

## *South Korea and the EU Have Strengthened Their Strategic Partnership: Increased Legal Certainty Creates More Business Opportunities*

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### **Introduction**

On 25 February 2013, the European Commission (the “**Commission**”) issued its first annual report on the implementation of the bilateral ‘*Free Trade Agreement*’ signed on 6 October 2010 between the European Union and South Korea (“**Free Trade Agreement**” or “**FTA**”).<sup>1</sup>

The report has added value because, in order to prepare it, the Commission gathered and analyzed the trading data between South Korea and the EU in the period for the year ended 30 June 2012, and compared it to the average data from the four previous years. Whilst all previous publications provided estimates and political aspirations, the report finally provides accurate business data.

This short memorandum will highlight the increasingly important business relationships between South Korea and the European Union (and its 27 member States)<sup>2</sup>, both as a result of market conditions and also the improved certainty provided by legal agreements such as the FTA. Since the FTA came into force, it is particularly interesting to note:

- the increased level of outbound M&A activity by South Korean companies with European targets, including financially distressed targets; and
- a material increase in the value of exports by European companies to South Korea.

However, there are ongoing discussions regarding the impact of the FTA, in particular in South Korea, and the debate among international scholars has also risen<sup>3</sup>. Whilst it is not possible at this stage to assess the actual long-term impact of the Free Trade Agreement, there are clear signs that indicate that businesses in both jurisdictions are exploiting the new legal framework and market conditions to create more business opportunities.

### **The Free Trade Agreement**

The FTA is a bilateral free trade agreement which entered into force on 1 July 2011. It is the largest free trade agreement that South Korea has entered into<sup>4</sup> and is a complex legal document that impacts, directly or indirectly, all players active in the EU or in South Korea.

The FTA continues a steady path of increased cooperation between South Korea and the EU, which dates back to 1997, with the first EU - South Korea agreement on co-operation and mutual administrative assistance in customs matters. In the words of the European Commissioner for Trade, Mr. de Gucht:

“The EU-Korea FTA is the most ambitious trade agreement ever negotiated by the EU; it is also the EU’s first trade deal with an Asian country. The Agreement is expected not only to boost bilateral trade and economic growth in both the EU and Korea, but also to have a wider impact in Asia and elsewhere by signaling the EU’s openness to doing business with third world countries and its commitment to free trade.

The Agreement is unprecedented both in its scope and in the speed at which trade barriers are to be removed. By the end of the transitional periods, virtually all import duties between the two economies will have been removed. Exporters and importers of all industrial products and almost all agricultural products will be able to trade without having to pay duties. Additionally, the FTA breaks new ground in tackling significant non-tariff barriers to trade, with a specific focus on the automotive, pharmaceuticals, medical devices and electronics sectors.

The Agreement will also create new opportunities for market access in services and investments, and lead to major advances in areas such as intellectual property, government procurement and competition policy”.<sup>5</sup>

In addition, the FTA is the first free trade agreement executed by the EU with a partner in Asia, and it has been described as “the **most comprehensive free trade agreement ever negotiated by the EU** [...] import duties are to be eliminated on nearly all products (**98.7 % of duties** in terms of trade value will be eliminated within five years) and there is far reaching **liberalization of trade in services** (including in telecommunications, environmental services, shipping, financial and legal services) covering all modes of supply. The FTA is expected to create substantial new trade opportunities in goods and services [...] as well as in investment. [...] Moreover, specific commitments to eliminate and to prevent the emergence of **non-tariff barriers** to trade have been agreed in sectors such as automobiles, pharmaceuticals and electronics” (emphasis supplied).<sup>6</sup>

As the European Union’s diplomatic corps stated: “since 2010, the EU and South Korea have upgraded their relationship to a Strategic Partnership, ensuring a high level of commitment from both sides. Relations are governed by two key agreements, as well as more specific agreements in several fields.”<sup>7</sup> The EU – South Korea relationship<sup>8</sup> was already strong on many levels<sup>9</sup> and, as a result of the Free Trade Agreement, trade between the EU and South Korea now also benefits from a clearer and more reliable legal framework, which will provide the legal certainty businesses seek when pursuing cross-border transactions.

The South Korea-EU FTA is comprehensive: it reduces and eliminates tariffs and other trade barriers in manufactured goods, agricultural products, and services and would also cover such trade-related activities as government procurement, intellectual property rights, labor rights, and environmental issues.

However, it should be noted that the tariff elimination/reduction will not apply indiscriminately to any product: only products originating in South Korea or in the EU are entitled to benefit from the FTA.

Therefore, **rules of origin** are an important part of the FTA and the relevant provisions are set forth in the Protocol on Rules of Origin which provide that only products which: (i) are wholly “originated”<sup>10</sup> in the EU or in South Korea; or (ii) have been “sufficiently processed”<sup>11</sup> in the EU or in South Korea will benefit from the FTA.

The industries which can potentially benefit from the FTA are numerous: industrial, fishery and agricultural products, power/non-electrical machinery, chemicals, transport equipment, optical and photo equipment and base metals, trade in services, and specialized services in such sectors as banking, financial, and accounting services.

### **Snapshot of Investment by South Korean Companies into Europe**

South Korean companies have been increasingly active in pursuing overseas M&A in Europe: there was a near doubling in the value of Korean companies’ acquisitions of European businesses, to \$1.34 billion in 2012 from \$756 million in 2011. This increase has been triggered by a number of reasons including:

- more European assets (many of which are undervalued) are for sale due to the protracted debt crisis in Europe; and
- the strength of the Korean Won against European currencies is making European targets cheaper for cash-rich Korean companies.

Many experts predict this trend to continue in the coming years as many Korean companies seek to exploit the increasing opportunities in Europe.

Amid such wide interest in the European market, Paul Hastings LLP has advised a number of leading Korean companies on major outbound M&A deals in Europe, such as: (1) the acquisition by a Korean conglomerate of the wireless connectivity business of a UK-listed international technology company, and (2) the acquisition by a Korean conglomerate of a major technology company based in Sweden.

### **Snapshot of the Exports to, and Investment in, South Korea by EU Companies**

The dramatic effect of the FTA on exports by EU companies can be easily summarized as follows:

- Before the Free Trade Agreement came into force, overall exports by EU companies to South Korea enjoyed an annual average growth rate of 7%.
- In the first year after the Free Trade Agreement came into force, exports by EU companies to South Korea increased by 37% overall.

In addition, between July 2011 and March 2012 EU’s investment in South Korea jumped 60.5% from the year before to \$3.57 billion. Considering that investment by EU companies in South Korea from July 2010 to March 2011 dropped 48.8% year-on-year, the Korea-EU FTA appears to have played a major role in boosting investment.

According to the European Commission, South Korea is the EU’s tenth largest trade partner and the EU is South Korea’s fourth largest export destination (after China, Japan, and the US). European companies are also the largest investors in South Korea.

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<sup>1</sup> The FTA was published in the European Union's official gazette at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:168:0001:0001:EN:PDF> (last visited, 6 May 2013).

<sup>2</sup> The European Union now has 27 Member States. From the six founding members of 1957, the EU has expanded through the decades, and in July 2013 also Croatia will join the EU, thus becoming the 28th Member State.

<sup>3</sup> For a more academic introduction to the matter, please see J. Harrison, *"The European Union and South Korea: The Legal Framework for Strengthening Trade, Economic, and Political Relations"*, Edinburgh University Press, March 2013.

<sup>4</sup> Notably, the FTA is said also to be the second largest free trade agreement worldwide, second only to the NAFTA.

<sup>5</sup> Mr. de Gucht, European Commissioner for Trade, in *"The EU-Korea Free Trade Agreement in practice"*, in Belgium, 2011, ISBN 978-92-79-20841-6.

<sup>6</sup> The European Commission's *"The EU-Korea Free Trade Agreement in practice"*, in Belgium, 2011, ISBN 978-92-79-20841-6.

<sup>7</sup> The European External Action Service is the EU's diplomatic corps, and it supports the EU foreign affairs chief in conducting the common foreign and security policy. The quote is from the EEAS' website dedicated to the European Commission delegation to the Republic of Korea.

<sup>8</sup> Moreover, the financial ties between the EU and Asia have become tighter, and the Euro is now the second most important reserve currency in Asia: *"the share of euros in the foreign exchange portfolio of Asia's major central banks has grown dramatically: by the end of 2012, euro-denominated assets accounted, on average, for around 25-27% of the holdings of Asia's major economies, reaching 30% and above in China (the world's largest holder). This makes the euro the second most important reserve currency in Asia - after the dollar, but ahead of the yen"* (N. Casarini, "The European 'Pivot'", published at the European Union Institute for Security Studies in March 2013).

<sup>9</sup> For example, co-operation in education and training between South Korea and the EU began in 2008. For further information on interactions between South Korea as key Asian player and the EU, please see "The European 'Pivot'", published at the European Union Institute for Security Studies in March 2013, by N. Casarini, whereby the authors highlights that: *"The Union is also the largest provider of development aid and humanitarian assistance in the region [Asia]. It has supported regional integration more consistently than any other international player: for instance, it was in the context of ASEM that consultations between the ten members of ASEAN and the three main countries of North-East Asia (China, Japan and South Korea) eventually led to the creation of the ASEAN + 3 - which now is the main institutional framework promoting regional integration" [...] "The European 'pivot' also entails high-tech and space technology cooperation with Asia's major powers. Europe is jointly developing Galileo (the EU-led global navigation satellite system) with China, India and South Korea, providing the Union with a foothold in Asia's evolving space-related power relations"*.

<sup>10</sup> E.g. plants, animals born and raised, fish when caught in the territorial waters or beyond the 12-mile limit by a vessel considered as Korean or European.

<sup>11</sup> The criteria for determining what is 'sufficient processing' are set forth for each product in the product-specific rules available in the FTA.