

STUDENT CONTRIBUTION

Investor-State Dispute between Lone Star and Korea: Legal and Policy Analysis

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This paper examines critical issues in the current dispute between Lone Star and South Korea regarding Lone Star's investment in the Korea Exchange Bank that has culminated in an investor-State dispute claim against Korea before an International Centre for Settlement of Investment Disputes arbitration panel. It further evaluates the merits and potential outcomes of each issue through careful analogy to preexisting international investor-State dispute awards, textual analysis of the bilateral tax and investment treaties between South Korea and Belgium, and publically available information regarding events during the course of Lone Star's investments in Korea. In particular, it will address well-covered topics in international investment law such as nationality of corporations, fair and equitable treatment, and discriminatory treatment. It will also investigate burgeoning topics on breach of domestic law by third parties, breach of domestic law in the course of an investment, and the rights of an investor to raise tax-based investment claims.

Keywords

ISD, Korea, Lone Star, KEB, ICSID, BIT, BTT, FET

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I. Introduction

The investor-state dispute (“ISD”) between South Korea and Lone Star came to a head in May 2015 when a hearing on the merits was held before an arbitration tribunal at the International Centre for Settlement of Investment Disputes (“ICSID”). Lone Star accused the Korean government of engaging “in a continuing pattern of arbitrary and discriminatory conduct” impairing the formers’ ability to dispose its investment in the Korea Exchange Bank (“KEB”). Lone Star also claimed that the government “subjected [it] and its personnel to repeated acts of harassment, and imposed arbitrary and contradictory tax assessments on [it] and its affiliates in contravention of bilateral tax treaties entered into by Korea.”¹

This case is particularly noteworthy because it is the first time Korea has been involved in an ICSID investor-State dispute settlement and the claimed damages of USD 4.68 billion are among the largest seen to date.²

This ISD poses many interesting questions that, when answered, will contribute to well-covered topics in international investment law such as nationality of corporations, fair and equitable treatment, and discriminatory treatment. They will also contribute to burgeoning topics on breach of domestic law by third parties, breach of domestic law in the course of an investment, and the rights of an investor to raise tax-based investment claims.

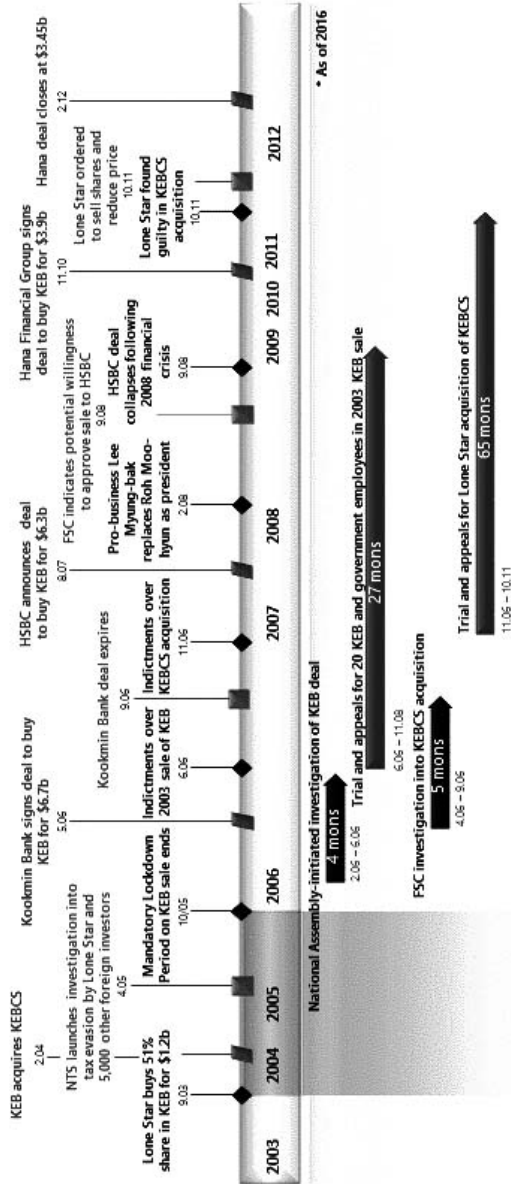
This research will explore these issues through analysis of the text in the Korea-Belgium bilateral investment treaty (“BIT”) and Korea-Belgium bilateral tax treaty (“BTT”). Through careful analogy to investor-State dispute precedent, the author will review events during the course of the investment, evaluate the merits of each issue, and ascertain potential outcomes of the current arbitration.

This paper is composed of six parts including a short Introduction and Conclusion. Part two will review the factual background of the research including the Asian Financial Crisis and the KEB investment dispute. Part three will discuss the delayed regulatory approval for the sale of KEB. Part four will examine tax assessments on the sale of KEB. Part five will analyze tax-based investment claims under FET.

¹ Letter from Michael D. Thomson, Director, Lone Star Investment Management SPRL, to His Excellency Lee Myung-bak, President of the Republic of Korea (May 21, 2012), available at <http://www.businesswire.com/news/home/20120805005041/en/Lone-Star-Funds-Update-Dispute-South-Korean> (last visited on Apr. 18, 2016).

² Hee-Jin Kim, *Lone Star Demanding 4.6 billion from Government*, KOREA JOONGANG DAILY, May 18, 2015, available at <http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3004273> (last visited on Apr. 18, 2016).

Figure 1: Timeline of Dispute between Lone Star and Korea



Source: Compiled by the author.

II. Background: The Asian Financial Crisis and the KEB Investment Dispute

The Asian Financial Crisis had a severe negative impact on KEB as bankruptcies among corporate clients resulted in significant losses on unpaid loans.³ Between 1998 and 2000, several remedial measures were taken to recapitalize and restructure KEB. The German Commerzbank AG injected almost USD 700 million into KEB.⁴ Despite these efforts, KEB's net profits fell to USD 56.4 million in 2002.⁵

Because of KEB's deteriorating capital position, a decision was endorsed in 2003 to seek funds from an external investor. On September 23, 2003, Lone Star acquired a 51 percent share for approximately USD 1.2 billion and a right to exercise call options for additional shares up to 65.23 percent.⁶ Lone Star paid a 13 percent premium over the publicly traded share price, typical of large block share purchases, and a 55 percent premium over the share price at the time it began its due diligence of KEB.⁷

This acquisition included an issue of new shares as well as those from Commerzbank and the Korean government entities. Lone Star was the only potential buyer willing to meet the demands of the KEB shareholders.⁸ Following the acquisition, shareholder structure changed dramatically leaving Commerzbank, the Bank of Korea, and the Export-Import Bank of Korea with only a combined 34.93 percent of shares.⁹

KEB doubled in valuation between 2003 and 2005. While much of this turnaround was attributed to the rebounding economy, Lone Star management also focused on restructuring KEB's balance sheet and improving margins rather than growing assets. This was possible because Lone Star was immune to much government pressure because of its foreign ownership.¹⁰

³ M. Menke & D. Schiereck, *Private Equity Investments in the Banking Industry – The case of Lone Star and Korea Exchange Bank*, 2 BANKS AND BANK SYSTEMS 25 (2007), available at http://businessperspectives.org/journals_free/bbs/2007/BBS_en_2007_02_Menke.pdf (last visited on Apr. 19, 2016).

⁴ *Id.*

⁵ *Id.* at 26.

⁶ S. Nathan Park, *What's at Stake: South Korea vs Lone Star Funds*, WALL ST. J., June 29, 2015, available at <http://blogs.wsj.com/korearealtime/2015/06/29/whats-at-stake-south-korea-vs-lone-star-funds> (last visited on Apr. 19, 2016).

⁷ Notification of Dispute and Accompanying Memorandum Given to South Korean Government Outlining Basis of Dispute as Required by Article 8.1 of the Agreement between the Government of the Republic of Korea and the Belgium-Luxembourg Economic Union, ¶¶ 10-11 (May 21, 2012), available at <http://www.businesswire.com/news/home/20120805005041/en/Lone-Star-Funds-Update-Dispute-South-Korean> (last visited Apr. 19, 2016).

⁸ *Supra* note 3, at 26.

⁹ *Id.* at 27.

¹⁰ C. Harvey, *HSBC's Acquisition of KEB*, DUKE UNIVERSITY'S FUQUA SCHOOL OF BUSINESS 7 (Oct. 30, 2015), available at https://faculty.fuqua.duke.edu/~charvey/Teaching/663_2014/Sapta/HSBC_KEB_LoneStar_case.pdf (last visited on Apr. 19, 2016).

In 2005, foreign investors began selling shares in Korean banking assets. Korean public perception of foreign investment firms took a decidedly negative turn as it became known Korea would be unable to collect taxes on these sales because of the investors' use of tax havens that had treaties restricting double-taxation.¹¹ Officials from the Ministry of Finance and Economy acknowledged these tax treaties were a necessary evil in the 1970s as Korea sought additional foreign capital to spur economic growth.¹²

The Korean government revised the tax code in 2005 to ensure foreign investors using tax havens would be ineligible for double-taxation benefits.¹³ On its face the changes were applicable to both foreign and domestic companies, but no large-scale investigation of Korean companies occurred until 2013.¹⁴

Korea began approaching other States hoping to amend its BITs and BTTs and deny shell companies access to the benefits provided therein.¹⁵ A delegation was sent to Belgium in 2007 seeking to modify the terms of the 2006 Korea-Belgium BIT.¹⁶ However, this BIT still remains in effect today.¹⁷ Belgium also formally requested the Korean National Tax Service ("NTS") begin a mutual agreement procedure in accordance with Article 24 of the Korea-Belgium BTT on behalf of Lone Star. The NTS denied this request and refused to discuss the matter any further.¹⁸

The NTS raided approximately 5,000 offices of foreign investors in 2005 looking for evidence of tax evasion. The NTS then levied USD 200 million in tax penalties against Lone Star.¹⁹ The KEB investment was not included because it was still in the

Apr. 19, 2016).

¹¹ See *S. Korea Wants to Rewrite its Tax Treaties*, HANKYOREH DAILY, July 10, 2007, available at http://english.hani.co.kr/arti/english_edition/e_business/221456.html (last visited on Apr. 19, 2016).

¹² *Id.*

¹³ See *Korea to Alter Tax Law*, ASIA TIMES ONLINE, Aug. 27, 2005, available at <http://www.atimes.com/atimes/Korea/GH27Dg02.html> (last visited Apr. 19, 2016).

¹⁴ Sungwoo Park, Cynthia Kim & Jungah Lee, *Korea will Probe Chaebol Executives in Tax-Evasion Reports*, BLOOMBERG BUS., available at <http://www.bloomberg.com/news/articles/2013-05-30/korea-will-probe-chaebol-executives-named-in-tax-evasion-reports> (last visited Apr. 19, 2016).

¹⁵ Jung-a Song, *S Korea Targets Foreign Funds in Tax Move*, FINANCIAL TIMES, Aug. 26, 2005, available at <http://www.ft.com/intl/cms/s/0/0961a0bc-1605-11da-8081-00000e2511c8.html#axzz3q7ndIVeG> (last visited Apr. 19, 2016).

¹⁶ *Supra* note 11.

¹⁷ Agreement between the Government of the Republic of Korea and the Belgium-Luxembourg Economic Union for the Reciprocal Promotion and Protection of Investments, Dec. 12, 2006, available at http://www.mofa.go.kr/incboard/faimsif/treaty_popup.jsp?ITEM_ID=37AD894E87608C3E492572BF0029DC50&ITEM_PARENT_ID=226A3B89AD70735049257244001C3C14 (last visited on May 3, 2016).

¹⁸ *Supra* note 7, at ¶ 53.

¹⁹ A. Alexander, *Policy Implications of Korea's Low Level of Foreign Direct Investment*, KOREAN ECON. SERIES, 19 (Dec. 2008), available at <http://uskoreainstitute.org/wp-content/uploads/2014/01/KES-08-03.pdf> (last visited Apr. 19, 2016).

mandatory lock-up period.²⁰

After the lock-up period ended, Lone Star indicated its intention to sell shares in KEB. Commerzbank also looked to sell its 14.6 percent stake around the same time.²¹ Commerzbank divested an 8.1 percent stake in 2006 rather than waiting to exercise a tag along option that would have entitled it to the same premium price as a large-block sale by Lone Star. Market experts speculated this decision was driven by concerns over regulatory delays and public sentiment in Korea.²²

Public perception began to spread that Lone Star was “dining and dashing,” receiving a huge windfall from its investment while paying none of the associated social costs.²³ In February 2006, suspicion over the quick turnaround of KEB’s stock valuation and strong negative public sentiment led politicians in the Korean National Assembly to launch an investigation into the original purchase of KEB to determine whether Lone Star, KEB, and South Korean regulators had colluded to make KEB appear insolvent so that Lone Star could take advantage of an exception to a law prohibiting investments in banks by non-financial institutions.²⁴

In May 2006, Lone Star exercised its option to acquire an additional 14.1 percent of KEB shares for USD 763 million, raising its total shareholding to 65.1 percent.²⁵ Despite the ongoing investigations, Kookmin Bank agreed to pay USD 6.7 billion for a 64.62 percent stake in KEB. KEB labor unions opposed a merger with another domestic banking institution because of fears about potential layoffs.²⁶ Unionists, joined by lawmakers who decried Lone Star as being a ‘public enemy,’ protested the sale.²⁷

In June 2006, prosecutors sought indictments for 20 individuals from the Financial Supervisory Commission (“FSC”), prime minister’s office, and KEB for manipulating the appearance of KEB’s financial status.²⁸ No indictments, however, were issued for

²⁰ *Id.*

²¹ *Id.*

²² Jeongjin Lim, *Korea Exchange Bank Shares Fall on Commerzbank Early Sale*, WALL ST. J., Mar. 3, 2006, available at <http://www.wsj.com/articles/SB114132390625187801> (last visited on Apr. 19, 2016).

²³ See “Dining and Dashing” Controversy surrounding Lone Star’s Sale of Kukdong Engineering and Construction 론스타 극동건설 매각 ‘먹튀’ 논란, CHOSUNILBO DAILY, June 22, 2007 <available only in Korean>, available at http://news.chosun.com/site/data/html_dir/2007/06/22/2007062200659.html (last visited on Apr. 19, 2016).

²⁴ *Supra* note 19, at 19.

²⁵ *Supra* note 7, at ¶ 11.

²⁶ See *Kookmin Bank to Sign Formal Agreement to Buy KEB*, HANKYOREH DAILY, May 19, 2006, available at http://www.hani.co.kr/arti/english_edition/e_business/124918.html (last visited on Apr. 19, 2016).

²⁷ Jeong-ju Na, *KEB Union Puts Pressure on Lone Star*, KOREA TIMES, Apr. 2, 2006, available at <http://www.nfvzone.com/news/2006/04/02/1529364.htm> (last visited on Apr. 19, 2016).

²⁸ *Supra* note 19, at 22.

Lone Star employees in connection with the purchase of KEB.²⁹

The deadline for the sale to Kookmin Bank passed amid public statements by government officials that no sale would be approved until all investigations had concluded. In late September 2006, the FSC requested that prosecutors investigate whether Lone Star had tampered with the share price of KEB Credit Service Co. (“KEBCS”), a KEB-owned company that had been absorbed during the asset consolidation process.³⁰ The Korean courts denied prosecutors’ requests for arrest warrants for Lone Star executives in connection with the KEBCS investigation citing a lack of evidence.³¹

Lone Star sold 13.6 percent of its KEB shares on the open market for approximately USD 1.1 billion in June 2007. This was possible without the FSC approval because no single buyer obtained a substantial stake in the bank, but was also not eligible for premiums customary with the sale of majority stakes.³²

Despite Lone Star’s ongoing legal battles, the UK-based HSBC Holdings (“HSBC”) announced in August 2007 that it was in negotiations to purchase a 51 percent stake in KEB from Lone Star for USD 6.3 billion.³³ Legal battles dragged on forcing Lone Star and HSBC to extend the contract until July 2008.

On February 1, 2008, the trial court found Lone Star guilty of stock manipulation in the acquisition of KEBCS. This ruling came during the last few weeks of the Roh Moo-hyun administration. Roh, a liberal politician and former human rights lawyer, had gained much popularity by catering to the opinions of young adults on the internet - the so-called ‘netizens’ of Korea.³⁴ Roh was replaced by pro-business Lee Myung-bak in February 2008. Lee, former CEO of Hyundai Engineering and Construction, argued that politics had no place in the law. He was often criticized by opponents for ignoring public sentiment.³⁵

The political tenor surrounding the dispute changed after Lee took office and rearranged his cabinet. The High Court of Korea overturned the trial court’s ruling and

²⁹ *Id.*

³⁰ *Id.*

³¹ See *S. Korea’s Top Court Refuses to Grant Warrant for Lone Star Executive*, YONHAP NEWS (Dec. 19, 2006), available at <http://trove.nla.gov.au/work/142714772?q&versionId=156295971> (last visited Apr. 19, 2016).

³² *Supra* note 7, at ¶ 27.

³³ Sang-Hun Choe, *HSBC in Talks to Acquire a Big Stake in Korean Bank*, N. Y. TIMES, Aug. 21, 2007, available at http://www.nytimes.com/2007/08/21/business/worldbusiness/21lone.html?_r=0 (last visited on Apr. 19, 2016).

³⁴ J. Watts, *World’s First Internet President Logs On*, GUARDIAN, Feb. 24, 2003, available at <http://www.theguardian.com/technology/2003/feb/24/newmedia.koreanews> (last visited on Apr. 19, 2016).

³⁵ See *President Lee Ignores Public Opinion Against Media-related Bills*, HANKYOREH DAILY, July 28, 2009, available at http://h21.hani.com/arti/english_edition/e_editorial/368164.html (last visited on Apr. 19, 2016).

acquitted Lone Star and its CEO of any wrong doing in the acquisition of KEBCS.³⁶ Despite this ruling, the FSC warned it would not approve any sale until all appeals had concluded.³⁷

However, in early September 2008, the FSC indicated that it might approve a sale to HSBC following another review. It is suspected that this position change occurred because of Lone Star's threats to sue the Korean government and pressure from President Lee, who had met with the UK Prime Minister Gordon Brown to discuss the deal.³⁸ No approval was granted, however, as HSBC walked away from the deal on September 18 following the collapse of Lehman Brothers and the resultant financial crisis.³⁹ President Lee acknowledged the government failed to work quickly enough in approving the Lone Star-HSBC deal and condemned public servants for placing personal politics above national interests.⁴⁰

In November 2010, Hana Financial Group agreed to buy Lone Star's 51 percent stake in KEB, valued around USD 3.9 billion at that time.⁴¹ However, the FSC once more refused to grant approval until the KEBCS appeal had concluded.

In 2010, the Supreme Court found KEB guilty of stock manipulation during its acquisition of KEBCS and remanded for further proceedings. In October 2011, Lone Star was fined USD 21 million and its local CEO, Paul Yoo, was sentenced to three years in prison. Yoo asserted that he had intended to shut down KEBCS and had only merged with it because of pressure from Korean officials.⁴² Such assertions, however, would not provide a justification for having done so illegally, but only a motivation for merging with KEBCS.

Lone Star was ordered to sell its stake in KEB below 10 percent because of a law restricting bank ownership by corporations convicted of criminal activity. Public statements by regulators intimated that no sale to Hana would be approved unless

³⁶ Jae-Soon Chang, *SKorea Court Overturns Lone Star Verdict*, USA TODAY, June 24, 2008, available at http://usatoday30.usatoday.com/money/economy/2008-06-24-2572310402_x.htm (last visited on Apr. 19, 2016).

³⁷ *Supra* note 19, at 23.

³⁸ Jae-Kyoung Kim, *Lone Star May Sue Korean Government*, KOREA TIMES, Sept. 4, 2008, available at <https://www.koreatimes.co.kr/www/news/include/print.asp?newsIdx=30576> (last visited on Apr. 19, 2016).

³⁹ Seonjin Cha & Bomi Lim, *HSBC Scraps KEB Purchase after Failing to Cut Price*, BLOOMBERG, Sept. 19, 2008, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a17ZufidoJFE> (last visited on Nov. 15, 2015).

⁴⁰ Jeong-ju Na, *Lee Lamets Delayed Decision on KEB Deal*, KOREA TIMES, Sept. 21, 2008, available at http://www.koreatimes.co.kr/www/news/nation/2015/10/116_31375.html (last visited on Apr. 19, 2016).

⁴¹ P. Stein & A. Tudor, *Lone Star Reaches Deal to Sell KEB*, WALL ST. J., Nov. 15, 2010, available at <http://www.wsj.com/articles/SB10001424052748703326204575616590933846442> (last visited on Apr. 19, 2016).

⁴² Jung-a Song, *Lone Star Found Guilty of Stock Manipulation*, FINANCIAL TIMES, Oct. 6, 2011, 4:35 AM, available at <http://www.ft.com/intl/cms/s/0/af819e02-ef1c-11e0-bc9d-00144feab49a.html#axzz3qGS6MrUx> (last visited on Apr. 19, 2016).

the price was significantly reduced.⁴³ Lone Star reluctantly reduced its price to USD 3.45 billion.⁴⁴ The transaction was completed in February 2012.⁴⁵ The NTS instructed Hana Financial Group to withhold KRW 431 billion in taxes from the purchase of KEB and to pay it directly to the Seoul Regional Tax Office on Lone Star's behalf.⁴⁶

The NTS imposed taxes on Lone Star's earnings from the KEB sale and other investments in Korea. It refused to apply the BTT to any of Lone Star's investments.⁴⁷ Lone Star asserts that the NTS made arbitrary and contradictory decisions to maximize taxation amounts against Lone Star.⁴⁸ Appeals filed by Lone Star have resulted in at least partial tax refunds including a USD 117 million refund from the block share sale of KEB stock in 2007.⁴⁹ The NTS, however, has often refused to abide by these rulings.⁵⁰

On December 10, 2012, Lone Star filed a request to ICSID for arbitration proceedings. The following year the tribunal arbitrators were selected, with Lone Star appointing Charles N. Brower and South Korea appointing Brigitte Stern, respectively. The two parties then selected V.V. Veeder⁵¹ as President of the arbitration tribunal.⁵²

An initial hearing on the merits was held at ICSID in Washington, D.C. in May

⁴³ Benedict B. Yim, *Lone Star Arbitration Case Study*, British Chamber of Commerce Korea, July 24, 2015, available at <http://bcck.or.kr/bcck/?p=2903> (last visited on Apr. 19, 2016).

⁴⁴ Jung-a Song, *Lone Star Agrees to Cut Price of KEB Sale*, FINANCIAL TIMES, Dec. 2, 2011, available at <http://www.ft.com/intl/cms/s/0/2521a8ba-1cca-11e1-8daf-00144feabdc0.html#axzz3qGS6MrUx> (last visited on Apr. 19, 2016).

⁴⁵ Seonjin Cha, *Hana Finishes \$3.9 Billion Korea Exchange Bank Takeover*, BLOOMBERG BUS., Feb. 9, 2012, available at <http://www.bloomberg.com/news/articles/2012-02-09/hana-completes-3-9-billion-takeover-of-korea-exchange-bank-from-lone-star> (last visited on Apr. 19, 2016).

⁴⁶ *Supra* note 7, at ¶ 54.

⁴⁷ Sung-eun S. Kim, *The Latest Win by Lone Star against National Tax Service*, INHOUSECOMMUNITY, June 13, 2014, available at <http://www.inhousecommunity.com/article.php?id=86KBGTV-W4KB07D-70WNUAY-H7P4763> (last visited on Apr. 19, 2016).

⁴⁸ *Supra* note 7, at ¶ 44.

⁴⁹ *See Lone Star Wins Tax Refund Case*, KOREA HERALD, June 13, 2014, available at <http://www.koreaherald.com/view.php?ud=20140613001304> (last visited on Apr. 19, 2016).

⁵⁰ The NTS levied a KRW 104 billion income tax on a sale of real estate which Lone Star challenged. The Supreme Court ruled that the income tax violated local tax and ordered the NTS to refund the full amount. The NTS then changed the classification of the tax from 'income tax' to 'corporate tax' post-judgment and refused to comply. As of April 2016, the issue is pending on appeal before the Supreme Court.

⁵¹ Veeder was also a member of an International Court of Arbitration (ICC) tribunal that ruled in Lone Star's favor in April 2011 in a contract dispute with the Korean government over a failed construction development in 2000. *See Min-ho Jung, \$4.7 bln Lone Star case will begin next week*, KOREA TIMES, Oct. 24, 2015, available at <http://www.koreatimesus.com/4-7-bl-lone-star-case-will-begin-next-week> (last visited on May 4, 2016).

⁵² *LSF-KEB Holdings SCA and others v. Republic of Korea*, ICSID Case No. ARB/12/37 (May 10, 2013), available at <https://icsid.worldbank.org/apps/icsidweb/cases/Pages/casedetail.aspx?caseno=ARB/12/37&tab=PRO> (last visited on Apr. 19, 2016).

2015.⁵³ Second and third rounds of hearings were held in both June 2015 and January 2016.⁵⁴

III. Delayed Regulatory Approval for Sale of KEB

A. Breach of Local Law

The Korean government is expected to assert that breaches of local law during the purchase of KEB and acquisition of KEBCS justified delaying approval of any KEB sale. These positions will be invoked in an attempt to assert the tribunal lacks jurisdiction over the current dispute or justify regulatory delays.

Failures by Lone Star to adhere to host state law or international custom, will greatly influence how the current ICSID tribunal views the accusations against Lone Star.

Misrepresentations and fraud on the claimant's part are generally considered a violation of good faith that prevents investors from invoking the substantial protective rights of a treaty.⁵⁵ In *Alasdair Ross Anderson v. Costa Rica*, a violation of host state laws and lack of due diligence to comply with host state laws resulted in a want of jurisdiction.⁵⁶ Some evidence suggests that violations of host state laws or principles of good faith will limit the protection of investment, even if there is no language in the BIT to that effect.⁵⁷ Additionally, some precedent suggests that when a government cooperates with or acquiesces to illegal act, it creates a waiver allowing the investor to receive protection under the BIT regardless of the illegality.⁵⁸ It is, however, relatively well understood that lack of jurisdiction or limits on protection may only be applicable when misconduct occurs during the initial

⁵³ *Id.*

⁵⁴ See Completion of the Second Hearing on the Merits with Lone Star 론스타 관련 제2차 심리기일 종료, Ministry of Justice Press Release (July 8, 2015) <available only in Korean>, available at http://www.moj.go.kr/HP/COM/bbs_03/BoardList.do (last visited on May 3, 2016).

⁵⁵ *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, ¶ 144 (Aug. 27, 2008), available at <http://www.italaw.com/cases/documents/862> (last visited on May 3, 2016).

⁵⁶ *Alasdair Ross Anderson et al v. Costa Rica*, ICSID Case No. ARB(AF)/07/03, Award (May 19, 2010), available at <http://www.italaw.com/cases/documents/86> (last visited on May 3, 2016).

⁵⁷ *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award (June 18, 2010), available at <http://www.italaw.com/cases/documents/528> (last visited on May 3, 2016).

⁵⁸ *Desert Line Projects LLC v. The Republic of Yemen*, ICSID Case No. ARB/05/17, Award (Feb. 6, 2008), available at <http://www.italaw.com/cases/documents/357> (last visited on May 3, 2016).

phases of the investment.⁵⁹

In *Plama v. Bulgaria*, an investor made fraudulent representations about his assets and managerial experience to Bulgaria in a privatization agreement. The tribunal held that contracts obtained by fraudulent representations were “contrary to the basic notion of international public policy” and thus should not be enforced by a tribunal.⁶⁰ If the Korean government were able to convince the ICSID tribunal that Lone Star had actively colluded with KEB executives and FSC regulators in order to make KEB appear insolvent, the tribunal might deny jurisdiction altogether because such an act would surely qualify as a fraudulent representation contrary to law. However, as Korean prosecutors were unable to show clear evidence of wrongdoing before Korean courts to secure an indictment for even a single Lone Star official for the acquisition of KEB in 2003, it seems unlikely they will be able to do so before the ICSID tribunal.

Fraudulent representations are not pre-requisite for denying to protection to investors under a BIT. In *Alasdair Ross Anderson v. Costa Rica*, the tribunal determined that even though the investors had not broken the law directly, they should have conducted thorough due diligence prior to any investment in order to ensure that the company they were investing in was also acting in accordance with the host state laws.⁶¹ The tribunal found specific language in the Canada-Costa Rica BIT that: “Investments subject to treaty protection be made or owned in accordance with the law of the host country” because the “assurance of legality with respect to investment has important, indeed crucial, consequences for the public welfare and well-being of any country.”⁶²

There was sufficient evidence provided by prosecutors for the indictment of twenty KEB executives and government regulators in connection with the 2003 sale of KEB.⁶³ Only two of those individuals, however, were ultimately convicted on minor bribery charges; the remaining eighteen were found not-guilty. As Lone Star relied on KEB and the FSC for documents during its due diligence and the level of malfeasance between KEB and the FSC was so low, it is unclear how easily Lone Star could have discovered this illegality during its due diligence prior to acquiring KEB.

Keeping the incredibly low level of criminality found by the Korean courts in

⁵⁹ R. DOLZER & C. SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 93 (2d ed. 2012). (citing *Hamester v. Ghana*)

⁶⁰ *Supra* note 55, at ¶ 143.

⁶¹ *Supra* note 56, at ¶¶ 55–6.

⁶² *Id.* at ¶ 53.

⁶³ L. Santini, *Lone Star is Cleared in Probe of KEB Deal*, WALL ST. J., June 20, 2006, available at <http://www.wsj.com/articles/SB115070749110983939> (last visited on Apr. 19, 2016).

mind, the tribunal would likely not impute any liability on Lone Star for failing to discover any illegality during its due diligence. It is also worth noting that the 1974 Korea-Belgium BIT did not indicate that investments should be made in accordance with local laws, as was found in the Canada-Costa Rica BIT. Therefore, it may also be difficult to demonstrate the ‘relative importance’ Korea placed on the legality of investments anyway.⁶⁴

Lone Star was found guilty of manipulating the market price of KEBCS in February 2004 during its asset consolidation process.⁶⁵ Illegal acts during the performance of an investment generally have no bearing on a tribunal’s jurisdiction or application scope of the BIT; though “it may well be relevant in the context of the substantive merits of a claim brought under the BIT” or on the amount of damages the tribunal awards.⁶⁶ Accordingly, the impact of Lone Star’s stock market manipulation for KEBCS would better be addressed in defense of Korea’s continued delays of the KEB sale as it relates to fair and equitable treatment.

B. Fair & Equitable Treatment in Regulatory Delays

Lone Star asserts that Korea’s continued delays in approving its sale of KEB and the subsequent economic loss qualify as a violation of Article 2.2 of the 2006 Korea-Belgium BIT which states that Korea has an obligation to provide “fair and equitable treatment” (“FET”), and “full and continuous protection and security” to investors.⁶⁷ The Korean government contends that it was authorized to deny approving any sale until the criminal proceedings surrounding the acquisition of KEBCS were resolved and that such an exercise of executive powers is not a violation of FET.⁶⁸

FET is a broad concept, the scope of which has often been debated in international investment arbitrations. An examination of tribunal awards demonstrates that FET would demand a host state generally adhere to certain minimum standards

⁶⁴ *Supra* note 56, at ¶ 53.

⁶⁵ Jung-a Song, *Lone Star Found Guilty of Stock Manipulation*, FINANCIAL TIMES, Oct. 6, 2011, available at <http://www.ft.com/intl/cms/s/0/af819e02-efc-11e0-bc9d-00144feab49a.html#axzz3qGS6MrUx> (last visited on Apr. 19, 2016).

⁶⁶ *Supra* note 57, at ¶ 127. See also *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines*, ICSID Case No. ARB/03/25, Award, ¶ 344 (Aug. 16, 2007), available at <http://www.italaw.com/sites/default/files/case-documents/ita0340.pdf> (last visited on May 3, 2016).

⁶⁷ Lone Star also raised claims of expropriation. However, because expropriation tests are altogether narrower and arbitral tribunals are somewhat reluctant to find indirect expropriation where a BIT contains a FET clause and a violation of FET is present, this paper chooses only to analyze FET for the sake of brevity.

⁶⁸ See The Korean Government’s Stance on the international Arbitration with Lone Star 론스타의 국제중재 제기에 대한 우리 정부의 입장, National Tax Service (Nov. 22, 2012) <available only in Korean>, available at http://www.korea.kr/policy/pressReleaseView.do?newsId=155863141&call_from=naver_news (last visited on May 4, 2016)

including providing stability and protecting the investor's legitimate expectations, transparency, complying with contractual obligations, procedural propriety and due process, good faith, and freedom from harassment and coercion.⁶⁹

An investor's legitimate expectations are generally measured by the laws and representations he or she relied upon when making an investment. More specifically, tribunals have stated that host states have a certain "obligation not to alter the legal and business environment in which the investment has been made."⁷⁰ This means that "if a new law is adopted, or an existing law is revoked or interpreted or applied in a new way," it could lead to state liability.⁷¹ Some tribunals have insisted that investors may only rely on specific representations by host states in establishing legitimate expectations.⁷² However, recent trends acknowledge that specific representations by governments are not indispensable for legitimate expectations claims. In *Electrabel v. Hungary*,⁷³ the tribunal chose to apply a 'balancing test' that looked to determine whether the State had a legitimate public policy objective and whether the means it used to achieve this objective were "excessive considering the relative weight of each interest involved."⁷⁴

Furthermore, sovereign exercises of power that lead to a breach of contract are often regarded as a violation of the FET standard.⁷⁵ This is particularly relevant when a government interferes into a contract between a private investor and a state entity.⁷⁶

There was an undeniable shift in public perception of foreign investment firms in Korea in 2005, from viewing them as 'potential saviors' to "opportunists and

⁶⁹ *Supra* note 59, at 145-60.

⁷⁰ *Occidental Petroleum Corporation Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, ¶ 191 (July 1, 2004), available at <http://www.italaw.com/sites/default/files/case-documents/italaw1094.pdf> (last visited on May 4, 2016).

⁷¹ L. Johnson & O. Volkov, *State Liability for Regulatory Change: How International Investment Rules are Overriding Domestic Law*, INVESTMENT TREATY NEWS, Jan. 6, 2014, available at <https://www.iisd.org/itm/2014/01/06/state-liability-for-regulatory-change-how-international-investment-rules-are-overriding-domestic-law> (last visited on Apr. 19, 2016).

⁷² *EDF (services) Limited v. Romania*, ICSID Case No. ARB/05/13 Award, ¶ 217 (Oct. 8, 2009), available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1215_En&caseId=C57 (last visited on May 3, 2016).

⁷³ This case is particularly noteworthy as both V.V. Veeder and Brigitte Stern, arbitrators in the current case, were members of the *Electrabel* tribunal.

⁷⁴ *Electrabel S.A. v. Republic of Hungary*, ICSID Case No. ARB/07/19, Award, ¶ 181 (Nov. 25, 2015), available at <http://www.italaw.com/cases/380> (last visited on May 3, 2016).

⁷⁵ *Rumeli Telekom A.S. and Telsim Mobil Telekomikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16 Award, ¶ 615 (July 29, 2008), available at <http://www.italaw.com/documents/Telsimaward.pdf> (last visited on May 3, 2016).

⁷⁶ *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No. ARB/07/16, Award, ¶ 422 (Nov. 8, 2010), available at <http://www.italaw.com/sites/default/files/case-documents/ita0026.pdf> (last visited on May 3, 2016).

profiteers.”⁷⁷ This served as the impetus for substantive government-driven reforms to the preexisting legal and business frameworks. Host States are entitled to investigate and prosecute breaches of domestic law. If Lone Star could demonstrate that the government investigations either exceeded preexisting legal frameworks, or were in bad faith initiated and prolonged based on negative public opinion rather than a well-founded suspicion of illegal behavior, however, Lone Star’s arguments would become even more tenable.

Korean Lawmakers Young-ju Kim of the Uri Party and Sang-jeong Sim of the Democratic Labor Party decried Lone Star as a ‘public enemy’ in the media as they participated in protests with KEB unions.⁷⁸ The government also released public statements that no approval for a sale to Hana Financial Group would be given until Lone Star significantly reduced its sale price.⁷⁹ The new presidential administration acknowledged in 2008 that the denial of regulatory approval had been a political rather than legal decision.⁸⁰ These actions were clearly unrelated to any Korean law or judicial order.

The Korean government may argue that it had the right to deny regulatory approval because of ongoing legal proceedings regarding the stock manipulation of KEBCS. While there is ample legal precedent for preventing companies and individuals convicted of crimes from investing in Korea, however, there is no specific law preventing them from selling their assets. Following its conviction for manipulating the stock market in its acquisition of KEBCS, Lone Star was ordered to immediately sell 41.02 percent of its shares by the FSC based on Article 16-4(3) of the Bank Act and Article 215 of the repealed Securities and Exchange Act.⁸¹ Lone Star asserts preventing its sale of KEB in effect prolonged a situation where a company that had violated a finance-related law remained in control of a banking institution in Korea - contrary to the intent of the Bank Act and Securities and Exchange Act.⁸²

When dealing with an area in which Korean law is silent or the Korean government’s actions are contrary in effect to the intent of its own laws, the tribunal might ask

⁷⁷ M. Fackler, *U.S. Firm Has Korea Up in Arms*, N. Y. TIMES, July 5, 2006, available at <http://www.nytimes.com/2006/07/05/business/worldbusiness/05star.html?pagewanted=print> (last visited on Apr. 19, 2016).

⁷⁸ Jeong-ju Na, *KEB Union Puts Pressure on Lone Star*, KOREA TIMES, Apr. 2, 2006, available at <http://www.nfvzone.com/news/2006/04/02/1529364.htm> (last visited on Apr. 19, 2016).

⁷⁹ *Supra* note 43.

⁸⁰ Jeong-ju Na, *Lee Lamets Delayed Decision on KEB Deal*, KOREA TIMES, Sept. 21, 2008, available at http://www.koreatimes.co.kr/www/news/nation/2015/10/116_31375.html (last visited on Apr. 19, 2016).

⁸¹ *See FSC to Order Lone Star to Sell its KEB Shares on the 18th... Now Debate Rages over Sale Method* 금융위, 18일 론스타 외환銀 지분 매각명령...막판 ‘매각방식’ 논란 후끈, SEGYE.COM, Nov. 16, 2011, <available in Korean>, available at <http://www.segye.com/content/html/2011/11/16/20111116004784.html> (last visited on Apr. 19, 2016).

⁸² *Supra* note 7, at ¶ 34.

if the government could have used more flexible means to ensure justice without causing undue harm to Lone Star. This reasoning has appeared in the tribunals' decisions on liability in determining whether government regulations were justified.⁸³ The tribunal could investigate whether the government might have held a bond on the sale of KEB shares to cover any potential fines in addition to placing travel bans on those under indictment, rather than preventing the sale of KEB entirely. This type of reasoning, however, has also been highly criticized by other tribunals and occasionally overturned in annulment proceedings.⁸⁴ So, it is uncertain whether the current panel will find such analysis to be either fruitful or persuasive.

Another potential issue against FET is government interference in the liquidation clause of the investment contract with KEB, allowing Lone Star to sell its shares two years after its initial investment. As KEB was partially a state entity at the time of the investment and refusal to grant regulatory approval is an exercise of executive power, Lone Star could claim it a breach of contract that amounts to a violation of FET. Any such clause in the investment contract almost certainly included wording that subjected any sale to regulatory approval significantly diminishing the power of Lone Star's argument for contractual breach. However, if the tribunal were to find bad faith or discriminatory treatment in the delay of regulatory approval on the part of the government, this contract could provide substantial proof of a specific promise Lone Star had received from Korea and relied upon when making its investment. Such a specific promise would be critical in asserting the expectations to liquidate its assets reasonably.

Whether the delay in granting regulatory approval for the sale of KEB was a violation of the FET standard will be determined by a fact-based analysis. Critical ground for this decision lies in balancing the reasonable expectations of Lone Star, based on preexisting legal frameworks and contractual promises, against Korea's national interests and public policy concerns in prosecuting criminal offenses and securing banking interests.

If the Korean government exceeded its legal frameworks to achieve political objectives, particularly when other less harsh alternatives were available, it may be most instrumental in demonstrating a violation of FET.

⁸³ *Suez, Sociedad General de Aguas de Barcelona S.A. and InterAgua Servicios Integrales del Agua S.A. v. Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Liability, ¶ 215 (July 30, 2010), available at <http://www.italaw.com/sites/default/files/case-documents/ita0813.pdf> (last visited on Apr. 19, 2016).

⁸⁴ J. Alvarez & K. Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse in the Heart of the Investment Regime*, in Y.B. INT'L INVESTMENT L. & POL'Y 382 (2008/2009).

IV. Tax Assessment on Sale of KEB : Validity and Applicability of the Korea-Belgium BITs and BTT

In determining whether Lone Star is eligible for the double-taxation exemption under bilateral agreements between Belgium and Korea, there are three primary issues that must be addressed: (1) which Korea-Belgium BIT applies?; (2) whether Lone Star's subsidiaries qualify as investors under the Korea-Belgium BIT?; and (3) whether Lone Star could justifiably rely on the Korea-Belgium BTT for its taxation-based investment claims.

A. Validity of the 1974 and 2006 Korea-Belgium BITs

There is some confusion as to which BIT should be invoked in the current arbitration before ICSID. While the ICSID case details state the 1974 Korea-Belgium BIT is the instrument invoked,⁸⁵ Lone Star cites to provisions from the 2006 Korea-Belgium BIT when asserting its claims against the Korean government in the notification of dispute.⁸⁶

The 1974 Korea-Belgium BIT was signed on December 20, 1974 and entered into force September 3, 1976 for a period of 15 years with an automatic renewal clause.⁸⁷ The treaty expired for the first time in 1991, but was automatically extended until 2006. In 2006, it was automatically renewed once again until March 27, 2011 when it was replaced by the Korea-Belgium BIT signed on December 12, 2006.⁸⁸

This timing may appear tricky because the majority of the governmental malfeasance alleged by Lone Star occurred between 2006 and 2011, when the 2006 Korea-Belgium BIT had been signed, but prior to its entry into force.

The 1974 BIT allows for protections to be provisionally granted to investors between the date of signing and the official entry into force date.⁸⁹ The 2006 BIT, however, contains no such wording, probably because the 1974 BIT was already in place to protect investments when the 2006 BIT was signed. The 2006 BIT states that it "shall apply to all investments, whether made before or after [the 2006 BIT's] entry

⁸⁵ *Supra* note 52.

⁸⁶ *Supra* note 7, at ¶ 59.

⁸⁷ *Agreement on the Encouragement and Reciprocal Protection of Investments*, Kor.-Belg. & Lux. (Dec. 20, 1974), available at <http://investmentpolicyhub.unctad.org/IIA/country/111/treaty/497> (last visited on May 3, 2016). [Emphasis added]

⁸⁸ 2006 Korea-Belgium BIT, art. 12.

⁸⁹ 1974 Korea-Belgium BIT, art. 12.

into force.”⁹⁰ This is qualified in the same article, however, where it states that the 2006 BIT is not “applicable to disputes concerning investments which are subject of a dispute settlement procedure under the [1974 Korea-Belgium BIT].”⁹¹

The question on which BIT is applicable in the current case could have a substantial effect on the outcome because the definition of ‘investors’ between the two treaties is so disparate that it could lead to differing outcomes on jurisdiction.⁹²

B. Qualifying Investors under the Korea-Belgium BIT

Lone Star contends that as its Belgium and Luxembourg affiliates are ‘investors’ under the Korea-Belgium BIT, they are entitled to the protection afforded investors in that agreement. The Korean government, however, argues that these affiliates are nothing more than paper companies established for tax evasion purposes and as such are not eligible for the protections afforded by the BIT.⁹³

Among the various criteria that determine a corporation’s nationality, the most commonly viewed is the place of incorporation.⁹⁴ However, the effective seat or so-called *siège social* may also be taken into consideration.⁹⁵ If an investment treaty defines an investor based on incorporation, investor-State tribunals have consistently refused to pierce the corporate veil to determine a company’s true ownership - even in cases where the owners are nationals of the host country itself.⁹⁶ Tribunals are often sympathetic with the fact that claimants are mere shell companies with no real connection to the State in question, but tend to defer to the plain meaning of the investment agreement reasoning that the parties to the agreement were in a better position to actually define terms.⁹⁷

In its preamble, the 1974 Korea-Belgium BIT states that it was ratified in recognition

⁹⁰ 2006 Korea-Belgium BIT, art. 11.

⁹¹ *Id.*

⁹² 1974 Korea-Belgium BIT, art. 3(2). *See also* 2006 Korea-Belgium BIT, art. 1(3).

⁹³ Joon Yoo, *South Korea’s First Major Investor-State Dispute in the 21st Century: Foreign Investors and Tax*, 37 MICH. J. INT’L L. (2015), available at <http://www.mjilonline.org/south-koreas-first-major-investor-state-dispute-in-the-21st-century> (last visited on Apr. 19, 2016).

⁹⁴ *Supra* note 59, at 47.

⁹⁵ *Id.*

⁹⁶ *Id.* at 48.

⁹⁷ *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL (1976), Partial Award, ¶¶ 240-1 (Mar. 17, 2006), available at <http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf>. *See also* *AES Corp v The Argentine Republic*, ICSID Case No. ARB/02/17, Decision on Jurisdiction, ¶¶ 75–80 (Apr. 26, 2005), available at <http://www.italaw.com/sites/default/files/case-documents/ita0011.pdf> (all last visited on May 3, 2016).

of “the need to protect investments by *nationals or legal persons* of either State.”⁹⁸ The phrase, “nationals or legal persons” appears fifteen times in the 1974 Korea-Belgium BIT and always appears in conjunction with the term - investment or investments - which would indicate that the agreement views “nationals and legal persons” as being synonymous with the term ‘investors.’⁹⁹ Article 3 of the Korea-Belgium BIT reads:

(2) a) The term ‘nationals’ are physical persons who, according to the law of each Contracting Party, are considered as citizens of that country; b) The term ‘companies’ are; ... 2) with respect to the Kingdom of Belgium and the Grand Duchy of Luxemburg, any juridical person as well as any commercial company, *having its seat in the territory of the Kingdom of Belgium or the Grand Duchy of Luxemburg* and lawfully constituted in accordance with the legislation of Belgium or Luxemburg.¹⁰⁰

The term, “nationals and legal persons” is the expression referring to investors in the agreement and yet the definition section includes ‘nationals’ and ‘companies’ without mentioning ‘legal persons.’ As the term ‘companies’ never appears again in the BIT, it would seem the parties intended to define ‘legal persons’ in Article 3(2)(b), but used the term ‘companies’ in error. The tribunal will likely excuse this mistake and the resultant ambiguity, choosing to instead apply the definition of ‘companies’ to the term ‘legal persons.’¹⁰¹

Article 3(2)(b) will be the key to determining whether Lone Star’s subsidiaries are eligible for BIT protection. It defines a company as “having its seat in the territory of the Kingdom of Belgium or the Grand Duchy of Luxemburg and lawfully constituted in accordance with the legislation of Belgium or Luxemburg.”¹⁰² This wording implies that a Belgian juridical person is determined by a two-part test that includes both (1) having its ‘seat’ in Belgium and (2) being lawfully incorporated under Belgian law.

The question of ‘seat’ promises to be the most contentious and least clear of the two tests. The Belgium-Luxembourg BITs have traditionally relied on ‘seat’ in combination with incorporation in classifying investors.¹⁰³ This occurs in a number of

⁹⁸ 1974 Korea-Belgium BIT. [Emphasis added]

⁹⁹ The controlling text, or *texte authentique*, for the 1974 Korea-Belgium BIT is English.

¹⁰⁰ 1974 Korea-Belgium BIT, art. 3(2). [Emphasis added]

¹⁰¹ A failure to interpret the BIT in this manner would be largely inequitable because it could create a want of jurisdiction which would deny Lone Star any protection under the BIT.

¹⁰² 1974 Korea-Belgium BIT, art. 3(2)(b)(2)

¹⁰³ R. DOLZER & M. STEVENS, *BILATERAL INVESTMENT TREATIES* 38 (1995).

Belgium BITs. The 1988 Belgium-Bulgaria BIT defines investors using the term *siège social* as one of its requirements.¹⁰⁴ Belgium has also applied *siège réel* in determining which national laws are applicable to companies within its own borders.¹⁰⁵ Criteria for *siège social* or *siège réel* are usually based on where a legal entity's judicial and economic integration are situated.¹⁰⁶ Whether the eight Lone Star subsidiaries can be considered to have seats in Belgium and Luxembourg will be another factual question. It depends on a sufficient level of contacts, investments, real estate, and management of those subsidiaries in those two countries.

Recently, Belgium has moved away from 'seat' as a defining characteristic for juridical persons. This trend can be seen in the 2006 BIT which defines 'juridical persons' more broadly, removing any reference to 'seat.' Article 1(3)(b) reads:

"Juridical person" means any entity such as companies, public institutions, authorities, foundations, partnerships, firms, establishments, organizations, corporations or associations *incorporated or constituted in accordance with the laws and regulations of the Republic of Korea, of the Kingdom of Belgium, or of the Grand-Duchy of Luxembourg.*¹⁰⁷

Lone Star's affiliates in Belgium and Luxembourg would thus qualify for protection more easily under the 2006 BIT than the 1974 BIT, which still includes seat in the determination of juridical nationality. It is, however, unclear whether the tribunal will give any weight to the 2006 Korea-Belgium BIT considering its limited applicability.

Korea's strongest argument is that Lone Star is not entitled to protection under the 1974 BIT because it fails to satisfy the seat requirement for Belgian nationality. Throughout the dispute, Lone Star's primary management center is evidently in Dallas, Texas. In 2008, Lone Star Chairman John Grayken, a US citizen flew to Korea out of Lone Star's Dallas headquarters in order to testify at a trial on behalf of Lone Star.¹⁰⁸ Grayken was critical of the Korean government in the media, further

¹⁰⁴ 1998 BLEU-Bulgaria BIT, art. 1(3)(B)(a) [Emphasis added]. See also 1989 BLEU-Czechoslovakia BIT and 1987 BLEU-Poland BIT, available at <http://investmentpolicyhub.unctad.org/IIA/CountryBits/19> (last visited on May 4, 2016).

¹⁰⁵ D. VAN GERVEN, CAPITAL DIRECTIVE IN EUROPE: THE RULES ON INCORPORATION AND CAPITAL OF LIMITED LIABILITY COMPANIES 98 (2014).

¹⁰⁶ C. WALLACE, THE MULTINATIONAL ENTERPRISE AND LEGAL CONTROL: HOST STATE SOVEREIGNTY IN AN ERA OF ECONOMIC GLOBALIZATION 133 (2002), available at <https://books.google.com/books?id=Y1G0qZG8OXUC&lpg=PA133&ots=9sPovONRpU&dq=The%20establishment%20of%20foreign%20companies%20in%20France%20xanthaki&pg=PA133#v=onepage&q=The%20establishment%20of%20foreign%20companies%20in%20France%20xanthaki&f=false> (last visited Apr. 19, 2016).

¹⁰⁷ 2006 Korea-Belgium BIT. [Emphasis added]

¹⁰⁸ V. Wai-yin Kwok, *Grayken to Testify in Korea Exchange Bank Trial*, FORBES, Jan. 11, 2008, available at http://www.forbes.com/2008/01/11/lonestar-keb-grayken-markets-equity-cx_vk_0111markets05.html (last visited Apr. 19, 2016).

demonstrating his hands-on involvement.¹⁰⁹ Other executives involved in KEB including Michael D. Thomson, who served as director of KEB and general counsel for Lone Star, were also based in Dallas. If the Korean government can convince the tribunal that the textual ambiguity in the 1974 BIT and reference to ‘seat’ justify piercing the corporate veil of Lone Star’s Belgian affiliates, it could create a want of jurisdiction. Lone Star, however, might take what it viewed as essential minimum steps to qualify as a Belgian investor under the BIT. So, this will undoubtedly be a contentious issue. Even if Lone Star’s Belgian affiliates qualify as investors under the BIT, the tribunal could decide it lacks jurisdiction for its tax-based claims.

C. Justifiable Reliance on the Korea-Belgium BTT

Lone Star argues that Korea “imposed arbitrary and contradictory tax assessments on Lone Star and its affiliates in contravention of bilateral tax treaties entered into by Korea.”¹¹⁰ Korea, however, counters that Lone Star’s affiliates did not qualify as Belgian companies because they were shell companies created for the express purpose of tax evasion.¹¹¹

It is unclear whether an investor can bring a claim under an international investment agreement for taxation policy pursued by the host State. These claims are often restricted by taxation carve-out clauses that push taxation claims outside the ambit of treaties.¹¹² The 1974 BIT neither contains a taxation carve-out clause, nor creates a right for taxation based claims or reference the BTT.

The Korea-Belgium BTT is a distinct instrument from the BIT. The BTT is an agreement between two States which creates no specific rights for investors.¹¹³ The BTT provides a right for residents of one contracting State to raise claims through said State. When a claim is deemed justified each respective Contracting State shall endeavor to resolve the case by mutual agreement procedure.¹¹⁴ This is the same procedure Belgium unsuccessfully attempted to initiate with Korea in 2007. In particular, Lone Star relies on Article 13(3) of the Korea-Belgium BTT which reads:

¹⁰⁹ See *Lone Star’s Criticism of Korea’s Investment Climate*, KBS WORLD RADIO, May 26, 2006, available at http://world.kbs.co.kr/english/archive/program/news_issue.htm?no=7203 (last visited Apr. 19, 2016).

¹¹⁰ *Supra* note 1.

¹¹¹ *Supra* note 68.

¹¹² M. Davie, *Taxation-Based Investment Treaty Claims*, 6 J. INT’L DISP. SETTLEMENT 202-27 (2015), available at <http://jids.oxfordjournals.org/content/6/1/202.abstract> (last visited on Apr. 19, 2016).

¹¹³ Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Kor.-Belg. (Apr. 20, 1994), available at http://www.nts.go.kr/eng/resources/resour_02.asp?minfoKey=MINF7620080220173406 (last visited on Apr. 19, 2016).

¹¹⁴ *Id.* art. 24(1)(2).

“Gains from the alienation of property ... shall be taxable only in the Contracting State of which the alienator is a resident.”¹¹⁵

While protections against arbitrary and discriminatory tax-based claims may not be addressed specifically in many investment treaties, there is a burgeoning body of law that has begun to recognize such claims when they fall afoul of non-expropriation or FET standards.¹¹⁶ In the course of determining whether an investor can raise a tax-based claim under an investment treaty, however, there is still an insufficient amount of law on the topic to provide much predictive value.¹¹⁷

The *Burlington v. Ecuador* case demonstrates some of the problems faced by tax-based investment claims. In that case, two arbitrators, including Brigitte Stern, held that: “Windfall taxes of between 50% and [99%] were not expropriatory as they did not render the claimant’s investment *totally* unprofitable.”¹¹⁸ The lone dissenter concluded that it was unreasonable to expect an investor to work “one half of its time, or close to 100% of its time, for the State while being allowed” only a minimal income.¹¹⁹

The *Burlington* Tribunal is particularly critical to Lone Star’s tax-based investment claims because Brigitte Stern is also a member of the current tribunal. This might indicate a significant obstacle in Lone Star’s attempts to raise these claims under anything other than an expropriation standard because Lone Star is not a party to the BIT and is therefore not guaranteed by any specific tax-based investment rights. As expropriation claims, however, are difficult to prove, Lone Star faces a daunting task in proving its tax related damages. The fact that the alleged damages fall far below the 50-99 percent tax rates deemed legitimate in *Burlington* also bodes poorly for Lone Star’s chances.

¹¹⁵ *Id.* art. 13(3).

¹¹⁶ *Supra* note 112, at 219-20.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 220. [Emphasis added]

¹¹⁹ *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Dissenting Opinion of Arbitrator Orrego Vicuña, ¶ 27 (Nov. 8, 2012) available at http://www.italaw.com/sites/default/files/case-documents/italaw1095_0.pdf (last visited on Apr. 19, 2016).

V. Tax-based Investment Claims under FET

Lone Star argues:

NTS has imposed taxes against Lone Star ... by blatantly disregarding the rights of Belgian shareholders ... while at the same time continuously altering its substantive positions from investment-to-investment ... as needed to achieve its singular goal of imposing the maximum tax on Lone Star.¹²⁰

Korea would contend that because Lone Star's affiliates are nothing more than shell companies, the application of the US-Korea tax treaties or local tax codes were more appropriate in levying taxes against Lone Star's investments.

While tax-based expropriation claims are somewhat difficult to prove, the tribunals have been receptive to claims that fall afoul of FET, national treatment (discriminatory treatment), or most favored nation treatment ("MFN") guarantees provided in BITs.¹²¹

State conduct that breaches FET is "arbitrary, grossly unfair, unjust or idiosyncratic... [it] is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety."¹²² If a State, *e.g.*, refuses to abide by judgments of its own courts, it has been deemed a violation of FET.¹²³ If a host State denies justice or due process for opportunistic reasons, it is facially discriminatory.¹²⁴ Discrimination based on citizenship has also been regarded as a failure to grant FET.¹²⁵

National treatment requires a host State treat investors no less favorably than its own domestic investors or investors of third parties.¹²⁶ Such a standard necessitates a comparable investor in a relatively similar position to determine whether discrimination has occurred. Unfortunately, most investments are extremely unique,

¹²⁰ *Supra* note 7, at ¶ 56.

¹²¹ *Supra* note 112, at 226–7.

¹²² *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, ¶ 98 (Apr. 30, 2004) available at <http://www.italaw.com/sites/default/files/case-documents/ita0900.pdf> (last visited on Apr. 19, 2016).

¹²³ *Supra* note 59, at 155.

¹²⁴ Benedict Kingsbury & Stephan Schill, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law*, New York University of Law, Public Law & Legal Theory Research Paper Series 9 (Sept. 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1466980 (last visited on Apr. 19, 2016).

¹²⁵ *Supra* note 59, at 144.

¹²⁶ *Supra* note 112, at 208.

so that it is difficult to find a sufficiently similar comparison.

In *Siag v. Egypt*, the tribunal held that the Egyptian government's refusal to abide by its own court rulings was tantamount to denying the due process of law.¹²⁷ The tribunal asserted that such a "failure to provide due process constituted an egregious denial of justice to Claimants, and [was] a contravention" of Egypt's obligation to ensure FET under the BIT.¹²⁸ In *Loewen v. United States*, the tribunal discussed how a trial jury had allowed a "jury to be influenced by persistent appeals to local favoritism as against a foreign litigant." It further stated that such a trial was "clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment."¹²⁹ In *Sergei Paushok v. Mongolia* and *Perenco v. Ecuador*, however, claimants' tax-based claims for violations of FET were dismissed. In these cases, although both parties asserted new taxes on commodities amounted to a violation of FET, the tribunals ruled that commodity prices and taxation on commodities are constantly subject to review and change and, absent a stabilization contract, the parties should have expected possible changes.¹³⁰

The Korean courts have ruled (at least partially) in favor of Lone Star in lawsuits against the NTS on multiple occasions. The NTS has ignored these rulings, but unilaterally changed the classification of the tax and post-ruling in order to justify non-payment of refunds. These trials are not as substantive as those in *Siag v. Egypt* because they address only taxation on an investment rather than a loss of the entire investment itself. However, it is similar because of the NTS's disregard for the court's authority at the expense of Lone Star's due process.

As discussed in *Loewen v. United States*, local sentiment was against Lone Star in Korea. This is evident from lawmakers' and high-level governmental officers' comments regarding foreign investors as 'public enemy' and "eating and running away" at the expense of the Korean people. However, investigations of 5,000 foreign investors for tax evasion, while leaving domestic corporations uninvestigated and undisturbed, is also facially discriminatory. It is both retroaction and potential bad faith for the government to change the tax code during an investment for the express purpose of denying foreign investors the benefits of international treaties they relied

¹²⁷ *Waguih Elie George Slag and Clorinda Vecchi v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award, ¶ 455 (June 1, 2009), available at http://www.italaw.com/sites/default/files/case-documents/ita0786_0.pdf (last visited on May 3, 2016).

¹²⁸ *Id.*

¹²⁹ *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award, ¶¶ 136-7 (June 26, 2003), available at <http://www.italaw.com/sites/default/files/case-documents/ita0470.pdf> (last visited on Apr. 19, 2016).

¹³⁰ *Supra* note 112, at 208.

upon. Korea's refusal to even discuss these changes with Belgium further shows a lack of transparency and fair dealing regarding FET.

Unlike *Paushok* and *Perenco*, Lone Star was not concerned with a tax on a commodity, but rather a tax on income. Like the investors in those cases, Lone Star did not invoke an agreement of its own to limit its tax burden, but relied instead on the Korea-Belgium BTT which provided an exception to double-taxation for capital gains.¹³¹ Because the Korean government decided to unilaterally reinterpret the BTT without requisite notice or the proper mutual agreement procedures with Belgium, Lone Star could not have predicted it would be taxed on its investments. Its legitimate expectations were accordingly frustrated.

If it is able to convince the tribunal to take jurisdiction over its tax-based investment claims under the FET standard, Lone Star can find ample evidence that the NTS denied due process by ignoring rulings of Korean courts and treating Lone Star and other foreign investors discriminatorily.

VI. Conclusion

The nearly decade-long dispute between Lone Star and Korea has resulted in a complicated and unique set of facts and legal issues that will contribute greatly to the body of international investment arbitration precedent as well as have a lasting effect on foreign investment and investment dispute resolution in Korea.

There is much evidence that the Korean government violated FET by exceeding its own legal frameworks in delaying the sale of KEB, arbitrarily taxing Lone Star's investments in contravention to its international agreements, and treating Lone Star discriminatorily because of strong negative public opinion over foreign investment firms.

However, there is no guarantee that the ICSID tribunal will get to fully consider Lone Star's claims because Lone Star might fail to qualify as an investor under the 1974 Korea-Belgium BIT. Additionally the tribunal might find that it lacks the jurisdiction to address Lone Star's taxation-based investment claims because the Korea-Belgium BTT neither grants rights to investors, nor jurisdiction to ICSID. Furthermore, Lone Star's conviction for the stock market manipulation of KEBCS could also decrease any award it might receive. So, while Lone Star's assertions

¹³¹ *Supra* note 7, at ¶ 56.

against Korea might be highly persuasive, it seems unlikely the court will award the full USD 4.68 billion in the end.

An ICSID award on Lone Star's breach of domestic law during its investment will be closely examined by the international investment community and could potentially serve as a predictive signpost for parties in ISDs in the future. The tribunal's reasoning is particularly significant because of the dearth of precedent on the issue. Taxation-based investment claim precedent is similarly lacking. There is a wealth of factors for the current ICSID tribunal to consider during Lone Star's attempt to raise taxation-based claims for its investments in Korea through a BIT; they are Korea's tax investigations of foreign firms, revision of its domestic tax code in response to foreign investments, and apparent contravention of its obligations under international tax treaties. Adding clarity and depth to an already exciting and burgeoning field of law, these factors may further help the tribunal predict which types of taxation-based investment claims can be justifiably heard in future ISDs.

Regardless of the outcome of the arbitration, Korea's image among foreign investors has substantially worsened as a result of the current dispute with Lone Star. A favorable award for Lone Star would go a long way in restoring faith among investors, particularly those who invest on the same scale as Lone Star and could afford to participate in an ISD settlement. Small-scale investors, for whom ICSID arbitration would be cost-prohibitive, however, are still likely to remain leery of investing in Korea until Korea will firmly adhere to internationally recognized standards of investor protection rather than the fickle whims of public opinion.

While the current ISD case between Lone Star and Korea is very unpopular with Korean citizens, it will provide invaluable experience and knowledge that Korea can utilize and apply when drafting its foreign investment law and policy moving forward. It will also provide a chance for foreign investors to look at the merits of investing in Korea anew.

