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May 21, 2012

His Excellency Lee Myung-bak
President of the Republic of Korea
Office of the President
1 Cheongwadae-ro
Jongno-gu, Seoul 110-820
Republic of Korea

Dear Mr. President:

I write on behalf of six Belgian investors that have suffered substantial financial losses due to actions taken by the Government of Korea. These Belgian investors are LSF-KEB Holdings SCA, Star Holdings SCA, HL Holdings SCA, LSF SLF Holdings SCA, Kukdong Holdings I SCA, and Kukdong Holdings II SCA (collectively referenced herein and in the attachment as "Lone Star"). These entities held a number of investments in Korea, most notably a 64.62% stake in Korea Exchange Bank ("KEB").

From at least 2005 until the present, the Korean government has engaged in a continuing pattern of arbitrary and discriminatory conduct toward Lone Star that has substantially and materially impaired the ability of Lone Star to dispose of its investment in KEB, subjected Lone Star and its personnel to repeated acts of harassment, and imposed arbitrary and contradictory tax assessments on Lone Star and its affiliates in contravention of bilateral tax treaties entered into by Korea. As a result of this conduct, Lone Star has suffered billions of euros in damages.

Such conduct by the Korean government is in breach of Korea's obligations to Belgian investors under the terms of the Agreement Between the Government of the Republic of Korea and the Belgium-Luxembourg Economic Union for the Reciprocal Promotion and Protection of Investments ("BIT"). Lone Star has on multiple occasions sent the Government of Korea written notifications of these violations, in particular, through Lone Star's letters to the Korean Financial Services Commission dated July 9, 2008; February 11, 2009; and January 17, 2012. Notwithstanding these repeated notices, the Korean government has failed to resolve the dispute between Lone Star and Korea.

Further to these notices and in accordance with the requirements of Article 8.1 of the BIT, therefore, Lone Star hereby submits to the Government of Korea its written notification of a dispute, accompanied by a sufficiently detailed memorandum, which describes the actions of the Korean government that have violated the treaty with respect to Lone Star's investments in Korea. Lone Star stands ready to resolve this dispute amicably and requests a meeting with a person

designated by you to discuss proposals for a possible resolution. Lone Star is prepared to propose specific, concrete steps that could be taken to resolve this matter expeditiously and without resort to arbitration. Absent resolution within six months, however, Lone Star will submit this dispute for arbitration at the International Centre for Settlement of Investment Disputes pursuant to Article 8.3 of the BIT.

Respectfully submitted,

Michael D. Thomson
Director

Attachment: Memorandum Required by Article 8.1 of the Agreement Between the Government of the Republic of Korea and the Belgium-Luxembourg Economic Union for the Reciprocal Promotion and Protection of Investments With Respect to the Dispute Between Lone Star and the Republic of Korea

cc: His Excellency Kim Seung-ho
Acting Ambassador of the Republic of Korea to Belgium and the European Union

Mr. Kim Dae-ki
Senior Secretary for Economic Affairs at the Office of the President

MEMORANDUM REQUIRED BY ARTICLE 8.1 OF THE AGREEMENT BETWEEN THE GOVERNMENT OF THE REPUBLIC OF KOREA AND THE BELGIUM-LUXEMBOURG ECONOMIC UNION FOR THE RECIPROCAL PROMOTION AND PROTECTION OF INVESTMENTS WITH RESPECT TO THE DISPUTE BETWEEN LONE STAR AND THE REPUBLIC OF KOREA

I. Overview

1. This document accompanies the notification of a dispute dated May 21, 2012 that six Lone Star companies ("Lone Star" or "Lone Star companies")[1] are providing to the Government of the Republic of Korea and constitutes the sufficiently detailed memorandum required under Article 8.1 of the Agreement Between the Government of the Republic of Korea and the Belgium-Luxembourg Economic Union for the Reciprocal Promotion and Protection of Investments ("BIT").

2. The central issue in this dispute concerns the failure by Korean regulatory authorities over a period of several years to approve the purchase by third parties of Lone Star's stake in Korea Exchange Bank ("KEB"). During that period, a series of potential acquirers entered into share purchase agreements with Lone Star, only to have the transactions eventually fall apart in the face of the Korean regulators' refusal to act on the acquirers' applications for approval. When Lone Star was finally permitted to sell its stake in KEB in 2012, the price that Lone Star could command had dropped dramatically, and the damage to Lone Star had escalated to billions of euros. Throughout this period, Korean regulators acted in clear disregard of their legal authority. They were driven, not by legitimate, legal considerations regarding the propriety of the would-be purchasers, but by a desire to avoid accountability and appease a public that was angry over the profits that the seller, Lone Star, stood to make.

3. Throughout this time, the Korean tax authorities also subjected Lone Star to a series of arbitrary tax assessments that were contrary both to Korean law and to Korea's obligations under its tax treaties with Belgium and other countries. Again, the regulators were not motivated by a legitimate, fair application of the relevant tax rules, but by a desire to appease public discontent over potential capital outflows to a foreign investor tax-free. Accordingly, the

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[1] The six Lone Star companies are Belgian investors LSF-KEB Holdings SCA, Star Holdings SCA, HL Holdings SCA, LSF SLF Holdings SCA, Kukdong Holdings I SCA, and Kukdong Holdings II SCA.

regulators used whatever means possible to maximize Lone Star's tax liability, regardless of the legality of such measures or their consistency over time.

4. In connection with these actions, Korean regulatory and law enforcement agencies subjected Lone Star personnel to continuing, unwarranted harassment, arrests, investigations, and audits.

5. Korea's conduct has resulted in billions of euros of damages to Lone Star, and, in the process, Korea has breached its obligations to Belgian investors and their protected investments under the BIT.

6. In this memorandum, Lone Star will detail: (1) Lone Star's acquisition of shares in KEB and the merger of Korea Exchange Bank Credit Service Co., Ltd. ("KEBCS"), a failing credit card affiliate of KEB, into KEB; (2) Lone Star's repeated efforts to sell its investment in KEB, and the pattern of harassment and arbitrary conduct exhibited by Korea during this process; (3) the arbitrary and contradictory tax assessments Korea has levied on Lone Star; and (4) claims that arise under the BIT as a result of Korea's conduct.

II. Acquisition of KEB and Rescue of KEBCS

A. Original Acquisition of KEB

7. In 2003, Lone Star invested in KEB, then Korea's fifth largest bank, which was in desperate financial straits due to significant bad debts and facing a serious risk of failure. KEB's plight was part of a much larger credit crisis that struck Korea's economy, which resulted in the failure or near-failure of several major financial institutions. At the time, KEB's major shareholders – Commerzbank AG ("Commerzbank"), the Export-Import Bank of Korea ("KEXIM"), and the Bank of Korea ("BOK") – were unwilling or unable to recapitalize KEB. In addition, the Korean government had signaled publicly that it was no longer willing to make public funds available to bail out failing banks. No other bank, foreign or domestic, was interested in recapitalizing KEB. Lone Star was the only investor willing to take the substantial risk of investing in this large, but failing, Korean financial institution to try to turn it around.

8. The Korean government had a direct financial interest in the viability of KEB and stood to benefit substantially from Lone Star's investment. The bank's second- and third-largest shareholders, KEXIM (32.5% of shares) and the BOK (10.67% of shares), were government-owned financial institutions. Consequently, considerable public funds had already been injected into KEB, and were at risk due to the bank's precarious financial condition. A KEB failure would also have had grave ramifications for the Korean economy at large, further destabilizing financial markets that were already weakened by the insolvencies of multiple Korean conglomerates (*chaebols*) and credit card companies. By injecting KRW 1.075 trillion (approximately EUR 783 million) of new capital into KEB and purchasing existing shares from KEXIM for KRW 166 billion (approximately EUR 121 million), Lone Star would enable the government to recover public funds invested in the bank and provide much-needed stability to Korea's financial system.

9. Lone Star stood ready to invest this significant amount into the bank and to work hard to return the bank to being a strong, consistently profitable institution. Under Korean law, however, any entity seeking to acquire a substantial stake in a Korean commercial bank must first receive approval from the Financial Supervisory Commission ("FSC"). Furthermore, under the Korean Bank Act (as amended on April 27, 2002), the FSC could only approve such an investment if the FSC was satisfied that the potential acquirer was not a non-financial business operator ("NFBO") (otherwise, the NFBO investor could hold no more than 4% of the bank's total issued and outstanding voting shares).

10. Lone Star submitted the required application to the FSC for approval shortly after entering into the binding agreement to recapitalize the bank. On September 26, 2003, the FSC approved Lone Star's acquisition of 51% of the outstanding shares of KEB, as well as Lone Star's right to exercise call options to acquire additional shares from Commerzbank and KEXIM within the limit of 65.23% of total issued and outstanding voting shares.

11. On October 30, 2003, Lone Star closed on its acquisition of 51% of KEB's shares for KRW 1.383 trillion (approximately EUR 1 billion). Contrary to later allegations, Lone Star did not purchase the KEB shares at a "fire sale" price. In fact, Lone Star paid a premium of 13% over the publicly traded price at the time the terms of Lone Star's investment were agreed and a

55% premium over the share price in March 2003, when Lone Star began full-scale due diligence on KEB. Lone Star exercised its call options to acquire an additional 14.1% of KEB shares for KRW 774 billion (approximately EUR 636 million) on May 30, 2006 (and provided the required notice of that acquisition to the FSC on May 11, 2006). Thus, at this point Lone Star had invested KRW 2.2 trillion (approximately EUR 1.6 billion) in KEB.

B. Merger of KEBCS into KEB

12. During the due diligence and negotiation period leading up to Lone Star's initial investment in KEB, Lone Star quickly discovered that KEBCS was in serious financial distress. Considering KEB's interest in KEBCS to be worthless, Lone Star was fully prepared to see KEBCS fail rather than risk the viability of KEB itself by having KEB try to rescue KEBCS. However, immediately after Lone Star made its enormous investment in KEB, the Korean regulators warned KEB that they would exercise their regulatory authority to hold KEB and its major shareholder (*i.e.*, Lone Star) responsible if KEB did not rescue KEBCS, and that KEB risked losing its ability to engage in the credit card business in the future. Capitulating to the intense pressure exerted by the regulators, on November 20, 2003, KEB, with Lone Star's acquiescence, first purchased the shares of KEBCS held by the other major shareholder in KEBCS, Olympus Capital, and then rescued KEBCS by merging it into the bank.

III. Arbitrary and Hostile Conduct of Korean Regulators in Response to Public and Political Opposition to Lone Star

13. Despite the fact that Lone Star had come to the rescue of a major Korean financial institution when no one else was willing, providing much-needed capital after the Asian financial crisis, and had relented in the face of the Korean regulators' intense pressure to then stretch that capital to rescue KEB's failing credit card affiliate, public opinion soon soured on foreign investment into Korea generally, and on Lone Star in particular. Lone Star quickly became the target of a hostile Korean public resentful of the profits that Lone Star was perceived to be earning on its investments in the country. The Korean public labeled Lone Star "meoktwi," or "eat and run" foreign capital, which supposedly bought Korean assets at fire sale prices only to re-sell them shortly thereafter at substantial profits.

14. The public demanded that Lone Star's profits be eliminated or curtailed, and the government responded. As explained below, Korean regulators undertook, by any means necessary without regard to legality, to block Lone Star from disposing of its investment in KEB at its fair market price, thereby preventing Lone Star – for years – from realizing the returns to which it was entitled. Throughout this process, the Korean public and government officials ignored the facts that Lone Star had rescued KEB (and its credit card affiliate) when the bank was failing, paid a substantial premium for its shares in KEB, and made possible a remarkable financial turnaround for the bank and its credit card operations. Rescuing the bank also had the effect of saving Korea from further collateral damage to its financial services industry and overall economy.

15. The unrelenting attacks on Lone Star continued for several years before Lone Star was finally permitted to sell its stake in KEB in 2012. During this time, Lone Star was constantly besieged by myriad government audits, investigations, exorbitant tax assessments, and other arbitrary and discriminatory measures, while its personnel were subjected to harassment, arrest, sanctions, and even imprisonment. These actions by the Korean government have caused Lone Star to incur losses of billions of euros.

A. Failed Attempts to Sell Lone Star's Investment in KEB and Related Harassment

16. Beginning in 2006, after KEB had returned to profitability, Lone Star made multiple attempts to sell its interest in KEB. The FSC frustrated those efforts by unreasonably, unjustifiably, and unlawfully delaying approval of the sales. The reason the FSC gave for the delays was that it did not wish to approve a sale while various investigations and legal proceedings relating to Lone Star were still pending. This position, however, was a mere pretext. None of the allegations relating to Lone Star were legitimate grounds for the FSC to withhold approval of the proposed purchasers of Lone Star's shares in KEB.

17. Under Korean law, a regulatory review of an application for approval of an acquisition of a substantial stake in a commercial bank is limited to an examination of the qualifications and conditions of the potential acquirer and the target subsidiary. Thus, by refusing to approve the applications made by proposed purchasers due to concerns over the *seller*, the FSC was acting outside the scope of its authority. As would become clear, the FSC's

behavior was driven by a desire to avoid becoming the target of public outrage for failing to prevent Lone Star from making what many perceived as unfair financial gains. The public demanded that the FSC block Lone Star from realizing profits on the sale of a controlling interest in KEB (or, at a minimum, drive down the price Lone Star could receive for the shares), and the FSC sought to placate those demands by simply refusing to act on the proposed sales.

18. Under Korean law, the FSC is required to process an acquiring entity's application within 30 days. Pursuant to Article 19 of the Administrative Procedures Act, this review period can be extended by an additional term no longer than the original review period (*i.e.*, an additional 30 days) only where unavoidable circumstances exist. In the case of Lone Star's proposed sales of its stake in KEB, however, applications to acquire Lone Star's stake in KEB remained pending for so long, sometimes for over a year, that a string of potential sales collapsed.

19. The FSC's treatment of the applications to acquire KEB stands in stark contrast to its treatment of applications to acquire other financial institutions that were being sold by other investors. In fact, all other applications for bank acquisitions that occurred during the period of Lone Star's investment in KEB were approved well within the 60-day period specified in Korean law.

20. As a result of the FSC's obstructive delays, Lone Star was repeatedly deprived of its right to dispose of its investment. As explained below, after years of delays, Lone Star was eventually permitted to sell its shares in KEB – but at a price drastically lower than the prices at which it had contracted with previous parties.

1. Attempted Sale to Kookmin Bank

21. Lone Star first put its stake in KEB up for sale in January 2006. By this time, under Lone Star's stewardship, KEB's financial situation had made a complete turnaround. Its share value had appreciated by 240%, its net equity had increased from KRW 1.838 trillion (as of June 30, 2003) to KRW 5.658 trillion (as of December 31, 2005), and its capital adequacy (BIS) ratio had surged from 9.32% (as of FYE 2003) to 13.68% (as of FYE 2005). With these positive results on the books, on May 19, 2006, Lone Star executed a Share Purchase Agreement

("SPA") with Kookmin Bank ("Kookmin") for the sale of Lone Star's 64.62% stake in KEB for KRW 6.3 trillion (approximately EUR 5.2 billion). Kookmin timely filed its application for approval of the acquisition with the FSC in late May 2006.

22. In the meantime, however, Lone Star had become the target of an onslaught of investigations by Korean government agencies prompted by public hostility to the profits that Lone Star stood to realize from the sale of its stake in KEB. These investigations included an audit of Lone Star's original acquisition of KEB by the Board of Audit and Inspection ("BAI") conducted at the request of the National Assembly on March 3, 2006; a criminal investigation of Lone Star by the Supreme Prosecutors Office ("SPO") in response to complaints filed by, *inter alia*, the Finance and Economy Committee of the National Assembly on March 7, 2006 and an anti-foreign activist group called SpecWatch Korea on September 14, 2005; and an investigation by the Financial Supervisory Service, an executive arm of the FSC. The root of these investigations was the unfounded allegation that the original sale of a majority stake in KEB to Lone Star was illegal due to wrongdoing by the government, KEB, and Lone Star actors involved.

23. In furtherance of these allegations, government agencies harassed key Lone Star personnel by subjecting them to intensive investigations, seeking warrants for their arrest, and imposing heavy sanctions. Beginning on October 31, 2006, the SPO made multiple attempts to obtain a detention warrant for Mr. Paul Yoo (the former head of Lone Star Advisors Korea, L.L.C. ("LSAK")), and arrest warrants (for questioning) for three other Lone Star-appointed directors on KEB's board at the time of the KEBCS merger, *i.e.*, Messrs. Ellis Short, Michael Thomson, and Steven Lee. In a dramatic example of the lengths to which the Korean authorities would go to pander to public opinion, the SPO took the unprecedented step of circulating a mass email on November 6, 2006 to thousands of Korean journalists, academics, and lawyers that openly disputed the ruling of the Seoul Central District Court dismissing the applications for the warrants. Notably, however, the SPO did not indict or seek arrest warrants for any of the KEB directors who were not affiliated with Lone Star, all of whom had also approved the KEBCS merger, including the director who had made the public statements that the SPO claimed were illegal.

24. Despite the fact that these investigations of Lone Star and its personnel had no bearing on the issue of whether Kookmin was eligible to purchase Lone Star's stake in KEB, the FSC delayed and ultimately refused to take any action on Kookmin's application on the basis that these investigations were ongoing.

2. Attempted Sale to DBS Bank

25. After Kookmin's proposed purchase of Lone Star's stake in KEB failed in November 2006, Lone Star was approached by Singapore-based DBS Bank ("DBS") in January 2007 to acquire Lone Star's stake in KEB. Again, however, the FSC quickly made it clear to DBS that it would not approve the sale. As a result, DBS had no choice but to abandon its efforts to acquire KEB.

26. Around the same time as the breakdown of negotiations with DBS, the FSC decided, in response to public pressure, that it would revisit its earlier interpretation that Lone Star was a non-NFBO. Despite initially accepting since 2003 that Lone Star was not an NFBO, and was therefore qualified to own more than 4% of KEB, the FSC commenced an extensive review of Lone Star's overseas affiliates to reassess Lone Star's status.

3. Block Sale of KEB Shares on the Open Market

27. Throughout this time, under Lone Star's stewardship, the bank continued to strengthen, reflecting stable profitability and prudent growth. Nevertheless, given the FSC's public stance that it would not consider approving any buyer of Lone Star's stake in KEB in the foreseeable future, there was growing uncertainty about when Lone Star would be able to exit its investment and on what terms. With this public posture, and after two failed sale attempts already, it was also unclear whether Lone Star could even find another interested buyer. Thus, in order to reduce its exposure while the investment remained in limbo, on June 22, 2007, Lone Star sold 13.6% of KEB's shares on the open market for KRW 1.2 trillion (approximately EUR 1 billion). The FSC could not block the sale because FSC approval is not needed when no single buyer acquires a substantial stake in the bank. At the same time, however, Lone Star had to sell the shares at a substantial discount to the price it could have commanded had it sold a controlling block; in fact, the sale price was below even the publicly listed per-share price at the time.

4. Attempted Sale to HSBC

28. Following the block sale, Lone Star was approached by HSBC Asia Pacific Holdings (UK) Ltd. ("HSBC"), and on September 3, 2007, Lone Star and HSBC executed an SPA at a price of approximately KRW 6.0 trillion (approximately EUR 4.7 billion) for what was now a 51.02% interest in KEB. On December 17, 2007, HSBC submitted its application to the FSC for approval of the acquisition. But the Korean government once again obstructed Lone Star's attempt to sell its stake in KEB.

29. By the time of HSBC's application, the abovementioned investigations by the BAI and SPO as to Lone Star's original acquisition of KEB had already concluded, with no charges brought against Lone Star or its representatives. Still, the FSC continued to refuse to rule on HSBC's application. As noted, the law required the FSC to limit its examination to the qualifications of the purchaser (*i.e.*, HSBC), but, once again, the FSC withheld approval for reasons related to the seller, Lone Star. To explain its delay in processing HSBC's application, the FSC cited ongoing legal proceedings relating to allegations that Mr. Yoo had manipulated the stock price of KEBCS in connection with its merger into KEB. On February 1, 2008, the FSC announced that it would not approve HSBC's acquisition of KEB until all legal battles were resolved. However, no statutory or regulatory basis exists under Korean law for withholding approval on such grounds.

30. Further demonstrating that the FSC's behavior was driven by political rather than legal factors, FSC Chairman Kwang-woo Jun announced on June 5, 2008 that the FSC "needed to take public sentiment into account" in its consideration of HSBC's application and that "sufficient national consensus would have to be obtained" in order for the FSC to change its stance and act on HSBC's application. Again, neither public sentiment nor national consensus is a legitimate basis for delaying or denying an application to acquire a substantial stake in a bank.

31. Between July and September 2008, Lone Star sent a series of letters to FSC Chairman Jun, urging a prompt decision on HSBC's application to acquire KEB, and indicating that Lone Star intended to pursue investment treaty arbitration due to the Korean government's refusal to act on HSBC's application. The FSC nevertheless failed to take any action on the

application. On September 18, 2008 – nine months after its application had been submitted – HSBC terminated the SPA.

5. Sale to Hana Financial Group

32. After weathering the global financial crisis of 2008-2009, Lone Star attempted for the fourth time to sell its stake in KEB. On November 25, 2010, after a year-long, transparent worldwide search for buyers, Lone Star found a potential acquirer, Hana Financial Group, Inc. ("Hana"). Lone Star and Hana executed an SPA with a contemplated sale price of KRW 4.7 trillion (approximately EUR 3.1 billion). The SPA provided for a generous six-month term to close the sale. Hana filed its application for approval with the FSC on December 13, 2010.

33. The Fair Trade Commission, the Korean antitrust authority, announced its approval of the sale on March 9, 2011. The FSC, meanwhile, announced that Hana's application, along with Lone Star's status as an NFBO, would be discussed at its meeting on March 16, signaling that the FSC expected to approve the application at that time. However, on March 10, in an appeal that had been pending before it for two-and-a-half years, the Supreme Court suddenly vacated the Seoul High Court's not guilty verdict against Mr. Yoo for stock price manipulation related to the KEBCS merger and remanded the case to the lower court. At its meeting on March 16, the FSC did re-affirm that Lone Star was not an NFBO (consistent with its determination in 2003), but it still did not approve Hana's application to acquire Lone Star's shares in KEB.

34. The FSC used the public uproar over the Supreme Court's unexpected remand as an excuse for delaying action on Hana's application. Under Article 16-4(3) of the Bank Act and Article 215 of the repealed Securities and Exchange Act, the FSC may order a shareholder that has been sanctioned within the preceding five years for violating a finance-related law or regulation to reduce its shareholding to the prescribed limit of 10% within a specified period of not more than six months. Thus, if the courts ultimately determined that Lone Star had violated a finance-related law or regulation as part of the merger of KEB and KEBCS, then the FSC would be authorized to order Lone Star to sell its shareholding in excess of 10% of KEB's shares. It was ostensibly on this basis that the FSC delayed acting on Hana's application. The

irony in the FSC's reasoning, of course, was that the FSC was using a law under which the FSC could *order* Lone Star to sell its majority stake in KEB as an excuse for *preventing* Lone Star from selling that same stake.

35. As the parties continued to wait for the FSC to act on the application, Lone Star and Hana agreed on July 8, 2011 to extend the SPA until November 30, 2011, a year after Hana's original application to the FSC.

36. On October 6, 2011, the Seoul High Court issued a ruling in the KEBCS stock manipulation case, finding Lone Star vicariously liable as a result of alleged wrongdoing during KEB's merger with KEBCS. Although Lone Star took the view that the court's verdict was baseless, Lone Star decided that it was in the best interest of its investors to allow the Seoul High Court decision to become final, and thereby to provide the finality in the case that the FSC had declared repeatedly and publicly as being necessary before it would act on any application to acquire Lone Star's stake in KEB. Accordingly, Lone Star did not appeal the Seoul High Court's decision, and the decision became final as of October 14, 2011. In a series of letters sent to the FSC, Lone Star explained that it had decided not to appeal the decision and could not bring itself into compliance with the requirements of the Bank Act. Lone Star noted that the end of the court litigation had removed the last of the FSC's stated obstacles to acting on Hana's application. Lone Star also pointed out that the only appropriate remedy at that point was to approve Hana's application, facilitating the removal of Lone Star as the major shareholder of KEB without needing to resort to issuing a sale order. On this basis, Lone Star urged the FSC to approve the sale promptly.

37. However, the FSC – responding to public and political pressure to sanction Lone Star and prevent it from reaping the profits that it stood to earn on the sale to Hana – appeared determined to postpone any approval until after November 30, 2011, the date when Hana's commitment under the SPA would expire, to pressure Lone Star to renegotiate a lower price. In fact, the FSC publicly made it clear that it would not approve Hana's application until the sale price was lowered.

38. On October 17, 2011, the FSC notified Lone Star that it intended to issue a "compliance order" based on the recently finalized (as to Lone Star) Seoul High Court decision

in the KEBCS case, which would require Lone Star to bring itself into compliance with the requirements of the Bank Act. This of course was impossible, because Lone Star's "noncompliance" was that it had been found guilty (vicariously) of a financial crime – a judgment that was now final and unappealable and, therefore, impossible to correct. Recognizing that this was no more than a delay tactic by the FSC, Lone Star responded to the FSC with a plea that the FSC focus instead on processing Hana's pending application. The FSC nevertheless issued the Compliance Order on October 25, 2011. Importantly, this formal order stripped Lone Star of its voting rights in excess of 10% of KEB's outstanding shares. Lone Star responded immediately, noting that it could not satisfy the Compliance Order and reiterating its request that the FSC take action on Hana's application.

39. Almost a month later, on November 18, 2011, the FSC issued a Disposition Order, which ordered Lone Star to dispose of its shares in KEB in excess of 10% by no later than May 18, 2012. As a result, Lone Star was now facing an order from the Korean government to dispose of the bulk of its shares within a short period of time, but without the ability to sell those shares to Hana, as it was contractually obligated to do and had sought to do for the past year. On that same day, while the SPA with Hana was still binding but subject to the FSC's approval, the FSC also announced that significant changes had occurred since Hana had submitted its original application almost a year earlier that would affect Hana's takeover of KEB and that, therefore, the FSC would direct Hana to submit a new application taking these changed circumstances into account. One of the changed circumstances highlighted by the FSC was that it had just stripped Lone Star of its majority voting rights with respect to its KEB shares. Public comments by FSC officials surrounding this press release made it clear that the FSC expected Hana to cut the price it was to pay for Lone Star's KEB stake.

40. On the strength of the FSC's announcement, Hana demanded that Lone Star agree to a substantial price reduction, asserting that a price reduction was necessary for the FSC to approve Hana's application without further delay. Facing the deadline of the Disposition Order, and with no realistic prospect of starting yet another sales process to find a buyer within such a limited amount of time, Lone Star determined that it had no choice but to accede to Hana's demands to cut the sale price. Thus, on December 3, 2011, Lone Star agreed to reduce the sale price to approximately KRW 3.9 trillion (approximately EUR 2.6 billion) from the initial KRW

4.7 trillion (approximately EUR 3.1 billion). Hana filed a second application with the FSC on the basis of this revised cut-price contract on December 5, 2012.

41. Because of the negative political climate surrounding the sale, however, the FSC continued to delay action on even this simple re-filed application. On January 17, 2012, almost two weeks after the 30-day statutory period had expired on Hana's second application, Lone Star wrote yet again to the FSC, noting the impossible situation in which it had been placed by the FSC's Compliance Order and Disposition Order absent approval of the Hana acquisition. Lone Star further stated that it would be compelled to pursue claims under the BIT. The FSC finally approved the sale to Hana on January 27, 2012, and the transaction closed on February 9, 2012 at the substantially discounted price that the parties had set on December 3, 2011.

B. Arbitrary Tax Audits and Assessments by the National Tax Service

42. In parallel with the events relating to Lone Star's efforts to sell its stake in KEB, the Korean government repeatedly imposed taxes on the Lone Star companies in direct contravention of Korea's obligations under its tax treaty with Belgium ("Korea-Belgium Tax Treaty"). In an effort to maximize Lone Star's tax liability to appease an increasingly hostile Korean public, the Korean National Tax Service ("NTS"), over the course of seven years, repeatedly reversed its own methodology for assessing taxes and improperly disregarded the treaty benefits to which the Lone Star companies, all resident in Belgium, were entitled.

43. Under the terms of the Korea-Belgium Tax Treaty, the capital gains realized by a Belgian entity from the sale of shares in a Korean corporation may not be taxed in Korea; Belgium retains the exclusive right to tax such gains. This type of provision, whereby the country of residence retains the right to tax gains and the source country (*i.e.*, the country in which the investment is made) cedes such right, is common in bilateral tax treaties. Nevertheless, based on a number of unsupported and far-fetched allegations, including that Belgium was a tax haven or that the Lone Star companies were mere conduits that served no purpose other than obtaining improper tax benefits, the NTS refused to honor Korea's binding obligations under its treaty with Belgium. Instead, the NTS took the position that it could disregard the Belgian entities and instead tax upper-level non-Belgian investors "in substance."

44. Additionally, as discussed in more detail below, between 2005 and the present, the NTS has taken a series of contradictory positions with respect to the taxation of Lone Star's sales of shares in Korean companies, with the end goal of maximizing taxation in each instance. Where taxation in Korea could be maximized if Lone Star were treated as having a fixed place within Korea through which it regularly and continuously conducted business (commonly called a "permanent establishment" or "PE" in tax treaties), then the NTS has argued that such a PE existed in Korea. Where the NTS believed that greater taxation could be realized without asserting that a PE existed, then the NTS has concluded that no such PE existed in Korea. Over the course of several transactions, the NTS initially concluded that Lone Star entities did *not* have a PE in Korea, then the NTS found that they *did* have a PE in Korea, and then, once again, it concluded that they did *not* have a PE in Korea. Further, even when the NTS concluded that Lone Star entities did not have a PE in Korea, the NTS ignored the applicable tax treaties and assessed or withheld Korean taxes based only on Korean domestic law.

45. Lone Star's dispute with the NTS began in April 2005, when the NTS initiated an audit of Lone Star by illegally and forcibly raiding the Seoul offices of LSAK without a warrant or LSAK's consent. LSAK is a separate company that existed to provide services to various Lone Star entities in Korea, and was never owned or managed by the Lone Star companies. The NTS raid was prompted by public discontent over profits earned by Lone Star from the sale of shares of a Korean company, the Star Tower Corporation, that owned an office building called Star Tower, as discussed below. During the raid, the NTS illegally seized certain sensitive, confidential, and highly proprietary business information that did not relate to the matters under audit and thus which Lone Star and the NTS had previously agreed would not be accessed as part of the audit.

46. Beginning in October 2005, the NTS assessed massive taxes relating to virtually all of Lone Star's Korean investments and operations and filed criminal complaints with the SPO against various Lone Star affiliates and personnel. In particular, the NTS assessed KRW 112 billion (approximately EUR 92 million) in capital gains taxes in connection with the sale of the shares of Star Tower Corporation.[2] Star Tower Corporation was owned by Star Holdings SCA, a

[2] The NTS also assessed taxes against 17 other Lone Star affiliates totaling KRW 72 billion (approximately EUR 59 million).

Lone Star investment holding company organized under Belgian law. The Korea-Belgium Tax Treaty expressly provides that Korea may not impose tax on the sale of shares of a Korean entity where the seller or "alienator" of the shares is a Belgian resident. However, the NTS asserted that Star Holdings SCA was not the true beneficial owner of the shares of the Star Tower Corporation, a position wholly at odds with the Korea-Belgian Tax Treaty. Indeed, as noted below, Belgium formally objected to the NTS's position and requested that Korea and Belgium discuss the issue as provided for in the treaty.

47. In disregarding Star Holdings SCA as the seller or "alienator" of the shares of Star Tower Corporation, the NTS asserted that the ultimate investors, *i.e.*, the investors in the U.S. and Bermuda partnerships that indirectly owned Star Holdings SCA, were the "true" owners of Star Tower Corporation. However, the NTS claimed that it did not know who those investors were, and then instead simply assessed taxes against the U.S. and Bermuda partnerships. Even if that determination were correct (which it was not), a majority of those gains still should have been exempt from taxes in accordance with Korea's tax treaty with the United States. Nevertheless, the NTS asserted, also incorrectly, that the proceeds were taxable in Korea under Korea's domestic law, regardless of the provisions of the treaty, because the gains in question arose from the sale of a Korean company whose primary asset was real estate. Under this pretext, the NTS assessed Korean taxes against the U.S. and Bermuda partnerships that had invested indirectly in Star Tower Corporation. Even if correct (which it clearly was not), taxing the non-Korean partnerships in that manner would only be permissible if those fund partnerships did not have a "permanent establishment" in Korea.

48. In addition, the NTS taxed these entities under Korea's personal income tax regime (*i.e.,* the regime applicable to individuals), which imposes higher tax rates than the corporate tax regime. After years of litigation through the Korean courts, the Korean Supreme Court in January 2012 found in favor of Lone Star, on the narrow (but sufficient) ground that, even assuming that all of the NTS's other arguments were valid, it was improper to tax these entities as individuals. The decision required the NTS to refund the tax imposed. Undaunted, however, the NTS simply re-assessed the entities under the corporate tax regime, and unilaterally applied the ordered refund against these new taxes (refunding only the balance that is attributable to the lower tax rates under that regime). Thus, after seven years of litigation and a favorable

ruling by the Supreme Court, Lone Star now faces years more of litigation over the same basic issues in the Korean courts.

49. In any case, as noted, under Korean law and the applicable tax treaties, the NTS could only impose these taxes (under the individual or corporate tax regime) in the manner that they did if the fund partnerships did not have a "permanent establishment" in Korea. The NTS's position in the Star Tower matter contrasts sharply with the position it adopted in virtually the same fact pattern involving Lone Star that arose only two years later.

50. In 2007, five Belgian investment holding companies affiliated with Lone Star sold shares in three other Korean companies: (i) a block sale of 13.6% of shares in KEB owned by LSF-KEB Holdings SCA ("LSF-KEB") (referenced in Section III.A.3 above); (ii) a sale of shares owned by HL Holdings SCA and LSF SLF Holdings SCA in Starlease Co., Ltd. ("Starlease"); and (iii) a sale of shares owned by Kukdong Holdings I SCA and Kukdong Holdings II SCA in Kukdong Engineering & Construction Co., Ltd. ("Kukdong"). The ownership structure of these Korean companies mirrored the ownership structure of Star Tower Corporation. However, in July 2008, the NTS assessed taxes on these sales by applying a methodology directly contrary to that which it had applied to the Star Tower Corporation sale, imposing aggregate taxes of KRW 153 billion (approximately EUR 93 million).

51. None of the three 2007 transactions involved the sale of a Korean company whose primary asset was real estate. Therefore, if the NTS wanted to assess Korean taxes on these three sales, it could not rely on the same theory (which itself was incorrect) that it had applied in the Star Tower Corporation context. Consequently, if the NTS concluded that the Lone Star entities involved in the three sales did not have a PE in Korea (as was the case with the Star Tower transaction), then the vast majority of the sale proceeds would be covered by a tax treaty (*i.e.*, the treaties with Belgium or the countries of residence of the ultimate fund investors) and not subject to tax in Korea. This outcome was evidently unacceptable to the NTS. It therefore developed a new theory to assess Korean taxes on the sales.

52. In this instance, the NTS again ignored each of the Belgian entities that had sold the shares, but this time asserted that the upstream U.S. and Bermuda partnerships *had* PEs in Korea (and a portion of gains from the sale of the shares was, therefore, taxable in Korea)

because of business activities performed by employees of LSAK and Hudson Advisors Korea, Inc. ("HAK"), an affiliated asset management company in Korea. As noted, the ownership structure of the Lone Star entities in the KEB, Starlease, and Kukdong transactions mirrored the structure of the entities in the Star Tower Corporation transaction, where the NTS had effectively determined only two years earlier that the upstream investors did *not* have a PE in Korea. As these events demonstrate, it was clear that the NTS would use whatever methodology was necessary, regardless of its legality or consistency with the NTS's previous positions, in order to ensure that significant Korean taxes would be assessed.

53. Concerned by Korea's violations of the Korea-Belgium Tax Treaty, on August 8, 2007, Belgium formally requested that the NTS begin a mutual agreement procedure pursuant to Article 24 of the treaty to resolve the dispute with respect to the treatment of Star Holdings SCA. On September 27, 2007, in violation of the treaty, the NTS denied Belgium's request for a mutual agreement procedure, refusing even to discuss the matter with the Belgian government.

54. Then, as noted above, in February 2012, Lone Star was finally allowed to sell its majority stake in KEB to Hana. But yet again, the NTS reversed its position with respect to the methodology for assessing taxes. Even before the FSC approved the sale, the NTS instructed Hana to withhold capital gains taxes from the sale price to be paid to Lone Star. Under Korean law, withholding taxes are imposed only where the selling person does *not* have a PE (and where that withholding tax is not eliminated by any applicable tax treaty). Therefore, by ordering Hana to withhold taxes in connection with the purchase and sale of the KEB shares, the NTS was necessarily of the view that Lone Star did *not* have a PE in Korea. In doing so, the NTS took a position that was directly opposite to the position it took with respect to Lone Star's 2007 block sale. Furthermore, the NTS ignored the fact that the proceeds of the 2012 sale were exempt from Korean withholding tax under the Korea-Belgium Tax Treaty (or, accepting for the sake of discussion the NTS's position that the ultimate fund investors are the "true" taxpayers with respect to this investment, under the treaties with the countries of residence of those ultimate investors). It would appear obvious that the NTS took a contradictory position here yet again because this was the only way that it could assess significant taxes on the sale.

55. Following the NTS's instruction, Hana withheld taxes of KRW 431 billion (approximately EUR 292 million) from the sale proceeds and paid this amount to the Seoul Regional Tax Office and the Namdaemun District Tax Office on March 5, 2012 and March 7, 2012, respectively.

56. In sum, the NTS has imposed taxes against Lone Star in respect of these investments in Korea, aggregating approximately KRW 800 billion (approximately EUR 540 million), by blatantly disregarding the rights of Belgian shareholders under the Korea-Belgium Tax Treaty, while at the same time continuously altering its substantive positions from investment-to-investment and time-to-time as needed to achieve its singular goal of imposing the maximum tax on Lone Star.

IV. Claims Raised Under the BIT

57. As demonstrated by the foregoing, the Government of Korea has violated its obligations to Lone Star under the terms of the BIT. Lone Star has on multiple occasions put the Korean government on notice of these violations, both orally and in Lone Star's letters to the FSC of July 9, 2008; February 11, 2009; and January 17, 2012.

58. Lone Star is herewith submitting to the Government of Korea its written notification of a dispute, accompanied by this sufficiently detailed memorandum, as required under Article 8.1 of the BIT.

59. The investors in this dispute are the Belgian companies LSF-KEB Holdings SCA, Star Holdings SCA, HL Holdings SCA, LSF SLF Holdings SCA, Kukdong Holdings I SCA, and Kukdong Holdings II SCA. These investors held investments protected under the BIT – primarily the 64.62% stake in KEB, but also other investments. Through the acts discussed above, the Korean government has violated with respect to these investments:

- Article 2.2: Obligations of fair and equitable treatment, and full and continuous protection and security;
- Article 2.3: Prohibition of impairment by arbitrary and discriminatory measures the operation, management, maintenance, use, enjoyment or disposal of investments;

- Articles 3.1 and 3.2: Obligation of treatment no less favorable than that accorded to investments and returns of Korean investors or investors of any third state, and that accorded to Korean investors or investors of any third state;

- Article 5: Prohibition of uncompensated expropriation; and

- Article 6: Obligation to guarantee to investors the free transfer of their investments and returns.

60. As a result of these violations of the BIT, Lone Star has suffered billions of euros in damages. Lone Star fully reserves the right to elaborate and expand on these claims.

61. In accordance with the requirements of Article 8.1 of the BIT, Lone Star stands ready to settle this dispute amicably and would welcome the opportunity to engage in serious, good faith discussions with the Government of Korea. As is made clear above, Lone Star has already exerted significant effort to prevent and resolve its dispute with Korea, but without success. Absent resolution of this dispute within six months through appropriate measures and compensation to Lone Star, in accordance with Article 8.3 of the BIT, Lone Star will submit this dispute for arbitration at the International Centre for Settlement of Investment Disputes.