Before the

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID)

LSF-KEB Holdings SCA,
LSF SLF Holdings SCA,
HL Holdings SCA,
Kukdong Holdings I SCA,
Kukdong Holdings II SCA,
Star Holdings SCA,
Lone Star Capital Management SPRL,
Lone Star Capital Investments S.àr.l.,
Claimants,

v.

Republic of Korea,
Respondent.

ICSID CASE NO. ARB/12/37

RESPONDENT'S COUNTER-MEMORIAL ON JURISDICTION AND MERITS

---

21 March 2014

ARNOLD & PORTER LLP

BAE, KIM & LEE LLC

TABLE OF CONTENTS

Page

TABLE OF CONTENTS

Page

I. INTRODUCTION

1. Respondent the Republic of Korea ("Korea") submits this Counter-Memorial in response to the Request for Arbitration and Memorial,[1] submitted by Claimants LSF-KEB Holdings SCA, LSF SLF Holdings SCA, HL Holdings SCA, Kukdong Holdings I SCA, Kukdong Holdings II SCA, Star Holdings SCA, Lone Star Capital Management SPRL, and Lone Star Capital Investments S.àr.l. ("Claimants"). For the reasons set forth herein, the claims against Korea are entirely without merit and should be dismissed.

2. The story Claimants tell is compelling theater. It has heroes that are pure and villains with diabolical motives and powerful weapons. There is only one problem. This story is completely divorced from reality — the reality both of Claimants' underlying investments and their conduct in Korea, between 2003 and 2012, and of the core factual and legal developments with respect to those investments, which are necessary context for understanding the various governmental acts that Claimants challenge in this case.

3. This Counter-Memorial is designed to set the record straight. It is accompanied by numerous exhibits referred to as "**Ex. R-__**," and by legal authorities referred to as "**RA-__**."[2] Tables of these exhibits and authorities are submitted with this Counter-Memorial.

4. In addition, Korea submits 14 statements of fact witnesses, alphabetically as follows:

(i) the Statement of Mr. Hyeonkee Bae ("Mr. H.K. Bae"), dated 19 March 2014 (the "H.K. Bae Statement");

(ii) the Statement of former Prime Minister Duck-Soo Han ("Prime Minister Han"), dated 14 March 2014 (the "D.S. Han Statement")

[1] Request for Arbitration, 21 November 2012 ("Request for Arbitration"); Memorial on the Merits, 15 October 2013 ("Memorial").

[2] Many of the exhibits and authorities have been translated from Korean, in full or in relevant part. Korea reserves the right to submit improved translations if upon further review it appears that doing so would be useful for the Tribunal.

(iii) the Statement of Mr. Do Gon Hwang ("Mr. D.G. Hwang"), dated 19 March 2014 (the "D.G. Hwang Statement")

(iv) the Statement of former FSC Chairman Dr. Kwang-woo Jun ("Dr. K.W. Jun"), dated 19 March 2014 (the "K.W. Jun Statement");

(v) the Statement of Mr. Dong Hoon Kang ("Mr. D.H. Kang"), dated 19 March 2014 (the "D.H. Kang Statement")

(vi) the Statement of Hana Deputy President Byoungho Kim ("Mr. B.H. Kim"), dated 19 March 2014 (the "B.H. Kim Statement");

(vii) the Statement of Mr. Ik Nam Kim ("Mr. I.N. Kim"), dated 19 March 2014 (the "I.N. Kim Statement");

(viii) the Statement of former Deputy Governor Jung Hoe Kim ("Deputy Governor J.H. Kim"), dated 20 March 2014 (the "J.H. Kim Statement");

(ix) the Statement of Mr. Myung Jun Kim ("Mr. M.J. Kim"), dated 19 March 2014 (the "M.J. Kim Statement");

(x) the Statement of former Minister and former FSC Chairman Seok Dong Kim ("Minister S.D. Kim"), dated 20 March 2014 (the "S.D. Kim Statement");

(xi) the Statement of former Hana Chairman Seung Yu Kim ("Chairman S.Y. Kim"), dated 19 March 2014 (the "S.Y. Kim Statement")

(xii) the Statement of Mr. Hae Sun Lee ("Mr. H.S. Lee"), dated 20 March 2014 (the "H.S. Lee Statement");

(xiii) the Statement of Mr. Joo Hyung Sohn ("Mr. J.H. Sohn"), dated 21 March 2014 (the "J.H. Sohn Statement");

(xiv) the Statement of Mr. Dai Gou Sung ("Mr. D.G. Sung"), dated 20 March 2014 (the "D.G. Sung Statement"); and

5. Finally, Korea submits 6 reports by expert witnesses, alphabetically as follows:

(i) the Expert Report of Mr. Brent Kaczmarek of Navigant Consulting ("Mr. Kaczmarek"), dated 21 March 2014 (the "Kaczmarek Report"); and

(ii) the Expert Report of Professors Geon-Shik Kim ("Prof. G.S. Kim") and Won-Woo Lee ("Prof. W.W. Lee"), dated 20 March 2014 (the "G.S. Kim/W.W. Lee Report");

(iii) the Expert Report of Professor Yong Jae Kim ("Prof. Y.J. Kim"), dated 21 March 2014 (the "Y.J. Kim Report");

(iv) the Expert Report of Professor Yoon Oh ("Prof. Y. Oh"), dated 20 March 2014 (the "Y. Oh Report");

(v) the Expert Report of Mr. Allan Schott ("Mr. Schott"), dated 20 March 2014 March 2014 (the "Schott Report"); and

the Expert Report of Professor Stef van Weeghel ("Prof. van Weeghel"), dated 21 March 2014 (the "van Weeghel Report").

II. EXECUTIVE SUMMARY

A. Summary Of Claimants' Story

6. According to Claimants, this case is about a white knight that invested in Korea at a time of great economic turmoil, performed an economic miracle while fully complying with local law, but then found itself at the center of a political maelstrom fueled by xenophobic hysteria, resulting in its ultimate victimization by government officials who deliberately subjected it to adverse treatment that caused it substantial losses. In Claimants' view, the relevant Government acts were arbitrary, irrational, and discriminatory, expropriated Claimants' investments in Korea, and in numerous other ways violated Korea's obligations under the 2011 investment treaty between Korea and the Belgium-Luxembourg Economic Union (the "2011 BIT").[3]

7. Claimants portray this dispute in the starkest of contrasts, with no areas of gray and no factual or legal nuances. On the one side sit Claimants, good corporate citizens from Belgium and Luxembourg, affiliated with the Texas-based Lone Star Funds ("Lone Star"), whom Korea always should have known intended to invest in Korea Exchange Bank ("KEB") and other Korean assets for a short time only, since their business model was widely known to specialize in quick turnaround of distressed asset investments rather than on long-term stewardship.[4] On the other side sits Korea, a country historically "suspicious of foreigners" and particularly hostile to Americans, whose society is driven by an unprincipled commitment "first and foremost to serve

[3] **Ex. C-1**, Agreement Between The Government Of The Republic Of Korea And The Belgium-Luxembourg Economic Union For The Reciprocal Promotion And Protection Of Investments, 12 December 2006, *entered into force* 27 March 2011 ("2011 BIT").

[4] *See* Memorial, ¶ 5 ("The nature of Lone Star's business was well known. Lone Star would work to turn the bank around and then, within a few years, sell its stake at a profit"); *see also id.*, ¶¶ 82, 503.

Korea, and only secondarily to pursue commercial interests."[5] Claimants' case rests largely on such indictments of Korean culture, driven by such gross generalizations as the statements that "[m]any Koreans believe that foreigners do not act in the greater interests of Korea and seek only to plunder Korea of its wealth,"[6] that this "attitude is pervasive in Korean culture, but is particularly acute with respect to the United States and U.S. companies,"[7] and that it results in "Koreans' inherent suspicions of foreign intervention,"[8] which have left an "indelible impression on the national psyche."[9]

8. Such sweeping and irresponsible stereotypes are characteristic of Claimants' case, in which speculation and rhetoric substitute for facts and law. Much of Claimants' "evidence" about the supposed motivations for government acts — as well as for many of the underlying "facts" that Claimants allege — is stitched together from press articles: indeed, an extraordinary ***182*** of Claimants' total of 474 fact exhibits (almost 40%) are simply excerpts from media reports, many of them culled from sensationalized news sources in Korea rather than the mainstream press. From these articles, Claimants extract the most heated and inflammatory quotes and characterizations — oblivious to their source or veracity — placing equal weight on statements by nongovernmental actors (unions, NGOs, opposition politicians, etc.) as they do on supposed quotes attributable to government officials themselves. Yet Lone Star itself remarked in June 2005 that "it has been our experience that the [Korean] press very often overstate the situation to create a sensational atmosphere," and that its own officials had experienced

[5] Memorial, ¶ 14.

[6] Memorial, ¶ 63.

[7] Memorial, ¶ 64 (quoting Witness Statement of T. Overby, 15 October 2013, ¶ 7 ("Overby Statement")).

[8] Memorial, ¶ 65.

[9] Memorial, ¶ 65.

misquotation.[10] Claimants buttress this "evidence" with opinions and speculation about government motivations by "witnesses" with little or no firsthand knowledge of events, such as a reporter from the Wall Street Journal (Mr. Ramstad),[11] a former representative of the American Chamber of Commerce (Ms. Overby),[12] and a former U.S. senator from Texas (Sen. Gramm).[13] The Tribunal can judge for itself whether such opinions and beliefs about government motivations constitute "evidence" at all, and what it says about Claimants' case that they felt the need to rely so heavily on such statements to prove their claims.

9. But in a broader sense, Claimants' parading of these American notables to testify about their views of the Korean psyche and culture is not surprising. Throughout the long life of this dispute with Korea (which long predated entry into force of the 2011 BIT), Lone Star — the U.S. company that is truly driving this supposed "Belgian" dispute — repeatedly lobbied U.S. governmental officials to lean on their Korean counterparts to alter Korean government policy. According to Lone Star's own lobbying registration and reports, for example, Lone Star regularly lobbied various U.S. government entities between 2005 and 2008 regarding what it

[10] **Ex. R-55**, Letter from M. Thomson to Y.C. Hoon, Seoul Regional Tax Office, 10 June 2005 ("Indeed, there was an article recently that quoted an unnamed Lone Star official; however, I can tell you for a fact that no one from the Lone Star organization provided any such quote (or even talked to the reporter). So I recognize that there is unfortunately an element of misreporting, which neither of us can fully control").

[11] Witness Statement of Evan Ramstad, 9 October 2012 ("Ramstad Statement"), ¶¶ 2, 4, 6, 9 (testifying that from "closely follow[ing] the events" as a reporter, the "motivations of the government became clear" to him, and expressing his opinions *inter alia* that "[t]he Korean people were emotionally wounded by the fact that the country had to turn to foreign investors for help," and that regulators eventually approved the sale to the Hana Financial Group ("Hana") of Lone Star's KEB shares because "people in Korea had grown tired" of delays and that an economic recovery had "restored Korean pride," so "the Korean public could reconcile itself" to Lone Star's profiting from its investment).

[12] Overby Statement, ¶¶ 6, 10 (testifying that "Korea's attitude [toward Lone Star] can best be understood in light" of a history of "hostil[ity] to foreign entities," and that "[i]n my view, it is likely that some in the Korean government share the public's anti-foreign attitude").

[13] Witness Statement of Phil Gramm, 15 October 2013 ("Gramm Statement"), ¶¶ 5,10 (testifying that "[i]n my opinion, Korean government officials believed that approving HSBC's application would be politically controversial," but "I believe . . . [t]he Korean government appears to have made a political calculation that the climate . . . was becoming more favorable" by the time of the Hana deal).

described as "*Lone Star USA's* tax dispute with the Government of Korea."[14] This tax dispute centered on the invocation by Korea's National Tax Authority (the "NTS") of the well-established "substance over form" doctrine, as the basis for the NTS's determination that Lone Star's U.S. capital-pooling partnership was one of the substantive owners of Lone Star's investments in Korea, rather than the single-purpose holding companies that Lone Star had set up in Belgium to try to avoid paying taxes in both Korea and Belgium. Lone Star described this existing dispute to U.S. authorities as presenting important issues of "investor tax relations" between the U.S. Government and the Government of Korea.[15]

10. Lone Star flexed its considerable U.S. lobbying muscle for a second core dispute. A February 2007 report by the U.S. Congressional Research Service to the U.S. Congress on "South Korea-U.S. Economic Relations" lists "the Lone Star Case" under the heading of "Major U.S. Trade Disputes with South Korea."[16] The document reveals that the pending U.S. dispute at issue involved criminal investigations into the circumstances of Lone Star's acquisition of KEB and alleged illegalities in transactions shortly after it obtained control, which Lone Star — *as*

[14] **Ex. R-52**, Lobbying Registration of Lone Star Fund III pursuant to Lobbying Disclosure Act of 1995, 13 May 2005, with attached semi-annual Lobbying Reports, 2005-2012 (revealing that Lone Star regularly employed recent former officials from the U.S. National Economic Council, U.S. Trade Representative and Senate Finance Committee between 2005 and 2008 to lobby members of the U.S. House of Representatives, U.S. Senate, U.S. Trade Representative, U.S. Departments of Commerce, Treasury and State, and the National Security Council to achieve "favorable resolution of Lone Star USA's tax dispute with the Government of Korea"). Lone Star continued to employ lobbyists in subsequent years, particularly in connection with KEB issues, but revised its disclosure documents to reference the pending Korea-U.S. Free Trade Agreement ("KORUS") and its potential impact on U.S. investors in Korea. *See id.* According to a report from the industry press, in *nine months alone* between 2011 and 2012, Lone Star paid U.S. lobbyists more than USD 1.5 million for these services. **Ex. R-53**, "Lone Star IV paid $1.5m for lobbyists," Private Equity International, 21 June 2012 (reporting on lobbying from the third quarter of 2011 through the first quarter of 2012).

[15] **Ex. R-52**, Lobbying Registration of Lone Star Fund III pursuant to Lobbying Disclosure Act of 1995, 13 May 2005, with attached semi-annual Lobbying Reports, 2005-2012.

[16] **Ex. R-7**, CRS Report for Congress, South Korea-U.S. Economic Relations, Order Code RL30566, 12 February 2007, pp. 10–11.

early as 2007 — complained had "stalled" its proposed sale of KEB.[17] Through its lobbying efforts, Lone Star persuaded U.S. Government officials to try to pressure Korea's bank regulatory officials into approving a sale of Lone Star's controlling stake in KEB, even while serious investigations and judicial proceedings were still pending involving its acquisition and stewardship of KEB. As Claimants' own Memorial confirms, such lobbying efforts included — among others — direct overtures from the U.S. Ambassador to Korea to the Chairman of Korea's Financial Services Commission ("FSC"),[18] and letters from a Texas senator and congressman to the Korean Ambassador to the United States, on behalf of their "constituents in Texas."[19]

11. Lone Star's history of characterizing its disputes with Korea as principally a U.S. concern is especially revealing of the way Lone Star *itself* viewed such disputes, for all the years prior to the filing of its notice of dispute in May 2012. **Section IV** below discusses the implications of Lone Star's invocation of the Belgium-Korea BIT, by means of which it now seeks not only to redefine as "Belgian" the longstanding disputes with Korea which previously it had consistently described as U.S. disputes, but also to reframe such disputes as somehow "new" ones that postdated the 2011 BIT's entry into force.

12. Over the same years that Lone Star was trying to enlist the full weight of the U.S. government on its behalf, it also was carefully building its litigation case against Korea. Lone Star first threatened Korea with an investment treaty claim in July of 2008,[20] more than three

[17] **Ex. R-7**, CRS Report for Congress, South Korea-U.S. Economic Relations, Order Code RL30566, 12 February 2007,pp. 10–11

[18] Memorial, ¶ 246.

[19] Memorial, ¶ 285.

[20] **Ex. C-195**, Letter from J. Grayken (Lone Star) to K.W. Jun (FSC), 9 July 2008 (expressly sent on behalf of both Lone Star and LSF-KEB).

years before the 2011 BIT entered into force, and it renewed that threat on other occasions before the BIT entered into force.[21] However, on none of these occasions did it reveal which nationality — and therefore, which investment treaty — it intended to select for this purpose. Lone Star may have been expecting that the Korea-US Free Trade Agreement ("KORUS"), signed on 30 June 2007, would soon come into force. In any event, it defined its existing dispute with Korea, as of 2008, as arising from the position adopted by the Korean financial authorities that before they could allow Lone Star to divest its controlling stake in KEB, they would need to carefully consider the potential implications of the unprecedented "legal uncertainty" swirling around Lone Star's acquisition and stewardship of KEB, including pending criminal investigations and judicial proceedings. Lone Star asserted then, just as it does now, that this position was contrary to Korean and international law. It also was already asserting at that early juncture — years before the 2011 BIT entered into force — that the dispute was "ripe" for resolution.[22]

13. From at least July 2008 on, Lone Star took every opportunity to "create a record" for its planned treaty arbitration case against Korea, while biding its time for an appropriate treaty vehicle through which retroactively to funnel its claims. It made no secret of its plan to sue Korea, even bragging to its commercial counterparts — like Hana Financial Group ("Hana"), to which it eventually sold its KEB shares — that it intended to collect any shortfalls in its desired KEB sale price from the government, through treaty arbitration.[23] And while it waited to do so, Lone Star set out to generate "evidence" that could support its story, with little regard for the truth or basic ethical standards.

---

[21] **Ex. C-367**, Letter from J. Grayken (Lone Star) to D.S. Chin (FSC), 11 February 2009 (likewise expressly sent on behalf of both Lone Star and LSF-KEB).

[22] **Ex. C-367**, Letter from J. Grayken (Lone Star) to D.S. Chin (FSC), 11 February 2009.

[23] B.H. Kim Statement, ¶¶ 17, 25-26.

14. The most telling example of this is Lone Star's surreptitious taping of its own negotiation meetings with senior Hana officials (as well as of Hana's own conversations with its outside counsel), transcripts of which Claimants now have the temerity to submit as evidence in this arbitration,[24] in violation both of Lone Star's confidentiality undertakings to Hana[25] and the criminal laws of Korea.[26] In any event, the transcripts do not even support the proposition for which Claimants try to use them, which is ostensibly to demonstrate Hana's supposed admission that the FSC instructed it to demand a lower price from Lone Star for the KEB shares.[27] Instead, they simply reveal Lone Star's unscrupulous and systematic efforts to place words in the Hana negotiators' mouths, by making a series of suggestions of government interference to the Hana representatives, which the latter deftly sidestepped. At both meetings, Lone Star's representatives continued to pose leading questions, such as "And the regulator wants us to take a lower price …?"[28], and at the next meeting, "So they specifically told you the price they wanted you …?"; "So you have, have you discussed this price reduction with the FSC?"; and "Have they asked you to reduce it?" [29] Each time, the Hana representatives responded that the

[24] **Ex. C-228**, Transcript of Meeting Between Lone Star and Hana Representatives, 25 November 2011; **Ex. C-268**, Transcript of Meeting Between Lone Star and Byoungho Kim, November 2011.

[25] **Ex. C-280**, Amended and Restated Share Purchase Agreement Between Lone Star and Hana Financial Group, 3 December 2011, Art. 10; *see also* B.H. Kim Statement, ¶ 20; H.K. Bae Statement, ¶ 24.

[26] **Ex. R-104**, Protection of Communications Secrets Act, 3 May 2010, Arts. 3, 4, 16.1; *see also* H.K. Bae Statement, ¶ 24.

[27] Memorial, ¶¶ 292–96, 305.

[28] **Ex. C-268**, Transcript of Meeting Between Lone Star and Byoungho Kim, November 2011, at 1.

[29] **Ex. C-228**, Transcript of Meeting Between Lone Star and Hana Representatives, 25 November 2011, at 3, 6.

government had not actually made such statements: "That makes not, not, not that way …."[30], and at the next meeting, "Not FSS…"; "Not really …"; and "No. They didn't say anything."[31]

15. Lone Star's secret transcripts thus read like a bad script, involving undercover "Keystone cops" wearing a hidden wire and trying to entrap a suspect with leading questions. But even without knowing they were being recorded, the Hana representatives declined to join in Lone Star's conspiracy theory. Their avoidance of Lone Star's attempts to have them implicate government officials during this meeting is consistent with their confirmation now, in witness statements submitted in this arbitration, that the FSC *never* asked them to renegotiate the sale price. Their testimony reveals that, instead, it was Hana itself that affirmatively had sought to renegotiate with Lone Star, for the purpose of obtaining a lower purchase price, and used what leverage it could in the negotiations.[32]

16. The real power of the referenced transcripts lies in what they reveal about the lengths to which Lone Star was willing to go in trying to manufacture "evidence" to support its already planned litigation against Korea. Perhaps most telling, Lone Star's own transcripts inadvertently captured a small segment of one of its own internal discussions — before one of the participants belatedly remembered to switch off the secret tape recording — in which its representatives explicitly discuss a plan to try to provoke the FSC into intemperate acts or heated

[30] **Ex. C-268**, Transcript of Meeting Between Lone Star and Byoungho Kim, November 2011, at 1.

[31] **Ex. C-228**, Transcript of Meeting Between Lone Star and Hana Representatives, 25 November 2011, at 3, 6.

[32] *See* S.Y. Kim Statement, ¶¶ 15-17; B.H. Kim Statement, ¶¶ 13-18, 25; H.K. Bae Statement, ¶¶ 23, 26.

statements,[33] presumably so that Lone Star could then invoke such statements in an eventual arbitration.

17. This episode, sorry and sordid as it is, is just a small example of how far Lone Star was willing to go to set up its extreme story of an overarching government conspiracy to deny it its rightful profits. Yet the Tribunal should keep this example clearly in mind as it evaluates the credibility of the rest of Claimants' story, as the example is emblematic of a general pattern both in Lone Star's conduct in Korea, and in the presentation of Claimants' arguments and evidence now. The Tribunal should also bear in mind that Lone Star's own version of events has evolved with its litigation strategy, as it told different stories about the same basic history in prior cases involving fallout within Lone Star's own family (*e.g.*, its law suits involving Lone Star's most senior executive in Korea, Steven Lee); with a former major shareholder of KEB's credit card subsidiary (Olympus Capital); and in the various administrative and judicial proceedings in Korea. The records that are publicly available reveal large discrepancies between the story Lone Star tells in its Memorial and its prior explanations of the same events. All of Lone Star's litigiousness and finger-pointing finally has caught up with it — revealing, for example, its admissions in other fora that the Government's investigations of Lone Star, and the effect such investigations could have on Lone Star's ability to sell its KEB stake, were the readily foreseeable consequence of misconduct by Lone Star's own senior executive Steven Lee.

18. As Korea demonstrates below, Claimants' story in *this* case bears little relation to the reality of how events truly unfolded during the years of Lone Star's investment in Korea. In

[33] **Ex. C-228**, Transcript of Meeting Between Lone Star and Hana Representatives, 25 November 2011, p. 58 (which captures Lone Star's former global second in command, Ellis Short, proposing to its Chairman John Grayken, "Here's what I'm gonna like. . . . We show up at the shareholders' meeting . . . and promote a big dividend against the wishes of the FSC . . . . *And then we'll cause them to do something outrageous* like, who knows. *Let me turn this off*.") (emphasis added).

fact, far from acting selflessly in the interests of the pension funds, university endowments and other institutional investors on whose behalf it now claims to seek justice,[34] Lone Star's executives had a substantial personal financial stake in their Korean investments, with five men sharing a right to an extraordinary *94 percent* of the proceeds from Lone Star Partners IV, L.P., which was the General Partner of Lone Star Fund IV (U.S.), L.P. and Lone Star Fund IV (Bermuda), L.P. — the entities Lone Star used to pool investments to be channeled into KEB and most of its other Korean investments. And far from being a white knight committed to rescuing KEB and other troubled Korean investments, Lone Star and its agents in Korea repeatedly broke the law, ignored the rules, and engaged in other reckless and wrongful conduct that injured other investors and put the Korean financial system at risk. Such misconduct included (a) refusing to cooperate with criminal investigations into Lone Star's acquisition and stewardship of KEB, which significantly heightened public mistrust of Lone Star and concretely delayed the progress of official inquiry, and as a result also the resolution of the very legal uncertainty that Claimants now complain delayed approval of their sale, and (b) refusing to submit relevant information to Korea's tax authorities, and indeed resorting on one occasion to physical violence (resulting in substantial injury) to block the NTS's access to records during an official tax audit. The record of the wreckage Lone Star left in its wake in Korea includes a conviction by a Korean court for criminal stock price manipulation, an ICC arbitration award by an eminent tribunal finding that Lone Star acted wrongfully and in breach of Korean law in connection with its squeeze-out of Olympus Capital, and at least one lawsuit in the United States brought by pension fund

[34] Memorial, ¶¶ 4, 84, and n. 794.

beneficiaries accusing Lone Star of fraud and breach of fiduciary duty in connection with its investments in Korea.[35]

19. Lone Star's conduct in turn placed Korean officials in an unprecedented and difficult predicament, which required considerable care and deliberation. As the true story reveals, government officials tried to walk a fine line between, on the one hand, the admittedly heated demands of certain elements of Korean civil society for a crackdown on Lone Star as a result of its conduct, and, on the other hand, the Government's desire to enable Lone Star to wrap up its activities in Korea (as it apparently wished to do). At the same time, those Korean officials had the obligation to take the appropriate steps to protect the integrity of the numerous ongoing judicial and investigatory proceedings that Lone Star's activities had prompted, and to preserve the Government's ability to take action in the event it were required to protect the public interest. In the end, the story of this case is one of reasonable and principled government conduct resulting from careful deliberation, under extreme and unusual circumstances, but always in a good faith effort to follow the dictates of applicable law.

20. Lone Star may not have been satisfied with all the decisions Korean officials made — even though at the end of the day it still earned handsome after-tax returns from each of the Korean investments at issue. Moreover, such rates were consistent with those historically achieved by Lone Star on its funds, and with the rates that Lone Star identifies to its own investors as profitability targets. But the rubric for decision in this case is not whether Lone Star might have earned even more spectacular returns had government officials rolled over and decided every single issue the way Lone Star might have wished. The question is whether the Korean government honored its basic obligations under the 2011 BIT, and proceeded rationally

[35] **Ex. R-20**, OREGONLIVE, *Lawsuit against Lone Star Funds accuses Oregon Public Employees Pension System trustees of risky Investment business*, 26 April 2012.

and in good faith in implementing applicable laws and policies. The evidence quite clearly shows that it did.

B. The True Story Of This Case

21. Given the extensive distortions of history in Claimants' Memorial — not to mention their tactical decision to challenge in this case virtually every act by every government official in Korea who crossed Lone Star's path over a full decade, under virtually every single legal standard in the 2011 BIT — it inevitably takes considerable space to set the record straight. Korea is aware that this Counter-Memorial is unusually long, and that the Tribunal necessarily will need to digest it over a period of time, in appropriate modules. The summary below is designed to facilitate that review, but of course it is no substitute for the more detailed examination of the evidence that follows, and that is fully supported by the extensive testimonial and documentary support that accompanies the Counter-Memorial.

1. KEB Sale Claims

22. The only Claimant that presents any claims with respect to the KEB sale issues is LSF-KEB Holdings SCA ("LSF-KEB"), a Belgian special purpose vehicle that Lone Star established to hold shares in KEB. LSF-KEB's claims rest on a fundamentally distorted portrait of Korea's bank regulatory framework, and for that matter of what Claimants characterize as "many modern regulatory systems" and "international regulatory best practices"[36] — sweeping generalizations for which Claimants select the U.S. banking system as their proxy. According to Claimants, the regulators charged with oversight of banking institutions — and thereby with protection of the stability and integrity of the nation's financial system — had but a single duty in connection with the events at issue in this case. Essentially, according to Claimants, the FSC

[36] Memorial, ¶¶ 24, 215.

was a paper processor, whose duty was to push through to approval within 30 days (or an extended maximum of 60 days) any application to acquire Lone Star's controlling stake in KEB, provided only that the applicant was qualified. Because this, according to Claimants, was the FSC's only relevant duty — and because it purportedly lacked any legal authority or discretion in this context to consider any issues arising from Lone Star's own acquisition or stewardship of KEB — Claimants suggest that it was *ipso facto* irrational, and otherwise a violation of Korea's obligations under the 2011 BIT, for the FSC not to approve HSBC's December 2007 application to acquire the KEB shares before the HSBC deal fell apart in September 2008, and thereafter to delay its eventual approval of Hana's subsequent application from December 2010 to January 2012.[37]

23. Once again, however, Claimants' pleading rests on an aggressively one-sided portrayal of both law and facts. On the facts, Claimants contort reality to minimize the seriousness of its misconduct in Korea and of the charges underlying the many investigations and judicial proceedings arising from Lone Star's acquisition and management of KEB. Such proven misconduct, and other potential charges for which there appeared at the time to be serious and credible evidence against Lone Star, placed Korea's bank supervisory authorities in an unprecedented and difficult situation. Claimants now seek to distance Lone Star from the criminal proceedings in Korea, for example by repeatedly referring to the case that resulted in a conviction for outrageous manipulation of stock prices, as the "Paul Yoo case."[38] This is nothing

[37] Claimants have seemingly abandoned any complaints regarding Lone Star's earlier abortive efforts to sell KEB shares to Kookmin Bank and DBS. *Compare* Request for Arbitration, ¶¶ 23–28 (suggesting an intention to claim against Korea for "obstructive delays" to the Kookmin and DBS deals) *with* Memorial ¶¶ 23, 185–86 (admitting that the Kookmin deal "was ultimately thwarted by the parties' diverging views on the appropriate price" and that DBS withdrew before ever even submitting an application, due to concerns that it could never qualify for a bank acquisition in Korea in light of its majority shareholder's status as an industrial conglomerate).

[38] *See, e.g.*, Memorial, ¶¶ 29, 204, 228, 231, 237, 286.

but a transparent effort to redefine the stock price manipulation issues as somehow the result of the actions of a single "rogue" employee, and thus to disassociate Lone Star from the serious implications of the criminal conduct underlying the conviction.

24. The truth, however, is that based on substantial evidence, indictments and warrants were issued for four of the five Lone Star-appointed directors on the KEB Board — Paul Yoo, Steven Lee, Ellis Short, and Michael Thomson — for deliberately causing KEB to make a false public announcement for the illicit purpose of depressing the stock price of KEB's credit card subsidiary, and to squeeze out minority shareholders. Claimants' characterization of the stock price manipulation case as the "Paul Yoo" case is particularly deceptive because the sole reason Lone Star employees other than Paul Yoo were not convicted in that case was that they had left the jurisdiction to avoid facing the charges. Thus, Steven Lee fled the country, and Messrs. Short and Thomson refused to return to Korea to face prosecution. That did not allow them, however, similarly to escape the condemnation of the Seoul High Court, which, in its judgment convicting Mr Yoo, expressly referenced his conspiracy with the other three Lone Star directors: "Defendant H.W. [Paul] Yoo, *in conspiracy with [Lone Star's General Counsel] Michael D. Thomson, [Lone Star's global second-in-command] Ellis Short and [Lone Star's top executive in Korea] Steven Lee* intentionally used deception for the purpose of gaining unjust profit in relation to the trade of securities and other transaction which resulted in Defendants KEB and LSF-KEB's profit of more than 5 billion won."[39]

25. Finally, and in another example of deceptiveness, Claimants repeatedly characterize LSF-KEB as having been held "vicariously liable"[40] in the stock price manipulation

[39] **Ex. R-140**, Seoul High Court Judgment, Case No. 2011*No*806, 6 October 2011, p. 35.

[40] *See, e.g.*, Memorial, ¶¶ 29, 204, 228, 231, 237, 286.

case — a euphemistic phrase designed to elide the fact that LSF-KEB itself was a co-defendant and was also convicted, along with Paul Yoo.

26. There are many other examples of Claimants' distortion of the facts, which will be developed further below. But equally important, Claimants also distort their presentation of the applicable law. Their suggestion that the FSC had one duty only, namely to examine the qualifications of a would-be acquirer and not look at all at the serious issues raised by pending proceedings against Lone Star, sidesteps the broader responsibilities and far more nuanced realities of bank supervision systems in general, and of Korea's system in particular. In Claimants' haste to portray the FSC as merely a paper-processing entity responsible for rubber-stamping the application of a would-be acquirer, Claimants entirely ignore the FSC's fundamental role as the supervisor of *existing* major shareholdings in regulated financial institutions.

27. Consistent with this role, the FSC had a duty to ensure that the nation's laws had been and were being fully respected in Lone Star's acquisition and stewardship of KEB, and to ensure that the interests of other stakeholders would be protected, including the other KEB shareholders directly affected by Lone Star's conduct. The FSC also had the broader responsibility, pursuant to the Act that established it — the Act on the Establishment of Financial Supervisory Organizations — to advance the financial industry, secure financial stability and promote sound credit practices and fair play in the marketplace. In light of these responsibilities, and as Professor Yong Jae Kim explains in his expert report, Korean law affords the FSC authority and discretion to take its supervisory responsibilities into account when deciding an application for approval.[41] Mr. Allan Schott similarly explains in his expert report that financial

[41] Y.J. Kim Report, ¶¶ 45-47.

regulation is a multi-faceted endeavor requiring the simultaneous discharge of multiple responsibilities, each of which has significant implications for the stability and health of the financial industry, and that it is precisely for this reason that bank regulators in general have a considerable measure of discretion in determining the proper order in which to discharge their competing responsibilities.[42]

28. Claimants' submission adopts an equally blinkered approach to the origins of the "legal uncertainties" that arose in connection with Lone Star's acquisition and stewardship of KEB, and the broader repercussions that Korea's banking sector could have suffered, depending on the outcome of the numerous investigations and proceedings that the controversy spawned. Although Claimants understandably seek to minimize Lone Star's own responsibility for the dark cloud in which it became enveloped in Korea, it is worth introducing a few basic facts, which are developed further below.

29. The reality is that Lone Star first acquired its controlling interest in KEB at a depressed price and under suspicious circumstances, involving among other things:

a. a suspiciously low projection of KEB's capital adequacy ("BIS ratio"), designed to enable KEB to qualify for an "exceptional circumstances" exception to normal limits that exist under Korean law on the size of a single entity's shareholding in banks (the "excess shareholding" restriction), all of this amidst conduct by Lone Star and its agents in Korea that bore all the hallmarks of possible corruption;

b. express assurances — articulated in the business plan it submitted with its application to the FSC for the acquisition of KEB shares — that it viewed its investment in KEB "as long-term in nature" and "intend[ed] to be a long-term

[42] Schott Report, ¶¶ 28, 45.

owner of the bank,"[43] rather than to turn around and sell it "within a few years" as Claimants now contend regulators somehow "had to have been aware";[44] and

c. a partial and misleading business plan that failed to disclose the reckless intention that it now says it always had — to allow KEB's critically important credit card subsidiary Korea Exchange Bank Credit Services Co. Ltd. ("KEB Card") to fail.[45] Such omission materially misled regulators in their evaluation of Lone Star's application, as the failure of KEB Card would have created significant systemic risk and brought on tremendous turmoil in the Korean financial market.

30. Further, after purchasing its controlling interest in KEB, Lone Star then promptly:

a. took advantage of a temporary liquidity crunch at KEB Card to squeeze out its principal minority shareholder (Olympus Capital) at an artificially reduced price — misconduct that later led to a major ICC arbitration award against Lone Star by an eminent three-member tribunal, and

b. engaged in criminal stock price manipulation at KEB Card to squeeze out the remaining minority shareholders and merge KEB Card into KEB at an artificially reduced price.

31. As Lone Star has admitted in other fora, virtually all of the difficulties that it later encountered in trying to exit its KEB investment — and that now form the basis for Claimants' claims in this arbitration — stemmed directly from Lone Star's own conduct (or the conduct of

[43] **Ex. R-17**, Business Plan for Korea Exchange Bank, 2 September 2003, p. 21.

[44] Memorial, ¶ 503.

[45] Memorial, ¶ 105–06.

the managers for whom it was responsible) in the fall of 2003.[46] Allegations of misconduct by Lone Star in connection with its initial investment in KEB prompted several investigations, starting with an investigation by the supreme auditing body of the Korean Government — the Board of Audit and Inspection ("BAI") — and continuing with an investigation by the Supreme Prosecutor's Office, which led to criminal proceedings.

32. Separately, Lone Star's stock price manipulation at KEB Card gave rise to criminal prosecutions, based on charges that Lone Star's appointed directors on the KEB Board — Paul Yoo, Steven Lee, Ellis Short, and Michael Thomson — conspired to cause KEB to make a false public announcement for the purpose of bringing down KEB Card's stock price. Mr. Yoo was tried and convicted of criminal stock price manipulation in conspiracy with the other three Lone Star directors, and sentenced to a three year prison term. (He was also convicted of tax evasion in connection with manipulation of profits, and of perjury for his untruthful testimony before the National Assembly). As noted above, the other three Lone Star directors implicated in the stock price manipulation had either fled the country (Steven Lee), or refused to return to face prosecution (Ellis Short and Michael Thomson —both of whom are serving as fact witnesses for the Claimants in this arbitration).

[46] *See, e.g.*, **Ex. R-66**, Lone Star Statement of Claim in Bermuda Proceeding, 6 May 2008, ¶ 23 ("As a result of [Steven Lee's] actions, the Partnerships, the Funds, and the whole of their investment activities in South Korea since 1998 have been the subject of a comprehensive criminal investigation and unprecedented regulatory scrutiny, causing damage to the Funds' ongoing investment activities and to their reputations"); **Ex. R-9**, Plaintiffs' Original Petition, July 16, 2009, *Lone Star Fund IV v. Steven Lee*, Cause No. 09-08900, District Court of Dallas County Texas ("Lone Star Petition, Dallas County"), at 18, 25-26 ("As a direct and foreseeable result of [Steven Lee's] wrongdoing in South Korea, the South Korean government commenced a number of investigations . . . As a result of [Steven Lee's] wrongful conduct, the deal with HSBC was lost. But for the delay in receiving government approval, which was caused by Defendant's fraudulent conduct, the HSBC sale would have closed . . . [Steven Lee's] fraudulent acts directly and proximately caused Plaintiffs to lose the sale of the 51% interest in KEB for a price of $5.9 billion").

33. Contrary to Claimants' contentions, the uncertainties created by these various pending investigations and court proceedings had significant potential to affect Lone Star's continued ownership of the KEB shares. For example, the BAI informed the FSC that, if Lone Star were found to have been involved in the BIS ratio manipulation, "appropriate measures" would be required from the FSC. The BAI noted that such measures could include *ex officio* cancelation of the 2003 approval of LSF-KEB's excess shareholding, which had been based on a finding of "exceptional circumstances" due to the seemingly dire BIS ratio. If the FSC were to cancel the 2003 approval, that would affect LSF-KEB's ownership of the shares because it would mean that LSF-KEB no longer would be authorized to hold shares in excess of the statutory limit, and could be ordered to dispose of such shares, potentially in a manner that would preclude a private change of control transaction. A finding of illegality in connection with Lone Star's initial investment in KEB also would have opened the door to judicial action by the Export-Import Bank of Korea ("KEXIM") — which had sold a portion of its KEB stake to Lone Star in 2003 — seeking to void the share purchase agreement by which LSF-KEB had acquired a portion of its KEB shareholding, or potentially to attach a portion of LSF-KEB's shares. In either scenario, LSF-KEB's ability to transfer the full extent of its shareholding would be called into question.

34. Similarly, a stock price manipulation conviction — as eventually occurred — would have had serious and immediate consequences for LSF-KEB's ability to continue as controlling shareholder of KEB. Under Korean law, an entity is not permitted to serve as excess shareholder of a financial institution if it has been punished for a violation of a finance-related crime within the past five years. A conviction of Lone Star in the stock price manipulation case thus necessarily would lead to suspension of voting rights and, eventually, an order from the FSC to sell its shares (known as a "disposition order"), potentially with a range of conditions and

sanctions. Contrary to Claimants' suggestion in these proceedings, it was far from clear at the time that such a mandatory disposition order necessarily would be unrestricted, allowing LSF-KEB to sell its shares in a single block to a new controlling shareholder.

35. These realities refute Claimants' contention that, in its review of Lone Star's proposed sale of shares to HSBC (and later to Hana), the FSC needed to focus solely on the purchaser and its qualifications, and not on the seller or the implications of pending proceedings for the underlying target bank and the broader financial sector. It is clear that the pending proceedings relating to Lone Star could have serious implications for the proposed sale of KEB shares, as well as the rights of other KEB shareholders. Given these complex dynamics, including several potential scenarios depending on the outcome of the judicial inquiries, the FSC would have had the challenging task of "unscrambling the eggs" if a major transaction involving LSF-KEB's stake in KEB were to occur in the midst of all of this uncertainty. It was therefore entirely reasonable for the FSC to adopt a conservative position to preserve the *status quo*, to allow the courts to resolve the predicate issues of fact before it would decide on an ultimate course of action concerning Lone Star's proposed sale of KEB shares. The FSC was transparent regarding its intended approach, stating its position regarding legal uncertainty openly and publicly on numerous occasions both before and after HSBC filed its application in December 2007 to acquire LSF-KEB's shares. The FSC made clear that its priority was first to achieve orderly supervision of Lone Star's conduct and status as a major shareholder of KEB, before deciding third-party applications to acquire Lone Star's KEB shares.

36. This does not mean that the situation remained utterly static, however; rather, the FSC tracked developments in the various court proceedings. For example, when progress in the court proceedings in mid-2008 suggested that some resolution of the legal uncertainty would soon be in sight, the FSC began reviewing the HSBC application, so as to put itself in a position

to decide the application if and when resolution finally occurred. The FSC was on the verge of approving HSBC's application in September of 2008 when HSBC abruptly withdrew from the deal, which HSBC was able to do only because Lone Star had refused one month earlier to agree to an extension of the commitment term of the parties' agreement, which would have locked HSBC in to the deal beyond the time when FSC approval was contemplated. Claimants now seek to hold Korea responsible for this poor business decision by Lone Star. During the ensuing 18 months, LSF-KEB would have faced no obstacles to regulatory approval of a potential sale of its stake in KEB. However, it opted not to propose any new transaction; instead, it exercised its own business judgment to gamble by waiting to sell its KEB shares at a later time, when it hoped to obtain a better price.

37. With respect to the Hana application, which was first submitted in December 2010, the FSC acted consistently with the policy it had articulated several years earlier, evaluating Hana's application when the circumstances were such that none of the key sources of legal uncertainty posed an obstacle to considering, and, if appropriate, approving the application. When a surprise remand in the stock price manipulation case in March 2011 caused one source of legal uncertainty to reemerge, the FSC took a reasoned approach that (a) was consistent with its prior practice; (b) took into account the full range of the FSC's responsibilities; (c) reflected the fact that, in the event of a guilty verdict in the stock price manipulation case, Hana's application might well become moot; and (d) was transparently communicated to all parties involved. The FSC's decision was the result of careful, reasoned, and principled internal analysis, supplemented by advice from internal and external legal counsel.

38. When the stock price manipulation case in fact concluded with a conviction, which affected Lone Star's eligibility to continue as majority shareholder of KEB, the regulators

responded reasonably, proportionately, and in accordance with Korean law and international best practices. Notwithstanding calls from civic organizations, media outlets, and national politicians for the FSC to "punish" Lone Star by imposing the most severe form of punishment permitted by the Banking Act, the FSC declined to exercise its authority to do so. Lone Star itself admits that the FSC rejected such calls for a "punitive" disposition order.[47] Instead, the FSC issued an order that enabled the Hana acquisition of LSF-KEB's stake in KEB to go forward. And contrary to Claimants' allegations in this case, the financial regulators did not force or pressure Hana to seek a reduced purchase price, or prevent Lone Star from recovering any dividends. Hana's top executives confirm as much, in witness statements submitted in these proceedings. Ultimately, of course, Lone Star was able to exit KEB at a significant profit — as was in fact the case for all of its other investments in Korea at issue in this proceeding.

2. Tax Claims

39. Much as their rendition of the KEB sale story, Claimants' presentation of the facts and law relevant to their tax claims is completely one-sided.

40. As explained below and in the expert report of Professor Stef van Weeghel, while Belgium is not a tax haven *per se*, several features of the Belgian tax system make it particularly attractive for non-Belgian companies (such as Lone Star). Such foreign companies use the Belgian tax system as a pass-through for more complicated overseas investment structure, to avoid paying virtually *any* taxes — not only in the source country (here, Korea), but in Belgium as well. The result is therefore not a situation of "double taxation," which is what international tax treaties are designed to eliminate or minimize, but rather the opposite: *de facto* "double *non-*

[47] Memorial, ¶ 298.

taxation," by improperly gaming international structures and shopping among tax treaties to avoid paying taxes in either the source jurisdiction or the jurisdiction of residence.

41. There is direct evidence in this case that this was precisely why Lone Star selected Belgium as a nominal insulating layer through which to funnel funds that originated elsewhere in the world. Lone Star pooled such funds into capital-accumulating partnerships in the United States and Bermuda, before passing them through Belgium for ultimate investment in Korea. Lone Star set up a complex web of special purpose vehicles, which on their own had no real economic substance in Belgium. Although Claimants' Memorial emphasizes the existence of personnel and offices in Belgium, it nowhere claims that any of these people actually were employed by any of the Claimant companies that actually owned shares in the Korean investments, nor that the lease on its Belgian office was held in any of these Claimants' names. To the contrary, Claimants admit in passing that the referenced personnel were all employed by different entities set up to *manage*[48] the many holding companies that Lone Star established in Belgium, primarily for tax avoidance purposes, and which evidently had no employee of their own. Nonetheless, Claimants breezily refer to such Belgium-based staff as "*the Claimant's* employees"[49] — another disingenuous circumlocution, of which Claimants indulge in many (including the simplest and most brazen one, already mentioned, which is the collective noun "Lone Star").[50] All such distortions and euphemisms are designed misleadingly to attribute to the Claimants themselves characteristics that more properly belonging to other entities.

[48] Memorial, n.780; *see also id.*, ¶ 402 ("Claimants *through their manager* maintained a physical office and a qualified workforce within Belgium"), ¶ 569 ("*Through their manager*, [Claimants] had a full staff of professionals" in Belgium) (emphasis added).

[49] Memorial, ¶ 403 (emphasis added).

[50] Memorial, ¶ 539 (referring to "*Lone Star*'s *bona fide* office and employees in Belgium") (emphasis added).

42. Claimants similarly resort to rhetoric rather than substantive analysis to describe the investigation process that the NTS undertook in Seoul, to gather the facts and evidence relevant to its eventual decisions regarding tax assessments. According to Claimants, the NTS was guilty of "unlawful raids . . . in open disregard of Korean law,"[51] under which warrants supposedly should have been obtained and notice provided in advance. However, Claimants entirely ignore the well-settled statutory exception to advance notice for tax investigations where authorities are concerned about the potential for destruction of evidence. In these cases, Korean law permits — and per its custom NTS regularly undertakes — unannounced visits to sites to gather relevant documents. The process involves presentation of a standard consent form and a request that the subject of the investigation sign it (which virtually always happens in Korea), followed by the collection of documents by a large team of NTS personnel, conducted as quickly as possible.

43. As discussed herein, the NTS followed precisely these customary procedures in Lone Star's case, both in 2005 and again in 2007. It was Lone Star that insisted on differential treatment in 2005, first by blocking access by investigators for an unusually long time, then by *signing* the standard consent forms but thereafter attempting to withhold materials covered by the form it already had signed, and even — in the case of individual Lone Star employees — attempting to destroy evidence under the very nose of the investigators, and resorting to violence to obstruct their investigation.

44. Claimants' articulation of the relevant tax law principles (both Korean and international) is as one-sided as their presentation of facts. For example, they contend that the NTS decided to "simply ignore the Tax Treaty" in effect between Korea and Belgium (the "Tax

[51] Memorial, ¶ 145.

Treaty"), in favor of applying the doctrine of "substance over form,"[52] which Claimants seek to characterize as an unorthodox and uniquely Korean doctrine, and as one that contravened Korea's pledges to Belgium and of settled international tax practice. The NTS supposedly did this solely to punish Lone Star for the profits it had reaped in Korea, and with no guiding principles other than to maximize its tax recovery. But a more balanced review of the law and facts reveals that, to the contrary, the NTS did not "ignore" either the Tax Treaty or other applicable laws. Rather, it made a principled finding that Lone Star could not rely on the Tax Treaty, in light of substantial evidence of its tax avoidance motivations and the purely nominal nature of the supposed "ownership" by the Belgian Claimants of the Korean investments at issue.

45. The "substance over form" doctrine recognizes as taxable entities the substantive owners of income rather than the nominal owners, based on the economic substance of the underlying activities and transactions rather than their superficial appearance. Contrary to Claimants' suggestion, this doctrine is not some kind of novel or uniquely Korean concept, nor was it one introduced by Korea solely for the Lone Star case. Rather, the doctrine has existed in Korean statutes and case law for decades, even before Lone Star invested in Korea — a fact that Lone Star's internal documents suggest it understood, even before devising its Belgian structure. Later, before Lone Star made its first divestment of the assets in dispute, its Korean counsel also reminded it of the substance-over-form rule, which could affect Lone Star's exposure to taxes on the transaction. Moreover, the substance-over-form doctrine it is a well-known doctrine — analogous to the "substantive owner" concept used in many countries — designed to resist efforts by creative tax planners to disguise the economic realities of transactions by the use of "conduit companies." The Organization for Economic Cooperation and Development ("OECD")

[52] Memorial, ¶ 539 (referring to "the ill-defined Korean domestic law concept of 'substance-over-form'").

defines such companies as ones that are "set up in connection with a tax avoidance scheme, whereby income is paid by a company to the conduit and then redistributed by that company to its shareholders as dividends, interest, royalties, etc."[53]

46. While Claimants contend that the NTS's use of this established doctrine "contradicts universally recognized principles of international taxation,"[54] nothing could be further from the truth, and Claimants arrive at this conclusion only by ignoring substantial State practice, international jurisprudence, and the guidance of the OECD itself. As Professor van Weeghel explains, the OECD itself has made clear — and a majority of States agree — that national tax authorities retain the power to consider tax avoidance motives, in conjunction with mere nominal ownership, when assessing the applicability of a particular tax treaty invoked by investors — even if the tax treaty itself is silent on the question. This power was understood to exist as far back as 1986, when the OECD issued its Report on Double Taxation Conventions and the Use of Base Companies,[55] and has been confirmed over and over again.[56]

47. Notably, Belgium itself adopts the same position, namely that it enjoys inherent authority to examine the substance of underlying transactions and not simply their form. As Professor van Weeghel explains, "the Belgian position on the application of domestic law anti-

[53] **Ex. R-24**, Glossary of Terms, OECD, Centre for Tax Policy and Administration.

[54] Memorial, ¶ 329.

[55] **Ex. R-68**, 1986 OECD Report on Double Taxation Conventions and the Use of Base Companies, ¶¶ 38-40 (explaining that "the question arises as to whether, quite generally, domestic rules as to who is regarded as the recipient of specific income for tax purposes are compatible with treaties. This question especially arises in the case of 'anti-abuse' or 'substance-over-form' rules according to which it is not the base company itself but its shareholder, who is regarded as the true recipient of the income shifted to the base company. *The large majority of OECD member countries consider that rules of this kind are part of the basic domestic rules set by national tax law for determining which facts give rise to a tax liability. These rules are not addressed in tax treaties and are therefore not affected by them. … [I]t is the view of the wide majority that such rules, and the underlying principles, do not have to be confirmed in the text of the convention to be applicable*") (emphasis added).

[56] Van Weeghel Report, ¶¶ 88-89, 94-97, 188-189.

abuse rules to tax treaties matches Korean law and policy: . . . Belgium endorses applying domestic law rules to prevent abuse of Belgian tax treaties."[57] Belgium's position is set forth explicitly in a Ministry of Finance publication, as well as in Belgium's 2010 official commentary to its own model tax treaty.[58]

48. Claimants argue that applying this doctrine in the context of the Korea-Belgium Tax Treaty was inappropriate. They contend that Korea and Belgium had opportunities to "amend" such tax treaty to include an express "limitation of benefits" provision in the article addressing capital gains, but did not do so. Such opportunities, they allege, included one in 2010 when Korea and Belgium adopted a single-purpose protocol designed to commit Belgium to greater information exchange, in response to severe criticism by the OECD of Belgium's lack of such cooperation in most of its tax treaties. According to Claimants, the failure of the two States to amend the Tax Treaty on that occasion to address limitation of benefits somehow "makes clear that the two countries did not intend to relinquish taxation rights to Korea in this situation."[59]

49. However, as the evidence shows, there was no need for a treaty amendment to express a power that *both* countries already believed was inherently enjoyed by their respective national tax authorities. Although some States certainly have chosen to make this inherent authority explicit in tax treaties, the majority have confirmed that such *clarifying* language is not essential, and certainly no inference can be drawn from the *absence* of such language when the two States in question, in their respective domestic laws, already agree that the relevant powers exist.

[57] Van Weeghel Report, ¶ 46; *see also id.*, ¶¶ 109-111.

[58] Van Weeghel Report, ¶ 46; *see also id.*, ¶¶ 110-111 (quoting Belgian authorities).

[59] Memorial, ¶ 396.

50. Claimants try to sidestep this fundamental fact in complaining that Korea, in what they deem an "unprecedented" move,[60] declined to engage in consultations with Belgium (through a "mutual agreement procedure" ("MAP") under the Tax Treaty) regarding the NTS's "substance over form" findings regarding Lone Star. But Belgium's request was not in protest of the NTS's underlying authority to make such an analysis, since Belgium's own position is that its tax authorities have an equivalent power. Rather, such request presumably was based on Belgium's different view of the *bona fides* of Lone Star's Belgian holding companies — although as Professor van Weeghel observes, the degree of scrutiny Belgium actually applies to such issues is questionable, given its rather deliberate encouragement of the use of its jurisdiction for treaty shopping — a practice that Claimants' own tax expert (Professor Luc de Broe) himself has acknowledged.[61]

51. Be that as it may, the NTS made clear at the time that going through the motions of bilateral State consultations in this instance would be futile, as the relevant tax authorities already had staked out binary positions on Lone Star's use of Belgium for tax avoidance reasons.[62] Declining to waste both State parties' time in these circumstances was hardly "unprecedented," as Claimants assert; other States have declined to request or grant MAP discussions in tax avoidance situations.[63] Nor was it fundamentally arbitrary or irrational, given the circumstances of the case. In any event, it certainly was not a violation of any duty owed by Korea to *Claimants*, and they can hardly trace any cognizable damages to Korea's decision to

[60] Memorial, ¶ 410.

[61] Van Weeghel Report, ¶¶ 78-80 (quoting Professor De Broe's published work on "International Tax Planning and Prevention of Abuse"); *see also id.*, ¶ 370 (concluding that "in situations where [a state] regularly serves as residence state in treaty shopping structures, as is the case with Belgium . . . , the residence state has a keen interest to protect its position as residence country and entertain MAP requests and in that context it can hardly be regarded as 'gatekeeper' for the source country").

[62] Memorial, ¶ 408 (acknowledging that the NTS made this clear at the time).

[63] Van Weeghel Report, ¶¶ 33, 376-390.

decline to MAP, since at most the MAP procedure involves a duty to consult, not a duty to reach agreement on disputed taxation.

52. Claimants also complain that after "looking through" the Belgian entities to determine the substantive owner of the income in question, the NTS stopped at the level of Lone Star's U.S. and Bermudan capital pooling partnerships, rather than continuing to trace Lone Star's ownership chain all the way up to the many "ultimate investors" who contribute to its funds.[64] This argument ignores both well-established understandings about tax treatment of collective investment vehicles in situations with large numbers of constituent investors with no management control over the assets,[65] and the raw fact that the NTS repeatedly asked Lone Star to identify its ultimate investors, for the very purpose of this analysis — a request that Lone Star repeatedly rebuffed, on alleged grounds of confidentiality. It is not the responsibility of national tax authorities to identify on their own the ultimate investors behind the capital-pooling level, nor would it have been possible for the NTS to do so. Under both Korean and international tax laws, it is the taxpayer, and not the tax authority, that bears the burden to prove its identity and that it is entitled to certain exceptional benefits under applicable tax treaties.

53. The rest of Claimants' tax complaints may be disposed of quickly. Claimants' contention that the NTS initially treated foreign partnerships as collections of individuals, rather than as corporations, is attributable to the unsettled state of Korean law at the time regarding such partnerships, for which there was no clear domestic analogy. The NTS in good faith determined that as the partnerships were not corporations, they should be treated as collections of individuals. The Korean courts ultimately disagreed, and the NTS accordingly implemented their ruling and issued a corrective assessment to apply corporate taxes instead. Curiously,

[64] Memorial, ¶ 413.

[65] Van Weeghel Report, ¶¶ 18, 210-224, 242, 255.

Claimants complain about the corrective assessment as well, even though it simply applied the very framework that Lone Star itself told the Korean courts the NTS *should* have applied, in any taxation of Lone Star's upstream partnerships.

54. Regarding Claimants' complaint that the NTS treated the sale of its Star Tower holding company as the sale of the underlying real property itself, this was in line not only with the substance of the transaction but also with an express agreement between Korea and the United States in 1999 regarding taxation by the source country of capital gains from the sale of holding companies mostly holding immovable property assets.[66] That this was effected in the form of an agreement rather than a formal tax treaty amendment is immaterial; States are not required to go through the process of formal treaty amendment each time they perceive value in clarifying their intent as to the interpretation or application of existing provisions, and the treaty with the United States expressly provides for this avenue, which Korea and the United States then jointly implemented. As to the Star Tower investment, Korea hardly acted arbitrarily or irrationally when the NTS complied with the specific terms of an applicable bilateral agreement with the United States. Indeed, international tax jurisprudence in this area *encourages* States to enter into such bilateral agreements to express their intentions regarding taxation of immovable property holding companies.[67]

55. A separate issue is presented concerning the "permanent establishment" principle, which Claimants admit is an established legal principle under both Korean law and international

[66] *See* van Weeghel Report, ¶¶ 25-26, 267, 273 (referencing the 1999 agreement of Korea and the United States, pursuant to Article 27 of the Korea-US Tax Treaty, regarding the taxation of capital gains derived from shares in Korean "immovable property companies," published in Internal Revenue Service Announcement 2001-34).

[67] *See* van Weeghel Report, ¶¶ 26, 272(referencing paragraph 21 of the Commentary on Article 13 of the 1963 OECD Model Convention, which confirms that States "may also bilaterally agree to treat the sale of all shares in a company holding exclusively immovable property as the sale of the immovable property itself").

tax practice, pursuant to which the source State is permitted to tax the business profits that are attributable to a non-resident's fixed place of business within a jurisdiction, in the same manner that they would those of a domestic business.[68] Such principle is relevant in this arbitration due to the fact that the NTS at one juncture deemed Lone Star to have a permanent establishment in Korea, and assessed taxes accordingly. While Claimants admit the existence and applicability of the permanent establishment doctrine, they disagree with the logic of the NTS's findings in the application of the doctrine, which were based on the substantial "business activity" at one time conducted in Korea by three Lone Star General Partners — Steven Lee, Paul Yoo and Heon Joo Cheong — in connection with the investments in question. The fact that the Korean courts ultimately disagreed with this finding — proving again that appropriate corrective mechanisms exist in Korea's judicial system, and that Lone Star faced no obstacles in invoking them — does not, without more, demonstrate that the NTS's original conclusions were arbitrary or in bad faith. Indeed, as Professor van Weeghel confirms, the whole doctrine of permanent establishment is "still ambiguous on essential points."[69] And while the NTS did not conclude a permanent establishment inquiry on all occasions, this was because with certain transactions there were alternative viable theories of taxation which were less dependent on detailed fact analysis, and which if anything were stronger as a matter of Korean law. There is no requirement that tax authorities pursue the same tax theory each time, particularly where different transactions involve different investments, over different periods of time, and featuring different evidentiary items.

[68] Memorial, ¶ 362.

[69] Van Weeghel Report, ¶ 297.

56. Finally, Claimants complain that the NTS "instruct[ed]" Hana to withhold taxes from LSF-KEB's sale of shares to Hana in 2012.[70] Claimants fail to mention that the referenced withholding by Hana was the direct consequence of Lone Star insisting on an unusual contractual provision in its Share Purchase Agreement with Hana. That provision purported to bar Hana from complying with its statutory obligation to withhold taxes from the purchase price paid to LSF-KEB, unless there was a specific written order from the NTS directing Hana to withhold taxes.[71] As Professor van Weeghel notes, the OECD describes withholding tax laws as "found in practically all tax systems."[72] Such universality renders all the more unusual Lone Star's contractual insistence that Hana *not* comply with its general withholding obligations under Korean law, unless the NTS specifically instructed it to do so. As a result of this contractual demand from Lone Star (and as discussed further herein), Hana sought to have the NTS issue it specific instructions regarding the withholding of taxes in the Lone Star transaction, even sending to NTS a draft model letter to that effect. However, the NTS *rejected* that draft — precisely because of its concern that the proposed letter could be misread as an order, which the NTS deemed inappropriate. Hana then proposed an alternate form that was simply a guidance letter, appropriately reminding Hana of its obligations to comply with Korean law. Lone Star at the time objected to Hana that the guidance letter the NTS finally issued to Hana did *not* qualify as a written order — one of the many inconsistencies with its present story that it neglects to reveal to this Tribunal.

57. Claimants also object that the NTS continues to hold the funds that Hana withheld and conveyed to the Korean Government, while allegedly "pretend[ing] that there was no

[70] Memorial, ¶¶ 387-88.

[71] **Ex. C-227**, ¶ 11.9.5.

[72] Van Weeghel Report, ¶ 311 (quoting **Ex. R-24**, Glossary of Terms, OECD, Centre for Tax Policy and Administration).

substantive owner at all" with regard to this KEB sale transaction.[73] This again distorts the facts; the NTS has made no such finding. The reality is that the NTS was not required to make an affirmative finding regarding which possible entity was the beneficial owner for purposes of this transaction, as the NTS has not made any relevant tax assessment. Rather, it has simply determined that the only entity that thus far has requested a refund — LSF-KEB — was itself not the substantive owner of KEB. This was consistent with all of the NTS's prior findings about the Belgian conduit companies (which, it bears emphasizing, have been fully upheld by the Korean courts). It was also consistent with the NTS's conclusion that LSF-KEB accordingly lacked standing to claim a refund for taxes withheld from the sale of KEB, as any such refund would belong to the substantive owner. Under both Korean and international tax law, the burden is now on Lone Star to identify the substantive owner of the relevant investment, so that such owner's entitlement to particular tax treatment (including applicable tax treaties) can be determined. It is not the obligation of the Korean authorities, having found meritless the only claims to ownership yet presented, to conduct a worldwide investigation to determine precisely who *else* may be the owner, in the absence of any particular entity coming forth to claim entitlement to such status.

C. The Jurisdictional Obstacles

58. As a threshold matter, Claimants bear the burden of establishing the Tribunal's jurisdiction, but their claims suffer from fatal jurisdictional deficiencies and therefore must be dismissed in their entirety. The Tribunal lacks jurisdiction over Claimants' tax claims because Claimants lack standing to assert claims on a representative basis; *i.e.*, based on taxes that they admit were assessed only on their parent companies, rather than on them directly. Indeed, Lone Star has admitted in multiple other fora, including in its own lobbying reports, that it is its *U.S.*

[73] Memorial, ¶ 414.

entity that has the "tax dispute with the Government of Korea."[74] As discussed further in Section IV.C, the same point was stated again and again by U.S. Congressmen whom Lone Star persuaded to approach the U.S. Trade Representative and the Korean Ambassador to the United States on its behalf. Claimants seek to conceal these key facts, in an effort to disguise the utter lack of cognizable tax-related injury to them specifically (*i.e.*, to the Belgian Claimants, as opposed to the non-Belgian parent companies that were actually taxed by Korea). Further, Claimants lack standing to assert claims under the 2011 BIT for alleged breaches of the Korea-Belgium Tax Treaty, which in no way creates a direct right of action at ICSID, and which, contrary to the Claimants' aspiration, may not be imported into the 2011 BIT by virtue of the latter's umbrella clause.

59. In addition, all of Claimants' claims — both the bank regulatory claims and the tax claims — suffer from fatal *ratione temporis* deficiencies, thereby warranting their dismissal. Specifically, and as discussed in Section IV.D, the disputes that Lone Star seeks to litigate in this arbitration arose well before the 2011 BIT's entry into force in March 2011, and therefore lie outside the BIT's temporal scope. Lone Star's own contemporaneous documents admit as much, including (a) the 2005-2008 lobbying reports described above, which address the core tax dispute about the NTS's application of the substance-over-form doctrine to assess taxes only on Claimants' non-Belgian upstream entities, and (b) Lone Star's 2008-2009 letters threatening investment treaty arbitration as a result of the FSC's decision to defer consideration of LSF-KEB's potential sale of KEB until resolution of the legal uncertainty arising out of LSF-KEB's acquisition and early stewardship of KEB . These are *precisely the same disputes* that Claimants now seek to litigate under the BIT, under the pretense that such disputes somehow crystallized

[74] **Ex. R-52**, Lobbying Registration of Lone Star Fund III pursuant to Lobbying Disclosure Act of 1995, 13 May 2005, with attached semi-annual Lobbying Reports, 2005-2012.

after the 2011 BIT entered into force, when in fact — by Claimants' own admission — they had arisen years before. Moreover, regardless of when the *disputes* can be deemed to have arisen, the Tribunal clearly lacks jurisdiction over any *acts or omissions* by Korea that predated the BIT. Importantly, the vast majority of Claimants' complaints relate to alleged acts and omissions that, to the extent they occurred, took place prior to the BIT's entry into force. Finally, the 2011 BIT's statute of limitations bars claims based on events giving rise to the dispute of which Claimants were or should have been aware before 10 December 2007 (*i.e.*, five years from the date the relevant dispute(s) was submitted by Claimants for resolution under the BIT).

D. Lone Star's Merits Claims

60. Even if Claimants' claims were to survive the Tribunal's jurisdictional scrutiny, they should be rejected in their entirety on the merits. Based on the facts and the law, there is no way that Claimants can sustain their burden of demonstrating violations of the international law standards reflected in the 2011 BIT.

61. In a number of respects, Claimants misconstrue the applicable legal standards, through a selective and misleading presentation of jurisprudence and creative reinterpretations of doctrine for which they advance no compelling authority. Regrettably, this has forced Korea to provide a far more expansive presentation of the relevant legal standards than otherwise would have been necessary, particularly for such an experienced Tribunal. Nonetheless, the determinant flaw in Claimants' merits case is ultimately on the facts and the evidence. For example, their claim for impairment of investment by arbitrary and discriminatory conduct rests on entirely distorted speculation about Korea's rationales for action, with regard to both the bank regulatory issues and tax issues raised in this case. Once the correct rationales are identified, and the unprecedented factual circumstances apprehended, there is no question that the actions of Korean officials bore a reasonable relationship to rational policy goals, which is the correct

standard for assessing claims of arbitrariness. This is particularly true given the heightened discretion that States enjoy in core sovereign areas such financial regulation and taxation.

62. Claimants' discrimination claims fare no better, particularly given that Claimants identify no purported Korean national comparators, and the only foreign bank shareholders that Claimants suggest as comparators — two other U.S. owned private equity funds — were not even remotely in like circumstances. This is so, among other reasons, because — unlike Lone Star — such entities never were the subject of extensive criminal investigations and proceedings relating to their bank holdings. The exceptional circumstances that regulators faced with respect to Lone Star not only distinguish Lone Star from potential comparators, but also fully justify any differential treatment that Lone Star may have received. The same factors also serve to defeat Claimants' national treatment and most favored nation treatment claims, which they barely attempt to distinguish from their basic discrimination claims.

63. Claimants' fair and equitable treatment claims fare no better. For the most part, Claimants simply collapse a "legitimate expectations" inquiry into an examination of Korea's compliance with domestic legislation or with allegedly applicable tax treaties. Thus, they argue that Korea violated their legitimate expectations any time that Korean authorities allegedly departed from Claimants' preferred reading of local law or of the referenced tax treaties. Claimants' approach completely ignores the well-established need for specific representations and assurances by a State to an investor as the basis for legitimate expectations, and effectively would impose a strict liability standard, under which any breach of law — even one based on a good faith or reasonable interpretation — would constitute a violation of a BIT. This is not a proper articulation of the legal standard.

64. Equally important, Korea's conduct was transparent, consistent, and rationally based in all matters raised by both Claimants' bank regulatory claims as well as their taxation

claims, and such conduct fully met any expectations by Claimants that objectively could be deemed legitimate. The reality is that Korea acted in good faith at all times in response to indications of serious misconduct by Claimants; that Korea at all times made its judicial system available for any redress Claimants wished to seek (and to which Claimants in fact resorted, in many instances with favorable results); and that Korea at all times complied with the rulings of its courts (which Claimants do not even attempt to use as the basis for any international claims, such as denial of justice). By any reasonable construction of the fair and equitable treatment standard, Claimants' claims therefore must fail.

65. As for full protection and security, Claimants virtually ignore the well-established view that such standard only requires States to grant reasonable protection to investors against foreseeable harm (physical or otherwise) *from third parties*. Instead, Claimants use their full protection and security claim simply as a vehicle to rehash their assertions of injury at the hands of Government actors (which are properly addressed by other treaty standards), rather than of third parties. In any event, the full protection and security standard is not absolute, as it provides States discretion to regulate reasonably in pursuit of rational policy goals, so long as they exercise due diligence to protect investors from unreasonable harm. In this case, the Korean regulators did just that. The FSC, for example, proceeded carefully to balance its dual policy responsibilities of (a) supervising existing bank shareholders and the financial sector as a whole, and (b) reviewing proposed bank acquisitions. In the exercise of such responsibilities, it concluded that it needed to allow the judicial proceedings relating to Lone Star to progress to a stage of findings of fact before taking final action on Lone Star's proposed sales of KEB shares, in order to prevent disruption and harm to KEB and other stakeholders arising from potential outcomes in such judicial proceedings. At the same time, the FSC declined to impose any regulatory sanctions on Lone Star not only until a final verdict had been rendered against it in the

stock price manipulation, but also until after Lone Star had waived its right to appeal. Even then the FSC declined to impose on Lone Star a heightened version of the sanctions that it was legally empowered to impose.

66. Similarly, on the tax side, the NTS consistently acted in good faith, based on its understanding of the relevant law. The NTS repeatedly sought Lone Star's cooperation with investigations (which for the most part was not forthcoming). Lone Star at all times had full access to the Korean courts, regularly availed itself of such mechanisms, prevailed on more than one occasion (with Korea fully respecting and complying with final judgments in Lone Star's favor), and in no way impugns the fairness of the judicial proceedings even in the cases it ultimately lost. "Legal security" was thus clearly provided by Korea to Lone Star.

67. Claimants' expropriation claims with respect to the KEB investment are equally far-fetched. They fail to identify any interference with legally protected rights, let alone the substantial level interference with the entire investment that is required to support a claim for expropriation. Claimants do not deny that LSF-KEB earned *substantial* returns on this investment. The expert Mr. Kaczmarek calculates that LSF-KEB's total net return on its investment in Korea was approximately 172 percent, which amounts to an enviable annual rate of return of 19.3 percent.[75] Instead, Claimants focus on specific legal rights they say were individually expropriated. But even if an investment could be parsed in this fashion into discrete individual rights — each capable of separately being expropriated (which tribunals have considered a dubious proposition) — the specific purported rights that Claimants identify as the subject of expropriation by Korea either do not exist as a matter of Korean law, or as a factual matter involved no government interference at all.

[75] Kaczmarek Report, ¶ 102 and Table 18.

68. In the first category is what Lone Star seeks to characterize as an unencumbered right to sell its stake in KEB at any time, in any form, to any willing buyer, and in the precise time period in which the buyer commits to a particular price, all regardless of the surrounding circumstances. Claimants admit that Lone Star was free to sell its KEB shares through the open market. However, it ignores the fact that, if it wished to sell its shares in a single block to a new controlling shareholder, such a transaction necessarily would be subject to considerable regulatory oversight — and even more so in the context of pending criminal proceedings regarding the legality of Lone Star's own acquisition and conduct as KEB's majority shareholder.

69. Claimants' expropriation claim based on the loss of LSF-KEB's majority voting rights fails on similar grounds; once its conviction for stock price manipulation was final and it declined to appeal, LSF-KEB no longer fulfilled the requirements for excess shareholding. A right cannot be expropriated if it no longer exists as a matter of law; it is no longer a right. In any event, even if the government conduct alleged by Lone Star somehow could be deemed an "interference" with a cognizable right, such conduct constituted a proper exercise of Korea's police powers in the circumstances. Finally, as for LSF-KEB's supposed right to receive a final dividend payment from Hana in 2012, Hana itself confirms that such payment was never part of its agreement with LSF-KEB, and that the decision not to pay it was Hana's alone, without interference from the FSC.

70. Claimants' final two legal claims are equally baseless. Their umbrella clause claim hinges on a supposed breach by Korea of its obligations under the Korea-Belgium Tax Treaty. As Professor van Weeghel explains, however, no obligations under such tax treaty were in fact violated by Korea. In any event, any such obligations were owed to Belgium, not to Claimants. Accordingly, even under standard umbrella clause jurisprudence, tax treaty

commitments could not be imported through the umbrella clause of the 2011 BIT. This is all the more true given that Korea and Belgium specifically opted to limit dispute resolution under the Tax Treaty to certain carefully delineated State-to-State consultation procedures, which at most require them to endeavor to resolve differences where it is clear that doing so would not be futile. In any event, and critically for present purposes, it is clear beyond cavil (a) that the Tax Treaty does not provide private rights of action for damages to third party beneficiaries of these State-to-State consultations, and (b) that Korea never consented in the 2011 BIT to ICSID arbitration of disputes over its dealings with Belgium. The umbrella clause claims are rendered even more spurious by the fact that none of the Claimants themselves were ever taxed by Korea, and that, due to their nationality, the upstream U.S. and Bermudan entities that in fact were taxed by Korea are not (and cannot be) beneficiaries of the Korea-Belgium Tax Treaty or of the Korea-Belgium BIT.

71. Finally, Claimants' free transfer claim is novel, to say the least. It is based on a theory that Korea prevented Lone Star's repatriation of capital by delaying approval of LSF-KEB's sale of its stake in KEB, by imposing certain "unlawful" taxes on Claimants' investments, and by "failing to release" certain amounts that were withheld by third parties (Hana and Credit Suisse) and paid over to NTS for potential tax liability. As for the KEB claims, as noted above, Claimants admit that they could have sold their shares on the open market at any time, so their free transfer claim boils down to the assertion that a regulated financial institution has a *right* to liquidate its investment as a single transaction to a single buyer, at the time of its choosing. Yet as the expert Mr. Allan Schott explains, the acquisition of a controlling interest in a bank is a privilege rather than a right, and regulators must be careful and deliberate in how they proceed. The BIT itself confirms that "free transfer" is implicated only in the event of "*undue* restriction or delay" — and what is "undue" is necessarily context-specific. Given the significant cloud in

this case over the legitimacy of LSF-KEB's acquisition and stewardship of KEB, and the fact that hasty approval of a sale could have had serious consequences for numerous KEB stakeholders (as well as law enforcement and financial stability more generally), there certainly was no "undue" restriction caused by the FSC's decision to allow judicial proceedings to reach conclusion before the FSC pronounced itself on the applications for acquisition of Lone Star's shares in KEB. Moreover, as the experts Professors G.S. Kim and W.W. Lee explain in their report, when the time periods for FSC review of HSBC's and Hana's bank acquisition applications are properly calculated, it is clear that in fact there was not any "undue" delay by the FSC.

72. As for Claimants' tax-related free transfer claims, Claimants do not allege any difficulty transferring out of Korea the majority of the proceeds of Lone Star's investments in Korea, *i.e.*, the capital gains and dividend income that were not subject to taxation. Rather, they simply allege that Korea wrongly imposed taxes on some portion of such proceeds. But Claimants' position would have the impermissible and illogical effect of automatically elevating any protest over taxation into a free transfer claim. In other words, a BIT claim could be manufactured by the simple expedient of positing that, had certain proceeds *not* been taxed, they would have been available for transfer. This cannot be the meaning of the standard, and particularly not in circumstances where Claimants fully availed themselves of Korea's courts to challenge various tax assessments and withholdings by the Korean authorities. Where Claimants prevailed in those challenges, the claims are moot. Where Claimants did not prevail, by definition the relevant acts of taxation were justified. By its terms, the free transfer standard only applies to *unjustifiable* restrictions on transfers, not valid acts of taxation that have been upheld at all levels by the national courts of Korea.

E. Claimants' Damages Case

73. Claimants' damages case is as aggressive and overreaching as their business conduct in Korea and their approach to evidence and law in this case. They seek an award of more than USD 4.3 *billion*, roughly 2-½ times the largest award ever in ICSID history, which was the USD 1.77 billion award issued in October 2012 against Ecuador in favor of Occidental Petroleum. In this case, Claimants seek an award of USD 4,378.6 million comprising:

a. USD 1,576 million in alleged damages and interest on Claimants' banking regulation claims;

b. USD 760 million in alleged damages and interest on Claimants' tax claims; and

c. USD 2,042.6 million in a tax "gross-up" for assumed post-arbitration domestic taxes on any damages awarded.

74. Having conceded in their own Memorial that the taxes they challenge were assessed not on them but on their parent entities, and having acknowledged in several prior lawsuits that the conduct of their own senior executive in Korea (Steven Lee) triggered the banking investigations in Korea about which they complain, Claimants singularly fail to establish the causation element required to support the damages they seek. Their damage analyses also fail to apply the very "fair market value" standard that Claimants invoke as applicable to their banking claims, while ignoring Claimants' duty to mitigate any harm allegedly suffered.

75. Among other relevant facts that they fail to acknowledge, Lone Star made a considered business judgment in August 2008 to decline HSBC's offer of a binding extension of

its Share Purchase Agreement at a revised offer price.[76] If Lone Star had accepted that proposal, HSBC could not have withdrawn from the transaction, and the FSC likely would have approved the sale in late September 2008, as it in fact had signaled to Lone Star and HSBC just one day before HSBC's withdral. Mr. Kaczmarek calculates that, had Lone Star not made the costly miscalculation of rejecting HSBC's revised offer,the difference between that offer (USD 5.56 billion).and the initial HSBC offer (USD 6 billion), after accounting for the USD 985 million in dividends received by Lone Star, would leave Claimants with a claim of no damages at all on their bank regulatory claims.[77]

76. In pursuit of a *double* windfall, Claimants in addition request a massive tax "gross-up" to cover highly speculative, potential domestic tax obligations that they claim might be assessed on a future award. Wholly unprecedented in investment arbitration jurisprudence, such a "gross up" would require that the Tribunal decide a matter that is neither genuinely before it nor ripe for adjudication, and which it has inadequate information to assess.

77. For these and other reasons discussed in Section VI, even if the Tribunal were to find that Claimants have established jurisdiction and liability for a compensable violation, no award of damages is appropriate.

F. The Structure Of This Submission

78. As the tabs in this Counter-Memorial indicate, the presentation following this Executive Summary is divided into four main Sections.

79. **Section III** contains a detailed Statements of Facts, designed to set the record straight after Claimants' highly selective and distorted rendition of events. Such Statement of

[76] H.S. Lee Statement, ¶ 38; H.K. Bae Statement, ¶ 17; **Ex. R-1**, Letter from J. Grayken (Lone Star) to K.W. Jun (FSC), 8 August 2008.

[77] Kaczmarek Report, ¶ 137.

Facts begins (in **Section III.A**) with a short section on Korea's open economy and democratic system of government, which would not be necessary in an ordinary case, but which Claimants have rendered essential by their resort to general indictments of Korean culture, fueled by sweeping and irresponsible stereotypes such as those referenced in the beginning of this Executive Summary. The Statement of Facts continues with an introduction to Lone Star's business model and investments in Korea (**Section III.B)**, highlighting the complex structures that Lone Star employed, with numerous holding companies and other special purpose vehicles, to route funds nominally through various jurisdictions. As other sections of this Counter-Memorial explain in more detail, Lone Star had a concrete tax avoidance motivation for structuring its investments in this way. Section III.B also introduces the four investments in Korea that are at issue in this case, and confirms Lone Star's own admission that it earned substantial capital gains from each of them. Such gains were fully in line with the range of returns that it historically has achieved on its funds and that it tells potential investors it targets for its investments. The Section also introduces the five principals most involved in Lone Star's investments in Korea, one of whom — Steven Lee, its senior executive in Korea — Claimants admit was guilty of fraudulent and deceptive activity, and another of whom (Paul Yoo, Lone Star's second-in-command in Korea) was convicted of a serious financial crime, in conspiracy with Steven Lee and two of the three other principals (Ellis Short and Michael Thomson), who were Lone Star's directors on the KEB Board.

80. Sections **III.C-J** then tell, in chronological order, the detailed story of the bank regulatory issues in this case. This includes the history of Lone Star's first regulatory approval to acquire shares in KEB in excess of the normal statutory limits. Lone Star obtained such approval by using an intermediary whose conduct later gave rise to a corruption prosecution, and by misleading the regulators regarding Lone Star's plan for KEB Card (**Section III.C**). After

acquiring control of KEB, Lone Star then engaged in misconduct that would have ramifications for the remaining life of its investment, including (a) the squeeze-out of the other major KEB shareholder (Olympus Capital) at an artificially reduced price, leading eventually to a major ICC arbitration award against Lone Star, and (b) the illegal manipulation of KEB Card's stock price, leading ultimately to the convictions referenced above, and to Lone Star's consequent ineligibility under the law to continue as KEB's major shareholder (**Section III.D**). Before the stock price manipulation conviction was final, however, there were many other allegations of potential misconduct by Lone Star, including allegations also of corruption and illegality with its initial investment in KEB. Such allegations gave rise to investigations and criminal prosecutions, along with the separate prosecutions for stock price manipulation (**Section III.E**).

81. Amidst these investigations, Lone Star attempted to sell its stake in KEB, notwithstanding the clear announcements by regulators that they would first need to achieve orderly supervision of Lone Star's conduct and status as a major shareholder of KEB, before deciding third-party applications to acquire its shares. This position by the regulators was reasonable and lawful, and stemmed from their need to balance and sequence their dual functions and responsibilities, both as supervisor of existing shareholders as well as approver of potential new transactions. Claimants ignore entirely the first set of critical regulatory functions, focusing only on the second (**Section III.F**). Yet the balancing of these two functions completely explains the FSC's rational and transparent handling both of HSBC's application for permission to acquire Lone Star's KEB shares (**Section III.G**), and their similarly rational and transparent handling of Lone Star's later sale of KEB shares to Hana (**Section III.I**).[78] Nonetheless, in the

[78] **Section III.J** addresses the regulators' diligent assessment of Lone Star's compliance with a different set of regulatory requirements, known as the "Non-Financial Business Operator" ("NFBO") requirements. The regulators ultimately declined to make a finding that Lone Star was an NFBO, despite evidence that could have supported such a finding under applicable law. In any event, the review of Lone

[FOOTNOTE CONTINUED ON NEXT PAGE]

middle of this process, beginning in 2008, Lone Star began threatening Korea with the filing of an ICSID arbitration, expressly stating that its claims arising from the regulators' consistent and transparent policy were already "ripe" for resolution (**Section III.H)**.[79]

82. The final portion of the Statement of Facts, **Section III.K**, addresses the separate but equally important tax issues in this case, and demonstrates that the NTS conducted tax investigations and assessments in accordance with Korean laws and international taxation standards. After first introducing some of the main principles of taxation in Korea and internationally, and reviewing the relevant processes and procedures in Korea, the Section explores chronologically the various audits and assessments that Claimants challenge in this case. It demonstrates that the NTS conducted its investigations in a proper, fair and customary manner, without discrimination; that it assessed taxes in accordance with law and international practice; that Lone Star at all times had full access to the Korean courts to challenge the assessments; and that Lone Star availed itself regularly of such access, even prevailing in some of the proceedings. Significantly, Claimants do not allege that any of the judicial outcomes — whether in their favor or otherwise — constituted a denial of justice.

83. With these detailed factual predicates in place, the Counter-Memorial then turns to the fundamental issues of law that the Tribunal must ultimately decide. First, **Section IV** addresses the serious jurisdictional infirmities of Claimants' case, including (as discussed above) three basic ones: (a) that Claimants lack standing to advance claims based on taxes that were never assessed on them but rather on their parent entities (which do not qualify for protection under the 2011 BIT) (**Section IV.C**); (b) that Claimants' claims center on disputes and conduct

[FOOTNOTE CONTINUED FROM PREVIOUS PAGE]
Star's NFBO status did not affect either the review or approval of any application for acquisition of the KEB shares.

[79] **Ex. C-367**, Letter from J. Grayken (Lone Star) to D.S. Chin (FSC), 11 February 2009.

that predate the 2011 BIT's entry into force (**Section IV.D)**; and (c) that, at the very minimum, the 2011 BIT's statute of limitations bars all claims based on events giving rise to such disputes of which Claimants were or should have been aware before 10 December 2007 (**Section IV.E**).

84. **Section V** addresses Claimants' legal arguments on the merits. As noted above, Claimants are advancing claims under virtually every substantive provision of the 2011 BIT. However, the claims are all equally invalid — not only because Claimants misconstrue the relevant legal standards, but also, more fundamentally, because the evidence simply does not support the claims. This would be true even if Claimants did not face the particularly high burden of overcoming the considerable degree of deference that sovereign States are owed in the core areas of financial regulation and taxation (**Section V.B**). Here, Claimants entirely fail to meet their burden. This is equally true for the claims for impairment of investment by arbitrary or discriminatory measures (**Section V.C**), for fair and equitable treatment (**Section V.D**), for full protection and security (**Section V.E**), for national and most-favored nation treatment (**Section V.F**), for expropriation (**Section V.G**), for observance of commitments (**Section V.H**), and, finally, for free transfer (**Section V.I**),

85. Finally, Korea turns to Claimants' damages claim in Section VI. It explains, inter alia, that Claimants have not proven they have suffered any damages in connection either with their bank regulatory claims or their tax claims, nor have they established a direct causal link to any alleged losses, as they are required to prove (**Section VI.A-C**). Claimants themselves have suffered no cognizable damages at all with respect to taxes assessed on their parent entities (**Section VI.D**). As for the damage claims related to the KEB Sale, these are entirely speculative and unwarranted, among other things because fluctuations in the price of KEB were due to many independent factors, including Claimants' own actions and decisions. (**Section VI.E**) It would be particularly inappropriate to measure damages based on what appears to be Claimants'

preferred theory, which is that Korea violated the BIT by not authorizing LSF-KEB to sell its KEB shares to HSBC at the original price of that deal, even though that whole transaction (and any alleged wrongdoing in connection therewith) took place years before the 2011 BIT ever entered into force (**Section VI.E**). Claimants also failed to mitigate their damages in several respects (**Section VI.F**), and improperly include a tax "gross-up" that is unsupported by any legal authorities and in any event is highly speculative (**Section VI.H**).

For all of these reasons, and as further explained below, Claimants' case should be dismissed in all respects, for lack of jurisdiction and/or as unsubstantiated as a matter of both law and evidence. Korea moreover is entitled to its full costs and expenses (including its substantial legal fees and expenses), for being put to the considerable burden of responding to abusive claims that never should have been presented in the first place.