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[Special Report] [Dr. Sung-Soo Han's Special Column] Approach Getting over the Lone Star Fund’s ‘Skillful’ Claims.pdf

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Approach Getting over the Lone Star Fund’s ‘Skillful’ Claims

<1. The 2nd Trial is a Critical Turning Point> The International Centre for Settlement of Investment Disputes (“ICSID”) held the 1st session from May 15th to 22nd, and had a hearing on witnesses with respect to the discriminative treatments allegedly raised by Lone Star Funds. Subsequent to the 1st session, the ICSID is going to hold the 2nd session from July 29 in which the tribunal of the ICSID plans to question on the jurisdiction issue which is expected to become a turning point of this dispute. According to the press report, the Korean government requested the ICSID to deal with the jurisdiction issue in the 1st session, but the tribunal declined the request. Since the related issues are emergent and critical to the national interests of Korea, we need to think about a countermeasure against Lone Star Fund’s claims.

<2. Contentions of both Parties> The Korean government asserts that, “Lone Star Belgium, established in the Kingdom of Belgium as an overseas related party of Lone Star Funds, U.S. private equity funds, is a paper company; and thus, Lone Star Belgium is not an appropriate party entitled to the agreement between the Government of the Republic of Korea and the Belgium-Luxembourg Economic Union for the Reciprocal Promotion and Protection of Investments (the “investment agreement” or “investment agreement between Korea and Belgium”). However, Lone Star argues back that “Lone Star Belgium is not a paper company, and even more, the investment agreement between Korean and Belgium does not have the ‘limitation on benefit’ clause with respect to the paper companies. Thus, Lone Star Belgium is an appropriate party covered under the investment agreement.”

<3. Related Regulations> The ICSID shall abide by its own two rules in reviewing and determining the dispute in issue. The first one is Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“ICSID Convention”), and the other one is Rules of Procedure for Arbitration Proceedings (“ICSID Arbitration Procedure Rules”). Thus, the above two rules will be applied to the Lone Star case.

<4. ICSID Jurisdiction> The Article 25(1) of the ICSID Convention states that “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State”, and the Article 25(2) of the same Convention states that “National of another Contracting State means:(a) any natural person who had the nationality of a Contracting State; and (b) any juridical person which had the nationality of a Contracting State”. The Article 1(3) of the investment agreement between Korea and Belgium also has the similar context. Therefore, since Lone Star Belgium is a juridical person established in accordance with the Belgian rule, Lone Star Belgium is an eligible juridical person for pursuing the ICSID arbitration proceedings.

Lone Star Funds is arguing that since Lone Star Belgium is not a paper company and there is no ‘limitation on benefit’ clause in the investment agreement between Korea and Belgium, Lone Star Belgium is an eligible juridical person for the ICSID arbitration proceedings. Thus, it would be difficult for the Korean government to rebut Lone Star’s argumentation.

The “paper company” and “limitation on benefit” arguments advocated by the Korean government are the legal concepts which can be utilized for the taxation purpose, in particular, when the “substance over form principle” should be applied to a case. Thus, the arguments such as a “paper company” and “limitation on benefit” have nothing to do with determining a juridical person who is entitled to pursue the arbitration proceedings, and it is completely wrong that the Korean government raised a jurisdiction issue to the ICSID based on the “paper company” argument. It is thought that this wrong approach made the ICSID tribunal decline the Korean government’s suggestion to deal with a jurisdiction issue first of all.

Therefore, if the Korean government continues to request the ICSID to dismiss the case based on the same approach, the possibility would be very low that the ICSID will accept the request by the Korean government. In addition, Lone Stars Funds’ on-going lobby activities within the United States would further lower the possibility.

<5. Place of Incorporation> Since the trials are being held in Washing D.C. which is Lone Star Funds’ home ground, it is expected that the U.S. legal principles will have a significant impact on the case. Since the U.S.A. applies the “Place of Incorporation” principle, the “paper company” does not become an issue when determining the legal status of a party. That is to say, even though an entity is
registered in the Delaware State only in a paper and runs its physical business operations in the New York State, the U.S. laws recognize
the legal substance and rights of the paper company registered in the Delaware State. If we think of the situation where a foreigner gave
a birth to her/his child in the U.S.A., and the U.S.A. grants the child an U.S. citizenship based on the “Territorial Principle”, it can be
easily understood.

Due to the unique background of the U.S. legal history, when the U.S.A. concludes a tax treaty with a foreign country, the U.S.A. always
inserts the “Place of Incorporation” clause which serves as a legal principle in determining the residency of an entity for the taxation
purpose according to the U.S. Model Tax Convention. In other words, even though an entity exists only in a paper, its legal status of
residency should be recognized under the U.S. laws.

<6. Hopeless Arguments by the Korean Representatives> It is very piteous to see the Korean representatives endangering the
national interest based on their hopeless arguments which could not be accepted by the ICSID without the correct understanding on the
ICSID rules and the historical backgrounds of the U.S. laws.

<7. Is There Any Solution to Get Out of the Arbitration?> Article 41(1) of the ICSID Arbitration Procedure rules that “(i) any
objection that the dispute or any ancillary claim is not within the jurisdiction of the Centre or, (ii) for other reasons,
is not within the competence of the Tribunal shall be made as early as possible. A party shall file the objection with
the Secretary-General no later than the expiration of the time limit fixed for the filing of the counter-memorial.”

The ICSID Convention stipulates two conditions that an objection can be made to the Centre; (i) the case where the dispute is not within
the jurisdiction of the Centre, and (ii) the case where, for other reasons, the dispute is not within the competence of the Tribunal.

As mentioned above, the ICSID wouldn’t accept the arguments based on the “jurisdiction” of first condition. Thus, the Korean
government should make out a logical solution based on the second condition relating to the “competence” of the Tribunal. In that case,
the Korean government will be able to successfully request the ICSID to dismiss the arbitration case initiated by Lone Star Funds. That
is the best approach that the Korean government can take.

The problem is that the Korean government should have filed the counter-memorial with the Secretary-General before the expiration of
time limit for the objection. Lone Star submitted the first position paper in October, 2013 and the Korean government submitted the
first position paper in March, 2014. And from April to August, 2014, the two parties had already entered into the evidence submission
stage. Thus, it is not possible for the Korean government to make an objection under the Article 41(1) because the time limit of filing was
expired.

If so, is there any other way to resolve a dilemma? Yes, there is one. The Article 41(2) of ICSID Arbitration Procedure rules provides
that “The Tribunal may on its own initiative consider, at any stage of the proceeding, whether the dispute or any
ancillary claim before it is within the jurisdiction of the Centre and within its own competence”. That is to say, if a
dispute is not within the jurisdiction of the ICSID or it is not within its own competence, the ICSID can dismiss the case on its own
initiative.

Accordingly, the Korean government should make a persuasive explanation to the ICSID that the dispute in issue is not within
the competence of the ICSID and therefore the case should be dismissed on ICSID’s own initiative in accordance with the Article 41(2) of
ICSID Arbitration Procedure rules.

The ICSID’s role is to resolve the dispute based on the fair principles. Thus, there would be no reason why the ICSID does not accept the
Korean government’s request if the request is justifiable legally.

<8. Lone Star’s Ineffective Arbitration Request> As mentioned in my news column for the Daily National Tax News (the “Daily NTN”) on May 20, 2015, the Lone Star’s arbitration request is not legally effective due to the fact that it does not meet two legal requirements explained below.

Firstly, the time when the Korean Financial Services Commission ("FSC") unapproved the sale of the KEB’s shares is the year of 2006,
and the time when Lone Star Funds sent a notification of arbitration intention to the Korean government is May, 2012. And the time
when Lone Star Funds filed its claims with the ICSID is November, 2012. Thus, the 5 years of statute of limitation stipulated under the
Article 8(7) of the investment agreement had already expired in 2011; thus, it is impossible for Lone Start to file the litigation with the
ICSID.

Secondly, the Korean tax authority made the tax assessments against Lone Star in 2005 and 2007, and the Article 3(4) of the Investment
Agreement between Korea and Belgium states that benefits of any treatment, preference or privilege relating to taxation including the
avoidance of double taxation should be given in accordance with the tax treaty between Korea and Belgium. This rule means that, if taxation issues arise out of investment activities, these taxation issues should be resolved in accordance with the tax treaty, not the investment agreement. Thus, it is not possible for Lone Star to bring the taxation cases before the ICSID. Furthermore, since Lone Star Funds voluntarily gave up the tax treaty benefit (i.e., relief from double taxation through mutual agreement procedure) which is allowed under the Korea-Belgium tax treaty by taking the domestic tax appeal procedures and finally lost the case in the Korea Supreme Court, there are no further legal remedies available to Lone Star Funds.

**9. Mistakes by the Korean Government** Accordingly, the Korea government should have not consented to Lone Star’s arbitration request based on the following legal arguments; 1) Lone Star Funds’ first claim based on the discriminative treatments by the Korean government has already passed the statute of limitation set under the investment agreement, and 2) its second claim based on the unreasonable taxation cannot be subjected to the arbitration proceeding since taxation issues should be resolved in accordance with the Korea-Belgium tax treaty. Thus, it is a big mistake that the Korean government had consented to the Lone Star Funds’ ineffective arbitration request; and thus the Korean government should frankly acknowledge it.

**10. ICSID’s Incompetence on Ineffective Arbitration Request** If a rule states that “taxpayers should file a case with the court no later than 90 days after the closing of administrative proceeding” and if a taxpayer files a case after the 90 days of the closing date, the court dismisses the case without a trial. Likewise, the time when Lone Star Funds delivered its arbitration request to the Korean government had already passed the 5 years of statute of limitation stipulated under the investment agreement between Korea and Belgium. Thus, Lone Star Funds’ dispute claim should be dismissed since the arbitration request made to the ICSID is not effective under the investment agreement.

A taxpayer, who thinks the tax assessment on him/her is unjust, should file an administrative litigation with the court based on the provisions of tax laws. But if a taxpayer files a civil case litigation (other than administrative litigation) with the court based on the torts arguments of civil laws with regard to the tax assessment case, the court will dismiss the case without a trial.

Under the similar principle, it is natural that Lone Star Funds’ arbitration request on the taxation matter which was brought before the ICSID according to the investment agreement between Korea and Belgium should be dismissed. This is because the taxation matter should be resolved through the mutual agreement procedure provided in the tax treaty between Korea and Belgium rather than the investment agreement.

The Article of 8(3) of the Investment Agreement between Korea and Belgium provides that “if the dispute cannot be settled within six (6) months from the date on which the dispute has been raised by either party, and if the investor waives the rights to initiate any local proceedings, the dispute shall be submitted to the ICSID”.

Lone Star Funds’ first arbitration request sent to the Korean government is, in fact, legally ineffective since the arbitration request made under the investment agreement does not meet the legal requirements set under the investment agreement. Thus, Lone Star Funds’ second arbitration request to the ICSID based on the first arbitration request is also legally ineffective since the second arbitration request is directly based on the first ineffective arbitration request.

Accordingly, only when the Korean government develops the above-mentioned legal logics that the ICSID has no competence to review Lone Star Funds’ second ineffective arbitration request directly based on the first ineffective legal action and thus should dismiss the Lone Star Funds’ request, it would be possible for the ICSID to dismiss the arbitration request.

Of course, the Korean government should admit that it had consented the arbitration by mistake. By doing so, the Korean government could lose its face, but it is not the time to care about the appearance.

Since it is the first time for the Korean government to handle a massive international arbitration proceeding and it is apparent that the Korean government consented to the arbitration request by mistake, the Korean government needs to acquire understandings from the ICSID on this important matter.
In order to understand the background of the Article 41(2) of ICSID Arbitration Procedure rules, we also need to briefly understand the Federal Rules of Civil Procedure of the U.S.A. The U.S.A. consists of 50 different states, and it is common that residents of one state travel to the other states, or run businesses in the other states. Thus, a number of legal conflicts can arise out of these activities over the states. For example, if a California State’s resident, X, ran into a car accident with a Virginia State’s resident, Y, while X was travelling the Virginia State and the accident turned into a civil law suit, it becomes a problem to which state’s court X and Y should file the law suit and make answers. X would definitely wants to file a lawsuit with the court in California State where he resides whereas Y would want to file a lawsuit with the court in Virginia State where he resides.

Accordingly, there takes place a conflict of interest between two parties in terms of jurisdiction. Thus, in case where residents of different states file a law suit, the Federal Rules of Civil Procedure gives the jurisdiction to the U.S. federal court instead of the state court which may be favorable to one of the concerned parties. By doing so, the concerned parties would not be unfairly treated due to the jurisdiction issue. Furthermore, in case where the U.S. Constitution or federal laws become an issue of litigation, the U.S. federal courts also can hear the case.

The above U.S. court system is called “Subject Mater Jurisdiction (SMJ)”. This is a court system which enforces SMJ to be attributed to the federal courts in case 1) where residents in different states file a law suit, or 2) the U.S. Constitution or federal laws become an issue of litigation.

If one party files a law suit in violation of the rules of SMJ, the other party can raise an objection based on the SMJ anytime (including the period of appeal procedure) before the final judgment by the court.

And, if the objection is found to be acceptable, the federal court can dismiss the case for lack of SMJ upon the motion of a party. Or it can dismiss the case upon its own discretion.

11. Why does the Government Hide Behind the Curtain?

It seems very simple to figure out why the government doesn’t open the information on the arbitration to the public. Firstly, it seems that the government has never been confident enough to win the case. Secondly, by keeping the information secret, the government can sneak out from the public censure when it comes to compromising with Lone Star Funds. If the government is confident, there is no reason that the government keeps the information secret. And it also could think of utilizing the open forum strategy.

The litigation with Lone Star Funds is the largest lawsuit case in the Korean history, and the future and pride of the nation is at stake. Thus, the government should never keep the related information secret. Otherwise it could eventually drive the government in a bigger pandemonium.

In fact, there is no perfectly sealed information in the information-oriented society. Thus, it would be much wiser for the government to seek out a workable wisdom based on the public opinion so that, whatever happens in the arbitration proceeding, the people of Korea could trust the government.

12. What is Bad Capital?

In the U.S.A., if we ask tax major students “Why do you pay tax?” The student would reply “Because the U.S. government protects us, we pay tax.” This is because the U.S. courts have recognized the taxing rights based on the above principle. Thus, if one asks “Why do the foreign enterprises in the U.S.A. pay taxes to the U.S. government, the reply would be the same - “Because the foreign enterprises run business under the protection of the U.S. government, they are obliged to pay taxes in the U.S.A.”

Regardless of their legal status (e.g., natives, foreigners, domestic companies, overseas companies), the equity of taxation can be achieved when there is no any unreasonable discrimination. This is the way the government can maintain the equity among taxpayers. This taxation principle is very universal in the international community including the U.S.A., Korea and other nations.

There are a number of foreign companies including the U.S. companies which advanced into Korea for their business, and almost all of the foreign companies pay taxes in good faith in accordance with the Korean tax laws.

Also, Korean companies such as Samsung and Hyundai which advanced into the United States for their world-wide business pay taxes in good faith to the U.S. government. This is a common sense.

On the other hand, Lone Star Funds objects to the tax payment in Korea. The taxes in issue were imposed in accordance with the domestic tax law and the international taxation norms by the Korean tax authority and finally approved by the Korean Supreme Court.

In spite of the fact that Lone Star Funds gained a huge amount of profits under the protection of the Korean government, it made a strong objection to the taxation by the Korean tax authority. What is more, it brought the case before the ICSID utilizing its massive capital power.
If a foreign enterprise tries to avoid taxes which are a consideration of protection by the foreign government, this enterprise can be classified as a bad speculative capital which chases only the profits and infringes upon the taxation system of the foreign government.

Because there are a number of incidents where such speculative capitals devastate the international taxation system by digging into loopholes which may exist in the local laws or the tax treaties, the OECD allows to penalize these base erosion activities by applying the concerned nation’s anti-avoidance laws.

In line with the international taxation norms, thus, the Korean Supreme Court held that the tax assessment against Lone Star Funds by the Korean tax authority is legally justified.

The international trade is increasing every day and this international trend will become more popular as the Free Trade Agreements (“FTA”) are expanding among nations. Thus, the global community came to the point where it should discuss how to maintain the equity of taxation among nations in line with the increasing international trade of multinational enterprises.

The equity among taxpayers can be maintained when they pay the equal amount of taxes according to their income level.

Likewise, if a multinational enterprise generates the 50% of its total income in the country they advanced into and the remaining 50% of income in its home country, the equity among nations can be secured when the enterprise pays the taxes corresponding to the 50% of income to the government of each country.

The reason why the OECD focuses on the exchange of information and the prevention of tax avoidance activities is ultimately to achieve the equity of taxation among nations.

Accordingly, in order to correspond to the trend of global community, the Korean government needs to protect and equally treat the foreign enterprises operating its business in good faith in Korea whereas it needs to strongly regulate the bad speculative capitals by applying international taxation norms.

13. Conclusion> The ICSID can become a place where the ability of the Korean government is tested internationally. Thus, the correct and wise approach of the Korean government is required. In addition, I sincerely hope that the Korean government will be able to perfectly manage the second arbitration request to the ICSID by the company owned by the worldwide well-known millionaire, Mr. Sheikh Mansour Bin Zayed Al Nahyan.