appointed by the competent distribution court subject to the supervision of the same court (Articles 39 through 58 of the ASCA).

d. Active Role of Courts in the Class Actions under the ASCA

With respect to the class actions under the ASCA, courts are assigned to intervene actively from the outset of the institution of the case through the proceeding and distribution process. Any of the major instances of class actions is subject to the approval of the court, such as the start of the class action, appointment and dismissal of a representative party, appointment, dismissal and addition of an attorney, withdrawal, settlement or waiver of claims, appointment and dismissal of distribution administrator, authorization of, and amendment to, the plan for distribution (Articles 15, 21, 23, 26, 35, 41, 46 and 48 of the ASCA). Also, courts have power to investigate evidence, ex officio, if deemed necessary (Article 30 of the ASCA).

3. Corporate Restructuring and Enhancement of Acquisition Laws

3.1 Legislation of Workout Programs

3.1.1 Background

In the wake of the IMF crisis, Korean government has made a new law, the Corporate Restructuring Promotion Act (the CRPA), in order to facilitate constant corporate

restructuring through market functions by providing for the matters required in promoting expedite and smooth corporate restructuring.

Prior to the enactment of the CRPA, corporate restructuring had been primarily consummated through the workout agreement among lending institutions and a borrower company with financial difficulty, under visible and invisible auspices of governmental authorities. The CRPA was to formalize the practices established in connection with the workout programs for a few years and to supplement the weak points in the workout programs that are basically relying upon voluntary participation by the relevant parties.

At first instance, the CRPA was designed to have been in force for a limited period of time with a sunset provision, in order to meet the needs caused by the 1997 IMF crisis. The law was enacted in 2001 (Act no. 6504) which had been effective since September 15, 2001 through the end of 2005. However, in 2007, Korean government decided to restore the law and the second CRPA (Act No. 8572) in order to have the corporate restructuring practices through agreements among creditor institutions deeply rooted in the market. The second CRPA had been effective from November 4, 2007 through the end of 2010. Immediately after expiration of the second term of the CRPA, Korean government has pursued further extension of the law because of its concerns on domestic and international economies given the delay in restoration of construction industry and fiscal crisis in Europe. As a result, in May 2011, the third CRPA (Act. No. 10684) was legislated to become effective from May 19, 2011 through the end of 2013. The CRPA has gone through a number of changes in its structures from time to time, but the explanation below will follow the most recent version of the CRPA (Act No. 10684). A number of corporations have been restructured successfully pursuant to the CRPA and the restructuring programs under the CRPA have contributed significantly to the recovery of Korean economy as well as rehabilitation of many troubled corporations.

3.1.2 Details of the CRPA Structure

a. Eligible Borrower Company

The CRPA is applicable only to a company which has been granted credit by creditor financial institutions and total amount of credit grant reaches or exceeds fifty billion won (Item 4, Article 2 of the CRPA). Smaller borrowers are not subject to, or benefit from, the CRPA.[59]

When determining the size of the credit grant, the “credit grant” includes not only a loan but also any of the following:

(a) Purchasing a bill or bond;

(b) Leasing a facility or equipment;

59 In case of companies with aggregate credit grant less than fifty billion Won, the Convention of Credit Banks Council has been applicable since June 2001.

(c) Guaranteeing payment;

(d) Making a payment in subrogation under a guarantee for such payment;

(e) Making a transaction that is likely to cause damage or losses to a financial institution if the counterparty to the transaction becomes insolvent; and

(f) Being involved in a transaction that may bring about the consequences of any of the foregoing transaction, although a financial institution has not made such transaction directly (Item 6, Article 2. of the CRPA).

b. Eligible Lending Institutions

The “creditor financial institutions” under the CRPA encompass most of the lending institutions so that the law has practical effect on corporate restructuring and include the following:

(a) A bank that has obtained authorization under the Banking Act (including a person who is deemed as a bank under Articles 5 and 59 of the same Act);

(b) The Korea Development Bank under the Korea Development Bank Act;

(c) The Export-Import Bank of Korea under the Export-Import Bank of Korea Act;

(d) The Industrial Bank of Korea under the Industrial Bank of Korea Act;

(e) An investment dealer, investment broker, collective investment manager, trust company, merchant bank, investment company, private equity fund and investment-purpose company under the CMFBA;

(f) a securitization-purpose company under the Asset-backed Securitization Act;

(g) An insurance company under the Insurance Business Act;

(h) A specialized credit finance company under the Specialized Credit Financial Business Act;

(i) A mutual savings bank under the Mutual Savings Banks Act;

(j) The Korea Asset Management Corporation under the Act on the Efficient Disposal of Non-Performing Assets, etc. of Financial Institutions and the Establishment of the Korea Asset Management Corporation;

(k) The Deposit Insurance Corporation under the Depositor Protection Act;

(l) The Korea Finance Corporation under the Korea Finance Corporation Act;

(m) The Credit Guarantee Fund established under the Credit Guarantee Fund Act;

(m) The Korea Technology Credit Guarantee Fund established under the Korea Technology Credit Guarantee Fund Act;

(n) Any resolution finance institution established under the Depositor Protection Act;

(o) Corporate restructuring limited partnerships under Article 15 of the Industrial Development Act (referring to the previous Industrial Development Act which was wholly amended by Act No. 9584) and private equity funds for improving corporate structure under Article 20 of the Industrial Development Act; and

(p) The Korea Export Insurance Corporation established under the Export Insurance Act. (Item 1, Article 2. of the CRPA)

Among the creditor financial institutions involving a specific borrowing company, the "principal creditor bank" plays a key role in restructuring process. The term "principal creditor bank" means the main creditor bank of a specific borrowing company (or the bank that has granted the largest amount of credit grant if no principal credit bank is designated). (Item 3, Article 2. of the CRPA)

c. Restructuring Processes under the CRPA

(1) Notification to the Borrowing Company that shows Signs of Insolvency

If the principal credit bank finds, as a result of the credit risk assessment of a borrowing company, that the company shows signs of insolvency (that is, it would be hard for such company to repay loans borrowed from financial institutions without additional financial aid or an external loan (excluding loans borrowed in the course of normal financial transactions), it shall notify the borrowing company that it is entitled to the restructuring proceedings under the CRPA and the borrowing company may apply for the commencement of the proceeding.

(2) Convocation of the Council

Upon such application above, the principal credit bank shall convene creditor financial institutions council (the "Council") and the Council determines to commence any of the following proceedings if they find that it is possible to normalize the borrowing company's business:

(i) Joint administration by creditor financial institutions through the Council;

(ii) Joint administration by creditor banks through the creditor banks' council ;

(iii) Administration by the principal creditor bank only. (Article 4 of the CRPA)

Even after the commencement of the proceedings under the CRPA, the borrowing company or the creditor financial institutions may file for a rehabilitation proceeding under the Debtor Rehabilitation and Bankruptcy Act (Article 4 (5) of the CRPA).

(3) Notification to the authority and suspension of claims

The principal creditor bank shall, when it calls a meeting of the Council for the commencement of the proceedings of joint administration by creditor financial institutions, notify the Governor of the Financial Supervisory Service and the Governor of the Financial Supervisory Service may request creditor financial institutions to suspend the exercise of

their rights to claims against the borrowing company up until the date on which the first meeting of the Council is held.

(4) Grace Period

Creditor financial institutions may set a grace period for to exercise the rights to claims at the first meeting of the Council held within seven days from the date on which a notice for the meeting is delivered within the limit of one month from the commencement date of the grace period (or three months if it is necessary to conduct a field inspection of assets and liabilities of the borrowing company), but may extend the period only once for one month or less. If the Council fails to set a grace period to exercise the rights to claims or fails to finally establish a plan for business normalization of the borrowing company by the end of the grace period, it shall be assumed that the proceedings of joint administration for the company by the creditor financial institutions are discontinued (Article 6 of the CRPA).

(5) Execution of Business Normalization Agreement

The Council shall execute an agreement (the "Agreement") for the implementation of a plan for business normalization of the borrowing company (the "business normalization plan") within the grace period above (Article 8 (1) of the CRPA). The Agreement shall contain the following terms for the business normalization of the borrowing company:

(i) Levels of business targets of the company, including sales and operating income;

(ii) Specific implementation plans, including plans for restructuring the company through adjustment of its manpower, organization, personnel expense and plans for improving its financial structure through issuance of new stocks, reduction of capital, etc. as may be necessary for attaining the target levels under item (i). In this case, the implementation period shall not exceed one year, but may be extended further by a resolution of the Council;

(iii) Additional implementation plans that shall be further carried out by the company, including adjustment of total personnel expenses, in the event that it fails to attain the target levels under item (i);

(iv) Consent letters concerning the matters that require consent of interested parties, such as the labor union or shareholders of the company in connection with the matters under items (ii) and (iii);

(v) Plans for readjustment of claims and credit grants to be established for supporting the liquidity required for the business normalization of the company;

(vi) Specific plans for business normalization by selling it to a third party, entrusting someone with the business management, or in any other way, if such is the case; and

(vii) Other matters as necessary for the normalization of the company's business (Article 8 (2) of the CRPA).

(6) Ongoing Monitoring

The principal creditor bank shall monitor the actual performance of the Agreement on a quarterly basis. Also, it shall regularly assess and examine the feasibility of continuing the joint administration of the company and the possibility of business normalization of the company on the basis of the results of its quarterly monitoring, and shall submit a report thereon to the Council. In this case, it shall retain a specialized independent institution for assessment at least once every two years from the commencement date of the proceedings of joint administration (Article 9 of the CRPA).

(7) Readjustment of Claims

Creditor financial institutions may, if deemed necessary for business normalization of the company showing signs of insolvency, readjust claims or grant new credits to the company subject to prior resolution by the Council. In this case, such readjustment of claims shall be performed in a fair and equitable manner, considering the priority of claims. A resolution of the Council on the readjustment of claims shall be effective only with an affirmative vote of creditor financial institutions whose secured claims amount to three-fourths or more of total amount of secured claims (referring to the claims amounting to the valid security value within the limit of the liquidating value of the relevant assets) of creditor financial institutions (Article 10 of the CRPA).

(8) Discontinuance of the Proceeding

The Council may pass a resolution to discontinue the proceedings of joint administration if any of the following events occurs:

(i) If it finds that the company has not performed any essential terms under the business normalization plan without justifiable grounds or if it determines that it would be difficult to implement the business normalization plan, as a result of its ongoing monitoring;

(ii) If it determines that it would be improper) to continue the joint administration or if there is no possibility of normalizing the enterprise's business, based upon its regular assessment;

(iii) If the borrowing company requests the discontinuance of the proceeding (Article 12 of the CRPA).

(9) Mediation Committee for Creditor Financial Institutions

The Mediation Committee for Creditor Financial Institutions is established for the purposes of efficient reorganization of an enterprise showing signs of insolvency, mediation of differences between creditor financial institutions, and carries out business affairs including the following:

(i) Mediating differences unsettled by free negotiations between creditor financial institutions (excluding differences in any resolution of the Council);

(ii) Mediating disputes concerning the purchase or redemption price of claims of dissenting creditors and the terms and conditions thereof;

(iii) Mediating disputes concerning the amount of penalty and the distribution of such penalty received under Article 21 (3);

(iv) Making judgments on whether resolutions of the Council have been violated or making decisions on the implementation of such resolutions.

3.2 Corporate Divisions

3.2.1 Background

While provisions for merger, consolidation or other similar transactions (together hereinafter referred as a "merger") have been in place in the Commercial Code from its inception in 1962, corporate division, a reverse of a merger, has not been implemented in Korea up until 1998 when Korean government introduced it through the amendments of the Commercial Code(Act No. 5591). Section 11 with 9 articles (Articles 530-2 through 530-11) was inserted after the Section 10 for merger. It resembles scission under French corporate law and was influenced by Aufspaltung, Abspaltung and Ausgliederung under the German Umwandlungsgesetz of 1995. The legislation intended to ease the inconveniences caused by absence of system for spin-off type transactions and to support corporate restructuring. There have been many corporate divisions since its introduction into the Commercial Code. At an earlier stage, corporate division was utilized for restructuring of insolvent corporations such as Daewoo group affiliates or outsourcing of human resources. Recently, it has been used more often as a tool to enhance governance structure and strategic restructuring for concentration and growth of a solvent corporation.

3.2.2 Details of the Corporate Division

a. Types of the Corporate Division

There are a number of types of corporate division permitted under the Commercial Code. A corporation may incorporate one or more new corporations by means of a corporate division. Also a corporation may merge with one or more existing corporations by means of its division (the "merger through division"). A corporation may be divided to incorporate one or more new corporations, which, in succession, may merge with other existing corporations. A corporation after dissolution may be divided or merged through division only when an existing corporation becomes the surviving corporation or when a new corporation is to be incorporated by such division or merger through division (Article 530-2 of the Commercial Code). Also a corporation which is to be divided may acquire the total number of shares of a corporation be incorporated due to a division or a merger through division (Article 530-12 of the Commercial Code).

b. Procedures for the Corporate Division

(1) BOD Resolution

BOD must approve the proposed corporate division and authorize the plan for the division or agreement for merger through division.

(2) Approval of General Shareholders Meeting

A corporation which is to be divided or merged through division must prepare a division plan or an agreement of a merger through division, which must be approved by the general meeting of shareholders by supermajority vote. With respect to such resolution, holders of non-voting shares also have a voting right. (Article 530-3 of the Commercial Code) In case of a merger through division, dissenting shareholders are given appraisal rights (Article 530-11(2) of the Commercial Code).

(3) Disclosure of the Division Balance Sheet

The director of a corporation to be divided shall keep the division plan or agreement of a merger through division and a balance sheet concerning the part that is to be divided, in the principal office from two weeks before the general shareholders meeting until six months after the registration of division or the merger through division (Article 530-7 of the Commercial Code).

A division of a corporation takes effect when the surviving corporation or the newly incorporated corporation in consequence of a division has effected registration of division at the place of its principal office (Article 530-11(1) of the Commercial Code).

Assets and liabilities of a corporation being divided will be assigned or assumed by the corporations which are incorporated or continue to exist due to a division or a merger through division, strictly as contemplated by the division plan or agreement of merger through division (Article 530-10 of the Commercial Code). However, the corporations which are incorporated or continue to exist due to a division or a merger through division, shall be jointly and severally liable for the performance of the obligation of the corporation before the division or merger through division (Article 530-9 (1) of the Commercial Code).

Where a corporation to be divided incorporates another corporation by means of division upon a supermajority vote of general shareholders meeting, it may be determined that the incorporated company only bears the obligations related to property contributed thereto from among the debts of the corporation to be divided. In this case, if the corporation to be divided continues to exist after the division, the corporation shall bear only the obligations which the corporation incorporated due to the division fails to take over (Article 530-9 (2) of the Commercial Code). In this case and the case of a merger through division, within two weeks after a resolution by the general shareholders meeting to the foregoing effect, the corporation shall give its creditors a public notice that an objection, if any, against the division should be raised within a period of no less than one month and shall give a separate peremptory notice to the creditors known to the corporation. A creditor who fails to raise

an objection within the periods shall be deemed to have approved the division. If a creditor raised an objection, the corporation shall perform its obligations to the creditor or furnish adequate security, or entrust a property of reasonable value to a trust company to the same purpose (Articles 530-9(4) and 530-11(2) of the Commercial Code).

3.3 Merger Transactions

3.3.1 Background

Under the Commercial Code, a consummation of a merger transaction must be approved both by the BOD and general shareholders meeting of all parties to the merger (Article 522(1) of the Commercial Code).[60] Supermajority vote is required to approve the merger at the general shareholders meeting (Article 522(3) of the Commercial Code). Appraisal rights of the opposing shareholders (Article 522-3 of the Commercial Code) mean that merger transaction is time consuming and costly. Cumbersome procedures, delay, and uncertainty potentially could be a deal breaker. There is no so called 'stock market exception' in corporate mergers under Korean law. Under the CMFBA, mergers between listed corporations are subject to further limitations such as that (i) consideration for merger transaction should be based upon market prices of the relevant shares and (ii) third party evaluation of the material terms of the mergers is mandated.

In 1998, amendments to the Commercial Code (Act No. 5591) provided for short form merger and small scale merger, to enable easier corporate reorganization transactions and to respond to the financial crisis. Small-scale mergers have contributed a lot for many corporations for their strategic restructuring.

In 2011, amendments to the Commercial Code (Act No. 10685) allowed cash merger and triangular merger and have enlarged the availability of the small-scale merger.

3.3.2 Details of the Developments

a. Short Form Merger

Shareholder authorization of the target corporation is not required if the acquiring corporation already has most of the shares of the target. Because in this situation, shareholder authorization would be meaningless and therefore it would be reasonable to omit such authorization process to save time and costs.In case where one of the constituent corporations of a merger survives, (i) if there is the agreement of all of the shareholders of a corporation to be extinguished due to the merger or (ii) if 90/100 or more of the total outstanding shares in such corporation to be held by the surviving corporation, approval of the general shareholders meeting of the corporation to be extinguished may be replaced

60 Article 522 (1) In order to effect a merger of companies, a written agreement for merger shall be prepared and be approved by a general shareholders' meeting.

by the approval of the board of directors of such corporation. In this case, a corporation to be extinguished due to a merger shall give public notice or make notification to the shareholders that the corporation shall be merged without approval by the general meeting of shareholders within two weeks after the written agreement of such merger has been prepared, provided, however, that the same shall not apply where the consents of the total shareholders have been obtained (Article 527-2 of the Commercial Code).

However, procedures for dissenting shareholders and creditors are not exempt. Dissenting shareholders will still have appraisal rights following the BOD resolution for the merger (Article 522-3 (2) of the Commercial Code). Also procedures for the protection of creditors must be undertaken following the BOD resolution for the merger (Article 527-5 (2) of the Commercial Code).

b. Small-Scale Merger

Shareholder authorization of an acquiring corporation is not required if the acquirer is much larger than the target corporation. Because in this situation the merger will have little impact on the interests of the shareholders of the acquiring corporation and therefore it need not allow shareholders' voice in the process.

In case where (i) the total number of new shares to be issued by the surviving corporation due to a merger does not exceed 10/100[61] of the total issued shares of the surviving corporation and (ii) a fixed amount, if any, to be paid to shareholders of a corporation to be extinguished in consequence of the merger, does not in exceeds 5/100[62] of the amount of net assets existing on the latest balance sheet of the surviving corporation, the approval of the general shareholders meeting of the corporation may be replaced by the approval of the board of directors of such corporation. In this case, the written agreement of the merger of the surviving corporation shall include statements that the merger shall be affected without approval of the general meeting of shareholders Also, the surviving corporation shall make a public notice or notification to the shareholders of the trade name and address of the principal office of the corporation to be extinguished, the date of the merger, and the statement that the merger shall be affected without approval of the general meeting of shareholders within two weeks after the written agreement of the merger has been prepared. However, if shareholders who hold no less than 20/100 of the total outstanding shares of the surviving corporation which continues to exist after a merger notify, in writing, the corporation of their intention to dissent from such simplified merger, the merger shall not be affected without approval of the general shareholders meeting of such corporation (Article 527-3 (1) through (4) of the Commercial Code).

Dissenting shareholders will not have appraisal rights (Article 527-3 (5) of the Commercial Code). But, procedures for the protection of creditors must be undertaken following the BOD resolution for the merger (Article 527-5 (2) of the Commercial Code).

61 Prior to the 2011 amendments to the Commercial Code, the threshold percentage was 5/100.

62 Prior to the 211 amendments to the Commercial Code, the threshold percentage was 2/100.

c. Cash Merger and Triangular Merger

Under current Commercial Code, it has been acknowledged that merger consideration should be confined to newly issued or outstanding stock of the surviving corporation or newly established corporation and accordingly a cash merger or a triangular merger should not be allowed. As a result, there could remain minority shareholders after consummation of a merger and merging companies have had severely limited options in structuring corporate reorganization and control transactions. In 2011, amendments to the Commercial Code (Act No. 10685, to become effective Apr. 15, 2012) have resolved this problem by liberalizing the type of assets eligible for merger consideration.

Item 4 of Article 523(1) of the Commercial Code specifically lifted limitations on the type of merger consideration and permit any property to become merger consideration as agreed upon by and among the merging companies. Further, Article 523-2 of the Commercial Code provides for a ground for a triangular merger. Under Article 342-2 of the Commercial Code, a subsidiary may not acquire shares of its parent corporation. Article 523-2 of the Commercial Code provides for exception from this limitation so that a subsidiary may acquire stocks of its parent company that would be allotted to the shareholders of the corporation which is to cease to exist upon completion of the merger.

3.4 Exchange/Transfer of All Outstanding Shares by Corporate Action

3.4.1 Background

An exchange or transfer of all outstanding shares of a corporation is a device to create a subsidiary wholly owned by a holding company, not through actions of individual shareholders[63] but by way of a corporate action. In the past, Anti-Monopoly and Fair Trading Act of Korea (AMFTA) had prohibited a holding company structure for reasons that a holding company structure would result in concentration of economic power. Therefore, there was no need for such device as an exchange or transfer of all outstanding shares of a corporation by a corporate action.

Having gone through the IMF crisis in 1997, however, Korean government has changed its policy to permit creation of a holding company in order to provide companies with useful devices for corporate restructuring. In 1999 amendments to the AMFTA (Act No. 5813) were made to permit creation of a holding company subject to certain limitations. In 2000, Korean government has newly enacted the Financial Holding Company Act (Act No. 6274) and introduced the concept of an exchange or transfer of all outstanding shares of a corporation by a corporate action to create a financial holding company.[64]

63 In this regard, it is differentiated from stock swap transaction by and among investors.

64 By virtue of the Financial Holding Company Act, Woori Financial Holding Co,. and Shinhan Financial Holding Co. have been created through restructuring of a number of affiliate companies.

In 2001 amendments to the Commercial Code (Act No. 6488)introduced provisions for an exchange or transfer of all outstanding shares of a corporation by a corporate action in order to facilitate formation of a 100% subsidiary and reorganize corporate group to a holding company structure. Two new Sub-sections are inserted following Sub-section 1 (Stock and Stock Certificates): New Sub-section 2 for an exchange of all outstanding shares of a corporation by a corporate action (with 12 articles from Article 360-2 through Article 360-14) and new Sub-section 3 for a transfer of all outstanding shares of a corporation by a corporate action (with 8 articles from Article 360-15 through Article 360-23).

There have been few cases where corporations were restructured into a holding company structure by virtue of the Commercial Code. However, since there is legally[65] and practically no need to have a wholly owned subsidiary, the corporations held far beyond the minimum control block in order to create a holding company.

3.4.2 Details of the Device

a. Substances and Procedures for an Exchange of All Outstanding Shares

An exchange of all outstanding shares involves two or more corporations (an acquiring company and companies to become subsidiaries) and consummated through an execution of an agreement between and among all corporations involved with requisite corporate authorizations. Upon closing, acquiring company becomes a holding company and owns 100% of the shares of the acquired company (s) and at the same time the shareholders of the acquired company (s) become the shareholders of the acquiring company (Article 360-2 of the Commercial Code).

In general, it proceeds in the following manner:

(1) Preparation of an agreement for share exchange

A corporation which intends to make a share exchange shall prepare a contract for share exchange. (Article 360-3 (1) of the Commercial Code)

(2) BOD approval

The BOD of each corporations involved must approve the share exchange transaction.

(3) Execution of the agreement for share exchange

All corporations that are parties to the stock exchange transaction must execute the agreement for share exchange.

(4) Disclosure

The directors shall keep, at the head office from two weeks prior to the meeting day of the shareholders' general meeting to the date on which six months elapse since the date of share

65 The AMFTA does not require a holding company to own 100% of the total issued and outstanding shares of its subsidiary, but requires a holding company to have at least 40% (20% in case of a listed corporation) of the total issued and outstanding shares of its subsidiary.

exchange, such documents as the agreement for share exchange, documents describing reasons for an allocation of stocks to the shareholders of the company becoming a complete subsidiary and final balance sheets and profit and loss statements of each corporation making the stock exchange (Article 360-4(1) of the Commercial Code).

(5) Shareholders' approval

A corporation which intends to make a share exchange must obtain an approval of the shareholders' general meeting by a supermajority vote (Article 360-3 (1) and (2) of the Commercial Code). Dissenting shareholders are entitled to appraisal rights (Article 360-5 of the Commercial Code).

(6) Invalidation of the existing stock certificates

The corporation becoming a complete subsidiary due to a share exchange shall invalidate outstanding stock certificates in due course (Article 360-8 of the Commercial Code).

(7) Effectiveness

As of the date for stock transfer as set forth in the agreement for exchange of all outstanding shares, all shares held by the subsidiary shareholders are automatically transferred to the acquiring company (parent company) and new shares of the parent are issued to the subsidiary shareholders (Article 360-2(2) of the Commercial Code).

(8) Ex post facto disclosure

For six months, material information on the stock exchange must be disclosed (Article 360-12). Certain simplified procedures are available for short-form share exchange and small-scale share exchange (Articles 360-9 and 360-10 of the Commercial Code).

b. Substances and Procedures for a Transfer of All Outstanding Shares

A corporation may by itself establish a complete parent company and become a complete subsidiary by consummating a transfer of all outstanding shares transaction pursuant to the Commercial Code. All of the shares of the corporation becoming a complete subsidiary upon the share transfer, which are owned by its shareholders, shall be transferred to a complete parent company being established upon the share transfer, and the shareholders of the relevant complete subsidiary shall become the shareholders of the relevant complete parent company by receiving an allocation of shares issued by the relevant complete parent company for the share transfer (Article 360-15 of the Commercial Code).

In general, it proceeds in the following manner:

(1) Preparation of a plan for share transfer

A corporation which intends to make a share transfer shall prepare a plan for share transfer (Article 360-16 (1) of the Commercial Code).

(2) BOD approval

The BOD approval for the share transfer transaction is required.

(3) Disclosure

The directors shall keep, at the head office from two weeks prior to the meeting day of the shareholders' general meeting to the date on which six months elapse since the date of share transfer, such documents as the plan for share transfer, documents describing reasons for an allocation of stocks to the shareholders of the company becoming a complete subsidiary and final balance sheets and profit and loss statements of the company becoming a complete subsidiary (Article 360-17 (1) of the Commercial Code).

(4) Shareholders' approval

A corporation which intends to make a share transfer shall obtain an approval of the shareholders' general meeting by a supermajority vote (Article 360-16(1) and (2) of the Commercial Code). Dissenting shareholders are entitled to appraisal rights (Article 360-22 of the Commercial Code).

(5) Invalidation of the existing stock certificates

The corporation becoming a complete subsidiary due to a share transfer shall invalidate outstanding stock certificates in due course (Article 360-19 of the Commercial Code).

(6) Registration of the share transfer

Any transfer of shares shall become effective upon registration of the share transfer by the complete parent company established due to such transfer at the location of its main office (Article 360-21 of the Commercial Code).

(7) Post facto disclosure

For six months, material information on the share transfer must be disclosed (Article 360-22).

3.5 Control Transactions

3.5.1 Background

Since 1997, there have been deregulations in laws on control transactions in order to encourage mergers and acquisitions

3.5.2 Abrogation of the 25% Mandatory Tender Offer Rules

In 1997, amendments to the SEA (Act No. 5254) introduced the so called "25% mandatory tender offer rule". Under Article 21 (2) of the SEA, the rule is triggered by the acquisition of 25% of the voting shares of the target company including the shares held by persons acting in concert with the acquirer. Once the rule kicks in, the acquirer is required to make a tender offer for majority of voting shares of the target company. The rule made the costs of control transactions higher.

However on April 1, 1998, Korean government repealed the “25% mandatory tender offer rule” so as to reduce its chilling effect on the number of control transactions and to facilitate more control transactions for corporate restructuring, particularly in the wake of the 97’financial crisis. Now, there exists no mandatory bid rule and partial offer is allowed so long as such term is clearly set forth in the disclosure documents for the tender offer.

3.5.3 Changes from Prior Filing to Ex post facto Filing System

In 2001, due to the amendments to the SEA (Act No. 6423) prior filing requirement was repealed and it is required to file the tender offer statement on the same date as the tender offer is made, so that more speedy and efficient tender offer would become available (Article 21-2 of the SEA).

3.5.4 Balancing the Interests of Acquirer and Target

In 2005, amendments to the SEA (Act No. 7339) abolished a waiting period[66] for tender offer statement to encourage effectiveness and so that the elapse of which would permit the start of the tender offer (Article 23 (1) of the SEA). Also the amendments repealed such limitation as prohibiting repeated tender offers by the same person within short period of time[67] to encourage control transactions (Article 23 (3) of the SEA).

On the other hand, the amendments also provided for some comforts to the target management and controlling shareholders, to secure fair competition in the corporate control market as follows:

(i) Abolished such limitation as prohibiting the target management from taking certain protective measures (including inviting a white knight) (Article 23 (4) of the SEA);

(ii) Mandated to specify the purpose of holding 5% or more of voting shares of a listed corporation, whether it is for management control or for portfolio investment, in the so-called “5% report” and differentiated the levels of disclosure depending upon such purpose (Article 200-2 of the SEA);

(iii) Added the type of the “5% report” so that any change in the purpose of holding must be disclosed within 5 business days (Article 200-2 (4) of the SEA);

(iv) Set the “cooling period” of 5 business days: that is, suspended exercise of voting rights and prohibited further acquisition of voting shares by the shareholder who files the “5% report” which discloses that the purpose of the holding is for management control, for 5 days (Article 200-3 (2) of the SEA).

66 It was 3 business days (or 10 business days prior to the 2001 amendments to the SEA).

67 It was 6 months (or 1 year prior to the 2001 amendments to the SEA).

Chapter 5

Conclusion

1. Regulatory Structure for Foreign Investment in Korea
2. Legal Infrastructure for Real Estate Investment
3. Legal Infrastructure for Corporate System

Conclusion

We have so far examined the legal infrastructure for foreign investment in Korea. In lieu of conclusion, we summarize what have been discussed.

We started from the presumption that a legal infrastructure plays a significant role in investment. Investors risk their financial resources as they involve themselves with investment-related activities. To minimize risks, they examine the soundness of the legal infrastructure that governs economic activities. Therefore, a sound legal infrastructure is a prerequisite in attracting investment. The need for a more reliable legal infrastructure becomes even more eminent when it comes to the matter of foreign investment. Since foreign investors are not familiar with investment environment of the nation they seek to invest in, they heed more to the wholesomeness of the legal infrastructure of the nation. This shows the close inter-relationship between a legal infrastructure and investment. Given the importance of a legal infrastructure for investment, this paper examined the legal infrastructure for foreign investment in Korea.

As it can be inferred from the term "infrastructure", this paper mainly concentrated on basic and fundamental legal frameworks rather than specific legal details relating to foreign investment. Civil law and commercial law have been chosen as main areas of law to be addressed in this paper. Considering the wide scope of these laws, this paper narrowed down the subject matters to issues pertaining to real estate investment and corporate system. Other relevant statutory laws concerning these issues were also reviewed when necessary. Further, the very front part of the paper was devoted to the brief overview of the foreign-investment regulatory scheme in Korea in order to give a general idea of how foreign investment is viewed and treated in Korea.

Against this backdrop, we have first explained how the foreign-related regulatory regime has evolved and worked in Korea (chapter 2). Then, we have elaborated on two notable features of Korean legal infrastructure relating to investment in the field of civil law and

commercial law – the very cores of Korean private law. One is the legal infrastructure for real estate investment (chapter 3), and another is the legal infrastructure for corporate system (chapter 4).

Below is the brief summary of chapter 2, 3 and 4.

1. Regulatory Structure for Foreign Investment in Korea

As Korea desperately needed to secure financial resources in order to establish the foundation of the nation's economy, Korean government strived to attract the influx of foreign capital. The initial legislative steps were taken mostly during 1960s. However, what were implemented were not completely open-ended legal frameworks. Rather, there were still abundant regulatory elements based on the fear that domestic industry will be overwhelmed and controlled by the foreign entities.

The closely-monitored foreign investment policy continued through 1980s. For this reason, foreign loan – which might not lead to the taking of control over Korean industry- was the main channel through which foreign financial resources were provided to the Korean economy, while foreign direct investment remained as a subsidiary tool. During the 1990s, the liberalization process was stimulated by the desire to attract foreign investment as well as by the external pressure, notably from Organization for Economic Cooperation and Development (OECD) members that demanded that Korea reduce barriers to foreign direct investment. With Korea's accession to the OECD in 1996, and in particular with the IMF crisis beginning in 1997, Korea was pushed to reform the legal regime to actively attract foreign investment. However, the movement also had voluntary motivation to diversify and expand the financial sources on which Korean economy could thrive. Most notably, the Foreign Investment Promotion Act was enacted in 1998 to accomplish this policy goal. With this change taking place, foreign direct investments began to increase.

Foreign portfolio investment-or foreign indirect investment-also increased with the advancement of the capital market.

In January 1981, Korean government announced "A Long-Term Plan for Liberalization of the Capital Market" in order to induce foreign capital and enhance the financing by Korean companies. According to the plan, foreign investment has been allowed step by step.

At first, an indirect investment through domestic securities investment trust was allowed with a specific license per each trust from the Minister of Finance pursuant the Securities Investment Trust Business Act and the Foreign Exchange Control Act of Korea, beginning in 1981.

Secondly, an indirect investment through offshore funds established for investment exclusively in Korean securities was allowed with a specific license per each fund from the Minister of Finance pursuant the Securities and Exchange Act and the Foreign Exchange Control Act of Korea, beginning in 1984.

As a third step, financing by Korean companies through overseas offerings of equity related securities was allowed with a specific approval per each offering from the Minister of Finance pursuant the Securities and Exchange Act and the Foreign Exchange Control Act of Korea, beginning in 1985.

In December 1988, Korean government announced “A Plan to Pursue Liberalization of Capital Market on an Enlarged Scale” in order to provide a specific schedule to push forward with the aforementioned 1981 plan. Following the 1988 plan, foreign investments in Korean stocks listed on the Korea Stock Exchange (KSE) subject to certain limitations pursuant the Securities and Exchange Act and the Foreign Exchange Control Act of Korea, beginning January 1, 1992.

In July 1993, Korean government announced “A Blue Print on Mid-term Plan for Liberalization of Financial Market” to further the opening of stock market and to provide for a schedule for gradual opening of bond market and securities industry. In 1994, foreign investment in Korean bonds listed on the KSE began to be permitted gradually.

In December 1996, Korean government has joined the OECD and provided an overall plan to liberalize the transfer of capital and to open financial market. In 1998, the limitations on the type of financial products available for foreign investment were lifted. Foreign investors were then allowed to invest in any Korean securities including stocks and equities listed or not, corporate bonds listed or not, mutual funds and trusts, listed derivatives, CPs and warrants, subject to certain procedural limitations pursuant the Capital Market and Financial Investment Business Act and the Foreign Exchange Management Act of Korea.

2. Legal Infrastructure for Real Estate Investment

The most general legal infrastructure for real estate investment is Korean Civil Code (KCC). It is the lengthiest and perhaps the most influential of all Korean statutory laws, and it includes the law of right in rem, that is the most relevant part to real estate investment. In particular, transfer of real estate ownership and the real estate secured transaction are two major components that affect real estate investment. As for the transfer of real estate ownership, the KCC as well as Real Estate Registration Act provides ample rules and procedures by which transfer of ownership takes place in a secure and efficient way. As for the real estate secured transaction, the KCC and other related statutes provide the way by which the real estate owner can make use of the financial value of the real estate, including a mortgage or issuing asset-backed securities.

Another noteworthy statute that may be classified as a part of the general legal infrastructure is the Trust Act. The trust is one of the most frequently used legal institutions in the context of real estate investment. It is generally understood that the trust is a relationship between three parties where one party (trustor) transfers property to another party (trustee) for the benefit of a third party (beneficiaries). Although the trustee holds the title of the property, he or she only does so for the benefit of beneficiaries. With its

insolvency insulation and high flexibility, the trust is frequently used in various different forms in real estate investment. The Trust Act offers a vast number of provisions regulating the complicated legal relationships arising out of trust. Dispute-resolution is also one of the important factors to be taken into consideration when investment is made. The Korean Civil Procedure Act provides a general mechanism by which a dispute is resolved by the judiciary.

Furthermore, there are some special legal infrastructures that have come into being in the wake of the so-called IMF (International Monetary Fund) crisis of 1997. This crisis strongly called for more open and transparent system in order to attract foreign investment, which was then a necessity to overcome this unprecedented national crisis. Confronted by the financial crisis, Korean government actively reformed the legal and financial system to make create even more investment-friendly environment. There are various statutes including 『Financial Investment Services and Capital Markets Act』, 『Real Estate Investment Company Act』, and 『Act concerning Asset-Backed Securitization』 that are all aimed at facilitating acquisition, financing and developing real estate.

3. Legal Infrastructure for Corporate System

In Korea, Chapter 3 of the Commercial Code provides a comprehensive regulation of companies that is mandatory unless provided otherwise therein. There is no independent statute regulating companies. Even though the Commercial Code provides for 4 types of companies, most of the companies that have significance in Korean economy are established in the form of a "chusik-heusa," an entity with legal personality, limited liability and transferable shares, having a centralized board of directors that is subject in certain major respects to the general shareholders meeting (in this paper, hereinafter referred to the "corporation"). Separate from the Commercial Code, there is a securities law that governs disclosure of equity holdings, solicitation of proxies, tender offers, public offering of securities, and certain fiscal aspects of listed corporations. Prior to February 2009, the securities law existed in the name of the Securities and Exchange Act (the "SEA"), which was repealed and incorporated as a part of the Capital Market and Financial Investment Business Act (the "CMFIBA") as of February 2009. Overall, Korean corporate system is largely governed by the Commercial Code and in certain aspects by the CMFIBA (or formerly, the SEA).

At an earlier stage of planning for economic developments, Korean government had directly intervened to induce foreign capital through various methods including direct or indirect government guarantee and legislation that provides benefits and privileges (including tax incentives) toward foreign lenders and foreign direct investment. As a result of such an approach, Korea could pile up primitive capital it needed for economic development as planned. In 1998, Korea fully opened its capital market for foreign investment. Since then, foreign investors have been allowed to invest in Korean capital market on an equal footing with Korean investors in general, except for certain procedural limitations and

foreign exchange regulations. In this paper, we have focused on Korean government's recent strategies that have been adopted since the Asian financial crisis in 1997. With this crisis as a momentum, Korean government determined that the fundamental soundness and competitiveness of individual Korean companies will ultimately become a determinant factor that could attract foreign capital. From this perspective, it has persistently endeavored to make institutions that would improve the transparency and competitiveness of Korean companies. Korean government has pursued this policy through the transformation of legal structure on corporate system and its efforts have been materialized by the legislations regarding the Commercial Code and the CMFIBA (or formerly, the SEA). Among others, we have described the government's efforts in two aspects: (i) mandatory enforcement of good corporate governance practice, and (ii) provision of the facilities for active corporate restructuring and revitalization of corporate control market.

With respect to the mandatory enforcement of good corporate governance practice, the government has taken a number of measures including the following:

(a) That a listed corporation must appoint minimum number of qualified independent directors in due course as mandated by statute;

(b) That a large listed corporation must have an audit committee, in place of traditional statutory auditor, that meets stringent requirements and a medium-sized listed corporation must appoint qualified standing auditor (s), while non-listed corporation or small-sized listed corporation may, at its option, choose either standing or non-standing auditor(s) or a lenient audit committee;

(c) That minority shareholders rights must be strengthened: that is, newly introducing rights to place an agenda for the general shareholders meeting and cumulative voting rule, and mitigating the threshold percentage requirements;

(d) That certain related party transactions involving a listed corporation must be strictly regulated so that managers, controlling shareholders and specially-related persons be prohibited from exploiting their position at the cost of the corporation or the shareholders in general;

(e) That 'de facto' or shadow directors (typically controlling shareholders or their specially-related persons) must be subject to the same liabilities as those of directors, in cases where they participate in or influence the management of a corporation and, as a result thereof, incur damages to the corporation;

(f) That class actions are for the first time permitted with respect to certain securities transactions by virtue of a special statute, so that investors may efficiently seek a relief for collective injuries caused in the course of securities trading.

With respect to the provision of the facilities for active corporate restructuring and revitalization of corporate control market, the government has taken a number of measures including the following:

(a) That workout programs, that were used to be arranged through private contracts among lending institutions and a borrowing company with financial difficulty, must be subject to a special statute that formalizes and supplements the past practices, while the agreements among the related parties still have a key role in the restructuring process;

(b) That a corporate division, a reverse of a merger, becomes available as a means for corporate restructuring;

(c) That a short form merger, small-scale merger, cash merger, triangular merger have been permitted, to enable easier corporate reorganization transactions and to respond to the IMF crisis;

(d) That an exchange or transfer of all outstanding shares of a corporation has been permitted, in order to provide a device to create a holding company and 100% subsidiary structure;

(e) That there have been deregulations to encourage M&A transactions; that is, abrogation of the 25% mandatory tender offer rule, changes from prior filing to ex post facto filing system regarding tender offer, and relaxation of limitations on both the raider side and the target side while balancing the interests of both sides.

It is not easy to find empirical evidence of the influence of legal infrastructure in attracting foreign investors. However, it is quite obvious that certain degree of security and reliability embedded in the legal system is a positive factor in terms of attracting foreign investment. We have so far examined the basic legal infrastructures centering on real estate and corporate system. Based on the assumption we have just provided, constant efforts to modernize relevant legal frameworks have helped the country in securing financial resources from abroad. The readers should be forewarned that the title may be slightly misleading, as the paper does not provide comprehensive and conclusive answers to the detailed question of the Korean foreign investment legal regimes. It is too multi-faceted and diverse to be addressed in a single paper. However, hopefully it will offer a starting point for a deeper understanding on Korean civil law and commercial law in terms of investment that have seldom been portrayed in books and literatures in English. It is hoped that the legal framework as introduced here in this paper can become a useful reference point for other developing countries as they design and implement their own legal frameworks.

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Abbreviations

ABS :	Asset Backed Securities
ASCA:	Act on Securities-related Class Actions
BOD:	Board of Directors
CIV:	Collective Investment Vehicle
CMFIBA:	Capital Market and Financial Investment Business Act
FCIA ;	Foreign Capital Inducement Act
FECA:	Foreign Exchange Control Act
FIPA:	Foreign Investment Promotion Act
FLAA:	Foreigner's Land Acquisition Act
FSC:	Financial Service Commission
IMF :	International Monetary Fund
KCC:	Korean Civil Code
KCPC:	Korean Civil Procedure Code
KSE :	Korea Stock Exchange
MBS:	Mortgage-Backed Securities
MOF:	Mimister of Finance of Korea
OECD:	Organization for Economic Cooperation and Development
PF:	Project Financing
REF:	Real Estate Fund
REITs:	Real Estate Investment Funds
SEA:	The Securities and Exchange Act
SIT:	Securities Investment Trust

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