Preliminary agreements (private company acquisitions) Q&A: South Korea

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Country Q&A | Law stated as at 30-Apr-2021 | South Korea

This Q&A provides country-specific commentary on *Practice note, Preliminary agreements (private company acquisitions): Cross-border*.

Preliminary agreements

1. What preliminary agreements are commonly made between the buyer and the seller before contract? Are letters of intent and/or term sheets commonly entered into on acquisitions? What issues are commonly covered?

The types of preliminary agreements commonly made between the parties are:

- Memoranda of understanding (MOU).
- Letters of intent (LOI).
- Term sheets.

The title, form and issues covered by preliminary agreements may vary depending on the nature of the transactions and the timing of the execution. However, they generally cover the following:

- Parties.
- Form of acquisition (merger, share transfer or issuance, assets or business transfer).
- Key terms of the transaction (for example, purchase price, conditions precedent, major representations and warranties, covenants and so on).
- Timeframe for the next steps (for example, due diligence, negotiation period for the finalisation of the definitive agreement).
- Exclusivity, confidentiality and no-shop.
- Whether and to what extent the preliminary agreement is legally binding.

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- Termination and indemnification.
- Return or confiscation of upfront deposit, if any (see *Question 3*).
- Other key boilerplate provisions (for example, costs and expenses, governing law, dispute resolution, notice, and so on).

2. Can you ensure that a letter of intent is not legally binding? Is there anything specific (for example, by way of labelling, express qualifications or content) that can prevent a letter of intent from being binding?

Parties can agree on the non-binding nature of, the entirety or a part of, a letter of intent. This is done by inserting an express clause to this effect. However, it is not uncommon for a seller to require a preliminary agreement to be legally binding for the following types of transactions:

- Out-of-court workout (distressed) M&A transactions where the sellers (that is, the shareholders) are financial institutions.
- Auction deals involving multiple bidders.
- Court-administered rehabilitation M&A transactions.

On the other hand, a purchaser (for example, the preferred bidder in auction deals) may also request for exclusivity or no-shop clauses in MOUs or LOIs to be legally binding.

3. Are there any particular formalities required for a legally binding letter of intent?

No, an express clause providing that the LOI (or a part thereof) is legally binding is sufficient. In cases where an express clause is missing, the court may still recognise the enforceability of the relevant document depending on the level of detail and matters addressed therein on a case-by-case basis.

However, in certain transactions where a legally binding preliminary agreement is executed (see *Question 2*), the seller may request an upfront deposit (generally referred to as a "performance guarantee deposit") upon execution of the preliminary agreement as a guarantee of the purchaser’s commitment to the underlying transaction.

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4. Can a non-binding letter of intent give rise to a duty to negotiate in good faith? If so, what might constitute breach of this duty and what liability arises on breach?

In principle, a non-binding letter of intent does not give rise to a duty to negotiate in good faith.

5.Is it permitted to have a lock-out agreement where the seller agrees not to negotiate with or provide information to another prospective buyer for a period of time?

Lock-out agreements (commonly known as exclusivity agreements) are commonly used in South Korea. However, terms governing exclusivity are generally included in LOIs or MOUs without requiring a separate agreement or negative covenants, unlike some other jurisdictions.

6. Is it permitted to have a lock-in agreement whereby the parties agree to continue negotiations for a set period of time? If so, how widely used are they?

Lock-in agreements are permitted in South Korea. Like lock-out agreements (see *Question 5*), terms governing lock-in periods are generally included in LOIs or MOUs without requiring a separate agreement. These terms commonly provide for timeframes for the completion of due diligence investigations as well as negotiations for definitive agreements. However, these timeframes are not generally legally binding unless specifically required by the seller. A seller usually requests a legally binding timeframe in the context of the following types of transactions (especially if there is an upfront deposit paid for the transaction):

- Out-of-court workout (distressed) M&A transactions where the sellers (shareholders) are financial institutions.
- Auction deals involving multiple bidders.
- Court-administered rehabilitation M&A transactions.

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If binding timeframes are included in preliminary agreements, the lock-out periods will typically mirror the lock-in periods. Therefore, if the lock-in period expires, the lock-out period will generally expire at the same time and parties are free to terminate the relevant preliminary agreement.

7. What remedies are available for breach of a lock-out agreement?

Ordinary damages

Ordinary damages may be claimed for breach of a lock-out agreement. They are awarded for losses arising directly from the breach of exclusivity, which are generally limited to the costs and expenses incurred in relation to the due diligence investigation and preparation and negotiation of the preliminary agreement as well as any other document relating to the transaction.

Special damages

Special damages may be claimed for breach of a lock-out agreement. These damages are awarded for losses arising indirectly from the breach, which may include loss of profits, and consequential or expectation damages. The plaintiff (buyer) must prove that the defendant (seller) was aware of, or should have been aware of, the special circumstances that resulted in the special damages. The parties may prohibit a claim for special damages by including an opt-out clause to this effect in the preliminary agreement.

Injunction

An injunction restricting the seller from engaging in negotiations with other potential buyers may be sought from the court.

8. Is it common to provide for either party to pay the other party a pre-determined sum if the deal does not complete because of the "fault" of the other party? Is there any mandatory provision applicable in this scenario?

Preliminary agreements

A pre-determined penalty or damages are occasionally, but not often, included in a preliminary agreement. However, in certain transactions, legally binding preliminary agreements may require the buyer to make an upfront deposit (see *Question 2*, *Question 3* and *Question 6*). If the definitive agreement is not executed due to the fault of the buyer in such cases, the deposit is forfeited to the seller as either:

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- A penalty.
- Pre-determined (liquidated) damages.

The main differences between a penalty and pre-determined damages are as follows:

- For a penalty, the seller may make a damages claim in addition to receiving payment of the penalty sum, whereas this is not possible for liquidated damages.
- The court cannot reduce the penalty amount at its discretion except in highly exceptional circumstances on a case-by-case basis, whereas for liquidated damages, the court may reduce the amount at its discretion.

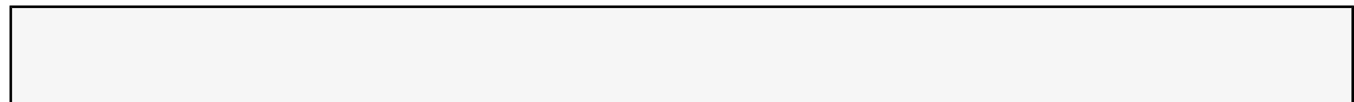
Definitive agreements

Where an upfront deposit is paid upon execution of a legally binding preliminary agreement (see *Question 2*, *Question 3* and *Question 6*), the seller may request an additional payment of a separate deposit upon the execution of the underlying definitive agreement. The additional deposit amount is generally 5% of the purchase price. Typically, if the transaction is not consummated due to the fault of the buyer, the deposit is forfeited to the seller (in this situation, the deposit serves the same function as a "reverse break-up fee"). If the transaction is not consummated due to the fault of the seller, the deposit is generally returned to the buyer along with accrued interest.

For a more general transaction (that is, any transaction that does not involve an out-of-court workout, an auction involving multiple bidders, and so on; see list at *Question 2* and *Question 6*), the seller may request payment of a deposit upon execution of a definitive agreement, although this is not particularly common. The deposit amount is generally between 5% and 10% of the purchase price. The deposit serves the function of a "reverse break-up fee". The difference here is that if the transaction is not consummated due to the fault of the seller, the definitive agreement could provide for a return of double the amount of the deposit, depending on the negotiations between the parties.

Mandatory provisions

If the seller is a governmental agency in Korea, a quasi-government entity or a government-controlled entity (for example, an entity whose majority shareholders are the governmental bodies or other government-controlled entities), the sale of shares is usually conducted by way of an auction. Bidders are typically required to provide an upfront deposit upon submission of the bid. The deposit amount is at least 5% of the purchase price. The seller may cause the bidder to forfeit the deposit if the bidder refuses to execute a definitive agreement without just cause. An additional upfront security deposit of 5% of the purchase price is required to be paid upon execution of a definitive agreement (resulting in 10% of the purchase price in total). The seller may also cause the bidder to forfeit this sum if it fails to complete the transaction without just cause. This mandatory requirement is significant given the number of deals initiated by quasi-government or government-controlled sellers after bail-out transactions involving distressed companies.



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9. Are confidentiality letters commonly used in private company or asset acquisitions?

Yes, confidentiality letters are commonly executed at the initial stage of the transaction.

A confidentiality letter is typically called a confidentiality agreement or a non-disclosure agreement and is usually executed as a separate document. The parties can, however, choose to include confidentiality provisions as part of a preliminary agreement instead of executing a separate confidentiality agreement.

10.Are there any formalities required for a binding confidentiality letter? Does a written confidentiality letter which is governed by the law of your jurisdiction need to be signed by all the parties on the one and same document? If not, what procedure needs to be followed if signature of separate (but identical) documents is to be effective?

No formalities are required.

A written confidentiality letter can be signed either by all the parties or only by the party who bears the confidentiality obligation.

11. Are there any national law restrictions on the disclosure of certain types of information?

The applicability of national law restrictions on the disclosure of certain types of information is based on a consideration of several factors, including the following:

- The nature of the information.
- The manner in which the information is disclosed or used.
- The type of business that the target company is engaged in.

Disclosure or exchange of competitively sensitive information between competitors within the same market may be considered a "collusion" if the disclosure or exchange is made in breach of anti-trust laws. In practice, the seller will usually delete competitively sensitive information before providing potential buyers with due diligence information, or sometimes provide such information only to counsels or members of the "clean room" which is composed mainly of advisors, especially when the buyers are competitors operating in the same market as the seller or the target company.

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Certain sensitive personal information collected from individuals by companies during the course of business cannot be disclosed to third parties without the consent of the individual owners of the personal information. An example of this type of personal information is the resident registration number allocated to each South Korean citizen at birth. Even if there is consent regarding disclosure, the use of such personal information is strictly limited to statutorily defined purposes, among which due diligence is not included. Therefore, any such personal information protected by the relevant laws is usually deleted or redacted in the disclosed documents.

On the other hand, technology laws relating to national defence interests or certain industries prohibit "unjust" disclosure of nationally sensitive information or secrets prescribed by the government. There are also other laws that punish unjust disclosure or use of third parties' trade secrets. Therefore, the use of such information in an M&A process must be undertaken with extra caution and its scope must be strictly limited to the legally prescribed boundaries.

For listed companies, there are laws and regulations restricting the use of inside information for pecuniary benefits or gain. Extra caution should also be exercised when disclosing or using information previously undisclosed to the stock market. Stock exchange rules, such as the fair disclosure rule, may also apply.

12. Is the target company usually made a party to the letter? Could members of the buyer's group enforce a confidentiality agreement, without being parties to the agreement?

No, the target company is not usually made a party to the letter, except when it can benefit from the confidentiality obligations provided for in the letter and enables the target company to enforce its terms against the potential buyer. The target company may also be made a party to the letter if the transaction involves the issuance of new shares (that is, by the target company) to the potential buyer.

The confidentiality agreement cannot be directly enforced by members of the buyer's group who are not parties to the agreement. It is, however, possible to enforce the agreement against a buyer who has executed a confidentiality agreement if a breach arises from actions of a buyer's group member.

13.Are restrictive covenants in the letter subject to public policy restrictions? If so, what are they?

The Korean Civil Code prohibits acts in breach of public policy, which include:

- Acts in violation of good morals or social order.

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- Grossly unfair acts (that is, acts which take advantage of the distress, destitution, carelessness or inexperience of the other party).

In practice, courts will rarely declare an agreement void in a negotiated M&A transaction on the grounds of violation of public policy.

14. Are there any restrictions on the duration of a confidentiality letter?

No. However, the duration of a confidentiality letter is typically between one to three years, depending on:

- The type and sensitivity of information being disclosed.
- The nature of the transaction.

15. What remedies are available for breach of a confidentiality letter?

Generally, damages and injunctions are available remedies, although damages may be difficult to quantify and injunctions are subject to a wide discretion of the court. Nonetheless, confidentiality agreements typically include indemnification provisions stating the remedies available in the event of a breach of the agreement. These remedies include:

- Damages.
- Injunctions.
- Specific performance.
- Other equitable relief.

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16. Can a confidentiality letter contain a penalty clause?

Yes, but it is uncommon to provide a fixed amount either as a penalty or as pre-determined (liquidated) damages in confidentiality agreements used in an M&A transaction setting. Parties usually proceed without a penalty clause (even in cases where the seller may wish to include a penalty clause) due to the confidentiality agreement typically being executed at a very early stage of the transaction (that is, before providing the potential buyer with an information memorandum or due diligence materials) so as to move forward to the transaction stage as quickly as possible. See also *Question 8*.

17. Under the law of your jurisdiction, can the law chosen as the governing law of a confidentiality letter restrict the parties' choice of law in respect of the subsequent transaction documents?

No, the law chosen as the governing law of a confidentiality letter does not restrict the parties' choice of law for subsequent transaction documents.

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Share acquisition documents Q&A: South Korea

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Country Q&A | Law stated as at 30-Apr-2021 | South Korea

This Q&A provides jurisdiction-specific commentary on *Practice note, Share acquisition documents: Cross-border*.

Share acquisition documents

1. In a private company share purchase, what are the main acquisition documents and who is generally responsible for preparing the first draft?

The main acquisition document used in a private company share purchase is a share purchase agreement; in addition, there may be ancillary agreements attached to the share purchase agreement, depending on the deal structure.

In a private deal, the first draft is more often prepared by the buyer. However, in an auction deal, the first draft is typically prepared by the seller and circulated to the bidders.

2. Outline the structure and key substantive clauses in a share purchase agreement. Are seller warranties/indemnities typically included and what main areas do they cover? In relation to cross-border transactions that present a connection to the UK, have you noticed the introduction of any "Brexit" wording or an increase in the use of material adverse change clauses?

The following are the common structure and key substantive clauses used in a typical share purchase agreement:

- Parties.
- Recitals describing the background of the transaction.
- Definitions and interpretation.

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- Agreement on the sale and purchase of the shares.
- Purchase price and price adjustment; purchase price may include an up-front deposit.
- Closing, and actions to be taken at the closing (including closing deliverables).
- Representations and warranties.
- Covenants (pre-closing and post-closing).
- Conditions precedent to the closing.
- Termination.
- Indemnification and limitations on claims.
- Miscellaneous clauses such as:
    - entire agreement;
    - confidentiality;
    - fees and expenses;
    - notices;
    - governing law;
    - dispute resolution;
    - severability;
    - amendment;
    - waiver;
    - assignment;
    - counterparts; and
    - Schedules and exhibits (if applicable).

A share purchase agreement typically includes the seller's representations and warranties, which would generally include the following, subject to negotiation of the parties and the business area of the company:

- With respect to the parties:
    - share ownership in case of the seller;
    - power and authority;
    - consents and approvals; and
    - no conflicts.

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- With respect to the company:
  - organisation of the company;
  - capitalisation;
  - financial statements;
  - no undisclosed liabilities;
  - compliance with law;
  - permits;
  - material contracts;
  - properties;
  - employment and labour matters;
  - intellectual property;
  - litigation and disputes;
  - tax;
  - insurance;
  - environment; and
  - no material adverse change.

We have not yet seen any noticeable changes, or introduction of any "Brexit" wording, or an increase in the use of material adverse change clauses. We have also not noticed any less inclination to choose English law as the governing law or the English courts as having jurisdiction over disputes. Instead, as English law and English-style M&A documents governed by English law are generally regarded as more favourable to the seller than the buyer (compared to US-style M&A documents), we have seen sellers using English law as the governing law even when England has no nexus to the parties or the target company.

3. Is the target company typically a party to the share purchase agreement?

The target company is not usually a party to the share purchase agreement, unless the transaction involves an issuance of new shares.

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4. Is it common to have recitals at the beginning of a share purchase agreement? How is a court likely to interpret the agreement if the recitals are inconsistent with the substantive terms of the agreement?

It is common to have recitals at the beginning of a share purchase agreement (see *Question 2*).

Although no court precedents expressly dealing with inconsistencies between recitals and substantive terms of an M&A agreement can be found, it is likely that the court would interpret the agreement in the following way:

- In general, the substantive terms would prevail over the recitals, since the court would likely interpret that the parties intended to be bound primarily to the substantive terms.
- If, however, the language of the substantive terms is not clear, the court would take into account the background and the purpose of the transaction and the intentions of the parties by considering the agreement, market practice terms, and other relevant matters (*Supreme Court Decision 93 D 3103 rendered on October 26, 1993*). Accordingly, the recitals may be considered by the court in interpreting the background of the transaction, the intention of the parties and the language of the agreement.

5. Please outline common conditions precedent. Are there any circumstances in which a condition precedent may be invalid or unenforceable?

Generally, conditions precedent would include the following:

- Each party's representations and warranties being accurate as of the closing (in material respects).
- Each party's covenants and obligations having been performed and complied with (in material respects).
- Government approvals having been obtained. These would usually include approval of the merger filing and other deal-specific governmental filings.
- Third-party consents having been obtained. These would usually include consents from the counterparties to any contracts entered into by the company that contain change of control provisions, and from the lenders and/or securities holders of the existing financing of the company. However, this covenant does not have to be included, or can be made applicable only to the material contracts, in order to maximise deal certainty.
- No laws, judgments, or proceedings that delay or make illegal the performance of the share purchase agreement.

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- No material adverse change or effect.
- Other deal-specific conditions, such as execution of ancillary agreements, amendment of the articles of incorporation, and completion of pre-closing restructuring of the company.

The validity and enforceability of the conditions precedent would be subject to the general rules of contract law (for example, the conditions precedent must not be against public policy, and must be clear enough to be enforceable) (*Article 103, Korean Civil Code*).

6. Is it implied that parties will use reasonable endeavours to fulfil conditions precedent within their control if there is no express obligation? Are the parties under a general duty to act in good faith in your jurisdiction?

Usually, the covenants section of a share purchase agreement will include a provision where the parties expressly agree to use reasonable efforts for all actions necessary to consummate and make effective the transaction. For certain conditions that are crucial to the completion of the transaction, the parties may separately agree to exert "best efforts" in order to fulfil said conditions.

If there is no such express obligation set out in the share purchase agreement, it is not generally implied that parties must use reasonable endeavours. However, under the Korean Civil Code, a party to a contract has a general duty to act in good faith and, more specifically, if a party actually hinders the fulfilment of conditions of a contract in bad faith, the conditions will be deemed fulfilled and the hindering party will be obliged to proceed with closing (*Article 2 and Article 150(1), Korean Civil Code*).

7. Are there any foreign investment controls relating to shares in your jurisdiction? Please ignore any industry specific controls.

There are no general restrictions on foreign investment in shares of companies incorporated in South Korea (though some industry-specific controls exist).

However, for foreign investments exceeding KRW100 million in shares of a South Korean company, the following requirement applies: when an offshore entity acquires at least 10% of the shares of a South Korean company or has the right to appoint a director of that company, that company must report the acquisition in advance to a designated foreign exchange bank in South Korea (*Article 2 and Chapter II, Foreign Investment Promotion Ac*t). This filing is of a procedural nature and is usually cleared within a few days. If a foreign investment does not satisfy the above criteria, the offshore entity is required to file a securities acquisition report to a designated foreign exchange bank in

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South Korea (*Article 18, Foreign Exchange Transaction Act*). This filing is also of a procedural nature and is usually cleared within a few days.

8. Are any terms implied by law as to the seller's title to the shares? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

Under the Korean Commercial Code, a possessor of a share certificate is presumed to be the legitimate owner of the shares represented by the certificate (*Article 336(2), Korean Commercial Code*). In order to enforce the ownership of the shares against the company, the name and address of the shareholder must be included in the company's shareholder registry (*Article 337(1), Korean Commercial Code*). Similarly, in the case of shares deposited with the Korea Securities Depository, a person who is recorded in an investor security account or a depository account through book entry system is presumed to hold ownership over the shares (*Article 311, Financial Investment Services and Capital Markets* Act). Furthermore, where shares are electronically registered, the person who is recorded in an electronic registration account is presumed to hold ownership over the shares (*Article 35, Electronic Securities Act*).

Since the title to shares by possession of share certificates or by recording in an investor security account or in an electronic registration account is merely a presumption of ownership (albeit a strong presumption in practice), a share purchase agreement will almost always include an express representation and warranty regarding the seller's title to the shares (see *Question 2*). The representation and warranty would provide that the seller is the legal and beneficial owner of the shares, and that upon closing, the buyer will acquire good and marketable title to the shares, free and clear of all encumbrances and liens.

9. If part or all of the consideration consists of new shares in the buyer, what provisions is the share purchase agreement likely to contain in relation to those shares?

It is not common to find a share transfer transaction in South Korea where all or part of the consideration consists of new shares in the buyer, especially if the buyer is a foreign entity. More common would be a comprehensive share exchange (usually involving existing shares rather than new shares) or a merger where new shares of the buyer as an absorbing entity are issued as merger consideration. That being said, any issuance of new shares would generally entail the following:

- Representations and warranties by the issuer as to:
  - its authorisation to issue new shares;

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    - the authorised number of shares; and
    - its capital structure before and after the issue.

- Conditions precedent and covenants:
    - approval by the issuer's board of directors of the share issue. Depending on the structure of the transaction, a shareholder resolution may also be required (see *Question 34*);
    - depending on the percentage of the new shares issued and the size of the transaction, a merger filing by the acquirer may be required;
    - if the issuer of the new shares is a foreign company, a foreign exchange report for the acquisition of shares by a South Korean acquirer will be need to filed; and
    - if the issuer of the new shares is a South Korean company, the new share acquisition will be treated as an in-kind contribution by the acquirer and so an appraisal process by a court-appointed inspector may be required (*Article 416, Korean Commercial Code*).

10. What act or document is it that transfers the shares in your jurisdiction and would be regarded as the core closing step?

The possessor of a share certificate is presumed to be the owner of the shares represented by the certificate, and in order to enforce the ownership of the shares against the company, the name and address of the shareholder must be included in the company's shareholder registry (see *Question 8*).

The seller's delivery of share certificates representing the sale shares and a copy of the shareholders register of the company showing the buyer as the holder of the sale shares should therefore be set out as one of the core closing steps.

In addition, the actual transfer between accounts and the registration of the electronic account are required to complete a transfer of electronically registered shares (*Article 35(2), Electronic Securities Act*).

11. Does any stamp, document or transfer tax or other charge, or notarial or other fee, have to be paid in your jurisdiction in connection with transferring shares in the target?

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In addition to capital gains tax, if any, a securities transaction tax is imposed on the seller in a share transfer (*Article 2, Securities Transaction Tax Act*). This securities transaction tax is currently 0.43% of the transfer price for non-listed companies, which was reduced from 0.45% effective from January 2021.

When the transfer is effected through a securities settlement company, that settlement company is generally required to withhold and pay the tax to the tax authorities (*Article 3, Securities Transaction Tax Act*). When such a transfer is made only through an investment dealer or an investment broker, that investment dealer or investment broker is required to withhold and pay the tax (*Article 3, Securities Transaction Tax Act*). If the seller is a foreign entity with no permanent establishment in South Korea other than through a securities settlement company, an investment dealer or an investment broker, the buyer must withhold and pay the securities transaction tax on behalf of the seller (*Article 3, Securities Transaction Tax Act*).

In addition, a deemed acquisition tax must be paid by the buyer if it acquires more than 50% of the target company's shares (excluding the shares in a listed company) together with its related parties. The tax base amount is the book value of certain properties owned by the company (for example, real estate, automobiles, and certain memberships), multiplied by the buyer's shareholding ratio.

For the issue of new shares, a registration tax equal to 0.48% (inclusive of education surtax which amounts to 20% of the registration tax) of the paid-in capital increase amount must be paid by the issuer under the Local Tax Act. This registration tax is tripled to 1.44% if the company is incorporated in the Seoul metropolitan area.

12. Can a seller (or its advisers, including legal advisers) be liable for pre-contractual misrepresentation, misleading statements or similar matters?

Yes, the seller and its advisers can, in principle, be liable for pre-contractual misrepresentation or misleading statements if they acted fraudulently or in gross violation of good-faith principles to the extent that such actions constitute grounds for the other party's tort claim (Article 750, *Korean Civil Code*).

However, it would be rare to find such a cause of action actually being pursued (especially an action against the seller's advisers) in sophisticated merger and acquisition transaction settings where due diligence is performed by the buyer and where the share purchase agreement would usually include an entire agreement clause (see *Question 2* and *Question 30*). In practice, it is common to include disclaimer language in the preliminary agreement or teaser letter (or similar documents in the merger and acquisition process) to the effect that the seller and its advisers are not making any representations by signing the preliminary agreement or sending the teaser letter, and that they will not be liable for any damages incurred by reliance on their statements.

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13. Do you draw a distinction between protection by warranty and protection by indemnity?

Although neither warranty nor indemnity as used in M&A transaction documents such as share purchase agreements are terms or concepts expressly provided for under South Korean law, almost all share purchase agreements in South Korea include extensive sections on warranties and indemnities.

A warranty, as in many other jurisdictions, may provide grounds for potential damages claims and may also function as a condition precedent of the obligation to proceed to closing, grounds for termination, and an incentive for the seller to disclose information to the buyer.

An indemnity clause may be triggered not only in the case of breach of warranties, but also in the case of breach of covenants. There may be special indemnities for future events or consequences that are not necessarily based on a breach of a warranty, even though such events are included in the disclosure schedule. Different time and amount limitations on damages may be applicable on breach of a warranty and of other contractual obligations (for example, covenants).

14. Is it usual to draft a share purchase agreement with extensive warranty protection?

Yes, it is quite common to include extensive warranties (see *Question 2*). However, in auction deals where the sellers have bargaining power over the bidders, it is also common to include a rather simple list of warranties.

Depending on the negotiation process between the parties, the scope of disclosures, materiality qualifications or knowledge qualifications may be different for each warranty.

15. How common are actions for breach of warranty?

In the past, actions for breach of warranty were uncommon. However, they have become more frequent in recent years, and warranty and indemnity insurance is now one of the key considerations of parties (see *Question 26*).

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16. What remedies can be sought for breach of warranty?

Remedies would generally be provided for in the share purchase agreement, which would usually include the following:

- A claim for damages pursuant to the indemnification provision of the share purchase agreement. This provision usually states that indemnification as provided for in the agreement is the sole and exclusive remedy of the non-breaching party after the closing has occurred.
- Termination of the share purchase agreement or walk-away rights (generally before the closing).
- A right to refuse or delay the closing until the breach is cured or waived.

17. Can the agreement confer the benefit of warranties and indemnities or other terms of the agreement on a third party that is not a party to the agreement which that party can then enforce directly?

Yes, if a share purchase agreement or other agreement between the original parties expressly provides for a conferment of benefits of indemnities to a third party as a beneficiary and the third party expressly accepts the benefits (*Article 539, Korean Civil Code*). For example, the buyer may request that the seller indemnify not only the buyer but also its officers and employees.

18. In the absence of agreement can the benefit of warranties be assigned to a later transferee of shares?

A share purchase agreement usually includes an anti-assignment provision under which the rights of one party cannot be assigned to a third party without the prior consent of the other party. This provision would apply even if the third party becomes a transferee of the relevant sale shares.

If there is no such provision and a breach of a warranty has already occurred, a claim for damages arising from such breach may be assigned to a third party (for example, the transferee of the shares) by notifying the party in breach. However, if a breach of a warranty is yet to occur, it would be very difficult to assign the benefit of warranties to a later transferee of the shares; this is because under the Korean Civil Code, in order to assign a right that has not been materialised, it would have to be highly likely that such right will materialise in the near future and the details

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of such a right would have to be specified at the time of the assignment (*Supreme Court Decision 88 Daka 6358 rendered on June 25, 1991*).

19. If acting for the sellers, are there any common limitations sought on the extent of warranties?

Limitations or qualifications on warranties that are commonly sought by sellers include:

- Disclosures: a draft disclosure letter or schedule is usually prepared by the seller; the final disclosure letter or schedule will be agreed upon after negotiations between the seller and the buyer. Although uncommon, the disclosures may be updated at the closing, if permitted under the share purchase agreement.
- Qualifications on the warranties: a knowledge and/or materiality qualifier on each representation and warranty is usually negotiated. In some cases, a material adverse change (effect) qualifier may also be included.
- Anti-sandbagging: anti-sandbagging clauses are commonly discussed and negotiated in M&A transactions, particularly as the Korean Supreme Court has provided that sandbagging is allowed if the transaction agreement does not include any clause prohibiting it (see *Question 24*).
- Survival periods (time limitation) of the warranties: the period for each representation and warranty usually varies (see *Question 20*).
- Limitation on claim amounts. The following limitations will normally be included:
  - a cap on the total claims amount;
  - a basket (minimum) aggregate claim threshold; and
  - a *de minimis* (exclusion of small claims) claim threshold.

20. What is the usual time limit for claims for breach of general commercial warranties and tax warranties?

This is one of the most heavily negotiated aspects of the share purchase agreement.

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For general commercial warranties, the time limit is usually between six months and three years. The buyer generally would request for the time limit to lapse at the completion of a full financial year following the closing.

For tax warranties, the usual time limit is between three and five years; alternatively, the time limit for certain tax warranties are negotiated to conform to the applicable statute of limitations period, which will vary depending on the tax liabilities but is generally set at five years.

21. Are warranties usually qualified by disclosure? If so, where are these disclosures found (for example, in a disclosure letter or a disclosure schedule attached to the share purchase agreement)?

Yes, warranties are generally qualified by disclosure (see *Question 19*). Unlike in some other jurisdictions where a disclosure letter is separately executed, disclosures are usually attached to the share purchase agreement in the form of schedules.

22. In the disclosures, do the sellers provide both general disclosures (disclosure of certain matters which appear in public records and/or which the buyer ought to know on the basis of searches or enquiries which a buyer might/ought to make) and specific disclosures (relating to actual matters which if not disclosed would be in breach of warranty/warranties given in the share purchase agreement)?

While it would depend on the negotiations between the parties, general disclosures that make reference to facts that could be found in public records is not common. Disclosures against due diligence documents (for example, those uploaded in the virtual data room set up for due diligence) would not be typical but are being more frequently used, especially by the sellers in auctions deals. The more typical approach is for the seller to provide specific disclosures (if any) based on particular matters or facts relating to each representation and warranty.

23. Are specific disclosures usually cross-referenced to the warranties to which they relate?

Yes, share purchase agreements usually provide that warranties are subject to the qualifications and exceptions set forth in the corresponding section of the disclosures.

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24. If a buyer has actual knowledge of a matter that qualifies a warranty (but this matter has not been formally disclosed by the sellers in the disclosure letter), can the buyer still sue for breach of warranty?

It depends on the language of the share purchase agreement. The parties may decide to allow (in the form a pro-sandbagging clause) or prohibit (in the form of an anti-sandbagging clause) the buyer from making such claims. A sandbagging clause provides for reservation of the buyer's right to indemnification for breach of representation and warranty (or covenant) by the seller notwithstanding the buyer's prior knowledge of such breach.

Where the agreement is silent on this issue, the Supreme Court recently ruled that even if a buyer had actual knowledge of a matter qualifying a representation and warranty at the time of the execution of a share purchase agreement, the buyer may still bring a claim for its loss arising from the seller's breach of that representation and warranty. The fact that the share purchase agreement was silent on the sandbagging was one of the grounds for the Supreme Court's ruling. The Supreme Court also considered the totality of circumstances to determine whether the buyers' claim was made in bad faith (*Supreme Court Decision 2012 Da 64253 rendered on October 15, 2015*).

25. If there is a delay between signing and closing in order to satisfy a condition precedent, does the share purchase agreement usually provide for warranties to be repeated at the time of closing?

Yes, this is usually the case.

26. Is it common for the seller to take out insurance against warranty claims?

Warranty and indemnity insurance has been introduced to the South Korean market, but it is not yet common for the seller to take out this type of insurance (as in most cases, the buyer is the insured). We are seeing an increasing trend of sellers requiring a warranty and indemnity insurance particularly in the context of auction deals and where the seller is a financial investor (for example, a private equity fund) desiring a non-recourse or limited recourse exit. Although this would depend on the negotiations between the parties, the current market practice is for the buyer to take out the insurance (buyer-side policy).

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27. If the buyer is concerned about the seller's ability to pay for breach of warranty, how can these concerns be addressed?

Common methods to address these concerns include:

- Establishing an escrow or a pledge on a portion of the purchase price.
- Partial deferred payment of the purchase price.
- Guarantee by the parent or affiliate of the seller.
- Taking out a warranty and indemnity insurance (see also *Question 26*).

28. Is it common to state that the purchase price is deemed to be reduced by the amount of any payment made under the warranties and indemnities? If so, is this wording effective for tax purposes (that is, that claims are treated as an adjustment to the consideration rather than being subject to capital gains tax)?

It is common to include this provision in the share purchase agreement. If included, the South Korean tax authorities will generally treat the payment under the warranties and indemnities as an adjustment of the purchase price (*Tax Tribunal Decision 2013 Seo 2376 rendered on February 25, 2014*). Even if this clause is not included, the payment may be deemed to be an adjustment under South Korean law, although parties cannot rule out the possibility that the Korean tax authorities will argue that it should be treated as a separate income of the buyer.

29. Is it common to provide that the seller will not compete with the target business for a given period after closing? If so, are there any restrictions on the duration and scope of such clauses?

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Yes, it is common for the seller to agree on the following non-compete (usually along with non-solicitation) obligations in the share purchase agreement, especially if the seller is a non-financial company (for example, a strategic investor) or the transaction is a buy-out deal:

- Duration: usually one to five years.
- Geographical area: this depends on the current (and future) geographical markets of the business of the parties (including the target company).
- Affiliates: the obligation usually applies not only to the seller but also its affiliate companies and/or specially-related persons or entities.

There is no court precedent which provides a definitive ruling on the validity of non-compete clauses in the context of merger and acquisition transactions. Nonetheless, non-compete clauses that are too extensive in the scope and duration may raise anti-trust issues as they could be construed as acts of collusion (market-sharing agreement), especially if the relevant parties are market competitors.

30. Is it common to have an entire agreement clause (excluding liability for any representations or warranties made during the course of negotiations that are not included in the agreement)?

It is common practice to include an entire agreement provision stating that the share purchase agreement will supersede all prior agreements, understandings, and representations.

However, even if there is an entire agreement provision, a party may still be liable for pre-contractual misrepresentations in extreme circumstances where the party acted fraudulently or in gross violation of good-faith principles to the extent that the actions serve as grounds for the other party's tort claim (see *Question 12*).

31. Can a share purchase agreement provide for a foreign governing law? If so, are there any provisions of national law that would still automatically apply?

Yes, a share purchase agreement can be governed by foreign law as South Korean law does not require a share purchase agreement to be governed by South Korean law. However, South Korean law is more commonly selected if the target company is a South Korean company.

In addition, if the target company is incorporated in South Korea, rights and obligations related to its shares, including their transfer, requisite governmental approvals, tax implications and corporate governance of the target

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must be interpreted according to South Korean law, even if the relevant share purchase agreement is governed by foreign law (*Article 7, Act on Private International Law*).

32. What form of dispute resolution is commonly provided for in share purchase agreements?

Share purchase agreements executed between South Korean parties would usually select the Seoul Central District Court as the forum for dispute resolutions.

For cross-border transactions where one or more party is a foreign entity, arbitration is increasingly becoming a popular forum for dispute resolution. While the Rules of Arbitration of the International Chamber of Commerce (ICC) are widely used in such cases, the Singapore International Arbitration Centre (SIAC) and the Hong Kong International Arbitration Centre (HKIAC) are also increasingly selected as the forum.

33. Is it common practice (or a legal requirement) that each page of the agreement, schedules and/or appendices are initialled by the parties upon execution of the agreement?

Although initialling is not statutorily required, it is often done on each page of the share purchase agreement. Stamping or punching can also be used instead of initialling.

34. In which scenarios is a shareholders' resolution required as one of the documents that the seller and/or buyer are required to deliver at closing?

For most share transfer transactions, only a board approval is required by both the seller and the buyer.

A shareholders' resolution may be required if the articles of incorporation of a party requires a disposal (for the seller) or an acquisition (for the buyer) of assets exceeding a certain threshold to be subject to a shareholders' approval. Where the target shares are the sole, or substantially all of, the assets of the seller, a shareholders' resolution by the seller may also be required.

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Additionally, where new shares are issued for the transaction, shareholders' approval at the level of the target company may be required if either:

- The company's articles of incorporation require shareholders' approval to issue new shares.
- The articles of incorporation are silent on:
  - the issuance of new shares to a third party who is not a shareholder; or
  - the change in number of authorised shares (which may be required in order to issue new shares).

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