CONTAINS CONFIDENTIAL INFORMATION—MAY NOT BE USED OR DISCLOSED OUTSIDE ICSID CASE NO. ARB/12/37

BEFORE THE
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

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.

Case No. ARB/12/37

CLAIMANTS' REPLY ON JURISDICTION AND MERITS

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I. EXECUTIVE SUMMARY

1. The parties have provided extensive argumentation and evidence in this proceeding, but the case is now simpler than it has ever been before. The record evidence, now amplified by documents that Respondent only recently produced during the discovery phase of the proceeding, provides compelling and overwhelming support for Claimants' claims. The evidence shows that the Korean regulators knowingly and calculatingly breached their duty to administer the law objectively and reasonably and instead acted for political ends. The regulators' own statements, recorded in internal memoranda and talking points over many years, show the extent to which their actions were driven by a desire to appease political constituencies and avoid responsibility, rather than by the rule of law. Their breaches of the BIT are manifest and inflicted US $4.7 billion in damages on Claimants.

2. Claimants have asserted two categories of claims in this arbitration. One category of claims relates to the unjustifiable refusal of Korea's Financial Services Commission ("FSC") to approve applications by HSBC and Hana Financial Group ("Hana") to acquire Lone Star's shares in Korea Exchange Bank ("KEB"). The other relates to the National Tax Service's ("NTS") use of whatever means necessary to maximize tax assessments against Lone Star, regardless of the legal basis (or lack thereof) for such assessments. Both of these categories of claims have the same root cause—the Korean public's hostility to foreign investors acquiring Korean assets following the 1997-1998 Asian financial crisis and then selling them within a few years at a substantial profit, generally paying little or no Korean tax on those profits. The Korean public even coined a pejorative phrase to describe such behavior—"eat and run"—which became a rallying cry for public protests against Lone Star, for media campaigns, and, most importantly, for the politicians and regulators who blocked Lone Star's efforts to sell its

investment and took whatever steps were necessary to reduce Lone Star's profits. Answering to their political masters, the financial and tax regulators contorted or cast aside the law, created legal controversy where there was none to justify delay, fabricated excuses for inaction, and colluded with and directed Hana to take actions that would reduce Lone Star's profits.

3. The legal issues with respect to both categories of claims are simple. They have only been made complicated by Respondent's efforts to contort the law to create some pretext for its actions—and inaction. With respect to Lone Star's attempts to sell its shares in KEB, the regulators had one and only one task relevant to this dispute: they were required to assess HSBC's and Hana's qualifications to control KEB, and they were required to complete that assessment within a specified period of time. That was the regulators' sole legal obligation and the sole basis of their authority to act. They failed to comply with that obligation and ignored the limitations on their authority. There was absolutely no legal bar to Lone Star selling its shares, and Respondent has never asserted (even in this arbitration) that HSBC and Hana were notqualified to purchase Lone Star's shares. But politics and fear of public criticism, and even prosecution, drove the regulators to act unlawfully, with the result that for months on end they refused to act on HSBC's and Hana's applications.

4. The FSC's own contemporaneous documents state in no uncertain terms that the FSC would not act on or approve HSBC's application to pay Lone Star US $6.2 billion for a controlling interest in KEB because the FSC preferred a Korean purchaser to create a Korean "mega bank." Likewise, FSC documents and Hana's own contemporaneous statements demonstrate that the FSC would not approve Hana's application unless Lone Star reduced the price. The FSC even pressured Hana to prevent KEB from paying dividends that Lone Star would have shared in as it exited its investment in KEB, out of concern that Lone Star's receipt

of its share of any dividends would be seen as adding to its "excess profits." That FSC pressure over dividends was evidently so severe that, in February 2012, Hana told Lone Star in a panic that Hana would not close the KEB sale transaction, in breach of Hana's obligations under the share purchase agreement, unless Lone Star withdrew its plans to propose or even support a year-end 2011 dividend.

5. The only excuse the FSC ever offered for delaying approval of HSBC's and Hana's applications was that, depending on the results of pending litigation, the FSC might have been called upon to order Lone Star to sell its shares. That is, the FSC claimed that it needed to prevent Lone Star from selling its shares indefinitely, in order to wait for a court decision some years later that might cause them to order Lone Star to sell its shares. The explanation for this absurd position—an explanation that is consistent with the FSC's own internal documents—is that, in order to appease an angry public and politicians, the FSC needed to be seen to be punishing Lone Star. And so it prevented Lone Star from selling its shares simply to preserve the opportunity to punish Lone Star by ordering it to do the very same thing—sell its shares (albeit, the FSC expected, at a lower price). This position is logically nonsensical and legally indefensible.

6. The steps the NTS took to maximize Lone Star's tax liability were equally absurd, but not out of character. The NTS has a history of acting as a corrupt political pit bull in Korea. Indeed, all three NTS commissioners who led the agency between 2005 and 2009—when several of the events relevant to this arbitration occurred—were indicted on corruption-related offenses, and two were convicted and sent to prison. The NTS' actions in this case were true to form. A member of Korea's National Assembly aptly summarized Respondent's state of mind: "The tax

issue of Lone Star," he said, "does not depend on the factual grounds but rather on political choice and will."

7. In order to understand the NTS' actions, it is necessary to understand the political context. The Korean public and the Korean National Assembly were angry that, under Korean and international law, Lone Star was not required to pay taxes in Korea on the sale of many of its Korean investments, including its shares in KEB. When the National Assembly castigated the government's "weak will" in not pursuing Lone Star more aggressively, the NTS had its marching orders. As the NTS itself stated, it went to "war" with foreign private equity funds, and Lone Star was public enemy number one. The NTS vowed to do whatever it could to assess the maximum amount of taxes on Lone Star, no matter how ludicrous or wildly inconsistent their legal theories might be. In the campaign that followed, the NTS disregarded the law, it disregarded any pretense of consistency and fairness, and it employed any tactic it could dream up to extract more than US $750 million in taxes from Lone Star.

8. Respondent denies these facts, but it is frustrated at every turn by the evidence, including its own internal documents. Respondent expresses outrage at the suggestion that Korean national and anti-foreign capital sentiment lay behind the regulators' actions. But one of Respondent's own witnesses, Ambassador Han, stated at the time that "Korean society's anti-foreign capital sentiment is too strong" and "it is problematic that the National Assembly, the people and the news media are all far too nationalistic when it comes to foreign capital." The FSC itself stated that approving the sale to HSBC "may lead to the negative public opinions on the government aiding Lone Star's 'eat and run'" and a "share disposal order to Lone Star" would "[m]itigate public sentiment on anti-foreign capital." The FSC expressed similar concern that approving Hana's proposed acquisition would "provoke criticisms that the government aids

and abets Lone Star's 'eat and run' scheme by rushing to approve the sale of KEB . . . ." Claimants have also provided with this Reply an expert witness statement from Dr. Kihwan Kim, one of Korea's most prominent elder statesmen in the area of international economic affairs. According to Dr. Kim, "Based on the spread of [an] anti-foreign investor political agenda, many Koreans quickly forgot about the risks taken by foreign investors in purchasing Korean assets following the 'IMF Crisis' and came to believe that 'eat-and-run' foreign investors simply took advantage of the nation while it was caught helplessly in the midst of an economic crisis." It is not credible for Respondent now to claim that anti-foreign sentiment played no role in the FSC's decision-making.

9. Lone Star ultimately closed on a sale of its shares in KEB to Hana in early 2012, but only at a price dramatically lower than the price HSBC had agreed to pay in 2008—and nearly 20% lower than the price Hana had itself first agreed to pay in 2010. Respondent predictably denies that it had anything to do with the fact that Hana received a price reduction. However, the evidence is clear that the FSC coordinated with, and pressured, Hana to demand a lower price as a condition for approving Hana's acquisition of Lone Star's shares in KEB. At a minimum, the FSC's unlawful delay, combined with ordering Lone Star to sell its shares in short order, clearly provided Hana the leverage to force a substantial price reduction. Transcripts of actual conversations between executives from Lone Star and Hana show the Hana executives admitting to the FSC's demand for a lower price, directly contradicting the testimony that the same Hana executives have provided in this arbitration. The FSC's own internal documents also clearly show that the regulators planned to manipulate the regulatory process to clear the path for Hana to renegotiate its share purchase agreement with Lone Star at a lower price.

10. Respondent also denies that, even after it approved Hana's acquisition of Lone Star's shares, the FSC intervened to prevent KEB from paying a 2011 dividend in which Lone Star would have participated. Yet, the FSC's own documents demonstrate that the FSC debated in November 2011 which approach would best prevent the payment of dividends, either removal of the Lone Star-appointed directors of KEB or suspension of their participation on the board. And, again, the contemporaneous documents show that Hana was acting at the behest of the FSC in demanding that Lone Star forgo this dividend as the price for closing the sale.

11. Respondent denies that its regulators were biased and asserts that they were objective administrators of the law. But the FSC's internal records show that its actions were motivated by a desire to create a Korean mega bank and—in order to appease an angry public and politicians and protect itself from criticism—to reduce Lone Star's profits. For its part, the NTS openly admitted that it was seeking to employ any and all means at its disposal to maximize Lone Star's tax liability. As one NTS Commissioner stated, a failure to levy "punitive taxes" on Lone Star "would have been tantamount to Korea's defeat in a power game with overseas hedge funds."

12. Against this background, it should come as no surprise that the agencies' actions were legally incoherent. They were rife with logical absurdities and inconsistencies. The most obvious example was the FSC's decision (mentioned above) not to allow Lone Star to sell its KEB shares in order to preserve the FSC's opportunity at some point in the future to order a sale of those very shares. Related to this was the FSC's rationale that it needed to prevent Lone Star from selling the KEB shares because the pending litigation could result in a finding that would render Lone Star ineligible to own the shares. Yet, if the FSC were truly concerned that Lone Star might have been found ineligible to own its shares in KEB, then the FSC should have

facilitated Lone Star's early exit from KEB rather than block it. Those, however, were not the only absurdities.

13. Respondent now argues (without any legal basis) that the same pending litigation potentially cast a cloud on Lone Star's title to the KEB shares and that the FSC reasonably blocked Lone Star's attempts to sell the shares until the litigation was resolved. However, Respondent also argues that Lone Star "could have sold their shares on the open market at any time"—as they did in 2007—which directly contradicts Respondent's argument that there was a cloud on Lone Star's title to the shares that prevented the FSC from approving HSBC's application. Respondent does not even attempt to explain this inconsistency in its arguments.

14. Indeed, the facts show that Respondent's entire theory of "legal uncertainty" was nothing more than a convenient pretext for inaction that the FSC could set aside as political winds shifted. Respondent argues that the FSC was justified in withholding approval of the HSBC and Hana applications because of legal uncertainty arising out of two legal proceedings. The first proceeding involved allegations of impropriety by government officials and KEB executives with respect to the original sale of shares to Lone Star (which we refer to here as the "Byeon Case"). No Lone Star executive was ever a party to that proceeding, and, in any case, that proceeding had concluded by the time of Hana's application. Yet, the FSC still refused to approve Hana's acquisition for over a year. The second legal proceeding involved questions regarding the merger of KEB Card into KEB (which we will refer to as the "KEB Card Case"). Neither of these cases had anything to do with Lone Star's authority to sell its shares, or the qualifications of HSBC and Hana to acquire them. The FSC clearly knew this, which enabled it to resurrect and discard its excuse of "legal uncertainty" at will, based on political convenience.

15. In the face of a looming global financial crisis, when the FSC realized (after seven months of inaction) that it needed HSBC to help shore up the Korean banking system, the FSC told both HSBC and Lone Star that it intended to approve HSBC's application *despite* the fact that *both* the KEB Card Case and the Byeon Case were still pending. Then, years later, after the Byeon Case had ended with an acquittal, the FSC cited the still-pending KEB Card Case as an excuse to delay approval of Hana's application. The FSC's inconsistent decision-making demonstrates that the excuse of legal uncertainty was simply pretext, nothing more.

16. The regulators' actions resulted in many other inconsistencies and absurdities. For example, the FSC concluded multiple times that Lone Star was not a non-financial business operator ("NFBO"), and thus was qualified to hold the majority of KEB's shares, but kept returning to the issue as an excuse to block Lone Star from selling its shares, as it was buffeted by political pressure. The FSC also determined very early on in its consideration of HSBC's application that it could not order Lone Star to sell its shares on the open market, yet it kept that issue alive for years as a talking point for asserting that there was "legal uncertainty" surrounding Lone Star's ability to sell its shares.

17. With respect to the tax assessments, the illogic of Respondent's actions is again manifest. Claimants were clearly entitled to the protection of the Korea-Belgium Tax Treaty given that they resided, and conducted real and substantial investment management activities, in Belgium. And, before the political controversy surrounding Lone Star exploded, the NTS agreed. However, once the controversy began, the NTS pursued a series of illegitimate taxation theories to deny Claimants any benefits under the Korea-Belgium Tax Treaty or any other applicable tax treaty.

18. In one example, in order to avoid granting tax treaty benefits, the NTS concluded that Lone Star had a permanent establishment ("PE") in Korea for a period of years. However, in the years immediately before and after this period—and in one instance even in the same year—the NTS reached the opposite conclusion with respect to the very same or substantially identical investments. The same corporate and management structure cannot at one and the same time create a PE and not create a PE. Yet, that is what the NTS found, and it did so in order to maximize Lone Star's tax liability.

19. The NTS also colluded with Hana to ensure that Hana withheld taxes on the proceeds of Lone Star's sale of KEB shares at the full domestic tax rate. Under the Korea-Belgium Tax Treaty, no taxes should have been withheld, but the NTS refused to refund the withheld taxes because it alleged (ludicrously) that it could not, and did not need to, determine who owned the shares.

20. Finally, days after Claimants initiated this arbitration, the NTS, ignoring the clear applicability of the Korea-Belgium Tax Treaty, forced Citibank Korea, Inc. ("CKI")—the custodian of Lone Star's shares in KEB— to pay an additional US $100 million of taxes on dividends paid to Lone Star from 2008 based on the higher domestic withholding tax rate, knowing that Lone Star was obligated to indemnify CKI for this tax assessment. Most egregiously, the NTS imposed a penalty on CKI for failing to recognize that one of the Claimants' indirect shareholders, was the "true" owner of the dividends in question, but then denied the petition for refund of the tax on the basis that it did not know who the "true" owner of the dividends was.

21. The ultimate irony, of course, at least with respect to Lone Star's attempts to sell its shares in KEB, was that despite the many protestations over many years that legal uncertainty made it impossible for the FSC to approve HSBC's or Hana's applications to acquire Lone Star's shares in KEB, none of that alleged legal uncertainty made any difference to the final outcome (other than, of course, to delay the sale and cause a dramatic reduction in price). The FSC did not issue an order for Lone Star to sell its shares on the open market. It did not label Lone Star an NFBO. It did not cancel its approval of Lone Star's original acquisition of shares in KEB. It did not seek to cancel Lone Star's title to the shares. It ultimately approved Hana's application based on an assessment of Hana's qualifications under the applicable statutory factors. And, when Lone Star was found vicariously liable in the KEB Card Case—the moment when the FSC's supervisory power was allegedly at its height and many of the questions of legal uncertainty crystallized—the FSC did nothing other than order Lone Star to do what it had wanted to do all along, *i.e.*, sell its shares.

22. These actions by the regulators, in isolation and in their totality, breached Korea's obligations under the BIT.

23. In Section II below, we explain that Claimants' investors included pension funds, university endowments and other institutional investors in the Lone Star Funds as well as world-class financial institutions, all of which were damaged by Respondent's actions in this case.

24. In Sections III.A and B below, we detail the relevant facts concerning Claimants' efforts to sell its stake in KEB to HSBC and Hana, focusing on many of the internal documents previously unavailable to Claimants. Included in that section is a discussion of the political context of the FSC's decision-making; the chronology of events demonstrating the FSC's

arbitrary conduct during its review of HSBC's and Hana's applications to acquire Lone Star's share in KEB; and an explanation of the actions taken by the FSC to frustrate the commercial arrangements between Hana and Lone Star, including to undermine the negotiated price for the KEB shares and the payment of dividends to Lone Star. We also explain how the FSC violated applicable provisions of Korean banking law and why, as a legal matter, there was never any "legal uncertainty" associated with the cases Respondent relies upon to excuse the FSC's inaction. In Section III.C, we address the many extraneous facts and spurious allegations Respondent has made with respect to Lone Star to distract the Tribunal's attention from the FSC's own arbitrary behavior.

25. In Section IV, we provide the factual and legal background to the NTS' tax assessments against Lone Star. Included in this section is an examination of the political context, and the National Assembly's attempts—through political pressure and threats to amend existing tax legislation—to ensure that Lone Star was subject to punitive taxation. We also explain the NTS' inconsistent and arbitrary conduct over several years to maximize Lone Star's tax liability.

26. In Section V, we explain that Respondent's objections to the Tribunal's jurisdiction over Claimants' claims are baseless.

27. In Section VI, we explain that the actions taken by Respondent, and most notably the FSC and NTS, breached Korea's obligations under the BIT. Specifically, Respondent breached its obligations under Article 2(2) of the BIT to refrain from "impair[ing] by arbitrary or discriminatory measures the operation, management, maintenance, use, enjoyment, or disposal of investments in its territory"; to ensure fair and equitable treatment of Claimants' investments; and to ensure "full and continuous protection and security" of Claimants' investments; under

Article 3 of the BIT to ensure national treatment and most favored nation treatment of Claimants' investments; under Article 5 of the BIT, to protect against uncompensated expropriations; under Article 10(3) of the BIT to "observe any other written obligation that may have entered into force with regard to investments in its territory by investors of" Belgium; and Article 6(2) of the BIT to "guarantee to investors . . . the free transfer of their investment and returns."

28. In Section VII, we explain the basis for Claimants' calculation of damages of close to US $4.7 billion.

II. LONE STAR IS A GLOBAL PRIVATE EQUITY FUND TRUSTED BY MAJOR INSTITUTIONAL INVESTORS

29. Respondent attempts to portray Lone Star as a fundamentally U.S.-based "company" that only masquerades as a global operation.[1] Respondent also alleges that Claimants did not act "in the interests of the pension funds, university endowments and other institutional investors" in the Lone Star Funds.[2] Both of these allegations are false. As explained below, (A) Lone Star is a global private equity fund, and (B) Lone Star acts on behalf of corporate and public pension funds, university endowments, and philanthropic foundations.

A. Lone Star Is a Global Private Equity Fund

30. A recurring theme in Respondent's Counter-Memorial is an undue focus on Lone Star's U.S. roots.[3] For example, Respondent refers to Lone Star's "decision-makers in the United States"[4] and claims that a "U.S. company . . . is truly driving this supposed 'Belgian' dispute."[5] Respondent places particular emphasis on the fact that Lone Star successfully persuaded U.S. legislators and government officials to bring diplomatic pressure to bear against their Korean counterparts in an effort to curb Korea's mistreatment of Lone Star and (indirectly) Lone Star's U.S.-based ultimate investors.[6] These attempts to characterize Lone Star as a

[1] *See, e.g.*, Respondent's Counter-Memorial on Jurisdiction and Merits, March 21, 2014 ("Respondent's Counter-Memorial"), paras. 9-12, 464-65, 484, 488, 641-43.

[2] Respondent's Counter-Memorial at para. 18.

[3] *See, e.g.*, Respondent's Counter-Memorial at paras. 9-12, 464-65, 484, 488, 641-43.

[4] Respondent's Counter-Memorial at paras. 464-65. It is unclear to whom Respondent refers when it points to Lone Star's "decision-makers in the United States," because Mr. Grayken has been based on the United Kingdom, and Mr. Short was based in Japan and later in Ireland and the United Kingdom.

[5] Respondent's Counter-Memorial at para. 9.

[6] *See, e.g.*, Respondent's Counter-Memorial at paras. 9-11.

parochial "U.S. company" with no substantial presence or interests outside the United States, and in Belgium in particular, are misplaced.[7]

31. Lone Star has its roots in the United States (and in Dallas, Texas more specifically) and maintains substantial operations there. Lone Star is proud of its U.S. heritage. However, since 1998, Lone Star has *genuinely* developed into a global private equity fund with real and substantial operations located in jurisdictions around the globe.[8] Lone Star has organized private equity funds totaling over US $52 billion that invest in real estate, equity, credit, and other financial assets around the world.[9] Lone Star and its various affiliated companies employ over 900 trained professionals based in locations around the world, including in Amsterdam, Brussels, Dallas, Dublin, Frankfurt, Hamilton, London, Luxembourg, Madrid, Montreal, Munich, New York, San Juan, Tokyo, and Washington, D.C.[10] Until Korea's campaign of harassment, intimidation, and other misconduct forced Lone Star to abandon the Korean market, Lone Star's Korean affiliates, Lone Star Advisors Korea ("LSAK") and Hudson Advisors Korea ("HAK"), employed as many as 95 employees in Seoul. The chart below provides a headcount of Claimants' employees in its offices around the world between 2002 and 2012:[11]

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[7] Indeed, Respondent has acknowledged the global nature of Lone Star's operations in other contexts. For example, in the NTS's Reasoning for Appeal to the Supreme Court, filed almost contemporaneously with Respondent's Counter-Memorial in this arbitration, the NTS openly acknowledges that: "Lone Star Fund is a *global private equity fund* that aims to generate profits through purchasing distressed assets in *various countries* raised from U.S. investors *or non-U.S. investors* and selling them at a high price." Korean Supreme Court, Case No. 2014*Du*3044, NTS Reasoning for Appeal to Supreme Court, March 10, 2014, at 3 [Exhibit C-567].

[8] *See* Grayken Witness Statement at para. 1 ("Lone Star currently operates in the United States, Europe, and Japan.") [Exhibit CWE-002].

[9] *See* Lone Star Funds Website, About Lone Star, *available at* http://www.lonestarfunds.com/about-us/ (last visited September 30, 2014) [Exhibit C-564].

[10] Second Thomson Witness Statement at para. 44 [Exhibit CWE-024].

[11] Table of Lone Star / Hudson Combined Headcount by Region and Year (2002-2012) [Exhibit C-846].

Lone Star / Hudson

Combined Headcount by Year as of May/June Annual Meeting

Region	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Americas	160	230	247	230	156	163	190	300	411	375	451
Europe	23	26	123	291	363	389	417	384	430	389	334
Japan	250	296	272	311	313	320	269	310	288	222	142
Other Asia	177	175	226	155	107	65	28	-	-	-	-
Korea	95	58	69	56	46	44	15	-	-	-	-
Bermuda	1	2	2	2	3	3	3	3	3	3	3
TOTAL	**706**	**787**	**939**	**1,045**	**988**	**984**	**922**	**997**	**1,132**	**989**	**930**

Table 1- Lone Star/Hudson Headcount by Region and Year

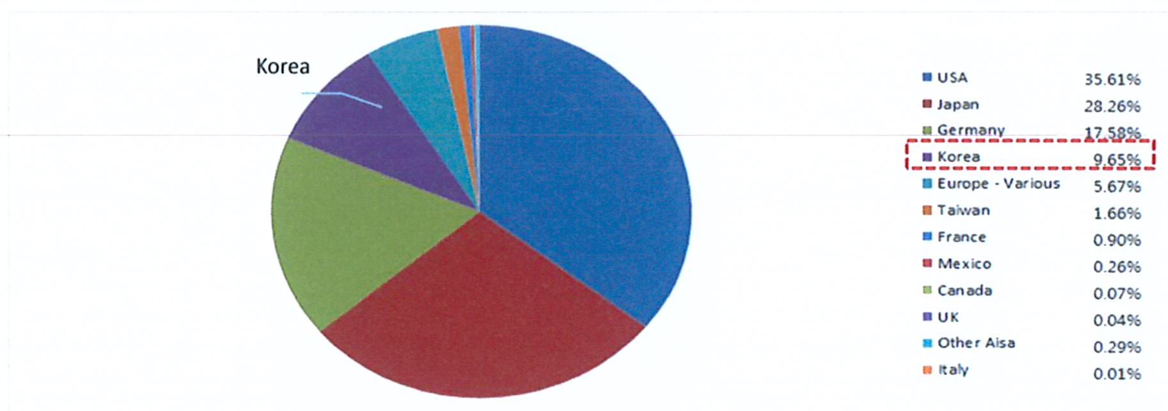
32. Initially, Lone Star raised funds from U.S. investors and invested primarily in distressed assets in the U.S. and Canada. In 1997, however, Mr. Grayken made the strategic decision to transform Lone Star into a global platform that could source and manage investments worldwide.[12]

33. To implement this strategic vision, Lone Star transferred some of its investment infrastructure to Europe and East Asia. Mr. Grayken relocated to London in 1998, and Mr. Ellis Short, the second-in-charge in Lone Star at the time, moved first to Japan in 1998 and then to Ireland in 2000. Lone Star opened several offices in Europe to serve as investment hubs for Lone Star's growing portfolio of global investments, including Luxembourg (in 1999), Ireland (in 2000), and Belgium (in 2001). There was nothing secretive about Lone Star's expansion into Europe. Indeed, a December 17, 2005 snapshot of Lone Star's website shows that Lone Star

[12] *See* Lone Star Funds Website, History, *available at* http://www.lonestarfunds.com/about-us/history/ (last visited August 9, 2014) [Exhibit C-565].

publicly touted the fact that it had "affiliate offices in London, Tokyo, Seoul, Taipei, Dallas, Dublin, *Brussels*, Luxembourg, and Frankfurt."[13]

34. The transformation of Lone Star from a primarily U.S.-focused private equity fund to a global one was a resounding success. By the early 2000s, Lone Star was making and managing investments in numerous other countries in North America, Europe, and East Asia. The chart below depicts the geographic allocation of Lone Star's investments between 1999 and 2005. During this period, over 64% of Lone Star's investments were located outside the United States. Korea ranked fourth on the list of destinations for Lone Star's investment, accounting for a little less than 10% of the total:



35. The fact that Lone Star also maintains a substantial operational presence in the United States[14] does not detract from the legitimacy of Lone Star's other affiliates.[15] The

[13] Internet Archive, Lone Star Website – Introduction, captured on December 17, 2005 (emphasis added) [Exhibit C-566].

[14] *See* Grayken Witness Statement at para. 8 (noting that "Lone Star's affiliated asset management company [Hudson Advisors is] based in Texas") [Exhibit CWE-002].

[15] *See Autopista Concesionada de Venezuela, CA. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Decision on Jurisdiction ("*Autopista*, Decision on Jurisdiction"), September 27, 2001, at para. 125 ("Further, in connection with corporate decision-making, the fact that Icatech exercises its voting rights (at least as far as major issues are concerned) in a way consistent with ICA Holding's strategy shows the group's coherence. It is certainly not sufficient to conclude that Icatech is a corporation of convenience.") [Exhibit CA-631]

business decisions for each investment are driven by the offices responsible for the particular investment, such as Belgium in this case.[16] All major decisions are subject to the close supervision and final approval of Lone Star's Chairman, John Grayken, who is based in London, U.K.[17]

36. Respondent is correct that numerous U.S. officials—including senators, Cabinet-level executive officials, former generals, and ambassadors—"lean[ed] on their Korean counterparts" in a concerted effort to "alter Korean government policy."[18] This intervention was entirely justified, because Korean government policy at the time was one of overt hostility toward foreign investment funds in an effort to appease public anger over the funds' supposedly "excessive profits" in Korea. Korea's economic nationalism and abusive conduct toward foreign investors threatened important interests and "constituents" in the United States. One of those constituents was indeed Lone Star itself, which has substantial commercial operations in the United States.[19] But Lone Star's U.S.-based ultimate investors, which include some of the United States' most cherished and influential educational, cultural, or charitable institutions, were the most important "constituents" that the U.S. government was determined to defend from Korea's abusive conduct.

37. The U.S. government was not alone in bringing diplomatic pressure to bear on Korea. Lone Star is also a "constituent" with substantial and legitimate interests in Belgium.

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[16] *See* Second Thomson Witness Statement at para. 45 [Exhibit CWE-024].

[17] *See* Second Thomson Witness Statement at para. 45 [Exhibit CWE-024]; Grayken Witness Statement at para. 2 ("As Chairman of Lone Star Funds, I determine the investment policy and strategy and approve all the important investment decisions.") [Exhibit CWE-002].

[18] Respondent's Counter-Memorial at para. 9.

[19] Lone Star's U.S. operations have employed as many as 300 professionals, which is roughly equivalent to the number of employees Lone Star has employed in Japan and Germany at various points in time. *See* Lone Star / Hudson Combined Headcount by Year as of May/June Annual Meeting [Exhibit C-846].

Thus, the Kingdom of Belgium has also intervened in a number of respects on Lone Star's behalf in an effort to curb Korea's misconduct. As explained in Claimants' Memorial, the Belgian government intervened in Lone Star's tax dispute with Korea in several ways. First, the Belgian tax authorities formally invoked the Mutual Agreement Procedure under the Korea-Belgium Tax Treaty to engage their Korean counterparts in negotiations on the matter.[20] The Korean tax authorities, however, wrongfully rejected Belgium's MAP request without even a single discussion to endeavor to reach an agreement.[21] Next, the Belgian government took the extraordinary step of submitting an *amicus* brief to the Korean courts to protest the Korean NTS's disregard of Korea's obligations under the Korea-Belgium Tax Treaty.[22] Belgium was also one of several European Union ("EU") countries that, together with the European Commission itself, forcefully protested Korea's attempts in 2006 and 2007 to circumvent its tax treaty obligations through enactment of a domestic law.[23]

38. Now, in yet another show of support, the Belgium Ministry of Finance (the competent authority for international taxation matters) has issued a formal letter to this Tribunal, in which it explains how Korea's conduct violates the letter and spirit of the Korea-Belgium Tax Treaty.[24] The Belgian tax authorities are not alone. The Deputy Prime Minister and Minister of

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[20] *See* Claimants' Memorial on the Merits, October 15, 2013 ("Claimants' Memorial"), para. 408; *see also* Request on behalf of Star Holdings to the Belgian Federal Public Service – Finance requesting initiation of mutual agreement procedures under the Korea-Belgium Tax Treaty, August 6, 2007 ("Star Holdings MAP Request") [Exhibit C-160].

[21] *See* Claimants' Memorial at para. 408; *see also* Letter from Korean NTS to Belgian Administration of Corporate and Income Tax Denying MAP Request, September 27, 2007 ("NTS Rejection of MAP Request") [Exhibit C-165].

[22] *See* Claimants' Memorial at para. 409.

[23] *See* discussion *infra* at paras. 660-662 (describing the diplomatic intervention by a number of European Union countries in response to Korea's threats to include Belgium and other EU countries on a list of "tax havens").

[24] *See generally* Letter from the Kingdom of Belgium's Federal Public Service – Finance to the International Centre for Settlement of Investment Disputes, May 12, 2014 ("Letter from the Belgian FPS Finance on the Korea-Belgium Tax Treaty"), at 14 (stating that Korea's refusal to engage in MAP "violates both the spirit and the letter of the Tax Treaty") [Exhibit C-890].

Foreign Affairs, Foreign Trade and European Affairs of the Kingdom of Belgium and the Minister of Foreign and European Affairs of the Grand-Duchy de Luxembourg have submitted letters setting forth their shared views on the proper interpretation of the 2011 BLEU-Korea BIT.[25]

39. Korea's mistreatment of Lone Star also threatened the interests and "constituents" of other countries, such as the United Kingdom. For example, the FSC's unjustified delays prompted U.K. Prime Minister Gordon Brown to write directly to the Korean President to express his support for prompt approval of the HSBC-Lone Star deal.[26] Thus, the "dispute" over Korea's mistreatment of Lone Star was far from a purely U.S. affair. The dispute, like Lone Star itself, its investments, and its investors, was transnational.[27]

40. In addition to being factually misleading, Respondent's attempt to cast this case as one involving a dispute with a "U.S. company" is nothing but a distraction. This is true with respect to both Claimants' claims under the BIT and the protection afforded to the Belgian SCA Claimants under the Korea-Belgium Tax Treaty. The presence or absence of a "dispute"

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[25] *See generally* Letter to the Tribunal from the Deputy Prime Minister and Minister of Foreign Affairs, Foreign Trade and European Affairs of the Kingdom of Belgium, September 5, 2014 [Exhibit C-891]; Letter to the Tribunal from the Minister of Foreign and European Affairs of the Grand-Duché de Luxembourg, September 4, 2014 [Exhibit C-892].

[26] *See* Anna Fifield and Song Jung-a, "Investors await HSBC's next move as S Korea deal expires," *Financial Times*, July 30, 2008 ("The deal is being closely watched both in London and in Seoul. Gordon Brown, the British prime minister, recently wrote to Lee Myung-bak, his South Korean counterpart, saying he strongly supported HSBC's bid.") [Exhibit C-569]; *see also* Grayken Witness Statement at para. 34 [Exhibit-CWE-002].

[27] Importantly, the dispute before this Tribunal is only part (albeit the most significant part) of a larger dispute with the Korean authorities concerning their treatment of Lone Star's investments in Korea. Other Lone Star investments that were subject to mistreatment, particularly by the NTS, were owned by companies based in other jurisdictions, such as Ireland and Luxembourg. Thus, Dr. Judith Cherry, a scholar specializing in EU-Korea affairs, observed in her recent book that:

> An example of the discrepancy between what the government said and what its officials did was the Lone Star affair in 2006, which directly involved a number of EU member states and had potentially serious repercussions for EU-Korean diplomatic relations.

Judith Cherry, FOREIGN DIRECT INVESTMENT IN POST-CRISIS KOREA: EUROPEAN INVESTORS AND 'MISMATCHED GLOBALIZATION' 146 (2007) [Exhibit C-570].

between Lone Star upper-level entities in the United States and Korea is immaterial to this arbitration.

41. First, Lone Star's U.S. operations and activities have no bearing on the validity of Claimants' claims under the BLEU-Korea BIT. It is well-established in investor-State jurisprudence that investors may prospectively structure their investments to take advantage of a jurisdiction's beneficial regulatory and legal environment, including with respect to taxation and investment treaty protection.[28] In this case, it is undisputed that the Belgian SCA Claimants owned the relevant investments from the outset. There is no colorable argument for "abuse," and, therefore, the investors' choice of a place of incorporation must be respected. Investor-State tribunals have appropriately given short shrift to arguments attempting to undermine the direct investor's nationality by claiming that the "real" dispute was with a parent entity located in another jurisdiction.[29] Likely cognizant of this fact, Respondent makes no such jurisdictional

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[28] *See Aguas del Tunari SA v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction, October 21, 2005 ("*Aguas del Tunari*, Decision on Jurisdiction"), at para. 330(d) ("It is not uncommon in practice, and—absent a particular limitation—not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.") [Exhibit CA-632]; *see also Sanum Investments Limited v. Lao People's Democratic Republic*, UNCITRAL, PCA Case No. 2013-13, Award on Jurisdiction, December 13, 2013 ("*Sanum*, Decision on Jurisdiction"), at para. 309 ("The search for a convenient place of incorporation is common practice whether for fiscal reasons or for the network of investment treaties a country may have concluded. There is nothing wrong *per se* in this search.") [Exhibit CA-633]; *Phoenix Action Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009, at para. 94 ("International investors can of course structure *upstream* their investments, which meet the requirement of participating in the economy of the host State, in a manner that best fits their need for international protection, in choosing freely the vehicle through which they perform their investment . . .") [Exhibit CA-634].

[29] *See Autopista*, Decision on Jurisdiction at paras. 44-46 (Venezuela arguing that the "real" dispute was between the Mexican parent company and Venezuela, as demonstrated by the diplomatic interventions by Mexican officials, and that the United States subsidiary "has no significant national interest in the matter") [Exhibit CA-631]; *see id.* at paras. 140 (rejecting Venezuela's objection, noting that Mexico's diplomatic intervention "would have no bearing on the jurisdiction of the Arbitral Tribunal") [Exhibit CA-631]; *Niko Resources (Bangladesh) Ltd. v. People's Republic of Bangladesh and Others*, ICSID Case No. ARB/10/11 & ARB/10/18, Decision on Jurisdiction, August 19, 2013, at paras. 201-08 (summarily rejecting the respondent State's arguments that the tribunal should disregard the direct owner, which was a Barbados "shell company," and instead look to the Canadian parent company as the entity with a "real connection" to the investment in Bangladesh) [Exhibit CA-635]; *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Paraguay*, ICSID Case No. ARB/07/9, Further Decision on Objections to Jurisdiction, October 9, 2012, at para. 92 ("It is still uncontested that the BIVAC Group

objection here, and instead characterizes the matter as a "U.S. dispute"[30] purely for atmospherics in the hope that it will somehow color the Tribunal's perception of the case. Clearly it should not.

42. Second, Lone Star's U.S. operations and activities do nothing to undermine the applicability of the Korea-Belgium Tax Treaty to income derived from Claimants' investments in Korea. Indeed, if anything, Respondent's efforts to highlight Lone Star's substantial ties to the United States—a jurisdiction that enjoys tax treaty benefits on Korea-sourced income comparable to Belgium—only underscores the irrationality of the Korean tax authorities' conclusion that Lone Star made the investments in question through the Claimants in Belgium with the sole or predominant purpose of evading Korean income taxes.

43. Accordingly, Respondent's fixation on Lone Star's presence in and ties to the United States is nothing but a diversion from the real issue in this case: Korea's arbitrary, abusive, and discriminatory treatment of Lone Star.

44. Because Lone Star is a private equity fund that manages funds contributed by others, Lone Star was not, unfortunately, the only victim of Korea's abusive conduct. As described in the next section, Korea's calculated efforts to diminish the profitability of Lone Star's investments in Korea had a corresponding detrimental impact on the investment returns of the diverse array of universities, public and private pension funds, religious organizations,

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operates (and has established companies in) several countries, including France and the Netherlands, and that the French S.A. is the headquarters and the parent company. The fact that the French President has intervened in favour of the group does not imply that the Claimant is French, nor does the non-intervention by Dutch political authorities imply that it is not Dutch. The intervention or non-intervention indicates a difference in the political culture of different countries but does not determine the legal reality of different members within a group of companies.") [Exhibit RA-82].

[30] *See* Respondent's Counter-Memorial at para. 10.

charitable foundations, and other blue-chip institutional investors that make up Lone Star's ultimate investors. We will now provide additional background on those ultimate investors and Lone Star's relationship to them.

B. LONE STAR'S INVESTORS INCLUDE CORPORATE AND PUBLIC PENSION FUNDS, UNIVERSITY ENDOWMENTS, AND PHILANTHROPIC FOUNDATIONS

45. Lone Star's reputation for integrity and investment performance has earned it the trust of blue chip institutional investors.[31] Many of these investors use the earnings from their investments with Lone Star to advance medical or scientific research, improve access to higher education, secure employee pension obligations, reduce poverty, or support the arts and literature. Representative examples from the investors in KEB include:

[31] *See* Grayken Witness Statement at para. 1 [Exhibit CWE-002].

Institution		Mission[32]
Philanthropy	Howard Hughes Medical Institute ("HHMI")	*"HHMI is a science philanthropy whose mission is to advance biomedical research and science education for the benefit of humanity. We empower exceptional scientists and students to pursue fundamental questions about living systems."*
Philanthropy	The William and Flora Hewlett Foundation	*"The Foundation's programs have ambitious goals that include: helping to reduce global poverty, limiting the risk of climate change, improving education for students in California and elsewhere, improving reproductive health and rights worldwide, supporting vibrant performing arts in our community, advancing the field of philanthropy, and supporting disadvantaged communities . . ."*
Arts	Henry E. Huntington Library and Art Gallery	*"The Huntington ... encourages research and promotes education in the arts, humanities, and botanical sciences through the growth and preservation of its collections, through the development and support of a community of scholars, and through the display and interpretation of its extraordinary resources to the public."*
Education	Stanford University[33]	*"Stanford University . . . is one of the world's leading teaching and research universities. Since its opening in 1891, Stanford has been dedicated to finding solutions to big challenges and to preparing students for leadership in a complex world."*
Education	Massachusetts Institute of Technology	*"The mission of MIT is to advance knowledge and educate students in science, technology and other areas of scholarship that will best serve the nation and the world in the 21st century — whether the focus is cancer, energy, economics or literature."*
Pension Funds	United Nations Joint Staff Pension Fund	*"The United Nations Joint Staff Pension Fund is a fund that was established by the United Nations General Assembly in 1949 to provide retirement, death, disability and related benefits for staff of the United Nations and the other organizations admitted to membership in the Fund. As of 31 December 2010, the Fund was serving 23 member organizations, with 121,138 active participants and 63,830 beneficiaries."*
Pension Funds	Cadim Fonds, Inc. (affiliate of The Caisse de dépôt et placement du Québec)	*"The Caisse de dépôt et placement du Québec manages institutional funds, primarily from public and private pension and insurance funds in Québec."*
Pension Funds	California State Teachers' Retirement System	*"Our mission: Securing the financial future and sustaining the trust of California's educators."*
Pension Funds	State of Oregon Public Employees' Retirement Fund	*"Mission: We serve the people of Oregon by administering public employee benefit trusts to pay the right person the right benefit at the right time."*
Pension Funds	Houston Firefighters' Relief and Retirement Fund's ("HFRRF")	*"Established in 1937 by state statute, HFRRF is the retirement system for Houston's firefighters. . . . The Fund's membership consists of approximately 3,700 active firefighters and 2,900 retirees and survivors."*

46. Lone Star's emergence on the international plane was also reflected in the diversity of the nationality of its investors. In addition to numerous U.S.-based institutional

[32] Sources for the mission statements in this chart: http://www.hhmi.org/about; http://www.hewlett.org/about-us; http://www.surdna.org/about-the-foundation/mission-and-history.html; http://www.stanford.edu/about/; http://web.mit.edu/aboutmit/; http://www.unjspf.org/UNJSPF_Web/page.jsp?page=Overview&role=info&lang=eng; http://www.lacaisse.com/en/about-us; http://www.calstrs.com/glance; http://www.hfrrf.org/about-us/.

[33] Legal name: "Board of Trustees of the Leland Stanford Junior University."

investors, Lone Star Fund IV and KEB-specific investors included investment affiliates of a major Canadian pension fund manager, a Dutch bank, the Government of Singapore Investment Corporation, the Abu Dhabi Investment Authority, and trusts benefiting individuals or families from U.K., Brazil, and Hong Kong.[34]

47. These institutional investors are among the most sophisticated in the world. They entrusted substantial sums of money, often in the hundreds of millions of dollars, to Lone Star's stewardship based on extensive pre-investment due diligence and Lone Star's reputation and track record.[35] They reasonably relied on Lone Star to apply its expertise and sound business judgment to structure and manage the investments prudently and efficiently—*i.e.*, in a way that minimizes the ultimate investors' costs and regulatory exposure and maximizes their returns on the contributed funds.

48. In return, Lone Star was entitled to charge fees for sourcing and advisory services provided by affiliated companies. In addition, when Lone Star's investments met certain benchmarks for return on capital, Lone Star Partners IV, L.P., the general partner of the Fund and co-investment partnerships involved in the investments at issue in this case (the "General Partner"),[36] would be entitled to a "carried interest" or "promote" ("GP Promote"), which was an additional share of the proceeds depending on how well the investments performed. The remaining proceeds from Lone Star's Korean investments were distributed to the ultimate investors in proportion to the capital they contributed.

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[34] *See* Lists of Ultimate Investors in Lone Star Fund IV (U.S. and Bermuda) and Lone Star Fund III (U.S. and Bermuda) [Exhibit C-850].

[35] *See generally* Grayken Witness Statement at para. 1 [Exhibit CWE-002]; *see also* Lists of Ultimate Investors in Lone Star Fund IV (U.S. and Bermuda) and Lone Star Fund III (U.S. and Bermuda) [Exhibit C-850].

[36] In the case of the investment in Star Tower Corporation, Lone Star Partners III, L.P. was the general partner.

49. Even taking into account the GP Promote, the overwhelming majority of the proceeds from KEB and other Lone Star investments in Korea were distributed to the ultimate investors. Korea's arbitrary and unlawful campaign to diminish the return "Lone Star" earned on KEB and other Korean investments in reality deprived Lone Star's ultimate investors of the funds they used to fulfill their missions. That meant fewer resources available for medical research grants, student financial aid, and pension benefits. Thus, to appease irrational and nationalistic public sentiment, Korea ultimately harmed the police officers, firefighters, pensioners, medical researchers, aspiring students, and others who depend upon the institutional investors who invest with Lone Star. This also means that a substantial majority of any award in this arbitration will ultimately inure to the benefit of these diverse stakeholders, who were indirectly harmed by the Korean government's wrongful conduct.

50. In sum, by the time Claimants were established in 2001-2003, Lone Star was both fundraising and sourcing investments on a global scale. The contributions of fund investors of various nationalities were pooled, routed, and invested into projects and investments around the world. Ultimately, however, sound and customary business practices required the use of investment holding companies to segregate the ownership of (and liability for) each of the relevant investments. Those companies had to be incorporated somewhere. For the investments at issue in this case, Lone Star decided to base the investment holding companies at its affiliated office in Brussels for a variety of legitimate business reasons,[37] as we will discuss later in Section IV.A below.

[37] The fact that one of those reasons related to Belgium's extensive network of tax treaties is, of course, not problematic under international investment treaty law. For example, the tribunal in *Aguas del Tunari* rejected the respondent State's contention that the claimant's "strategic changes in the corporate structure . . . somehow [rose] to the level of fraud or abuse of corporate form," noting as a *valid justification* for such corporate changes the fact that "a decision as to where to locate a joint venture is often driven by taxation considerations, although other factors

51. Contrary to Respondent's allegations, it is simply not true that Lone Star is a U.S.-based company masquerading as a global operation. Respondent's allegation that Claimants did not act "in the interests of the pension funds, university endowments and other institutional investors" is not only false, but also offensive.[38] In reality, Lone Star is a global private equity fund that acts on behalf of pension funds, university endowments, and philanthropic foundations.

III. THE FSC REPEATEDLY INTERFERED WITH LONE STAR'S ATTEMPTS TO SELL KEB FOR POLITICAL REASONS

52. Below, we explain that (A) Respondent's actions were politically motivated, (B) the FSC violated multiple provisions of Korean banking law, and (C) Respondent attempts to distract the Tribunal from the FSC's actions with an assortment of allegations that are both unfounded and immaterial to this dispute.

A. RESPONDENT'S ACTIONS WERE POLITICALLY MOTIVATED

53. Respondent's Counter-Memorial ignored the political motivations behind the FSC's extraordinary delays in deciding both HSBC's and Hana's applications to acquire control of KEB. Respondent would have the Tribunal believe that politics had nothing to do with the FSC's decision-making. However, the FSC's internal documents that the Tribunal ordered Respondent to produce confirm Claimants' allegation that politics, rather than the law, drove the

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such as the availability of BITs can be important to such a decision." *Aguas del Tunari*, Decision on Jurisdiction at para. 330 [Exhibit CA-632].

[38] Respondent's Counter-Memorial at para. 18.