

National Assembly Plenary Session Passes Amendments to the Subcontracting Act

On July 6, 2015, the National Assembly passed amendments to the Fair Transactions in Subcontracting Act (the "Subcontracting Act") at the plenary session. The key provisions of the amendments are (i) protecting enterprises of middle standing ("middle standing companies") that fall below a certain size as subcontractors, (ii) unifying the standard for determining a prime contractor based on the revenue and (iii) strengthening the monitoring and enforcement efforts against unfair subcontracting practices against small/mid-sized companies.

1. Categorizing middle standing companies below a certain size as "subcontractors" in order to protect subcontract payments

- **(Background of Amendment)** Under the prior version of the Subcontracting Act, since "subcontractors" were limited to small/mid-sized companies, in the case that middle standing companies* transacted with small/mid-sized companies, such middle standing companies were treated as prime contractors under the Subcontracting Act and were imposed various burdens (e.g., remittance of payment within 60 days). However, when the middle standing companies transacted with conglomerates, such companies were not protected as subcontractors under the Subcontracting Act (conglomerates can issue promissory notes with maturity date of 90~120 days instead of immediate payment). Due to the above limitations in the previous version of the Subcontracting Act, these middle standing companies were exposed to the issue of "paying subcontracting payments early but receiving subcontracting payments late."

※ "Middle standing companies" refers to those companies that do not constitute small/mid-sized companies, state-owned companies or business groups subject to the limitations on mutual shareholding.

- **(Contexts and Expectations of Amendments) The Amendments will categorize subcontractors** (Article 13(11) of the Amendments) that have low total revenue as small/mid-sized company subcontractors to protect their subcontract payments, which will not only avail these subcontractors' cash flow, but also the cash flow for all subcontractors in the market.

Expected Changes Based on Amendments	Key Points of Amendments
Requirements for Protection of Middle Standing Companies as Subcontractors	<ul style="list-style-type: none"> ① If a middle standing company with total revenue below KRW 300 billion per annum subcontracts for a conglomerate belonging to business groups that are subject to limitations on mutual shareholding ("conglomerate"). ② If a "larger" middle standing company subcontracts to a "smaller" mid-sized company, the "smaller" middle standing company (*specific total revenue standard will subsequently be stipulated based upon an amendment of the Enforcement Decree).

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Expected Changes Based on Amendments	Key Points of Amendments
<p style="text-align: center;">Matters for Compliance for Prime Contractors that Transact with Middle Standing Companies</p>	<ul style="list-style-type: none"> ① A prime contractor must remit the subcontract payment to the middle standing company within 60 days of the delivery date. ② If the prime contractor receives a payment for completion or milestone payment(s) from the project owner, such prime contractor must pay the applicable payment to the middle standing company within 15 days. ③ The prime contractor must pay the middle standing company's subcontracting payment at a higher ratio of cash payment relative to the ratio of cash payment received by the prime contractor from the project owner. ④ If the prime contractor makes a subcontracting payment either with a promissory note or a similar method of payment, and if the maturity date of the promissory note exceeds 60 days of the actual delivery date of the goods, the prime contractor must pay additional fees to the subcontractor for every day that has exceeded the maturity date.

2. Unified the standard for determination of a prime contractor based on the total revenue and excluded the number of permanent employees as a standard for determination

- The prior version of the Subcontract Act determined whether a small/mid-sized company constitutes a prime contractor under the Subcontracting Act based on the "total revenue" and the "total number of permanent employees." However, (i) having a large number of permanent employees did not necessarily signal superiority in terms of bargaining power and (ii) the Framework Act on Small and Medium Enterprises was amended so that the actual size of a company is determined based on its total revenue instead of total number of permanent employees (implemented as of January 1, 2015). Factors such as the above were comprehensively taken into account in the amendments (Article 2(2)(2) of the Amendments).
 - **The Amendments to the Subcontracting Act has unified the standard for determination of whether a small/medium-sized company constitutes a prime contractor** under the Subcontracting Act based only on the total revenue of the company as opposed to the number of permanent workers. Small-medium-sized companies with low total revenue, but with a large number of permanent workers are now alleviated from the burdens imposed as a prime contractor.

3. The Amendments now implements a statute of limitations period after the Korea Fair Trade Commission ("KFTC") commences its investigation for unfair subcontracting practices

- Under the current Subcontracting Act, the KFTC does not have time restrictions once it commences its investigation since there is no statute of limitations period. As a result, there were concerns over delayed relief for complainants and a legally unstable status for the company alleged to have engaged in the unfair subcontracting practices.
 - Under the Amendments, once 3 years elapses since the first day of the KFTC's investigation, the KFTC can no longer impose corrective measures or fines due to the newly implemented statute of limitations period (Article 22(4) of the Amendments).

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4. The prime contractor is prohibited from retaliating against a subcontractor by cancelling the entrusted subcontract based on such subcontractor's participation in the KFTC's sectoral inquiries

- If the prime contractor retaliates against a subcontractor based on such subcontractor's participation in the KFTC's sectoral inquiries, the prime contractor is subject a **fine of up to KRW 300 million or up to twice the total subcontracting cost**. Such provision will be newly implement **to protect subcontractors from potential retaliation by prime contractors** (Article 19(3) of the Amendments).
(Immediate implementation once promulgated)

5. Points of Causation for Companies

- The amended Subcontracting Act will be implemented 6 months after the promulgation (but, the clause prohibiting retaliation will be immediately implemented once promulgated), and the KFTC will further provide amendments to the Enforcement Decree of the Subcontracting Act.
- Based on the Amendments, it is anticipated that companies will face **changes in regard to application of the Subcontracting Act based on the size of the company and changes to obligations under the Subcontracting Act**. Companies are advised to check the changes to the Subcontracting Act and confirmation compliance and risks based on the Subcontracting Act.

Company	Points of Causation Based on Amendments
Conglomerates	Since the scope of subcontractors has expanded to middle standing companies with total annual revenue of less than KRW 300 billion, it should be confirmed whether a given company is protected under the Subcontracting Act.
Middle Standing Companies	It should be confirmed (i) whether a given middle standing company with total revenue less than KRW 300 billion is protected under the Subcontract Act if it is subcontracting with conglomerates and (ii) whether the Subcontracting Act applies to transactions of middle standing companies once the specific standards are stipulated under the Enforcement Decree of the Subcontracting Act.
Small/Mid-Sized Companies	It should be confirmed if, a small/mid-sized company which was previously viewed as a prime contractor when subcontracting with another small/mid-sized company since it had a large number of permanent workers despite the fact that it had low annual revenue, is now excluded from the application of the Subcontracting Act.

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