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□ SPECIAL ARTICLES ABOUT NAGOYA PROTOCOL□

□ARTICLES□

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(3) Appeals Courts (고등법원) Seoul High Court, 2003Na80798 (Jan. 25, 2005).

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Hyungbae Kim, Kyuwan Kim & Myungsook Kim, Lecture on Civil Law Theory, at 50-51 (8th ed. 2009)

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Jeongho, Kim, *A Study on the Path to Introduce the Multiple Derivative Suit in Korea*, Journal of Business Administration & Law Vol. 23, No.4, 2013. at 209-254.

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SPECIAL ARTICLES ABOUT NAGOYA PROTOCOL

How to Approach the Issue of Digital Sequence Information: Focusing on the AHTEG*

Nohyoung Park

ABSTRACT

The issue of 'digital sequence information on genetic resources' [hereinafter "DSI"] was discussed in a serious way in the governing bodies of the Convention on Biodiversity [hereinafter "CBD"] and the Nagoya Protocol in December 2016. The following two decisions were taken: Decision XIII/16 adopted by the thirteenth meeting of the Conference of the Parties to the CBD [hereinafter "COP"] and Decision NP-2/14 adopted by the Conference of the Parties serving as the Meeting of the Parties to the Nagoya Protocol [hereinafter "COP-MOP"]. In accordance with these decisions a coordinated and non-duplicative process for further work on the issue of DSI was established for the 2017-2018 period. This process includes the submission of views, the commissioning of a study to clarify terminology and concepts and to assess the extent and terms and conditions of the use of DSI, a meeting of an Ad Hoc Technical Expert Group and consideration of this matter by the Subsidiary Body on Scientific, Technical and Technological Advice, which will make recommendations to COP 14 and COP-MOP 3. The Parties will consider any potential implications of the use of DSI for the three objectives of the Convention and the objective of the Nagoya Protocol at the meetings of COP 14 and COP-MOP 3 in 2018. In the process the Ad Hoc Technical Expert Group on DSI is a primary element, and the first meeting was held in February 2018. This paper is briefly reviewing the issue of DSI by focusing on its activities.

KEYWORDS: Nagoya Protocol, Convention on Biodiversity, digital sequence information, genetic resources,

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* This paper, originally to be a modification of a presentation made in Jeju Island in November 2017, is mainly reflecting the activities of the AHTEG as the latter met in February 2018. This article is supported by National Research Foundation of Korea. (NRF-2016M3A9A5919086)

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I. Terms of Reference for the AHTEG

The Ad Hoc Technical Expert Group on digital sequence information on genetic resources [hereinafter " AHTEG] was established by Decision XIII/16 of COP 13. In accordance with Decision NP-2/14, the group also serves the Nagoya Protocol. Among other tasks, the AHTEG is to consider the compilation and synthesis of views and information submitted by Parties, other Governments, relevant organizations and stakeholders, as well as a fact-finding and scoping study commissioned by the Executive Secretary.

The terms of reference for the AHTEG is set in the Annex of Decision XIII/16. First, the AHTEG is to consider the compilation, synthesis and the study referred to in paragraph 3(a) and (b) of the Decision in order to examine any potential implications of the use of DSI on genetic resources for the three objectives of the Convention and the objective of the Nagoya Protocol and implementation to achieve these objectives.[1] Second, it is to consider the technical scope and legal and scientific implications of existing terminology related to digital sequence information on genetic resources. Third, it is to identify the different types of digital sequence information on genetic resources that are relevant to the Convention and the Nagoya Protocol. Fourth, it is to meet at least once face-to-face, subject to the availability of financial

[1] Para. 3(a) states that the Executive Secretary to "Prepare a compilation and synthesis of the views and information submitted, including the information gathered from engagement with relevant ongoing processes and policy debates", while Para. 3(b) states that the Executive Secretary to "Commission a fact-finding and scoping study, subject to the availability of financial resources, to clarify terminology and concepts and to assess the extent and the terms and conditions of the use of digital sequence information on genetic resources in the context of the Convention and the Nagoya Protocol."

resources, prior to the fourteenth meeting of the Conference of the Parties and make use of online tools to facilitate its work, as appropriate. Accordingly, a meeting of the AHTEG was convened from February 13 to 16, 2018 in Montreal, Canada. Finally, it is to submit its outcomes for consideration by a meeting of the Subsidiary Body on Scientific, Technical and Technological Advice to be held prior to the fourteenth meeting of the Conference of the Parties.

II. Composition of the AHTEG

Based on the nominations received and in consultation with the Bureau of the Subsidiary Body on Scientific, Technical and Technological Advice [hereinafter "SBSTTA"], experts were selected, taking into account relevant expertise and with due regard to regional and gender balance, and notified on 20 October 2017.[2] The number of the experts nominated by the Parties to the Convention is 25, of which are from five regions: three from Africa including Namibia, three from Asia-Pacific including Japan and Korea, two from Central and Eastern Europe, three from Group of Latin America and the Caribbean including Argentina and Brazil, and three from Western Europe and Others including Canada and EU. The expert nominated by other governments is from the USA. The experts nominated by organizations are ten from those covering the Secretariat of the Commission on Genetic Resources for Food and Agriculture [hereinafter "CGRFA"], the Secretariat of the International Treaty on Plant Genetic Resources for Food and Agriculture [hereinafter "ITPGRFA"], the World Health Organization, the CGIAR, the Third World Network, and the International Chamber of Commerce.

III. Submissions from Parties, Other Governments, Relevant Organizations and Stakeholders

In Decision XIII/16 on Digital sequence information on genetic resources of 16 December 2016, the COP to the Convention invited Parties, other Governments, indigenous peoples and local communities, and relevant organizations and stakeholders to submit views and relevant information to the Executive Secretary on any potential implications of the use of DSI for the three objectives of the Convention. The COP serving as the MOP to the Nagoya Protocol invited these submissions to include information relevant to

[2] CBD, Notification on Composition of the Ad Hoc Technical Expert Group on Digital Sequence Information on Genetic Resources (Oct. 20, 2017).

the Nagoya Protocol.[3] The Secretariat invited the submission of views and information through notification 2017-37 on April 25, 2017.

The number of submissions given to the Secretariat was 53.[4] 14 CBD Parties, including Argentina, Australia, Brazil, Canada, Ethiopia on behalf of the African Group, the EU and Member States, India, Japan and Switzerland, gave submissions. The US, non-Party, also gave a submission by recommending to use the term 'Genetic sequence data' [hereinafter "GSD"] instead of 'DSI'. 38 organizations and stakeholders, including BioIndustry Association, CGRFA, International Chamber of Commerce, ITPGRFA, Japan Bioindustry Association, Royal Society of Biology, Third World Network, UN Division of Ocean Affairs and the Law of the Sea, did so.

It is interesting to see a clear difference of positions depending on the status being a providing Party or a using Party. First, with respect to whether the combination of DSI and synthesis technologies poses problems to fair and equitable sharing of benefits, there was an argument that users of DSI are obligated to share benefits, and the rights of genetic resource providers, indigenous peoples and local communities [hereinafter "IPLCs"] in particular are to be protected, when biodiversity is sequenced, if and when such information is shared and/or placed in databases.[5] Sequence data should accordingly be considered equivalent to biological material, as suggested by many developing country Parties at COP 13. Users of DSI should, in general, be subject to the same benefit sharing obligations as users of the biological materials that are the source of that DSI.[6] Genetic resource providers may thus choose to make DSI available without the underlying biological material and, these providers should be fully enabled to ensure the application of obligations that will result in fair and equitable benefit sharing.[7]

Another opposing argument was that any action that hinders the sharing and use of GSD would hinder achievement of the CBD's three objectives and the Nagoya Protocol's objective.[8] GSD are neither genetic material nor a

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[3] CBD, Decision 2/14 on Digital sequence information on genetic resources, CBD/NP/MOP/DEC/2/14 (December 16, 2016).

[4] CBD, AHTEG on Digital Sequence Information on Genetic Resources, at https://www.cbd.int/abs/dsi-gr/ahteg.shtml#peerreview.

[5] The Third World Network, "Potential implications of the use of digital sequence information on genetic resources for the three objectives of the Convention" (6 September 2017), in response to Decision XIII/16, para. 1.

[6] *Id.*

[7] *Id.*

[8] The US, "U.S. Submission on Digital Sequence Information on Genetic Resources" (18 August 2017) (US Submission 2017), in response to Decision XIII/16, at 2; International Chamber of Commerce, "DIGITAL SEQUENCE INFORMATION AND THE NAGOYA PROTOCOL" (September 14, 2017) (ICC Submission 2017), in response to Decision XIII/16, at 2. The US stated that the term "digital sequence information on genetic resources" means the genetic sequence data (GSD) that describe the order in which nucleotides are situated in a

genetic resource, as there is a "a conceptual and definitional distinction between genetic material itself and data describing that material".[9] DSI is not within the scope of the CBD or the Nagoya Protocol, because the definition of genetic resources relates to genetic material and not abstract information.[10] The definition of a "genetic resource" — as provided by Article 2 of the CBD and referred to in Article 2 of the Protocol — is "genetic material of actual or potential value". "Genetic material" is also defined as "material of biological origin containing functional units of heredity," with genes recognised as the basic units of heredity. It thus follows from this definition that, in the absence of material, the resource in question does not qualify as a genetic resource under the CBD or the Nagoya Protocol. Genetic resources are accordingly understood to cover materials such as organisms, or parts thereof, in which genetic material is present.[11] The term refers to tangible genetic material which must physically contain genes. Therefore intangible DSI as such cannot constitute a genetic resource as defined by the CBD.[12]

IV. Fact-finding and Scoping Study under Peer Review

The Executive Secretary was requested to commission a fact-finding and scoping study to clarify terminology and concepts and to assess the extent and the terms and conditions of the use of DSI in the context of the Convention and the Nagoya Protocol. Accordingly, a draft version of the Emergence and Growth of Digital Sequence Information in Research and Development: Implications for the Conservation and Sustainable Use of Biodiversity, and Fair and Equitable Benefit-Sharing — A Fact-Finding and Scoping Study Undertaken for the Secretariat of the Convention on Biological Diversity [hereinafter "scoping study"] was written by Sarah A. Laird and Rachel P. Wynberg, and finally published on 10 January 2018.[13]

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chain relative to one another in DNA or RNA molecules contained in genetic material of actual or potential value. US Submission 2017, at 1.

[9] US Submission 2017, at 1.

[10] ICC Submission 2017, at 1.

[11] The material of human origin has been explicitly excluded.

[12] ICC Submission 2017, at 2. Further expanding the definitions of "genetic resources" in the CBD and/or the "utilisation of genetic resources" in the Nagoya Protocol to include DSI or its use would create legal uncertainty around the use of such information and as to how access and benefit obligations would apply. Open exchange of scientific information, including DSI, contributes to these activities that support the objectives of the CBD and the Nagoya Protocol, and should be explicitly qualified as benefit sharing in itself. Imposing further obligations on this type of data would go against the objectives of the CBD and Nagoya Protocol. ICC Submission 2017, at 2.

[13] *See* Sarah A. Laird and Rachel P. Wynberg, with contributions from Arash Iranzadeh and Anna Sliva Kooser*, A Fact-Finding and Scoping Study on Digital Sequence Information on*

The scoping study, based on literature analysis and interviews, provided for useful fact-finding on the DSI under the Nagoya Protocol. It covered issues including: Terminology variations of DSI; Various kinds of conditions of use notices; Difficulties involving monetary benefits from the use of DSI; Challenges in determining value of DSI, identifying contributors and users of DSI, identifying provenance of DSI, monitoring the utilization of DSI, and distinguishing commercial and non-commercial research over DSI.

The scoping study discussed an issue of terminology of DSI in particular. Some of the points made by the scoping study is explained as follows. The term DSI used in Decisions CBD XIII/16 and NP 2/14, has grown from the CBD policy process. Terms more commonly employed by the scientific community and databases, however, include "genetic sequence data", "nucleotide sequence data", "nucleotide sequence information", and "genetic sequences". Differences in terminology in scientific circles may reflect differences in the material referred to, as well as the speed and transformative nature of technological change today, which make it difficult to harmonize terminology. In ABS policy discussions, accordingly differences in terminology often reflect divergent views of what falls within the scope of the Nagoya Protocol and national laws.[14]

Terminology also varies between international policy processes. Steps have been taken to harmonize terminology across international policy processes. The ITPGRFA, for example, elected to use the term "sequence data" in its recently commissioned scoping study on synthetic biology. The UN General Assembly's policy process on marine biodiversity in areas beyond national jurisdiction began with the term "resources in silico" but has moved to "digital sequence data". The WHO PIP Framework uses the term "genetic sequence data", which is defined as: "The order of nucleotides found in a molecule of DNA or RNA... contain[ing] the genetic information that determines the biological characteristics of an organism or a virus".[15]

The scoping study, under peer review for comments by Dec. 1, 2017, is expected to be complemented by a synthesis of views and information on potential implications of the use of DSI to be prepared by the Executive Secretary. The comments were given by 11 Parties including China, the EU and Switzerland, one non-Party (the United States), and 26 organizations and stake-holders including International Union for the Protection of New Varieties of Plants [hereinafter "UPOV"], Third World Network, United Nations Division of Ocean Affairs and the Law of the Sea and World Health

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Genetic Resources in the Context of the Convention on Biological Diversity and the Nagoya Protocol, CBD/DSI/AHTEG/2018/1/3 (January 12, 2018). The scoping study as of 10 January 2018 is a version of the draft circulated on Nov. 9, 2017, which was made to reflect the comments in response.

[14] Scoping Study, at 8.

[15] *Id*.

Organization.[16]

For example, Switzerland made the following comment: "the study fails in providing a clear picture on the quantitative importance of "digital sequence information" compared to "genetic resources" as such." [17] According to it, although researches make use of DSI, most labs certainly still work with physical material and not just with information. Thus, it proposed particularly the following amendment to be reflected in the Executive Summary:[18] "Physical samples are still of interest to and are broadly used by researchers, but th~~eir role~~ use/importance of "digital sequence information" in the research and commercialisation process seems to be ~~is~~ changing~~, and the future is unclear~~." The US also made the following comment: considering the amount of research that is still based on material samples, ""most" over-states the amount of research … using only genetic sequence data".[19] Thus, it recommended changing "most research" to "some research" as follows: "Most research is based on sequences accessed through databases or parts registries, but some groups sequence and analyze physical samples…" to "Some research is based on sequences accessed through databases or parts registries, with many groups sequencing and analysing physical samples …"[20] It also recommended to add at the end "Sequencing genetic materials from organisms being studied in the laboratory is a standard research technique."[21] According to it, it is important to capture the generic and ubiquitous nature of DSI, as this is not something restricted to field prospecting or synthetic organism creation.[22]

V. The Meeting of the AHTEG in February 2018

The meeting of the AHTEG was held from February 13 to 16, 2018 in Montreal, Canada. The outcome of the meeting would inform deliberations on this issue by the Subsidiary Body on Scientific, Technical and Technological Advice [hereinafter "SBSTTA"] at its twenty-second meeting, to be held from

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[16] CBD, AHTEG on Digital Sequence Information on Genetic Resources, "Peer review of the fact-finding and scoping study", at https://www.cbd.int/abs/dsi-gr/ahteg.shtml#peerreview. Switzerland gave four comments.

[17] Swiss Federal Institute of Intellectual Property (IPI), "Comments on the draft fact-finding and scoping study", in response to Notification No. 2017-115, at 1, 3.

[18] *Id*., at 3.

[19] The US, "Submission on Peer Review of Fact-Finding and Scoping Study on Digital Sequence
Information on Genetic Resources" (1 December 2017), in response to Notification No. 2017-115, at 2.

[20] *Id.*

[21] *Id.*

[22] *Id.*

July 2 to 7, 2018. The resulting outcomes would enable both the COP and COP-MOP to consider any potential implications of the use of digital sequence information on genetic resources for the objectives of the Convention and the Protocol, at their next meetings from November 10 to 22, 2018. The outcomes of the meeting is introduced rather simply as reported as follows.

A. Terminology and different types of digital sequence information on genetic resources

The participants discussed the various types of information on genetic resources that may be relevant to the three objectives of the CBD and the objective of the Nagoya Protocol. There was consensus that the term "digital sequence information" [hereinafter "DSI"] is not the appropriate term to refer to these types of information.[23] There was an understanding that information that provides an indication of the genetic and/or biochemical composition of the genetic resource at some point originated from a physical source.[24] There was also general agreement that "digital" only refers to the method by which the information is stored and transmitted and that new alternative forms of storage or transmission could raise similar questions.[25]

With respect to the relationship between DSI and definitions in the CBD and the Nagoya Protocol, divergent views were expressed as follows.[26] First, some were of the view that the definition of genetic resources[27] includes DSI, while others were of the view that the definition of genetic resources refers to tangible or physical material while DSI is intangible and so is not covered by the definition. Second, some experts considered that the phrase "or other

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[23] CBD, "Annex: Outcomes of the Meeting of the Ad Hoc Technical Expert Group on Digital Sequence Information on Genetic Resources" in the Report of the Ad Hoc Technical Group on Digital Sequence Information on Genetic Resources (Outcomes of the Meeting), CBD/DSI/AHTEG/2018/1/4, (20 February 2018), para. 1. However, the group continued to use DSI as a place holder, without prejudice to future consideration of alternative terms. The experts identified various types of information that may be relevant to the utilization of genetic resources, including: (a) The nucleic acid sequence reads and the associated data; (b) Information on the sequence assembly, its annotation and genetic mapping. This information may describe whole genomes, individual genes or fragments thereof, barcodes, organelle genomes or single nucleotide polymorphisms; (c) Information on gene expression; (d) Data on macromolecules and cellular metabolites; (e) Information on ecological relationships, and abiotic factors of the environment; (f) Function, such as behavioural data; (g) Structure, including morphological data and phenotype; (h) Information related to taxonomy; (i) Modalities of use. Outcomes of the Meeting, para. 2.

[24] Outcomes of the Meeting, para. 5.

[25] *Id*., para. 10.

[26] *Id*., para. 7.

[27] Convention on Biological Diversity, Article 2: "Genetic resources" means genetic material of actual or potential value.

origin" contained in the definition of genetic material[28] refers, for example, to other taxonomic categories not listed in the definition, while others were of the view that the phrase could include DSI. Third, some experts were of the view that, even if DSI is not within the definition of genetic resources, it is within the scope of the Nagoya Protocol insofar as it results from the utilization of the genetic resource or subsequent applications and commercialization and therefore should be covered by benefit-sharing, while others expressed that the only DSI that may be considered a result of utilization of the genetic resources is nucleic acid sequence reads and the associated data. Fourth, some experts noted that the legal implication of understanding DSI as equivalent to a genetic resource would be obligations for prior informed consent, mutually agreement terms and benefit-sharing. The legal implication of understanding DSI as the product of utilization of a genetic resource would be obligations for benefit-sharing.

With respect to the terms "sequence", "information" and "functional unit of heredity", divergent views were expressed as follows.[29] First, some experts recalled the reference to functional unit of heredity in the definition of genetic material and expressed concern that the concept of a sequence may not include units of heredity. Second, some noted that genomic sequence is the description of a nucleic acid molecule, which is not the same as a functional unit of heredity. Third, some noted that genomic sequence is the description of a nucleic acid molecule, which could be re-materialized as a functional unit of heredity. Fourth, some experts noted that the CBD does not contain a definition of functional unit of heredity and that, therefore, further discussions might be useful. Fifth, some experts also noted that sequence refers mainly to the linearity of a DNA, RNA or protein molecule but not to other kinds of molecules resulting from the metabolism of a genetic resource or to the natural post-transcriptional or post-translational modifications/regulations (i.e. methylations, folding, etc.).

B. Potential implications of the use of DSI for the fair and equitable sharing of benefits arising out of the utilization of genetic resources

While considering potential implications of the use of DSI for the fair and equitable sharing of benefits, there was general understanding among the experts that the COP and MOP did not decide whether utilization of DSI falls within the scope of the CBD or the Nagoya Protocol.[30] They further noted as follows.[31] First, DSI could bring transformational change to the use of genetic

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[28] Convention on Biological Diversity, Article 2: "Genetic material" means any material of plant, animal, microbial or other origin containing functional units of heredity.

[29] Outcomes of the Meeting, para. 11.

[30] *Id*., para. 20.

[31] *Id.*

resources, which may influence the type of benefits and the way benefits are shared. There may be useful lessons in this respect from how digitization of information in other sectors has impacted benefit-sharing, including possible lessons from the music, software, publishing and other industries. Second, access to and utilization of DSI can lead to the generation of benefits, and promote the sharing of non-monetary benefits through technology transfer, partnerships and collaboration, information exchange and capacity development in support of several articles of the CBD, in particular Articles 12 and 18 as well as Articles 8, 20, 22, 23 and the annex to the Nagoya Protocol. Third, DSI, in the light of advances in sequencing technologies in particular, may, in some cases, challenge the implementation of arrangements for access to genetic resources and benefit-sharing [hereinafter "ABS"] by obviating the need for users to seek access to the original tangible genetic resource, thus potentially enabling users to bypass procedures for access and benefit-sharing. In the context of the Pandemic Influenza Preparedness [hereinafter "PIP"] Framework of the WHO, for example, laboratories and manufacturers are relying increasingly on genetic sequence data to the exclusion of physical materials. This has the potential to undermine the PIP Framework. Fourth, accessing and using DSI for some scientific activities is cheaper relative to sequencing, and is enabled by databases. Fifth, DSI is commonly used for analysis, while it is also used for re-materializing genetic material and both are relevant for benefit-sharing. Sixth, there may be a need for economic valuation of the information per se. Seventh, for comparative purposes, larger data sets are more valuable. Eighth, specific benefit-sharing conditions related to DSI resulting from utilization of a genetic resource could be included in mutually agreed terms [hereinafter "MATs"]. Ninth, in the light of the challenges related to the bilateral benefit-sharing approach as it relates to DSI, consideration of multilateral approaches may be warranted in some circumstances: (i) Such circumstances might include: sequences with no known provenance; conserved genes; sequences of widely distributed genetic resources and information voluntarily contributed by Parties; (ii) A multiplicity of national approaches to ABS relating to DSI may create cumbersome processes, and could lead to access restrictions, or to "jurisdiction shopping". One effect of such restrictions may be to limit benefit-sharing and its contribution to conservation and sustainable use; (iii) Fair distribution of benefits among providers may be difficult if genetic material from various sources is combined; (iv) However, a multilateral benefit-sharing mechanism under the Nagoya Protocol cannot extend beyond the scope of the Protocol; (v) The global multilateral benefit-sharing mechanism referred to under Article 10 of the Nagoya Protocol is still under discussion; (vi) Other discussions on DSI are also ongoing in other forums; (vii) A multilateral approach for DSI could provide an alternative to requirements for prior informed consent [hereinafter "PIC"] and MATs and

therefore help to reduce transaction costs and facilitate equitable sharing of benefits. Tenth, monetary benefits are important for conservation in situ and ex situ and sustainable use. Eleventh, the boundary between research for commercial and non-commercial uses can be particularly blurred in the context of DSI. Twelfth, the special considerations in Article 8 of the Nagoya Protocol are to be made.[32] Thirteenth, the fact that a number of challenges related to the implementation of the Nagoya Protocol have not yet been addressed continues to be a subject of concern for a number of stakeholders who are therefore apprehensive of discussions that could create further barriers to access and scientific research, in particular fundamental biodiversity research.

C. Non-monetary Benefits

With respect to non-monetary benefits, the participants made the following points.[33] First, there are large social and public benefits from use of and access to DSI underscoring the importance of publicly accessible databases. Second, while the sharing of information and data is also a benefit in and of itself, it is not, alone, sufficient to meet the expectations for benefit-sharing. Furthermore, the benefits from data sharing do not necessarily accrue to the providers proportionately or predominantly. Third, continued effort for technology transfer and capacity-building is essential, in order to enable developing countries to access and use DSI. Fourth, although there is already international cooperation, there is a need to learn from existing practices and build on them to further develop capacity. Fifth, it would be helpful to develop further studies to quantify non-monetary benefit-sharing. It may be easier to examine this by sector.

It was suggested that a challenge to monetary benefit-sharing is the fact that there may be no cutoff point and that benefit-sharing obligations may continue in perpetuity.[34] It was also noted that monitoring, access to and use of DSI may be very complex.[35]

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[32] According to Article 10, in the development and implementation of its ABS legislation or regulatory requirements, each Party shall: "(a) Create conditions to promote and encourage research which contributes to the conservation and sustainable use of biological diversity, particularly in developing countries …; (b) Pay due regard to cases of present or imminent emergencies that threaten or damage human, animal or plant health … Parties may take into consideration the need for expeditious access to genetic resources and expeditious fair and equitable sharing of benefits …; (c) Consider the importance of genetic resources for food and agriculture and their special role for food security."

[33] *Id*., para. 21.

[34] *Id*., para. 22.

[35] *Id*., para. 23.

D. Other Issues

With respect to monitoring, it was noted that some countries and international frameworks have taken the approach to establish as the triggering event for benefit-sharing, and to focus monitoring on, the commercialization of products arising from the utilization of DSI, rather than controlling research and technological development from DSI.[36] Some experts noted that intellectual property rights and other property rights should be safeguarded.[37]

With respect to the issue of databases, some experts expressed the following views.[38] First, there can be different interpretations of what constitutes a publicly accessible database. These may range from databases that allow completely open access (e.g. GenBank) to those that impose certain requirements (e.g. the Global Initiative on Sharing All Influenza Data [hereinafter "GISAID]), which requires registration by users and data access agreements). Second, access to publicly available databases is important and could require user agreements that address benefit-sharing. Third, data in publicly accessible databases may still be subject to intellectual property rights or be utilized for intellectual property-protectable subject matter or be subject to ABS obligations. Fourth, the value of including information on environmental context in the metadata associated with DSI is increasingly recognized by the scientific community as it contributes to conservation efforts and good research practices. This information may also contribute to ABS. Fifth, although some databases (e.g. the DNA Databank of Japan) provided information on user statistics and metadata of DSI, there continues to be a need for more information on where DSI comes from (e.g. country of origin of the genetic resource whose sequences are in databases), by whom it is submitted and the countries from which users are accessing DSI. Sixth, there is a need for more information on the extent of use of DSI (e.g. public/private databases, commercial/non-commercial) to inform future discussions. Sixth, the experts agreed that restricting the use of publicly accessible data would not be desirable, while some pointed out that there are proprietary data, the content of which is not publicly known. Seventh, some experts shared information on steps being taken by different sectors with a view to respecting the principles of the Nagoya Protocol. Good practices have been developed and are available (e.g. International Barcode of Life Project, TRUST, GGBN).

With respect to traceability, experts noted the following.[39] First, there

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[36] *Id*., para. 24.
[37] *Id*., para. 25.
[38] *Id*., para. 26.
[39] *Id*., para. 29.

are concerns that requirements for traceability may create unnecessary barriers to data access and use. Second, a framework for traceability would be helpful for tracking information through the value chain and this could be facilitated through the use of unique identifiers. Third, the ability to trace is improving with new technological developments (e.g. blockchain) and there is a need to keep an eye on developments to determine whether traceability remains a challenge. Fourth, traceability should be mandatory in order to be effective. Fifth, the nature of DSI does not lend itself to traceability.

Finally, it is interesting to note that some experts suggested that the concept of "bounded openness over natural information" may merit consideration, although the concept was not discussed by the AHTEG.[40] Once genetic resources are interpreted as natural information[41], the policy implication is bounded openness, as "genetic resources would continue to flow freely (the openness) but would no longer be free (the boundedness)".[42] Royalties on intellectual property over the value added would be levied ex post utilization. The income would then be distributed to the countries of origin, proportional to habitat, thus achieving the fairness and equity which has so long alluded the Parties. And when the resources are ubiquitous? Or when the sums collected are too low to be worth distributing? In such cases, the income would finance the requisite infrastructure to make the whole thing work.[43]

VI. Conclusion: A Way Forward

Although the CBD and the Nagoya Protocol have institutionalized an ABS legal regime for many years, any meaningful and material benefit has not realized for those provider countries. According to a very recent study,

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[40] *Id*., para. 30.

[41] To avoid a situation where emerging biodiversity governance policy is overtaken by rapid technological innovation and change, the term "natural information", which is neutral and wide, is suggested, while it may be possible that different types of natural information might eventually be subject to different governance regimes. Ethiopia, "Potential implications of the use of "digital sequence information on genetic resources"" (September 8, 2017), in response to the Notification SCBD/SPS/DC/VN/KG/jh/86500.

[42] Joseph Henry Vogel, Manuel Ruiz Muller, Klaus Angerer, and Omar Oduardo-Sierra, "Inside Views: Ending Unauthorised Access To Genetic Resources (aka Biopiracy): Bounded Openness", Intellectual Property Watch (06/04/2018), at http://www.ip-watch.org/2018/04/06/ending-unauthorised-access-genetic-resources-aka-biopiracy-bounded-openness/.

[43] *Id.*

very few ABS agreements have been concluded so far.[44] Between 1996 and 2015, 217 such agreements for commercial research and 248 for non-commercial research have been concluded. On average, out of the 14 countries with an ABS legislation in force, 2.05 ABS agreements for commercial researches have been concluded per year. It was also observed that there is a significantly more important ratio of countries with a national ABS legislation currently into force among the Parties to the Nagoya Protocol compared with the States Parties to the CBD only.[45] That may indicate that there is a less important will among the latter to adopt a functioning ABS framework. In addition, with the notable exception of Switzerland, all the other 38 Parties having an ABS law into force belong to the category of provider States. Those countries include 12 out of the 17 megadiverse countries. Out of the current 20 members of the Group of Like-Minded Megadiverse Countries [hereinafter "GLMMC"], 14 are Parties to the CBD and the Nagoya Protocol or the Nagoya Protocol only, with an ABS legislation into force. Those 14 GLMMC members represent 35.9% of the 39 Parties having successfully implemented an ABS legislation. Therefore, it is to be pointed out that a significant number of the existing ABS legislations have been elaborated and adopted by countries known for their restrictive position on ABS. That may also indicate the strong will of this group to regulate the access to their genetic resources.[46]

The monetary benefits from those ABS legislations are so low that contracting parties do not like to disclose them. The Brazilian ABS Law of 2015, which came into effect on 6 November 2017, for example, allows royalties on net sales to be as low as one tenth of one percent.[47] According to a distinguished legal scholar, users are paying "peanuts for biodiversity."[48]

To avoid the obligation of benefit sharing, users may argue that no genetic material was accessed, as long as material is misinterpreted as matter. However, providers will insist that material is not synonymous with matter and that the sequence was simply disembodied.[49] The predictable rejoinder is

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[44] Nicolas Pauchard, "Access and Benefit Sharing under the Convention on Biological Diversity and Its Protocol: What Can Some Numbers Tell Us about the Effectiveness of the Regulatory Regime?", Resources 2017, 6(1) (February 19, 2017), at 11 of 15.

[45] *Id.*

[46] *Id.*

[47] Brazil, Law No. 13.123 of May 20, 2015 (Access and Benefits Sharing of Genetic Resources and Associated Traditional Knowledge), Article 20, available at http://www.wipo.int/edocs/lexdocs/laws/pt/br/br161pt.pdf, quoted from Supra note 42.

[48] Drahos, P. (2014). Intellectual Property, Indigenous People and their Knowledge (Cambridge Intellectual Property and Information Law). Cambridge: Cambridge University Press, pp.141-56.

[49] The term material should not be confused with the term matter, as the definition of the former allows the interpretation of the term to include the set of information associated with

as cynical as it is dispiriting: regardless of how material is interpreted, the disembodiment may have occurred in one of the two non-Parties where the CBD does not bind, viz. the Holy See or the United States of America.[50]

DSI should be accepted affirmatively in the context of R&D, as technology and science are progressing rapidly. Now even a portable and real-time sequencing device is in use.[51] DSI should be also relevant for the objectives of the Convention and the Nagoya Protocol so as to serve the greatest public good, as long as it originates from and is related to genetic resources. Novel forms of fair and equitable benefit sharing, not explicitly featured in ABS agreements, should be developed in inventive ways to ensure benefits for the global community from the use of DSI for rapid access in the context of the conservation and sustainable use of biodiversity. Resolving the issue of DSI, amicable both to providers and users, must be a touchstone for a future bio-digital innovation for the world.

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the genetic resource, that is, the substrate information or working material. Brazil, "DIGITAL SEQUENCE INFORMATION", in response to Decision XIII/16.

[50] *Supra* note 42.

[51] For example, there is a produce called "MinION" from Oxford Nanopore, which is a portable, real-time DNA/RNA sequencing device. It can be used in the laboratory or in the field. See https://nanoporetech.com/products/minion.

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Implementation and Challenges of Korean Marine Bio-Resources Policy on the Nagoya Protocol

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ABSTRACT

The Nagoya Protocol is an outcome of intense negotiations between both advanced countries and developing countries and the provider countries and user countries of genetic resources over the past 17 years since the entry into force of Convention on Biological Diversity (CBD) in 1993 until the adoption of the Protocol at the 10th Conference of the Parties to the CBD. As an international regime on transparent and fair access to genetic resources and the fair and equitable sharing of benefits arising from their utilization, the Nagoya Protocol has influenced relevant legal systems, policies and implementation on marine genetic resources of individual countries. In the case of Korea, it has improved its legal systems and relevant policy on implementing the Nagoya Protocol at the domestic level through enacting "Act on Securing, Management, use, etc of Marine Bio-Resources" in 2012. This paper will analyze main issues relevant to marine genetic resources (MGRs) of the Nagoya Protocol, the legal systems of Korea on marine biological resources for the implementation of the Nagoya Protocol and further discuss the challenges in implementing the Korean domestic Acts and the Nagoya Protocol surrounding MGRs.

KEYWORDS: Korean Policy, Marine and Fisheries Bio-Resources, Nagoya Protocol, Implementation, Marine Genetic Resources (MGRs)

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I. Introduction

Marine biological resources including Marine Genetic Resources (MGRs) can become a fundamental resources to produce new materials and commercial products since they have unique structures and unusual compounds with abundant antimicrobial activity in particular various metabolic path ways, reproductive systems and defense mechanism. Marine biological resources have potential and actual value that can be utilized in various fields such as pharmaceuticals, functional cosmetics, foods, chemical materials, and bioenergy. Costanza (1997) estimated that the annual total value of marine ecosystem where 80% of the marine species live is US$ 20.9 trillion.[1]

In particular, marine biological resources have been recognized as nutrients and potential new medicine candidates for the treatment of human diseases. The US Food and Drug Administration (FDA) has recently approved three new medicines derived from marine biological resources. Recently, 13 new drugs from marine biological resources have been undergoing clinical trials.[2] Thus, marine biological resources have a promising effect on several chronic and unbeatable diseases like cancer and they may prove to open up a new chapter of making treatment of chronic diseases cheaper and successful.

In addition, as the global economy moves into the bio-economy, the market for biotechnology industry is steadily expanding. The global marine biotechnology market is estimated at US $3.5billion by 2015, and is expected to grow at a rapid rate of 10% annually, reaching US $5.6billion by 2020. The United States, as the largest in the world biotechnology market, focuses on

[1] Robert Costanza, Ralph d'Arge, Rudolf de Grootet et al., The value of the world's ecosystem services and natural capital, Nature volume 387, 1997, 253-260.

[2] Harshad Malve, Exploring the ocean for new drug developments: Marine pharmacology, Journal of Pharmacy and Bioallied Science, 8(2), 2016, 83–91, https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4832911/#ref2

bio-energy production using microalgae, and the European market is specialized in the marine bio-pharmaceutical industry. Korean marine biotechnology market is expected to grow more than 14% annually from US$ 70million in 2012 to US$ 360 million in 2020.

Accordingly, as the importance of marine biological resources increases, access to and securing those resources among countries become more competitive and the issue of Access and Benefit-Sharing (ABS) of those resources has become the major concern of countries interested as well as the international community as a whole. To address the issues of access to those resources and fair and equitable sharing of benefit from utilizing such resources, the international community has made efforts to set up the relevant international regime. As a result, the Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising from their Utilization to the Convention on Biological Diversity was adopted on 29 October 2010 in Nagoya, Japan after the 17 years of negotiation. The Nagoya protocol entered into force on 12 October 2014, 90 days after the deposit of the fiftieth instrument of ratification.[3]

With entry into force of the Nagoya Protocol, user states and provider states can be influenced and affected since the Nagoya Protocol has provided the international standards for ABS of the genetic resources and associated traditional knowledge (TK).

II. Main Issues Relevant to MGRs of the Nagoya Protocol

The Nagoya Protocol is composed of preamble, 36 articles and 1 Annex. Its main contents focus on access, benefit-sharing, and compliance, etc. Among those provisions, the relevant parts of the Nagoya Protocol on MGRs are Article 2, 10 and 11. Article 2 of the Nagoya Protocol stipulates the use of terms of the protocol, Article 10 deals with Global Multilateral Benefit-sharing Mechanism (GMBSM) and Article 11 addresses transboundary cooperation.

ABS concept of the Nagoya Protocol is based on the bilateral relationship between providers and users of genetic resources. In addition, relevant principles and provisions of both the Nagoya Protocol and CBD apply to genetic resources within national jurisdiction. MGRs, like other land-based genetic resources are also subject to the Prior Informed Consent (PIC), Mutually Agreed Terms (MATs) and other relevant ABS provisions of the Nagoya Protocol.

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[3] Currently 106 Parties participate in the Nagoya Protocol, 92 States signed and 111 States ratified on 10. Sep. 2018, https://www.cbd.int/abs/nagoya-protocol/signatories/default.shtml.

However, there are unique features to be considered in implementing and applying the ABS of the Nagoya Protocol to MGRs. There are four issues to be considered: the definition of the MGRs; how to apply principles and provisions of the Nagoya Protocol on MGRs located in sea areas where marine delimitations are not decided; the relations between marine scientific research (MSR) and the ABS activities for MGRs; and whether the Nagoya Protocol can apply to the MGRs in areas of beyond national jurisdiction (ABNJ).

A. Definition of MGRs

Although both the CBD and the Nagoya Protocol deal with the fair and equitable sharing of the benefits arising out of the utilization of genetic resources, including by appropriate access to genetic resources, both documents do not specify MGRs in their texts. Article 2 of CBD only mentions the definition of genetic resources as genetic material of actual or potential value and it does not define the MGRs itself. Likewise, the Nagoya Protocol only stipulates that the terms defined in Article 2 of CBD shall apply to the Nagoya Protocol.

In addition, the United Nations Convention on the Law of the Sea (UNCLOS) in 1982 does not specifically refer to MGRs since at the time of adoption of UNCLOS there existed no sufficient knowledge on MGRs. It merely mentions marine living resources in the relevant regulations including preamble, Article 61 and 62 on conservation and utilization of living resources in EEZ and Part VII of conservation and management of the living resources of the High seas. Article 136 of UNCLOS only defines the Area and its mineral resources as the common heritage of mankind and that no state shall claim rights over any part of the Area or its resources since they belong to the common heritage of mankind.[4]

Thus, in the absence of an internationally agreed definition of MGRs, it is key to determine which MGRs can be subject to the ABS related regulations and principles of the Nagoya Protocol.

B. MGRs in areas where marine delimitations are not determined

Generally, marine biological resources are settled and inhabited on the coastal areas of a state or within jurisdiction of a state. However, there are other kinds of marine biological resources outside of those areas, such as

[4] Article 137 (Legal status of the Area and its resources)
No State shall claim or exercise sovereignty or sovereign rights over any part of the Area or its resources, nor shall any State or natural or juridical person appropriate any part thereof. No such claim or exercise of sovereignty or sovereign rights nor such appropriation shall be recognized.

species occurring within the exclusive economic zone (EEZ) of two of more coastal States or both within EEZ and in an area beyond and adjacent to it, highly migratory species, anadromous and catadromous species.

The reason why these marine biological resources are at issues is that they are located in areas where the delimitation of the marine boundaries is not fixed, so their ownership, which is the basis of the ABS of the Nagoya Protocol, is unsettled.

While UNCLOS stipulates the conservation, management and cooperation of coastal states regarding fish stocks from Article 63 to 67, it does not clearly specify the access and use of biological species located in area where the maritime boundaries are not delimitated.

Then, can Article 10 and Article 11 of the Nagoya Protocol apply to MGRs located in areas where the maritime boundaries are not determined?

Article 10 of the Nagoya Protocol mentions the consideration of the need for and modalities of a GMBSM to address the fair and equitable sharing of benefits derived from the utilization of genetic resources and associated traditional knowledge that occur in transboundary situations or for which it is not possible to grant or obtain PIC. Article 11 of the Nagoya Protocol stipulates the transboundary cooperation, states "in instances where the same genetic resources are found in situ within the territory of more than one Party, those Parties shall endeavor to cooperate, as appropriate, with the involvement of indigenous and local communities concerned, where applicable, with a view to implementing this Protocol."

The key question on Article 10 and 11 of the Nagoya Protocol is to decide what transboundary situations are. Based on the interpretation of Article 10, MGRs in areas where the delimitation of marine boundaries is unclear can be interpreted that they are in a transboundary situations and the Article 10 and 11 can apply for those MGRs in implementing relevant ABS provisions and regulation.

However, substantial ambiguities still exist in several provisions of the Nagoya Protocol. There remain further questions to be considered with regard to the interpretation and application of the Nagoya Protocol. Currently, the international community has still discussing details on Article 10 and 11, and further analysis and discussion are required for the specific ways of application and operation of GMBSM of Article 10; who determines the transboundary situation and based on what grounds; and require what methods in order to supporting the conservation of biological diversity and the sustainable use of its components globally by GMBSM.

C. Marine Scientific Research (MSR) & the Nagoya Protocol

When it comes to implement and apply the Nagoya Protocol to MGRs, consideration is also required for Marine Scientific Research (MSR), in

particular, the relations between MSR stipulated in UNCLOS and ABS related activities subject to the Nagoya Protocol. It is because it is closely related to the issue as to which regulations between UNCLOS and the Nagoya Protocol can be applicable and should be applied to specific activities.

Part XIII of the UNCLOS contains 27 articles in six separate sections which deal specifically with MSR, but there is no definition of MSR in UNCLOS text. That is mainly due to the fact that the discussions on MSR at the time of discussion of adopting UNCLOS were extremely complicated and did not lead to a consensus on it. In addition, MSR is a complex concept which consists of a number of disciplines concerned with the physical, chemical, biological, geological and other features of the oceans.

Article 240 of UNCLOS only deals with general principles for the conduct of MSR; MSR shall be conducted exclusively for peaceful purposes; MSR shall be conducted with appropriate scientific methods and means compatible with UNCLOS; MSR shall not unjustifiably interfere with other legitimate uses of the sea compatible with UNCLOS and shall be duly respected in the course of such uses; MSR shall be conducted in compliance with all relevant regulations adopted in conformity with UNCLOS including those for the protection and preservation of the marine environment.[5]

In addition, in accordance with Article 241 of UNCLOS, MSR activities shall not constitute the legal basis for any claim to any part of the marine environment or its resources and any state cannot claim the right over the outcomes out of MSR activities conducted in the territorial waters, EEZ and continental shelf of other states. In order to conduct MSR in the territorial sea, EEZ and on the continental shelf, it requires the regulation and authorization of the coastal states. In particular, the coastal states have the exclusive right to regulate, authorize and conduct MSR in the exercise of their sovereignty in their territorial sea.

Then, is there any possibility for the Nagoya Protocol to apply to the activities that subject to MSR under the UNCLOS even though there is no concrete definition or scope of MSR?

This question can be answered with the interpretation of Article 4 of the Nagoya Protocol, which deals with relationship with international agreements and instruments. Paragraph 1 of Article 4 stipulates, the provisions of the

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[5] Article 240 (General principles for the conduct of marine scientific research)
In the conduct of marine scientific research the following principles shall apply:
(a) marine scientific research shall be conducted exclusively for peaceful purposes;
(b) marine scientific research shall be conducted with appropriate scientific methods and means compatible with this Convention;
(c) marine scientific research shall not unjustifiably interfere with other legitimate uses of the sea compatible with this Convention and shall be duly respected in the course of such uses;
(d) marine scientific research shall be conducted in compliance with all relevant regulations adopted in conformity with this Convention including those for the protection and preservation of the marine environment.

Nagoya Protocol shall not affect the rights and obligations of any Party deriving from any existing international agreement, except where the exercise of those rights and obligations would cause a serious damage or threat to biological diversity. And it clearly specifies that it is not intended to create a hierarchy between the Nagoya Protocol and other international instruments. Thus, from the interpretation of such provision, it is possible for both UNCLOS and the Nagoya Protocol to apply the activities unless those activities would cause a serious damage or threat to biological diversity.

Thus, here is one more question we need to consider with regard to MSR and the Nagoya Protocol: what activities could be identified as one that corresponds to MSR under the UNCLOS and at the same time the Nagoya Protocol can apply?

To answer this question, it is required to distinguish between access to MGRs for commercial purpose and those for non-commercial purpose. Although it is not clear-cut to distinguish such two activities since the purpose is gradually evolving as the research develops, it can be expected that the access activities with non-commercial purpose under the Nagoya Protocol would not conflict with MSR activities allowed by Part XIII of UNCLOS. On the other hands, as for the bio-prospecting activities conducted with commercial purpose, there are no specific provisions of UNCLOS to apply. Thus, it is necessary to conduct such activities based on the procedures of ABS under the Nagoya Protocol.

However, it should be well noted that further studies and international agreements are necessary on the practical and legal issues of how to separate bio-prospecting activities from MSR.

D. MGRs in the Areas Beyond National Jurisdiction (ABNJ)

The last but not least issue regarding on implementation of the ABS of the Nagoya Protocol to MGRs is the question of the MGRs in the Areas Beyond National Jurisdiction (ABNJ). The geographical scope of the ABNJ is the High Seas and the Area which covers more than 60 percent of the earth's ocean and it has its own importance as a habitat and source for all cellular life and valuable MGRs.[6] MGRs in ABNJ have been of rapidly increasing interest over the last couple of decades as technological advances in deep sea exploration and resources collection has expanded the range of resources considered to have value.[7]

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[6] Su Jin Park, Changes in the Law of Marine Genetic Resources in the ABNJ and under UNCLOS, Ocean Law Debates, the 50-Year Legacy and Emerging Issues for the Years Ahead, Edited by Harry N. Scheiber, Nilufer Oral, Moon-Sang Kwon, Brill Nijhoff, 2018, at 420.

[7] Catherine Rhodes, Governance of Genetic Resources, Edward Elgar, Cheltenham, UK/Northampton, USA, 2013, at 36-37.

The issue at stake is that the ownership, scope and access right of MGRs in ABNJ are not clear. In addition, there exist the regulatory gaps and legal uncertainties in the current international regime on genetic resources for MGRs in ABNJ.

For example, there might be some complex problems with regard to ABS, in particular to benefit sharing. When the origin of specific MGRs is from ABNJ, the application of traditional patent regime can be possible and the patent could be granted to whom applies the patent rights. However, when it comes to achieving the principles of ABS, it is not easy to identify with whom the benefit should be shared. It is closely related to the legal status of the MGRs in ABNJ – whether they belong to the common heritage of mankind or not. Further considering that access to such MGRs in ABNJ for collection and research purpose is very expensive and requires advanced technologies that are beyond the capacity of most countries, such inequitable access is likely to result in corresponding inequitable distributions of benefits from research and development involving such resources.[8]

The reason why this issue is of such significance is that international norms that apply to access to and benefit sharing of MGRs are divided based on whether they are within the national jurisdiction or beyond national jurisdiction. Accordingly, it could pose another challenge to the application and interpretation of the Nagoya Protocol and the new international instrument for conservation and sustainable use of marine biological diversity beyond areas of national jurisdiction.

To be specific, the scope of application of the CBD is clearly limited to areas within the limits of the national jurisdiction under Article 4(a) by stipulating "the provisions of the CBD apply in the case of components of biological diversity, in areas within the limits of its national jurisdiction." Even though several provisions of the CBD including the Article 3[9], Article 4(b)[10] and Article 14.1(c)[11] and (d)[12] are possible to apply states' activities

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[8] *Ibid*., at 37.

[9] States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.

[10] In the case of processes and activities, regardless of where their effects occur, carried out under its jurisdiction or control, within the area of its national jurisdiction or beyond the limits of national jurisdiction.

[11] Each Contracting Party, as far as possible and as appropriate, shall promote, on the basis of reciprocity, notification, exchange of information and consultation on activities under their jurisdiction or control which are likely to significantly affect adversely the biological diversity of other States or areas beyond the limits of national jurisdiction, by encouraging the conclusion of bilateral, regional or multilateral arrangements, as appropriate.

[12] Each Contracting Party, as far as possible and as appropriate, shall in the case of imminent or grave danger or danger, originating under its jurisdiction or control, to biological diversity

relating to ABNJ, the extent of those provisions is limited to incidental or consequential results of activities within states' national jurisdiction.[13] In the case of the Nagoya Protocol, it has more potential than the CBD in applying to MGRs in ABNJ since Article 10 of the Nagoya Protocol stipulates the possible creation of GMBSM.

In order to address the regulatory gaps and legal uncertainties, the international community has made efforts by establishing an "Ad Hoc Open-ended Informal Working Group to study issues relating to the conservation and sustainable use of marine biological diversity beyond areas of national jurisdiction (UN BBNJ Meeting)".[14] The BBNJ Meetings had held 9 times between 2006 and 2015. MGRs had been included as one of the four main topics since the 4th BBNJ Meeting, the main issue on MGRs in ABNJ is the legal status of MGRs in the Area – whether it belongs to Common Heritage of Mankind or whether freedom of the high seas principles should be applied. The discussions of UN BBNJ Meetings did not reach any concrete outcome.

In 2015, the UN General Assembly adopted additional resolution A/RES/69/29 to develop an international legally binding instrument (ILBI) under UNCLOS for the conservation and sustainable use of marine biological diversity in ABNJ and to establish a Preparatory Committee(Prep-Com) to make substantive recommendations to the UNGA on the elements of a draft text of an ILBI under UNCLOS.[15] Between March of 2016 and July of 2017, four Prep-Com meetings were held and further discussed MGRs issues. The core issues under the framework of the preparatory committee meetings are the status of MGRs in ABNJ; open access including bio-prospecting vs. application of MSR under UNCLOS; discussion on IPRs, etc.

In its resolution 72/249 of 24 December 2017, the General Assembly decided to convene an Intergovernmental Conference (IGC) on an ILBI under the UNCLOS on the conservation and sustainable use of marine biodiversity of areas beyond national jurisdiction. And four IGC sessions will be held, with the first session to be convened from 4 to 17 September 2018.[16] The IGC is expected to draw on the recommendations from the BBNJ Preparatory Committee that completed its work in 2017 and to take consensus-based decisions on the preparation process of a zero draft of ILBI.[17]

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within the area under jurisdiction of other States or in areas beyond the limits of national jurisdiction, notify immediately the potentially affected States of such danger or damage, as well as initiate action to prevent or minimize such danger or damage.

[13] Park, *supra* notes, at 428.

[14] UN General Assembly resolution 59/24, "Oceans and the Law of the Sea,"(17 November 2004), UN Doc A/RES/59/24.

[15] UNGA resolution A/RES/69/29.

[16] The second and third sessions will take place in 2019, and the fourth session in the first half of 2020. https://www.un.org/bbnj/.

[17] http://enb.iisd.org/oceans/bbnj/igc1/.

III. Korean Marine Bio-Resources Implementation Law

A. Legislation progress of the Marine Bio-Resources Implementation Law

The Korean government ratified the Nagoya Protocol on 19th May 2017 and became the party to the Nagoya Protocol on 17th August 2017. In order to implement the Nagoya Protocol, the Korean government enacted on 17th January 2017, "Act on access, utilization and benefit sharing of genetic resources [hereinafter Genetic Resources Act]" and it has been in effect since the date the Nagoya Protocol became effective.

However, before the Genetic Resources Act was enacted, "Act on securing, management, use, etc. of marine bio-resources of 2012[hereinafter Marine Bio-Resources act]" [18] and "Act on the preservation, management and use of agro-fisheries bio resources of 2011[hereinafter referred to as Agro-Fisheries Bio Resources Act]" [19] was enacted for Korea's marine bio-resources. On December 27, 2016, Act on securing, management, use, etc. of marine and fisheries bio-resources [hereinafter Marine and Fisheries Bio-resources Act] was amended by incorporating the provisions concerning fisheries of Agro-fisheries bio resources act into the existing Marine Bio-resources act.

B. The Relations with Other Acts

In Korea the implementation of the Nagoya Protocol on marine biological resources has been conducted through largely both Genetic Resources Act and Marine and Fisheries Bio-Resources Act.

The general regulations and principles of the Genetic Resources Act can apply to access to MGRs, benefit sharing, Competent National Authorities, and Check points. The relationship between those two Acts can be found from the provisions of Article 6 of Marine and Fisheries Bio-Resources Act and Article 5 of Genetic Resources Act. Article 6 of Marine and Fisheries Bio-Resources Act stipulates, "Except as otherwise provided for expressly in any other Act, the securing, management, and use of marine and fisheries bio-resources shall be governed by provisions of this Act".[20] In addition,

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[18] Enforcement Date 26. Jul, 2012, No.11478, 01. Jun, 2012., New Enactment. This act integrated-regulates marine bio-resources and fishery bio-resources that was whole amended 27.Dec.2016.

[19] Enforcement Date 26. Jul, 2012, No.10938, 25. Jul, 2011., Whole Amendment from Act on the preservation, management and utilization of agricultural genetic resources cause of governmental system reshuffle.

[20] Marine and Fisheries Bio-resources Act of the Republic of Korea, Article 6 (Relationship to other Acts).

Article 5 of Genetic Resources Act also stipulates, "Except as otherwise provided in any other Act, access and benefit sharing of genetic resources shall be governed by provisions of this Act"[21].

Accordingly, the regulations laid down in Marine and Fisheries Bio-resources Act is applied prior to those of Genetic Resources Act since those regulations were enacted first. Thus in the event of there are no special provisions in Marine and Fisheries Bio-Resources Act, then Genetic Resources Act would be applied.

C. Access to Marine Genetic Resources

According to Article 9 of Genetic Resources Act, foreigner, overseas Koreans, foreign organizations, international organizations and those who are equivalent as decided by the degree of the Ministry of Environment for the purpose of the use of domestic genetic resources and associated traditional knowledge shall report to the head of the Competent National Authority according to the Presidential decree. However, if obtained the acquisition of marine and fisheries bio-resources under Article 11(1) of Marine and Fisheries Bio-Resources Act or the approval of taking those resources out of Korea pursuant to Article 22(1) of Marine and Fisheries Bio-Resources Act, it is deemed that the report was received.

In other words, as for marine bio-resources in the jurisdictional sea area of the Korea, if obtained the acquisition of Marine Bio-resources by foreigners pursuant to Article 11[22] of Marine and Fisheries Bio-Resources Act and obtained the permission or approval to foreigners for Joint Acquisition pursuant to Article 12[23] of Marine and Fisheries Bio-Resources

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[21] Genetic Resources Act of the Republic of Korea, Article 5 (Relationship to other Acts).

[22] Article 11 (Acquisition of Marine Bio-resources by Foreigners, etc.) (1) If a foreigner or an international organization [hereinafter foreigner] intends to marine and fisheries bio-resources for research, development, production, or commercial use of marine bio-resources in the jurisdictional sea area of the Republic of Korea, the foreigner shall obtain prior permission therefor from Ministry of Oceans and Fisheries: Provided, that the foregoing shall not apply where a foreigner has obtained permission or approval from the Ministry of Oceans and Fisheries [hereinafter permission or approval] pursuant to any other Act or a treaty entered into with the Government of the Republic of Korea with regard to marine living creatures (including where a foreigner is deemed to have obtained such permission or approval).

[23] Article 12 (Permission or Approval to Foreigners for Joint Acquisition)(1) If a foreigner intends to acquire marine and fisheries bio-resources jointly with a citizen or State agency of the Republic of Korea [hereinafter Korean citizen] pursuant to Article 11 (1) through delegation, entrustment, or agreement, the foreigner or the Korean citizen who participates in the joint acquisition shall obtain permission pursuant to the aforesaid provisions: Provided, that the foregoing shall not apply where permission or approval has been granted (including where it is deemed that permission or approval has been granted). (2) Article 11 (2) through (5) shall apply mutatis mutandis to permission for joint acquisition prescribed in paragraph (1).

Act, they don't need to go through the reporting process pursuant to Article 9 of Genetic Resources Act.

It is noteworthy that if there is a risk of causing or endangering the conservation and sustainable use of biodiversity and of adversely affecting the value of biodiversity, access to or use of the genetic resources and associated traditional knowledge may be prohibited or restricted.[24] Marine and Fisheries Bio-Resources Act also stipulates the cases where the suspension of acquisition for a period not exceeding one year can be imposed including: if the head of a related central administrative agency requests to suspend the acquisition of marine bio-resources on the ground of a military operation or security, maintenance of public order, or public welfare of the Republic of Korea; if a person does an act specified in Article 7(4) of the Marine Scientific Research Act; if the diversity of marine bio-resources is likely to be substantially undermined or reduced; if a person does not acquire marine bio-resources in accordance with the survey plan submitted pursuant to Article 11(2) (including cases to which the aforesaid provisions shall apply mutatis mutandis pursuant to 12(2)); if a person fails to fulfill his or her obligations in violation of Article 1(3); if a person violates an order issued under this Act or a limitation or condition imposed under this Act.[25]

D. Benefit-Sharing of Utilization out of Marine Biological Resources

Article 25 of Marine and Fisheries Bio-Resources Act contains the principles of benefit sharing and the basis for the government to implement the necessary measures. In other words, in accordance with Article 25, the benefits arising from the research and development of marine and fisheries biological resources or marine fisheries traditional knowledge and its commercial use should be fairly and equitably shared between providers and users of marine bio-resources. In addition, the Government of the Republic of Korea may pursue measures necessary to promote fair and equitable sharing of benefits arising from marine and fisheries biological resources.

In this regard, Article 11 of Genetic Resources Act contains provisions with a declarative nature of fair and equitable sharing of benefits based on principles of freedom of contract by stipulating that "providers and users of genetic resources should agree to fairly and equitably share the benefits of domestic genetic resources". With regard to benefit sharing of overseas genetic resources, Article 14(2) states, "Any person who intends to access to genetic resources in a foreign country and use those resources domestically shall make efforts to share the benefits fairly and equitably with providers of those resources."

[24] Article 12 of the Genetic Resources Act.
[25] Article 13(2) of the Marine and Fisheries Bio-resources Act.

E. Traditional Knowledge Associated with MGRs

Article 7 of the Nagoya Protocol states that appropriate measures should be taken to ensure that access to associated traditional knowledge held by indigenous and local communities (ILCs) is in accordance with PIC or approval and involvement of these ILCs, and that MATs have been established.

Furthermore, Article 12 of the Nagoya Protocol stipulates that in implementing obligations, Parties shall in accordance with domestic law take into consideration ILCs' customary laws, community protocols and procedures, as applicable, with respect to traditional knowledge associated with genetic resources. It also stipulates that efforts should be made to establish mechanisms to inform potential users of traditional knowledge associated with genetic resources about their obligations, including measures as made available through the Access and Benefit-sharing Clearing-House for access to and fair and equitable sharing of benefits arising from the utilization of such knowledge.

In this regard, Marine and Fisheries Bio-Resources Act does not include separate provisions directly related to Articles 7 and 12 of the Nagoya Protocol. However, Article 25 of Marine and Fisheries Bio-Resources Act stipulates conservation and management of relevant traditional knowledge by stating that the Minister of Oceans and Fisheries should carry out policies to preserve and systematically manage associated traditional knowledge. In other words, it should promote measures including discovery, research and conservation of marine and fisheries traditional knowledge, establishment of a system for collecting and managing information on marine and fisheries traditional knowledge, laying the foundation for utilization of marine and fisheries traditional knowledge, and promoting education and publicity policies. In addition, the Minister of Oceans and Fisheries can designate and manage the best marine and fisheries traditional village in order to preserve and systematically manage excellent maritime and fisheries traditional knowledge.

In sum, the domestic implementation of Article 7 and Article 12 of the Nagoya Protocol has been conducted through comprehensive provisions of genetic resources and associated traditional knowledge including Article 10 (Access report of domestic genetic resources), 11 (Benefit Sharing of domestic genetic resources) and 14 (Compliance of procedure for access and use of overseas genetic resources) of Genetic Resources Act. As for the traditional knowledge associated with marine genetic resources, the relevant provisions of Genetic Resources Act can be applicable.[26]

[26] Article 10, 11 and 14 of Genetic Resources Act.

IV. Conclusion: Challenges and Perspectives

A. Challenges Regarding Implementation Acts of the Korean Government

The Acts on ABS of marine biological resources in Korea are divided into Marine and Fisheries Bio-Resources Act and Genetic Resources Act. As for the marine biological resources under Korean jurisdiction, the relevant activities have been conducted in the form of marine scientific research allowed under UNCLOS. Thus, when foreigners want to access to marine biological resources, they also need to comply with regulations of Marine Scientific Research Act of Korea. However, in the case of bio-prospecting for commercial purposes, the Marine and Fisheries Bio-Resources Act should be applied.

To any person who acquires marine bio-resources in a jurisdictional sea area outside of the territorial sea of the Republic of Korea without permission of acquirement and joint acquirement shall be punished by a fine not exceeding 100 million Korean won, and marine bio-resources so acquired shall be confiscated. If it is impossible to confiscate such marine bio-resources, the equivalent of the value of the marine bio-resources shall be collected. In the event of illegally acquiring marine and fisheries biological resources from EEZ, penalties other than imprisonment are generally applied. However, if it fails to report on access to resources in violation of Article 9(1) of Genetic Resources Act, a fine of 10 million Korean won shall be imposed.

Excessive deviation in penalties between those two Acts is considered an area to be addressed in the future.

B. Challenges Regarding Implementation of the Nagoya Protocol on MGRs

The first challenge is the relationship between the Nagoya Protocol and UNCLOS. The relationship is unclear between the biological resources of UNCLOS and the genetic resources of the Nagoya Protocol, and UNCLOS only provides MSRs but there are no specific provisions on ABS of genetic resources for commercial purposes.

In addition, while according to UNCLOS any rights cannot be claimed over the results obtained from MSR, the Nagoya Protocol acknowledges that ABS activities subject to MAT. In order not to conflict those two instruments and principles, it is necessary for the international community to continuously make effort to have a consensus to distinguish MSR from biological exploration activities.

The second challenge is ambiguity of the Nagoya Protocol. Although the Nagoya Protocol stipulates derivatives in the definition of terms, there is no

regulation on derivatives in the procedures for ABS of genetic resources and associated traditional knowledge. Although derivatives can be interpreted as included in utilization of genetic resources and associated traditional knowledge, the Nagoya Protocol is still ambiguous on this.

In addition, discussions on digital sequencing information (DSI) are being conducted by the Conference of the Parties to the CBD, but there is a continuing confrontation over whether DSI is an agenda for the Nagoya Protocol to deal with or for the Biosafety protocol to address.

Furthermore, it is required to further discuss and study the details of Article 10 and 11 of the Nagoya Protocol, the key provisions in the implementation of the Protocol on marine genetic resources. In other words, if relevant states with shared oceans cannot reach an agreement on maritime delimitation, how GMBSM of the Article 10 and the cooperation provision of Article 11 of the Nagoya Protocol apply? In this regard, the Nagoya Protocol has still lack of specificity in interpreting and application. Thus, additional discussions and consensus among the parties are inevitable.

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National Implementation Mechanism on the Nagoya Protocol in the Republic of Korea*

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ABSTRACT

The ABS Act and its Enforcement Decree entered into force on August 17, 2017 as Korea became a Party of the Nagoya protocol. Some procedural provisions regarding access and user compliance declaration have had one year grace period to enter into force on August 18, 2018. In this regards, the tasks ahead of Korea are to promote awareness and understanding of the Nagoya Protocol and its implementation mechanism among industries and researchers who utilize the genetic resource. Korea also need to provide and share information of ABS measures provided by main genetic resources provider countries and develop the case studies, to prepare Korea to comply with applicable laws and regulations and deal with possible legal disputes. It is necessary to discover domestic genetic resources and associated traditional knowledge by survey and research and to keep them in the database system or registries so that they are not to be used in abusing manner. It should be noted that the Nagoya Protocol and implementing measures in its Parties contain many phrases having obscure meaning as it was created by coordinating differing interests and views of various countries. Competent authorities and ABS Help desks should consult with experts and competent authorities in the provider countries to clarify these uncertainty.

KEYWORDS: Nagoya Protocol, Convention on Biological Diversity ABS Act, Access and Benefit Sharing, Access Declaration, Compliance Declaration.

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I. Introduction

'The Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising from their Utilization to the Convention on Biological Diversity' [hereinafter Nagoya Protocol] – was adopted on October 29, 2010 in Nagoya, Japan at the Tenth Meeting of the Conference of the Parties to the Convention on Biological Diversity and entered into force on October 12, 2014. Ninety-two countries, including Korea, have signed the Nagoya Protocol during the period that the Protocol was opened for signature from February 2, 2011 to February 1, 2012 at the United Nations Headquarters in New York.

After Korea signed the Nagoya Protocol on September 20, 2011, Korean government launched Cooperative Action Plan with relevant twelve government authorities on November 8, 2011.[1] Cooperative Action Plan in 2011 carried out several tasks in response to implement the Nagoya Protocol.[2] After two years of Cooperative Action Plan organized, Korean government announced Notice of Legislation 'Act on Access to, Utilization, and Benefit Sharing of Genetic Resources' [hereinafter ABS Act] on December 19, 2013 to implement the Nagoya Protocol and to establish national policy on access to and utilization of genetic resources. The final ABS Act, Law No 14533, was enacted on January 17, 2017. In May 19, 2017, The Ministry of Foreign

[1] As of November 2011, the relevant twelve government authorities were the following: Ministry of Foreign Affairs; Ministry of Science, ICT & Future Planning; Ministry of Environment; Ministry of Justice; Ministry of Agriculture, Food & Rural Affairs; Ministry of Trade, Industry & Energy; Ministry of Health & Welfare; Ministry of Oceans & Fisheries; Ministry of Food & Drug Safety; Rural Development Administration; Korea Forest Service; Korean Intellectual Property Office.

[2] These tasks include: Survey & Discovery of Genetic Resources in Korea; Survey & Discovery of Traditional Knowledge in Korea; Survey of Current State in Export of Biological Resources originated in Korea (~ 2020); Establishment of Total Management System on the National Biological Resources; Revision of National Legislation System.

Affairs deposited the ratification of the Nagoya Protocol with the United Nations Secretariat and Korea became a Party of the Protocol since August 17, 2017.

II. ABS Legal Framework in Korea

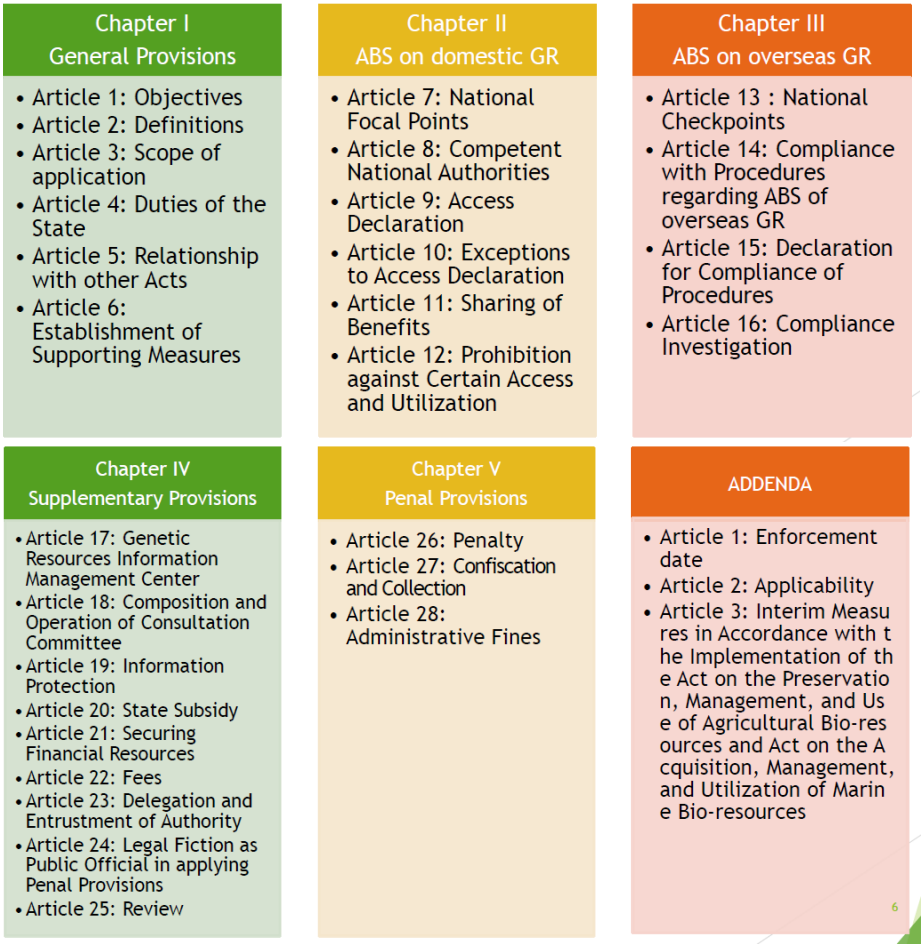
A. Overview of Act on Access, Utilization, and Benefit Sharing of Genetic Resources

The ABS Act aimed to implement the Nagoya Protocol and to establish national policy on access to and utilization of genetic resources as well as to contribute conservation and sustainable use of biological resources, to improve the quality of life of citizens, and to enhance international cooperation in transaction of genetic resources. However, it took more than three years to be enacted after the Notice of Legislation as the ABS Act, since Korean government, as a user country of genetic resources, took a careful approach to ratify the Nagoya Protocol in concerned with economic effect in industries concerned once the Nagoya Protocol was in full effect. Also the government needed to coordinate various and differing demands as well as review other countries' examples. In this line, the government engaged researchers on various occasions to examine other countries' examples and establish a Korea-specific benefit-sharing model based on such research.

The government also established the "Korea ABS Research Center" and "Genetic Resources Information Center" to promote governmental support and awareness of the Nagoya Protocol in related research institutes and industries.

The Presidential Decree No 28246 and the Implementation Rules of ABS Act are adopted to enforce and regulate specific contents and procedures regarding access and user compliance measures, and tasks of competent authorities in detail.

Structure of the ABS Act



B. Other ABS Legal Framework

In addition to the ABS Act, concerned Ministries operate several ABS legislations under their competency over the relevant genetic resources. Most of them are recently revised in response to the Nagoya Protocol. Also these concerned Ministries are provided as the Competent National Authorities and the National Check Points under the ABS Act.

Ministries	Legislation
Ministry of Science and ICT	Act on the Acquisition, Management, and Utilization of Biological Research Resources
Ministry of Agriculture, Food and Rural Affairs	Act on the Preservation, Management and Use of Agro Bio-resources
Ministry of Health and Welfare	Act on the Collection, Management, and Utilization of Pathogen Resources
Ministry of Environment	Act on the Conservation and Use of Biological Diversity
	Wildlife Protection and Management Act
Ministry of Ocean and Fisheries	Act on the Acquisition, Management, and Utilization of Marine(Marine-fishery) Bio-resources

III. Competent Authorities

As the Nagoya Protocol required to designate a national focal point, one or more competent national authorities[3] and the checkpoints,[4] the ABS Act provides national authorities to manage ABS measures for those concerned genetic resources.

A. National Focal Points

In accordance with Article 13(1) of the Nagoya Protocol, the ABS Act designated two responsible National Focal Points: Ministry of Foreign Affairs and Ministry of Environment.[5] As Enforcement Decree[6] provides their tasks in detail, Ministry of Foreign Affairs mainly liaise as a contact point with CBD secretariat and Ministry of Environment carry out to disseminate information with regard to ABS matters.

B. Competent National Authorities

The ABS Act also designated five Competent National Authorities that have managed concerned resources with their competency: Ministry of Science and ICT (Biological research resources); Ministry of Agriculture,

[3] Nagoya Protocol Article 13(1), (2).
[4] Nagoya Protocol Article 17(1)(a).
[5] ABS Act, No. 14533, Article 7 (Jan 17, 2017).
[6] Enforcement Decree on the Act on Access, Utilization, and Benefit Sharing of Genetic Resources, Presidential Decree, No 28246, Article 2.

Food and Rural Affairs (Agro bio resources); Ministry for Health and Welfare (Pathogenic resources); Ministry of Environment (Biological resources); Ministry of Ocean and Fisheries (Marine-fishery bio resources).[7] Competent National Authorities carry out following tasks: i) processing of access declaration or modified access declaration on domestic genetic resources,[8] ii) prohibition of access to and utilization of domestic genetic resources,[9] iii) supporting fair and equitable benefit sharing on utilization of domestic genetic resources, iv) other matters determined by Enforcement Decree regarding ABS.[10]

C. National Check Points

The ABS Act provides National Check Points in article 13 to carry out i) processing of declaration on user compliance with procedures,[11] ii) investigation and advice on user compliance with procedures,[12] iii) supporting domestic users who utilize overseas genetic resources. Also the Enforcement Decree may further determine other tasks of check point regarding ABS. Five National Competent Authorities and Ministry of Trade, Industry and Energy are responsible for National Check Points. Ministry of Trade, Industry and Energy is included in concern of economic effect of ABS rules to those relevant industries.

IV. ABS Implementation Mechanism in the ABS Act

A. Definitions

The ABS Act defines some key terminologies for their clear meaning in this Act.[13]

1. Genetic resource

Genetic resource means materials which have practical or potential value, among plants, animals and microorganisms or other genetic material which becomes genetic origins including a genetic functional unit. This definition is a verbatim ascribed in Article 2, section 4 of the Act on the Conservation and Utilization of Biological Diversity.

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[7] ABS Act, No. 14533, Article 8 (Jan 17, 2017).
[8] ABS Act, No. 14533, Article 9 (Jan 17, 2017).
[9] ABS Act, No. 14533, Article 12 (Jan 17, 2017).
[10] Enforcement Decree Article 3.
[11] ABS Act, No. 14533, Article 15 (Jan 17, 2017).
[12] ABS Act, No. 14533, Article 16 (Jan 17, 2017).
[13] ABS Act, No. 14533, Article 2 (Jan 17, 2017).

2. Traditional knowledge

Traditional knowledge means knowledge, technology and practice, etc. of individuals or local communities which have maintained a traditional life style appropriate for the conservation and sustainable use of genetic resources.

3. Access

Access means the collection of information regarding the acquisition of a specimen or substance of a genetic resource, or of a genetic resource and its associated traditional knowledge. In this Act, genetic resource and its associated traditional knowledge are called "genetic resource(s)", collectively.

4. Utilization

Utilization means to conduct research and development, through the application of biotechnology, on the genetic or biochemical components by utilization of genetic resources.

5. Benefit

Benefit means monetary benefits, including but not limited to loyalties and revenue, and non-monetary benefits including but not limited to sharing of research results and transfer of technology, etc., arising from utilization of genetic resources.

B. Scope of Application

The ABS Act apply to the following genetic resources:[14]

(i) Human genetic resources;
(ii) Genetic resources in the area beyond state jurisdiction including Antarctica;
(iii) Genetic resources accessed for the purposes other than utilization describe in Article 2(4);
(iv) Genetic resources that are subject to other international agreements relevant to the access and benefit sharing of genetic resources;
(v) Genetic resources have been granted patent pursuant to Article 87(1) of the Patent Act.[15]

C. Access Declaration on Domestic Genetic Resources

1. Duty of Access Declaration

Foreigners, overseas Koreans, foreign institutions, international

[14] ABS Act, No. 14533, Article 3 (Jan 17, 2017).
[15] Article 87(1) of Patent Act provides 'A patent shall take effect when the grant of the patent is registered.'

organizations, etc. who seek to access and utilize the domestic genetic resources, shall declare to the Competent National Authority in accordance with the procedures of Enforcement Decree.[16] However, if the approval, permission or declaration has been made and granted in accordance with other ABS legal framework described in chapter II section B of this artlcle, it will be deemed that the duty to declare access under the ABS Act has been fulfilled.[17]

[Approval, permission, or declaration system under other ABS legislations]
(i) Approval under Article 11(2) of "Act on the Conservation and Utilization of Biological Diversity" or declaration under Article 13(1) of same Act
(ii) Approval under Article18(1) of "Act on the Preservation, Management, and Use of Agricultural Bio-resources"
(iii) Permission under Article 11(1) 0f "Act on the Acquisition, Management, and Utilization of Marine Bio-resources" or approval under Article 22(1) of the same Act.
(iv) Approval or permission under Article 16(1) or Article 18(1) of "Act on the Collection, Management, and Utilization of Pathogen Resources" or declaration under Article 16(2) of the same Act.

Korean nationals who access to domestic genetic resources for the purpose of utilization, may declare to the Competent National Authority subject to the procedures of Enforcement Decree, including when it is necessary to verify that the provider country of the genetic resource is Republic of Korea.[18] According to the Nagoya Protocol, provider can be either a country of origin of genetic resources or a country that has acquired the genetic resources in accordance with the Convention of Biological Diversity.[19] If a person who has declared access to domestic genetic resources and seeks to modify the contents of declaration prescribed by Enforcement Decree, then that person shall declare the modification to the Competent National Authority.[20] This duty of access declaration has taken effect on August 18, 2018, which is one year grace period after the enforcement of the ABS Act.

2. Access Declaration Procedures

Enforcement Decree on the ABS Act provides the procedure for declaration of access to domestic genetic resources. Anyone who seeks to declare access shall submit the declaration document containing following

[16] ABS Act, No. 14533, Article 9(1) (Jan 17, 2017).
[17] ABS Act, No. 14533, Article 9(2) (Jan 17, 2017).
[18] ABS Act, No. 14533, Article 9(4) (Jan 17, 2017)
[19] Nagoya Protocol Article 5(1).
[20] ABS Act, No. 14533, Article 9(3) (Jan 17, 2017).

information to Competent National Authority: user information (name, affiliation, address, contact etc.); name, quantity or concentration of the genetic resources; methods of access, period of utilization; provider information (name, affiliation, address, contact etc.); purpose of access; methods of utilization including application of biotechnology; country to utilize the genetic resources; mutually agreed terms, if concluded.[21] Competent National Authority that received access declaration shall notify its decision to declarer whether the declaration is approved within 30 days from the receipt of access declaration. If the declaration is approved, Competent National Authority shall issue a certificate of declaration.[22]

In case where a person who has declared access to domestic genetic resources and seeks to modify the access declaration in accordance with Article 9(3) in the ABS Act, that person shall submit a declaration on notification of change to the Competent National Authority which includes modified purpose of access, modified purpose of utilization, increase of quantity or concentration of genetic resources, or modification of mutually agreed terms, if concluded.[23] Ministry of Environment established a comprehensive declaration system to promote electronic processing and efficient management of access declaration procedure.[24]

D. Exceptions to Access Declaration to Domestic Genetic Resources

There are some exceptions to the duty of access declaration to domestic resources.

Where Competent National Authority recognizes the need for expeditious access to or utilization of genetic resources for developing therapeutic treatment or food security due to threat or damage to the life and health of humans, animals, or plants, or in case of access for the purpose of non-commercial research, the access declaration procedures and requirement may be simplified or waived. However, when the purpose of non-commercial research is changed, the user shall declare without delay in accordance with Article 9(1).[25]

E. Sharing the Benefit of Domestic Genetic Resources

The users and providers of genetic resources shall agree to share the benefits of domestic genetic resources fairly and equitably.[26] This provision

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[21] Enforcement Decree Article 4(1).
[22] Enforcement Decree Article 4(3).
[23] Enforcement Decree Article 4(5), (6).
[24] Enforcement Decree Article 7.
[25] ABS Act, No. 14533, Article 10 (Jan 17, 2017).
[26] ABS Act, No. 14533, Article 11 (Jan 17, 2017).

also took effect on August 18, 2018, which is one year grace period after the enforcement of the ABS Act.

F. Prohibition Against Certain Access to and Utilization of Domestic Genetic Resources

Competent National Authority may seek to prohibit or restrict the access and utilization of domestic genetic resources in case of threat or likely to threat to the conservation and sustainable use of biodiversity, or adverse effect socio-economically to the value of biodiversity.[27] Any person who accesses or uses genetic resources that are prohibited or restricted from access or utilization in violation of Article 12(1) shall be punished by imprisonment for not more than 3 years or by a fine not to exceed 30 million won.[28] In case of above punishment in accordance with Article26, the applicable genetic resources will be confiscated; however, if confiscation is not possible, then equivalent fee thereof shall be collected.[29]

G. Compliance with Procedures for Access to and Utilization of Overseas Genetic Resources

1. Duty of Compliance Declaration

When the user seeks to access the overseas genetic resources and to utilize them in the territory of Korea, he/she shall observe and comply with the procedures established by the providing country. In this case, the user should endeavor to share the benefit arising from utilization of genetic resources with the provider fairly and equitably.[30]

The user in Article 14 shall declare to the National Check Points that he/she has complied with the provider country measures. The duty of user compliance declaration under this provision is limited to the cases where it is used in Korea by accessing the genetic resources of the provider country that is a party to the Nagoya Protocol and has established domestic measures for access and utilization of genetic resources.[31] This provision has taken effect on August 18, 2018.

2. Compliance Declaration Procedure

Where a person seeks to declare compliance with the provider country measures in accordance with Article 15(1) in the ABS Act, the person shall submit a declaration of procedural compliance to one of the six designated

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[27] ABS Act, No. 14533, Article 12(1) (Jan 17, 2017).
[28] ABS Act, No. 14533, Article 26 (Jan 17, 2017).
[29] ABS Act, No. 14533, Article 27 (Jan 17, 2017).
[30] ABS Act, No. 14533, Article 14 (Jan 17, 2017).
[31] ABS Act, No. 14533, Article 15 (Jan 17, 2017).

National Check Points within 90 days from the prior informed consent[hereinafter PIC] is approved. The declaration shall include following information: user information (name, affiliation, address, contact etc.); name of provider country; name and address of the provider; issuer of PIC (name of issuing authority, date of PIC, issuance number); name of the genetic resources that PIC is approved, quantity or concentration; purpose and utilization of genetic resources; whether mutually agreed terms are concluded and its contents, if any.[32]

Ministry of Environment established comprehensive declaration system to promote electronic processing and efficient management of procedural compliance declaration.[33]

H. Investigation on Compliance with Procedures

National Check Points may seek to investigate whether the domestic user of foreign genetic resources in Article 14 has complied with provider country measures in following cases:[34]

(i) In case where there is an objection to the user's compliance with procedural violations from the provider country;

(ii) In case where a third party has provided information regarding procedural violations of the provider country measures;

(iii) In case where there is reasonable doubt that the user is not complied with the provider country measures.

National Check Points may recommend that the domestic user of foreign genetic resources observe the provider country measures in accordance with Article 14(1) if necessary,[35] and the content and method of investigation shall be determined by the Enforcement Decree.

V. Conclusion

The ABS Act entered into force on August 17, 2017 as Korea became a Party of the Nagoya protocol. Korea also enacted Enforcement Decree and Implementation Rules under the ABS Act. Since several provisions in the ABS Act that are related to the duty of access declaration and compliance have one year grace period to be effective, those provisions have entered into force on August 18, 2018. In this regards, the tasks ahead of Korea are to promote awareness and understanding of the Nagoya Protocol and its

[32] Enforcement Decree Article 6.
[33] Enforcement Decree Article 7.
[34] ABS Act, No. 14533, Article 16(1) (Jan 17, 2017)
[35] ABS Act, No. 14533, Article 16(2) (Jan 17, 2017).

implementation mechanism among industries and researchers who utilize the genetic resource. Korea also need to provide and share information of ABS measures provided by main genetic resources provider countries and develop the case studies, to prepare Korea to comply with applicable laws and regulations and deal with possible legal disputes. It is necessary to discover domestic genetic resources and associated traditional knowledge by survey and research and to keep them in the database system or registries so that they are not to be used in abusing manner.

It should be noted that the Nagoya Protocol contains many phrases having obscure meaning as it was created by coordinating differing interests and views of various countries. Even the implementing legislations in Parties of the Nagoya Protocol contain phrases with vague meaning. Competent authorities and ABS Help desks should consult with experts and competent authorities in the provider countries to clarify these uncertainty. Also the subsequent issues of the Nagoya Protocol should be fully discussed among the Parties to narrow the gaps for understandings.

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The Legal Framework for Marine Genetic Resources: The Relationship between the UNCLOS and the Convention on Biological Diversity Regime*

*Tomoaki Nishimura***

ABSTRACT

Marine genetic resources, which are located in the oceans, are of course subject to the law of the sea, whereas there is possibility they are also regulated by the regime on access and benefit sharing under international environmental law regarding sustainable use of biodiversity. The purpose of this article is to review the legal gap on marine genetic resources. In order to proceed the analysis, this article focuses on the outcome of the current negotiating process of marine biological diversity of the area beyond national jurisdiction until 2017. In addition, the global multilateral benefit sharing mechanism under Article 10 of the Nagoya Protocol is also evaluated. This negotiating process on a law-making benefit sharing regime of marine genetic resources in this area is currently in progress. In view of mutual relationship between the law of the sea and the legal regime of biodiversity, it is essential to confirm that a new instrument under the UN Convention on the Law of the Sea will have a great influence on the future implementation of the Nagoya Protocol.

KEYWORDS: Marine Genetic Resources, Access and Benefit Sharing, The Nagoya Protocol, UNCLOS, BBNJ

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I. Terms of Reference for the AHTEG

The Ad Hoc Technical Expert Group on digital sequence information on genetic resources [hereinafter " AHTEG] was established by Decision XIII/16 of COP 13. In accordance with Decision NP-2/14, the group also serves the Nagoya Protocol. Among other tasks, the AHTEG is to consider the compilation and synthesis of views and information submitted by Parties, other Governments, relevant organizations and stakeholders, as well as a fact-finding and scoping study commissioned by the Executive Secretary.

The terms of reference for the AHTEG is set in the Annex of Decision XIII/16. First, the AHTEG is to consider the compilation, synthesis and the study referred to in paragraph 3(a) and (b) of the Decision in order to examine any potential implications of the use of DSI on genetic resources for the three objectives of the Convention and the objective of the Nagoya Protocol and implementation to achieve these objectives.[1] Second, it is to consider the technical scope and legal and scientific implications of existing terminology related to digital sequence information on genetic resources. Third, it is to identify the different types of digital sequence information on genetic resources that are relevant to the Convention and the Nagoya Protocol. Fourth, it is to meet at least once face-to-face, subject to the availability of financial resources, prior to the fourteenth meeting of the Conference of the Parties and

[1] Para. 3(a) states that the Executive Secretary to "Prepare a compilation and synthesis of the views and information submitted, including the information gathered from engagement with relevant ongoing processes and policy debates", while Para. 3(b) states that the Executive Secretary to "Commission a fact-finding and scoping study, subject to the availability of financial resources, to clarify terminology and concepts and to assess the extent and the terms and conditions of the use of digital sequence information on genetic resources in the context of the Convention and the Nagoya Protocol."

make use of online tools to facilitate its work, as appropriate. Accordingly, a meeting of the AHTEG was convened from February 13 to 16, 2018 in Montreal, Canada. Finally, it is to submit its outcomes for consideration by a meeting of the Subsidiary Body on Scientific, Technical and Technological Advice to be held prior to the fourteenth meeting of the Conference of the Parties.

II. Composition of the AHTEG

Based on the nominations received and in consultation with the Bureau of the Subsidiary Body on Scientific, Technical and Technological Advice [hereinafter "SBSTTA"], experts were selected, taking into account relevant expertise and with due regard to regional and gender balance, and notified on 20 October 2017.[2] The number of the experts nominated by the Parties to the Convention is 25, of which are from five regions: three from Africa including Namibia, three from Asia-Pacific including Japan and Korea, two from Central and Eastern Europe, three from Group of Latin America and the Caribbean including Argentina and Brazil, and three from Western Europe and Others including Canada and EU. The expert nominated by other governments is from the USA. The experts nominated by organizations are ten from those covering the Secretariat of the Commission on Genetic Resources for Food and Agriculture [hereinafter "CGRFA"], the Secretariat of the International Treaty on Plant Genetic Resources for Food and Agriculture [hereinafter "ITPGRFA"], the World Health Organization, the CGIAR, the Third World Network, and the International Chamber of Commerce.

III. Submissions from Parties, Other Governments, Relevant Organizations and Stakeholders

In Decision XIII/16 on Digital sequence information on genetic resources of 16 December 2016, the COP to the Convention invited Parties, other Governments, indigenous peoples and local communities, and relevant organizations and stakeholders to submit views and relevant information to the Executive Secretary on any potential implications of the use of DSI for the three objectives of the Convention. The COP serving as the MOP to the Nagoya Protocol invited these submissions to include information relevant to

[2] CBD, Notification on Composition of the Ad Hoc Technical Expert Group on Digital Sequence Information on Genetic Resources (Oct. 20, 2017).

the Nagoya Protocol.[3] The Secretariat invited the submission of views and information through notification 2017-37 on April 25, 2017.

The number of submissions given to the Secretariat was 53.[4] 14 CBD Parties, including Argentina, Australia, Brazil, Canada, Ethiopia on behalf of the African Group, the EU and Member States, India, Japan and Switzerland, gave submissions. The US, non-Party, also gave a submission by recommending to use the term 'Genetic sequence data' [hereinafter "GSD"] instead of 'DSI'. 38 organizations and stakeholders, including BioIndustry Association, CGRFA, International Chamber of Commerce, ITPGRFA, Japan Bioindustry Association, Royal Society of Biology, Third World Network, UN Division of Ocean Affairs and the Law of the Sea, did so.

It is interesting to see a clear difference of positions depending on the status being a providing Party or a using Party. First, with respect to whether the combination of DSI and synthesis technologies poses problems to fair and equitable sharing of benefits, there was an argument that users of DSI are obligated to share benefits, and the rights of genetic resource providers, indigenous peoples and local communities [hereinafter "IPLCs"] in particular are to be protected, when biodiversity is sequenced, if and when such information is shared and/or placed in databases.[5] Sequence data should accordingly be considered equivalent to biological material, as suggested by many developing country Parties at COP 13. Users of DSI should, in general, be subject to the same benefit sharing obligations as users of the biological materials that are the source of that DSI.[6] Genetic resource providers may thus choose to make DSI available without the underlying biological material and, these providers should be fully enabled to ensure the application of obligations that will result in fair and equitable benefit sharing.[7]

Another opposing argument was that any action that hinders the sharing and use of GSD would hinder achievement of the CBD's three objectives and the Nagoya Protocol's objective.[8] GSD are neither genetic material nor a

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[3] CBD, Decision 2/14 on Digital sequence information on genetic resources, CBD/NP/MOP/DEC/2/14 (December 16, 2016).

[4] CBD, AHTEG on Digital Sequence Information on Genetic Resources, at https://www.cbd.int/abs/dsi-gr/ahteg.shtml#peerreview.

[5] The Third World Network, "Potential implications of the use of digital sequence information on genetic resources for the three objectives of the Convention" (6 September 2017), in response to Decision XIII/16, para. 1.

[6] *Id.*

[7] *Id.*

[8] The US, "U.S. Submission on Digital Sequence Information on Genetic Resources" (18 August 2017) (US Submission 2017), in response to Decision XIII/16, at 2; International Chamber of Commerce, "DIGITAL SEQUENCE INFORMATION AND THE NAGOYA PROTOCOL" (September 14, 2017) (ICC Submission 2017), in response to Decision XIII/16, at 2. The US stated that the term "digital sequence information on genetic resources" means the genetic sequence data (GSD) that describe the order in which nucleotides are situated in a

genetic resource, as there is a "a conceptual and definitional distinction between genetic material itself and data describing that material".[9] DSI is not within the scope of the CBD or the Nagoya Protocol, because the definition of genetic resources relates to genetic material and not abstract information.[10] The definition of a "genetic resource" — as provided by Article 2 of the CBD and referred to in Article 2 of the Protocol — is "genetic material of actual or potential value". "Genetic material" is also defined as "material of biological origin containing functional units of heredity," with genes recognised as the basic units of heredity. It thus follows from this definition that, in the absence of material, the resource in question does not qualify as a genetic resource under the CBD or the Nagoya Protocol. Genetic resources are accordingly understood to cover materials such as organisms, or parts thereof, in which genetic material is present.[11] The term refers to tangible genetic material which must physically contain genes. Therefore intangible DSI as such cannot constitute a genetic resource as defined by the CBD.[12]

IV. Fact-finding and Scoping Study under Peer Review

The Executive Secretary was requested to commission a fact-finding and scoping study to clarify terminology and concepts and to assess the extent and the terms and conditions of the use of DSI in the context of the Convention and the Nagoya Protocol. Accordingly, a draft version of the Emergence and Growth of Digital Sequence Information in Research and Development: Implications for the Conservation and Sustainable Use of Biodiversity, and Fair and Equitable Benefit-Sharing — A Fact-Finding and Scoping Study Undertaken for the Secretariat of the Convention on Biological Diversity [hereinafter "scoping study"] was written by Sarah A. Laird and Rachel P. Wynberg, and finally published on 10 January 2018.[13]

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chain relative to one another in DNA or RNA molecules contained in genetic material of actual or potential value. US Submission 2017, at 1.

[9] US Submission 2017, at 1.

[10] ICC Submission 2017, at 1.

[11] The material of human origin has been explicitly excluded.

[12] ICC Submission 2017, at 2. Further expanding the definitions of "genetic resources" in the CBD and/or the "utilisation of genetic resources" in the Nagoya Protocol to include DSI or its use would create legal uncertainty around the use of such information and as to how access and benefit obligations would apply. Open exchange of scientific information, including DSI, contributes to these activities that support the objectives of the CBD and the Nagoya Protocol, and should be explicitly qualified as benefit sharing in itself. Imposing further obligations on this type of data would go against the objectives of the CBD and Nagoya Protocol. ICC Submission 2017, at 2.

[13] *See* Sarah A. Laird and Rachel P. Wynberg, with contributions from Arash Iranzadeh and Anna Sliva Kooser*, A Fact-Finding and Scoping Study on Digital Sequence Information on*

The scoping study, based on literature analysis and interviews, provided for useful fact-finding on the DSI under the Nagoya Protocol. It covered issues including: Terminology variations of DSI; Various kinds of conditions of use notices; Difficulties involving monetary benefits from the use of DSI; Challenges in determining value of DSI, identifying contributors and users of DSI, identifying provenance of DSI, monitoring the utilization of DSI, and distinguishing commercial and non-commercial research over DSI.

The scoping study discussed an issue of terminology of DSI in particular. Some of the points made by the scoping study is explained as follows. The term DSI used in Decisions CBD XIII/16 and NP 2/14, has grown from the CBD policy process. Terms more commonly employed by the scientific community and databases, however, include "genetic sequence data", "nucleotide sequence data", "nucleotide sequence information", and "genetic sequences". Differences in terminology in scientific circles may reflect differences in the material referred to, as well as the speed and transformative nature of technological change today, which make it difficult to harmonize terminology. In ABS policy discussions, accordingly differences in terminology often reflect divergent views of what falls within the scope of the Nagoya Protocol and national laws.[14]

Terminology also varies between international policy processes. Steps have been taken to harmonize terminology across international policy processes. The ITPGRFA, for example, elected to use the term "sequence data" in its recently commissioned scoping study on synthetic biology. The UN General Assembly's policy process on marine biodiversity in areas beyond national jurisdiction began with the term "resources in silico" but has moved to "digital sequence data". The WHO PIP Framework uses the term "genetic sequence data", which is defined as: "The order of nucleotides found in a molecule of DNA or RNA... contain[ing] the genetic information that determines the biological characteristics of an organism or a virus".[15]

The scoping study, under peer review for comments by Dec. 1, 2017, is expected to be complemented by a synthesis of views and information on potential implications of the use of DSI to be prepared by the Executive Secretary. The comments were given by 11 Parties including China, the EU and Switzerland, one non-Party (the United States), and 26 organizations and stake-holders including International Union for the Protection of New Varieties of Plants [hereinafter "UPOV"], Third World Network, United Nations Division of Ocean Affairs and the Law of the Sea and World Health

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Genetic Resources in the Context of the Convention on Biological Diversity and the Nagoya Protocol, CBD/DSI/AHTEG/2018/1/3 (January 12, 2018). The scoping study as of 10 January 2018 is a version of the draft circulated on Nov. 9, 2017, which was made to reflect the comments in response.

[14] Scoping Study, at 8.

[15] *Id*.

Organization.[16]

For example, Switzerland made the following comment: "the study fails in providing a clear picture on the quantitative importance of "digital sequence information" compared to "genetic resources" as such." [17] According to it, although researches make use of DSI, most labs certainly still work with physical material and not just with information. Thus, it proposed particularly the following amendment to be reflected in the Executive Summary:[18] "Physical samples are still of interest to and are broadly used by researchers, but th~~eir role~~ use/importance of "digital sequence information" in the research and commercialisation process seems to be ~~is~~ changing~~, and the future is unclear~~." The US also made the following comment: considering the amount of research that is still based on material samples, ""most" over-states the amount of research … using only genetic sequence data".[19] Thus, it recommended changing "most research" to "some research" as follows: "Most research is based on sequences accessed through databases or parts registries, but some groups sequence and analyze physical samples…" to "Some research is based on sequences accessed through databases or parts registries, with many groups sequencing and analysing physical samples …"[20] It also recommended to add at the end "Sequencing genetic materials from organisms being studied in the laboratory is a standard research technique."[21] According to it, it is important to capture the generic and ubiquitous nature of DSI, as this is not something restricted to field prospecting or synthetic organism creation.[22]

V. The Meeting of the AHTEG in February 2018

The meeting of the AHTEG was held from February 13 to 16, 2018 in Montreal, Canada. The outcome of the meeting would inform deliberations on this issue by the Subsidiary Body on Scientific, Technical and Technological Advice [hereinafter "SBSTTA"] at its twenty-second meeting, to be held from

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[16] CBD, AHTEG on Digital Sequence Information on Genetic Resources, "Peer review of the fact-finding and scoping study", at https://www.cbd.int/abs/dsi-gr/ahteg.shtml#peerreview. Switzerland gave four comments.

[17] Swiss Federal Institute of Intellectual Property (IPI), "Comments on the draft fact-finding and scoping study", in response to Notification No. 2017-115, at 1, 3.

[18] *Id*., at 3.

[19] The US, "Submission on Peer Review of Fact-Finding and Scoping Study on Digital Sequence

Information on Genetic Resources" (1 December 2017), in response to Notification No. 2017-115, at 2.

[20] *Id.*

[21] *Id.*

[22] *Id.*

July 2 to 7, 2018. The resulting outcomes would enable both the COP and COP-MOP to consider any potential implications of the use of digital sequence information on genetic resources for the objectives of the Convention and the Protocol, at their next meetings from November 10 to 22, 2018. The outcomes of the meeting is introduced rather simply as reported as follows.

A. Terminology and different types of digital sequence information on genetic resources

The participants discussed the various types of information on genetic resources that may be relevant to the three objectives of the CBD and the objective of the Nagoya Protocol. There was consensus that the term "digital sequence information" [hereinafter "DSI"] is not the appropriate term to refer to these types of information.[23] There was an understanding that information that provides an indication of the genetic and/or biochemical composition of the genetic resource at some point originated from a physical source.[24] There was also general agreement that "digital" only refers to the method by which the information is stored and transmitted and that new alternative forms of storage or transmission could raise similar questions.[25]

With respect to the relationship between DSI and definitions in the CBD and the Nagoya Protocol, divergent views were expressed as follows.[26] First, some were of the view that the definition of genetic resources[27] includes DSI, while others were of the view that the definition of genetic resources refers to tangible or physical material while DSI is intangible and so is not covered by the definition. Second, some experts considered that the phrase "or other

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[23] CBD, "Annex: Outcomes of the Meeting of the Ad Hoc Technical Expert Group on Digital Sequence Information on Genetic Resources" in the Report of the Ad Hoc Technical Group on Digital Sequence Information on Genetic Resources (Outcomes of the Meeting), CBD/DSI/AHTEG/2018/1/4, (20 February 2018), para. 1. However, the group continued to use DSI as a place holder, without prejudice to future consideration of alternative terms. The experts identified various types of information that may be relevant to the utilization of genetic resources, including: (a) The nucleic acid sequence reads and the associated data; (b) Information on the sequence assembly, its annotation and genetic mapping. This information may describe whole genomes, individual genes or fragments thereof, barcodes, organelle genomes or single nucleotide polymorphisms; (c) Information on gene expression; (d) Data on macromolecules and cellular metabolites; (e) Information on ecological relationships, and abiotic factors of the environment; (f) Function, such as behavioural data; (g) Structure, including morphological data and phenotype; (h) Information related to taxonomy; (i) Modalities of use. Outcomes of the Meeting, para. 2.

[24] Outcomes of the Meeting, para. 5.

[25] *Id*., para. 10.

[26] *Id*., para. 7.

[27] Convention on Biological Diversity, Article 2: "Genetic resources" means genetic material of actual or potential value.

origin" contained in the definition of genetic material[28] refers, for example, to other taxonomic categories not listed in the definition, while others were of the view that the phrase could include DSI. Third, some experts were of the view that, even if DSI is not within the definition of genetic resources, it is within the scope of the Nagoya Protocol insofar as it results from the utilization of the genetic resource or subsequent applications and commercialization and therefore should be covered by benefit-sharing, while others expressed that the only DSI that may be considered a result of utilization of the genetic resources is nucleic acid sequence reads and the associated data. Fourth, some experts noted that the legal implication of understanding DSI as equivalent to a genetic resource would be obligations for prior informed consent, mutually agreement terms and benefit-sharing. The legal implication of understanding DSI as the product of utilization of a genetic resource would be obligations for benefit-sharing.

With respect to the terms "sequence", "information" and "functional unit of heredity", divergent views were expressed as follows.[29] First, some experts recalled the reference to functional unit of heredity in the definition of genetic material and expressed concern that the concept of a sequence may not include units of heredity. Second, some noted that genomic sequence is the description of a nucleic acid molecule, which is not the same as a functional unit of heredity. Third, some noted that genomic sequence is the description of a nucleic acid molecule, which could be re-materialized as a functional unit of heredity. Fourth, some experts noted that the CBD does not contain a definition of functional unit of heredity and that, therefore, further discussions might be useful. Fifth, some experts also noted that sequence refers mainly to the linearity of a DNA, RNA or protein molecule but not to other kinds of molecules resulting from the metabolism of a genetic resource or to the natural post-transcriptional or post-translational modifications/regulations (i.e. methylations, folding, etc.).

B. Potential implications of the use of DSI for the fair and equitable sharing of benefits arising out of the utilization of genetic resources

While considering potential implications of the use of DSI for the fair and equitable sharing of benefits, there was general understanding among the experts that the COP and MOP did not decide whether utilization of DSI falls within the scope of the CBD or the Nagoya Protocol.[30] They further noted as follows.[31] First, DSI could bring transformational change to the use of genetic

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[28] Convention on Biological Diversity, Article 2: "Genetic material" means any material of plant, animal, microbial or other origin containing functional units of heredity.

[29] Outcomes of the Meeting, para. 11.

[30] *Id*., para. 20.

[31] *Id.*

resources, which may influence the type of benefits and the way benefits are shared. There may be useful lessons in this respect from how digitization of information in other sectors has impacted benefit-sharing, including possible lessons from the music, software, publishing and other industries. Second, access to and utilization of DSI can lead to the generation of benefits, and promote the sharing of non-monetary benefits through technology transfer, partnerships and collaboration, information exchange and capacity development in support of several articles of the CBD, in particular Articles 12 and 18 as well as Articles 8, 20, 22, 23 and the annex to the Nagoya Protocol. Third, DSI, in the light of advances in sequencing technologies in particular, may, in some cases, challenge the implementation of arrangements for access to genetic resources and benefit-sharing [hereinafter "ABS"] by obviating the need for users to seek access to the original tangible genetic resource, thus potentially enabling users to bypass procedures for access and benefit-sharing. In the context of the Pandemic Influenza Preparedness [hereinafter "PIP"] Framework of the WHO, for example, laboratories and manufacturers are relying increasingly on genetic sequence data to the exclusion of physical materials. This has the potential to undermine the PIP Framework. Fourth, accessing and using DSI for some scientific activities is cheaper relative to sequencing, and is enabled by databases. Fifth, DSI is commonly used for analysis, while it is also used for re-materializing genetic material and both are relevant for benefit-sharing. Sixth, there may be a need for economic valuation of the information per se. Seventh, for comparative purposes, larger data sets are more valuable. Eighth, specific benefit-sharing conditions related to DSI resulting from utilization of a genetic resource could be included in mutually agreed terms [hereinafter "MATs"]. Ninth, in the light of the challenges related to the bilateral benefit-sharing approach as it relates to DSI, consideration of multilateral approaches may be warranted in some circumstances: (i) Such circumstances might include: sequences with no known provenance; conserved genes; sequences of widely distributed genetic resources and information voluntarily contributed by Parties; (ii) A multiplicity of national approaches to ABS relating to DSI may create cumbersome processes, and could lead to access restrictions, or to "jurisdiction shopping". One effect of such restrictions may be to limit benefit-sharing and its contribution to conservation and sustainable use; (iii) Fair distribution of benefits among providers may be difficult if genetic material from various sources is combined; (iv) However, a multilateral benefit-sharing mechanism under the Nagoya Protocol cannot extend beyond the scope of the Protocol; (v) The global multilateral benefit-sharing mechanism referred to under Article 10 of the Nagoya Protocol is still under discussion; (vi) Other discussions on DSI are also ongoing in other forums; (vii) A multilateral approach for DSI could provide an alternative to requirements for prior informed consent [hereinafter "PIC"] and MATs and

therefore help to reduce transaction costs and facilitate equitable sharing of benefits. Tenth, monetary benefits are important for conservation in situ and ex situ and sustainable use. Eleventh, the boundary between research for commercial and non-commercial uses can be particularly blurred in the context of DSI. Twelfth, the special considerations in Article 8 of the Nagoya Protocol are to be made.[32] Thirteenth, the fact that a number of challenges related to the implementation of the Nagoya Protocol have not yet been addressed continues to be a subject of concern for a number of stakeholders who are therefore apprehensive of discussions that could create further barriers to access and scientific research, in particular fundamental biodiversity research.

C. Non-monetary Benefits

With respect to non-monetary benefits, the participants made the following points.[33] First, there are large social and public benefits from use of and access to DSI underscoring the importance of publicly accessible databases. Second, while the sharing of information and data is also a benefit in and of itself, it is not, alone, sufficient to meet the expectations for benefit-sharing. Furthermore, the benefits from data sharing do not necessarily accrue to the providers proportionately or predominantly. Third, continued effort for technology transfer and capacity-building is essential, in order to enable developing countries to access and use DSI. Fourth, although there is already international cooperation, there is a need to learn from existing practices and build on them to further develop capacity. Fifth, it would be helpful to develop further studies to quantify non-monetary benefit-sharing. It may be easier to examine this by sector.

It was suggested that a challenge to monetary benefit-sharing is the fact that there may be no cutoff point and that benefit-sharing obligations may continue in perpetuity.[34] It was also noted that monitoring, access to and use of DSI may be very complex.[35]

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[32] According to Article 10, in the development and implementation of its ABS legislation or regulatory requirements, each Party shall: "(a) Create conditions to promote and encourage research which contributes to the conservation and sustainable use of biological diversity, particularly in developing countries …; (b) Pay due regard to cases of present or imminent emergencies that threaten or damage human, animal or plant health … Parties may take into consideration the need for expeditious access to genetic resources and expeditious fair and equitable sharing of benefits …; (c) Consider the importance of genetic resources for food and agriculture and their special role for food security."

[33] *Id*., para. 21.

[34] *Id*., para. 22.

[35] *Id*., para. 23.

D. Other Issues

With respect to monitoring, it was noted that some countries and international frameworks have taken the approach to establish as the triggering event for benefit-sharing, and to focus monitoring on, the commercialization of products arising from the utilization of DSI, rather than controlling research and technological development from DSI.[36] Some experts noted that intellectual property rights and other property rights should be safeguarded.[37]

With respect to the issue of databases, some experts expressed the following views.[38] First, there can be different interpretations of what constitutes a publicly accessible database. These may range from databases that allow completely open access (e.g. GenBank) to those that impose certain requirements (e.g. the Global Initiative on Sharing All Influenza Data [hereinafter "GISAID]), which requires registration by users and data access agreements). Second, access to publicly available databases is important and could require user agreements that address benefit-sharing. Third, data in publicly accessible databases may still be subject to intellectual property rights or be utilized for intellectual property-protectable subject matter or be subject to ABS obligations. Fourth, the value of including information on environmental context in the metadata associated with DSI is increasingly recognized by the scientific community as it contributes to conservation efforts and good research practices. This information may also contribute to ABS. Fifth, although some databases (e.g. the DNA Databank of Japan) provided information on user statistics and metadata of DSI, there continues to be a need for more information on where DSI comes from (e.g. country of origin of the genetic resource whose sequences are in databases), by whom it is submitted and the countries from which users are accessing DSI. Sixth, there is a need for more information on the extent of use of DSI (e.g. public/private databases, commercial/non-commercial) to inform future discussions. Sixth, the experts agreed that restricting the use of publicly accessible data would not be desirable, while some pointed out that there are proprietary data, the content of which is not publicly known. Seventh, some experts shared information on steps being taken by different sectors with a view to respecting the principles of the Nagoya Protocol. Good practices have been developed and are available (e.g. International Barcode of Life Project, TRUST, GGBN).

With respect to traceability, experts noted the following.[39] First, there are

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[36] *Id*., para. 24.
[37] *Id*., para. 25.
[38] *Id*., para. 26.
[39] *Id*., para. 29.

concerns that requirements for traceability may create unnecessary barriers to data access and use. Second, a framework for traceability would be helpful for tracking information through the value chain and this could be facilitated through the use of unique identifiers. Third, the ability to trace is improving with new technological developments (e.g. blockchain) and there is a need to keep an eye on developments to determine whether traceability remains a challenge. Fourth, traceability should be mandatory in order to be effective. Fifth, the nature of DSI does not lend itself to traceability.

Finally, it is interesting to note that some experts suggested that the concept of "bounded openness over natural information" may merit consideration, although the concept was not discussed by the AHTEG.[40] Once genetic resources are interpreted as natural information[41], the policy implication is bounded openness, as "genetic resources would continue to flow freely (the openness) but would no longer be free (the boundedness)".[42] Royalties on intellectual property over the value added would be levied ex post utilization. The income would then be distributed to the countries of origin, proportional to habitat, thus achieving the fairness and equity which has so long alluded the Parties. And when the resources are ubiquitous? Or when the sums collected are too low to be worth distributing? In such cases, the income would finance the requisite infrastructure to make the whole thing work.[43]

VI. Conclusion: A Way Forward

Although the CBD and the Nagoya Protocol have institutionalized an ABS legal regime for many years, any meaningful and material benefit has not realized for those provider countries. According to a very recent study,

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[40] *Id*., para. 30.

[41] To avoid a situation where emerging biodiversity governance policy is overtaken by rapid technological innovation and change, the term "natural information", which is neutral and wide, is suggested, while it may be possible that different types of natural information might eventually be subject to different governance regimes. Ethiopia, "Potential implications of the use of "digital sequence information on genetic resources"" (September 8, 2017), in response to the Notification SCBD/SPS/DC/VN/KG/jh/86500.

[42] Joseph Henry Vogel, Manuel Ruiz Muller, Klaus Angerer, and Omar Oduardo-Sierra, "Inside Views: Ending Unauthorised Access To Genetic Resources (aka Biopiracy): Bounded Openness", Intellectual Property Watch (06/04/2018), at http://www.ip-watch.org/2018/04/06/ending-unauthorised-access-genetic-resources-aka-biopiracy-bounded-openness/.

[43] *Id.*

very few ABS agreements have been concluded so far.[44] Between 1996 and 2015, 217 such agreements for commercial research and 248 for non-commercial research have been concluded. On average, out of the 14 countries with an ABS legislation in force, 2.05 ABS agreements for commercial researches have been concluded per year. It was also observed that there is a significantly more important ratio of countries with a national ABS legislation currently into force among the Parties to the Nagoya Protocol compared with the States Parties to the CBD only.[45] That may indicate that there is a less important will among the latter to adopt a functioning ABS framework. In addition, with the notable exception of Switzerland, all the other 38 Parties having an ABS law into force belong to the category of provider States. Those countries include 12 out of the 17 megadiverse countries. Out of the current 20 members of the Group of Like-Minded Megadiverse Countries [hereinafter "GLMMC"], 14 are Parties to the CBD and the Nagoya Protocol or the Nagoya Protocol only, with an ABS legislation into force. Those 14 GLMMC members represent 35.9% of the 39 Parties having successfully implemented an ABS legislation. Therefore, it is to be pointed out that a significant number of the existing ABS legislations have been elaborated and adopted by countries known for their restrictive position on ABS. That may also indicate the strong will of this group to regulate the access to their genetic resources.[46]

The monetary benefits from those ABS legislations are so low that contracting parties do not like to disclose them. The Brazilian ABS Law of 2015, which came into effect on 6 November 2017, for example, allows royalties on net sales to be as low as one tenth of one percent.[47] According to a distinguished legal scholar, users are paying "peanuts for biodiversity."[48]

To avoid the obligation of benefit sharing, users may argue that no genetic material was accessed, as long as material is misinterpreted as matter. However, providers will insist that material is not synonymous with matter and that the sequence was simply disembodied.[49] The predictable rejoinder is

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[44] Nicolas Pauchard, "Access and Benefit Sharing under the Convention on Biological Diversity and Its Protocol: What Can Some Numbers Tell Us about the Effectiveness of the Regulatory Regime?", Resources 2017, 6(1) (February 19, 2017), at 11 of 15.

[45] *Id.*

[46] *Id.*

[47] Brazil, Law No. 13.123 of May 20, 2015 (Access and Benefits Sharing of Genetic Resources and Associated Traditional Knowledge), Article 20, available at http://www.wipo.int/edocs/lexdocs/laws/pt/br/br161pt.pdf, quoted from Supra note 42.

[48] Drahos, P. (2014). Intellectual Property, Indigenous People and their Knowledge (Cambridge Intellectual Property and Information Law). Cambridge: Cambridge University Press, pp.141-56.

[49] The term material should not be confused with the term matter, as the definition of the former allows the interpretation of the term to include the set of information associated with

as cynical as it is dispiriting: regardless of how material is interpreted, the disembodiment may have occurred in one of the two non-Parties where the CBD does not bind, viz. the Holy See or the United States of America.[50]

DSI should be accepted affirmatively in the context of R&D, as technology and science are progressing rapidly. Now even a portable and real-time sequencing device is in use.[51] DSI should be also relevant for the objectives of the Convention and the Nagoya Protocol so as to serve the greatest public good, as long as it originates from and is related to genetic resources. Novel forms of fair and equitable benefit sharing, not explicitly featured in ABS agreements, should be developed in inventive ways to ensure benefits for the global community from the use of DSI for rapid access in the context of the conservation and sustainable use of biodiversity. Resolving the issue of DSI, amicable both to providers and users, must be a touchstone for a future bio-digital innovation for the world.

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the genetic resource, that is, the substrate information or working material. Brazil, "DIGITAL SEQUENCE INFORMATION", in response to Decision XIII/16.

[50] *Supra* note 42.

[51] For example, there is a produce called "MinION" from Oxford Nanopore, which is a portable, real-time DNA/RNA sequencing device. It can be used in the laboratory or in the field. See https://nanoporetech.com/products/minion.

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ARTICLES

Trusts in the World – A Comparative Study of the Trust Property Ownership Approaches

Gechun Lin[*]

ABSTRACT

In the era of economic globalization, countries were anxious to improve their competiveness and have more opportunities in the international market. It is widely acknowledged that the trust played an important role in the economic development. Unlike the indigenous institution in the England, trusts in mixed legal systems and civil law systems were introduced by legislation mainly in the period of the twentieth century.

During the importation of the trust, some barriers exist when transplanting the trust to non-common law jurisdictions. The primary one is the civilian property principle of indivisible and absolute ownership. To solve this conflict, non-common law jurisdictions have developed approaches regarding the trust property ownership.

This article first identifies three major approaches adopted by non-common law jurisdictions: (1) vesting the ownership of trust property in the beneficiary; (2) assigning no one the ownership of trust property; and (3) transferring the ownership of trust property to the trustee—and present Chinese scholars' evaluations of each approach. It shows that some Chinese scholars advocate these approaches, while others conclude that none of the existing approaches to the trust property ownership fits China's specific national conditions. Then, this article provides the enactment background of Chinese trust law and discuss the current Chinese model of trust property ownership, which adopts another approach of allowing the settlor to retain the ownership of trust property.

KEYWORDS: trusts, trust property ownership, common law system, civil law system, mixed legal system, Chinese trusts

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I. Trusts in Common Law Jurisdictions

The trust is an important creation of English property law. It evolved through an age-old process that continues to today. The origin of the trust was the medieval use,[1] where the feoffors (settlors) conveyed lands to feoffees to uses (trustees) for the benefit of the cestui que uses (beneficiaries).[2] During the twelfth and thirteenth centuries, knights left England to join the Holy Crusades.[3] Before leaving, they transferred their property rights to others for the uses of themselves and their families.[4] Such uses instruments continued until their return or death.[5] The wide recognition of the use could be traced back to the middle of the thirteenth century when the Franciscan friars came to England.[6] At that time, friars were prohibited to own property.[7] Thus, benefactors conveyed lands to friends of the friars for the uses of the friars.[8]

The feoffment to uses became increasingly popular in England.[9] For one thing, it is a tool for the landowners to transfer lands to younger sons, daughters and any others, avoiding the primogeniture rule, which requires lands to descend to the eldest son.[10] For another thing, landowners applied

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[1] *See* Granham Moffat, Trust Law 34-39 (4th ed. 2005) (stating that "the medieval forerunner of the modern trust was not called a trust, but a 'use'." and providing a detailed history of medieval uses). *See also* Jesse Dukeminier & Robert H. Sitkoff, Wills, Trusts and Estates 386-87 (9th ed. 2013) (providing a brief introduction of the origins of the trust).

[2] *See* Barlow Burke et al., Fundamentals of Property Law 276 (4th ed. 2015). *See also* Nertila Sulce*, Trust as a Relationship Treated by Common Law Legal Systems and as a Relationship Treated by Civil Law Legal Systems. Things in Common and Comparison between the Two Systems*, 4 Eur. J. Sustainable Dev. 221, 221 (2015).

[3] *See* Carly Howard, *Trust Funds in Common Law and Civil Law Systems: A Comparative Analysis,* 13 U. Miami Int'l & Comp. L. Rev. 343, 349 (2006).

[4] *See id.*

[5] *See id.*

[6] *See* Dukeminier & Sitkoff*, supra* note 1, at 386.

[7] *See id*.

[8] *See id*.

[9] *See id*. at 387.

[10] *See id.*

uses to avoid feudal taxes upon death and marriage.[11] Due to the abuse of uses to avoid feudal dues, the Statute of Uses was enacted in 1536 to restrict the uses.[12] However, the use was not abolished by the Statute and then re-emerged under the name of the trust.[13]

"The history of [the] trust is also the history of equity."[14] Historically, a separation of two systems of law developed in England, one called common law and one known as equity.[15] In common law, the ownership of trust property in uses is vested in the feoffee to uses (trustee), and the interest of the cestui que trust (beneficiary) cannot be enforced.[16] To protect the beneficiary's interest, the equity court began to treat it as a claim against the feoffee to uses (trustee).[17] Soon after, such interest was recognized as a form of ownership.[18]

A common law trust is established when the settlor transfers trust property to the trustee for the benefit of the beneficiary or for certain purposes.[19] "The common law draws a sharp distinction between revocable and irrevocable trusts."[20] If the trust is irrevocable, the creation of the trust will be deemed an absolute gift under the common law.[21] After the creation of a trust, "the settlor has no right to enforce the trust's terms unless that right had been specifically reserved in the trust document."[22]

For the common law trust, the core of a trust is the trustee and the beneficiary.[23] The ownership of trust property is split between the trustee who holds legal ownership for the beneficiary's interest or trust purpose and the beneficiary who acquires equitable ownership for the enjoyment of trust benefits.[24] This is known as "dual" or "split" ownership.

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[11] *See id.*
[12] MJ de Waal, In Search of a Model for the Introduction of the Trust into a Civilian Context, 12 Stellenbosch L. Rev. 63, 64 (2001).
[13] *See id.*
[14] *Id.*
[15] *See id.*
[16] *See id.*
[17] *See id.*
[18] *See id.*
[19] *See* Dukeminier & Sitkoff, *supra* note 1, at 400 ("[T]he creation of a trust requires (1) intent by the settlor to create a trust; (2) ascertainable beneficiaries who can enforce the trust; and (3) specific property, the res, to be held in trust. In addition, if the trust is testamentary or is to hold land, (4) a writing may be required to satisfy the Wills Act or the Statute of Frauds.").
[20] David English & Yuan Zhu, *Comparing the Chinese Trust Law with the US Uniform Trust Code,* 20(1&2) Trusts & Trustees 87, 89 (2014).
[21] *See id.*
[22] *Id*.
[23] *See* Zhengting Tan, *The Chinese Law of Trusts—A Compromise between Two Legal Systems,* 13 Bond L. Rev. 224, 235 (2001).
[24] *See* Daniel Clarry, *Fiduciary Ownership and Trusts in a Comparative Perspective*, 63 Int'l & Comp. L.Q. 901, 905 (2014).

During the existence of the trust, the trustee will be responsible for managing trust property on behalf of the beneficiary.[25] The trustee owes a series of fiduciary duties to the beneficiary, mainly including the duty of loyalty, the duty of prudence, the duty of impartiality, and the duty to inform and account. The duty of loyalty, as the most fundamental duty, requires the trustee to "administer the trust solely in the interests of the beneficiary."[26] After loyalty, the duty of prudence "imposes on the trustee an objective standard of care,"[27] meaning that the trustee should act as a prudent person and exercise reasonable care, skill, and caution during the trust administration.[28] As for the duty of impartiality, impartiality is not in the sense of equality.[29] Rather, the trustee should construe the trust instrument and "[give] due regard to the beneficiaries' respective interests as defined by the settlor in the terms of the trust."[30] Finally, the trustee has the duty to inform beneficiaries about the administration of the trust and to account to the beneficiaries.[31]

"It is the beneficiary who enforces the trust."[32] Upon the creation of a trust, the beneficiary has a proprietary interest in the trust property.[33] The proprietary interest is enforceable in equity against not only the trustee but also the third parties who obtain trust property.[34] The exception is a purchaser for value of the trust property without notice of the beneficiary's proprietary interest.[35]

Since its early English origin, the trust has spread to common law jurisdictions worldwide. These jurisdictions include Australia, United States, Hong Kong, and Singapore. Although these jurisdictions have introduced diverse reforms to trust law, they remain committed to the core English model of dual ownership of trust property.

Although trusts are ubiquitous among common law jurisdictions, the concept of trust is relatively new for many non-common law jurisdictions. Unlike the indigenous institution in the England, trusts in mixed legal systems and civil law systems were introduced by legislation mainly in the period of the twentieth century.[36] Before the twentieth century, trusts were used in the

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25 *See* Samantha Hepburn, Principle of Equity and Trusts 265 (2d ed. 2001).
26 Dukeminier & Sitkoff, *supra* note 1, at 588.
27 *Id.* at 602.
28 *See id.*
29 *See id.* at 658.
30 *Id.*
31 *See id.* at 667-68.
32 *See* John Duddington, Essentials of Equity and Trusts Law 64 (2006).
33 *See id.* at 68.
34 *See id.*
35 *See id.*
36 *See* Zhang Ruiqiao, *A Comparative Study of the Introduction of Trusts into Civil Law and Its Ownership of Trust Property*, 21(8) Trusts & Trustees 902, 907 (2015) (providing a brief

context of wealth transfer within families in mixed jurisdictions.[37] Afterward, the reception of trusts in mixed and civilian jurisdictions was driven by the commercial functions of trusts.[38] In the era of economic globalization, countries with civil or mixed legal systems were anxious to improve their competiveness and have more opportunities in the international market.[39] It is widely acknowledged that the "trust played a role in the acceleration of economic development" and "became a main engine of liberal-capitalist economics."[40]

During the importation of the trust, some barriers exist when transplanting the trust to non-common law jurisdictions.[41] The primary one is the civilian property principle of indivisible and absolute ownership.[42] In the civilian context, it is impossible to accept that there is dual or split ownership over trust property, one legal title and one equitable title.[43] To solve this issue, these jurisdictions have developed approaches regarding trust property ownership.

As the remainder will discuss, some non-common law jurisdictions have also introduced the trust. However, these jurisdictions, such as South Africa, Québec, Scotland, Japan and China, rejected the common law model of trust property ownership and developed their own distinctive approaches.

In the following, Part II identifies three major approaches adopted by non-common law jurisdictions: (1) vesting the ownership of trust property in the beneficiary; (2) assigning no one the ownership of trust property; and (3) transferring the ownership of trust property to the trustee—and present Chinese scholars' evaluations of each approach. Some Chinese scholars advocate these approaches, while others conclude that none of these existing approaches to the trust property ownership fits China's specific national conditions. Part III provides the enactment background of Chinese trust law and discuss the current Chinese model of trust property ownership, which adopts another approach of allowing the settlor to retain the ownership of trust

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history of the introduction of trusts into mixed jurisdictions and pure civil law systems).

37 *See id*.

38 *See* István Sándor, *Different Types of Trust from an Ownership Aspect,* 24(6) Eur. Rev. Private L. 1189, 1191 (2016) (stating that "trust schemes have been introduced on-demand as civil law economies find the need").

39 *See* Zhang, *supra* note 36, at 908.

40 Sándor, *supra* note 38, at 1191.

41 *See* Zhang, *supra* note 36, at 903-05.

42 "Indivisible ownership" is a civil law concept in contrast to the "dual ownership" in common law. *See* Sándor, *supra* note 38, at 1190 ("In civil law systems, in the tradition of Roman law, ownership is recognized as an undivided right, which means that ownership of something at a given time is exclusive.").

43 *See* Donovan W.M. Waters, *The Future of the Trust Part I*, 13 J. Int'l Tr. & Corp. Plan. 179, 182 (2006) ("The civil law . . . has no doctrine of an estate or interest interposed between the person and the thing owned by the person; and therefore, there can be no division of the rights of ownership between two or more persons.").

property. Part IV concludes.

II. Trusts in Non-common Law Jurisdictions

A. The Beneficiary-owned Bewind Trust

1. The Ownership Approach

One possible approach of accommodating the trust to civilian contexts is by vesting the ownership of trust property in the beneficiary subject to the trustee's management of the property;[44] however, this approach is still considered theoretical because very few jurisdictions have adopted it.[45] The bewind in the Netherlands and bewind trust in the South Africa are rare examples.[46]

In the Netherlands, bewind (administratorship) is a trust-like device of Roman-Dutch law.[47] In the bewind, the beneficiary has the ownership of the property, while an administrator (like a trustee) is given control of the property and manages the property.[48] Property owners in the Netherlands use this trust-like device mainly to bequeath or to gift property to incapacitated persons (including minors), or unborn persons, subject to a fideicommissum.[49] In contrast to the trust, the bewind can only be created by will or gift. "It [could not] be used for an impersonal object such as a charitable purpose, as then there were no persons as beneficiaries in whom the property could vest unless the fund was created as a foundation with its own legal personality."[50] For this reason, Lusina Ho observes that "the bewind has limited application in the succession context as a civilian correspondent to spendthrift trusts."[51]

Notably, bewind has not yet been recognized as a trust institution by Dutch domestic law,[52] but such bewind trust can be found in South African law, a mixed legal system resulting from the combination of Roman-Dutch

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[44] *See* Lusina Ho, Trust Law in China 36 (2003).
[45] *See id.* at 39.
[46] *See id.* Another example of trust with ownership in the beneficiary may be the Louisiana trust. Pursuant to Article 1782 of Louisiana Trust Code, title of trust property is transferred to the trustee. However, a series of cases showed that title is just held to denote "a power of administration and disposition rather than ownership." Trust property ownership is vested in the beneficiary. *See* A. N. Yiannopoulos, *Trust and the Civil Law: the Louisiana Experience, in* Louisiana: Microcosm of a Mixed Jurisdiction 229 (Vernon V. Palmer ed., 1999).
[47] *See* B. Beinart, *Trust in Roman and Roman-Dutch Law*, 1 J. Legal. Hist. 6, 10 (1980).
[48] *See id.* at 10.
[49] *See id*.
[50] *Id*.
[51] Ho, *supra* note 44, at 39.
[52] *See* Waal, *supra* note 12, at 73.

law and English law.[53] Although English common law has mainly influenced the development of the trust in South Africa, the effect of Dutch civilian law still remains on the South African trust legislation.[54] Accordingly, the Trust Property Control Act 57 of 1988 recognized two forms of trusts:[55] the ownership trust, having English heritage, where the trustee is the owner of trust property; and the bewind trust, with Dutch ancestry, where the beneficiary owns trust property.[56] In fact, despite the fact that the law allows a settlor to transfer ownership of trust property to a trustee or beneficiary, the form of trusts where trustees are owners are the majority in practice.[57] In other words, the beneficiary-owned bewind trusts are less commonly used.

2. The Chinese Scholars' Evaluations

Although this approach of vesting the ownership of trust property in the beneficiary is uncommon, some Chinese scholars advocate it. For example, Zhang Chun proposes that, for a testamentary trust, the trust property ownership should transfer to beneficiaries; for other types of trust, the settlor reserves the trust property ownership.[58] Otherwise, the testamentary trust will not be effectively established since the decedent (settlor) cannot own property.[59] Also, Wen Jie, in his book Xintuo Fa Zhuanti Yanjiu, explains that in Chinese trusts, the trust property ownership should be vested in the

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[53] *See* Francois Du Toit, *Jurisprudential Milestones in the Development of Trust Law in South Africa's Mixed Legal System*, *in* The Worlds of the Trust 257 (Lionel D. Smith ed., 2013) (providing a brief introduction of South Africa's legal system).

[54] *See id.* at 257-58.

[55] Trust Property Control Act 57 of 1988 §1 (S. Afr.) ("'[T]rust' means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed——

(a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or

(b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act No. 66 of 1965).").

[56] *See* Clarry, *supra* note 24, at 913.

[57] *See id.* at 914.

[58] Zhang Chun, *Tiaokuan Zengbu: Woguo Xintuo Fa zhong de Zhongyao Chuangshexing Guiding de Wanshan* [*The Supplement of the Terms: the Perfecting to the Important Innovative Regulations in the Trust Law of China*], 23(12) Hebei Faxue 44, 45 (2005).

[59] *Id*.

beneficiary while the trustee has the power of administration.[60] The logic behind this is that the creation of a trust is essentially for the benefits of the beneficiary.[61] During the existence of the trust, the beneficiaries receive beneficial interests from the trust; upon termination of the trust, the trust property usually goes first to the beneficiary or the beneficiary's heirs, unless otherwise provided.[62] Thus, this approach is in accordance with the intention of the settlor, wherein the beneficiary is the owner of trust property.[63] Wen also states that the beneficiary's rights under the Trust Law of China are derived from the beneficiary's ownership of trust property.[64] As for the trustee's power of administration, he suggests that it should be defined as a new type of usufruct[65] since such a definition is compatible with the facts that: (1) the trustee manages and disposes of trust property during the existence of trust; but (2) the trust property will not belong to the trustee after the end of the trust.[66]

Yu Haiyong objects to the vesting of the trust property ownership in the beneficiary.[67] In the civilian context, ownership refers to the exclusive and full control over property.[68] The owner has the right to possess, use, seek profits from, and dispose of the trust property.[69] During the existence of the trust, the trust property is not under the control of the beneficiaries.[70] Instead, the trustee manages and disposes of the trust property. Therefore, the beneficiaries' rights are not within the civilian concept of ownership.[71] From Yu's perspective, the beneficiaries' equitable ownership in the common law system should be recognized as an obligatory right in the civil law system.[72]

In practice, vesting the trust property ownership in the beneficiary is defective. Lusina Ho et al. expound first, that the administration of the trust

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[60] Wen Jie, Xintuo Fa Zhuanti Yanjiu [Project on Trust Law Study] 21-24 (2012) (reasoning his opinion of vesting the ownership of trust property in the beneficiary).
[61] *Id.* at 21.
[62] *Id.*
[63] *Id.*
[64] *See id*. at 22-23 (identifying that the beneficiary has: (1) the right to claim interests; (2) the right to supervise; and (3) the right of rescission).
[65] *Id.* at 23.
[66] *Id.* at 24.
[67] *See* Yu Haiyong, *Lun Yingmei Xintuo Caichan de Suoyouquan Guishu* [*On Ownership of Trust Property*], 50(2) Zhongshan Daxue Xuebao (Shehui Kexue Ban), 189, 193-94 (2010).
[68] *Id.* at 193.
[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *See* Yu Haiyong, *Shuangchong Suoyouquan zai Zhongguo de Bentuhua* [*Sinofication of Dual Ownership of Trust Property in the Anglo-American Law System*], 32(3) Xiandai Faxue, 159, 163-65 (2010).

will be negatively affected.[73] Since the beneficiary is the prima facie owner of trust property, the trustee "will need his cooperation in managing the trust and has to dance to the bidding of the beneficiary," especially when there are no additional rules to counter-balance the power of beneficiaries.[74] The trustee will need the beneficiary's permission to enter into a transaction, which makes the trustee act like an agent.[75] Second, the advantages of traditional common law trusts in tax and privacy may not be obtained in trusts "where the beneficiary is the prima facie owner to the outside world."[76] Additionally, in a charitable or private purpose trust and discretionary trust, the ownership of trust property would be in legal limbo for a period when there are no certain beneficiaries.[77]

B. The Ownerless Québec Trust

1. The Ownership Approach

The legislation of Québec devised a distinctive approach to incorporate the trust into its mixed legal system where civil matters are governed by French-heritage civil law.[78] This approach does not grant the ownership of trust property to any trust parties. Pursuant to the Québec Civil Code (1991), a trust results from the transfer of property from the settlor to a patrimony for a particular purpose and the trustee manages the trust property.[79] However, none of the trust parties, the settlor, trustee, or beneficiary, has the ownership of trust property.[80] For this reason, the Québec trust is called ownerless trust.

At the beginning, the trust in Québec was introduced by English settlers who insisted on using this institution in their wills.[81] As early as 1879, the use

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[73] *See* Ho, *supra* note 44, at 40. *See also* Ruiqiao Zhang, *A Better Understanding of Dual Ownership of Trust Property and Its Introduction in China*, 21(5) Trusts & Trustees 501, 507-08 (2015).

[74] *See* Ho, *supra* note 44, at 40.

[75] *See* Zhang, *supra* note 73, at 507-08. *See also* Zhang, *supra* note 67, at 194.

[76] *See* Ho, *supra* note 44, at 40.

[77] *See* Zhang, *supra* note 73, at 508. *See also* Zhang, *supra* note 67, at 194.

[78] *See* Honoré, *supra* note 36, at 2 (providing a brief history of the French system of private law in Québec). *See also* Jean Goulet, *The Quebec Legal System*, 73 Law Libr. J. 354, 355 (1980) ("Québec has been governed and influenced by a possessive mother, France, who has succeeded in keeping her child under her influence, Québec being ruled today by a Code of the same form and philosophy as the one found in the French Civil Code.").

[79] *See* Civil Code of Québec, S.Q. 1991, c. 64, Article 1260 (Can.) ("A trust results from an act whereby a person, the settlor, transfers property from his patrimony to another patrimony constituted by him which he appropriates to a particular purpose and which a trustee undertakes, by his acceptance, to hold and administer.") [hereinafter Québec Civil Code].

[80] *See id.* Article 1261 ("The trust patrimony, consisting of the property transferred in trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right.").

[81] *See* Waal, *supra* note 12, at 79-80.

of trusts in wills and gifts was acknowledged by one statute.[82] However, Québec law never recognized the common law theory that the trustee is the legal owner of the trust property.[83] The courts originally held that "the ownership of trust property resided in the revenue beneficiary; later that the trustee had a form of ownership of the property."[84] Finally, in the 1982 case, Royal Trust Co v. Tucher,[85] the Supreme Court of Canada held that ownership could be vested only in the trustee in the Québec trust through examining three different approaches in which the settlor, trustee or beneficiary owns trust property during the existence of trust.[86] On the one hand, Québec's civil law provided no effective measures to ensure trustee's faithful and competent management of trust property; on the other hand, there were no remedies in equity for beneficiaries as common law jurisdictions would because it never accepted the distinction between legal ownership and equitable ownership.[87] Therefore, the trustee would become the sole owner of trust property while the beneficiaries could only rely on an action based on abuse of right or fraud if the trustee breached his duties.[88]

Ultimately, this holding was voided by the Québec Civil Code (1991). Before its amendment, one group of Québec jurists believed that the trust property must be owned by a legal person (trustee, beneficiary or settlor), applying rules and principles from the civilian system to the trust.[89] Meanwhile, another group argued that the trust could be a special institution with its own rules and principles where no one owns the trust property.[90] The jurists debated all four approaches of trust property ownership before finally passing the amendment.[91]

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[82] *See* Madeleine Cantin Cumyn, *The Trust in a Civilian Context: the Québec Case*, 3 J. Int'l Tr. & Corp. Planning 3, 69 (1994). *See also* Waal, *supra* note 12, at 80 (describing the statute as a further step of the already existing civilian institution, French *fiducie*).

[83] *See* William E. Stavert, *The Québec Law of Trust*, 21 Est. Tr. & Pensions J. 130, 130 (2002).

[84] *Id*.

[85] Royal Trust Co. v. Tucker, [1982] 1 S.C.R. 250 (Can.) *available at* SCC Cases (Lexum), https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/5454/index.do (last visited on Apr. 21, 2017).

[86] *Id.* at 264-73.

[87] *See id.*

[88] *See id.*

[89] *See* Daniel N. Mettarlin, *The Québec Trust and the Civil Law*, 21 McGill L.J. 175, 177 (1975).

[90] *See id.*

[91] *See* István Sándor, *Attempts at Adoption of the Anglo-Saxon Trust*, 55 Annales U. Sci. Budapestinensis Rolando Eotvos 411, 456 (2014) ("Under the first approach, the trustee is the owner, but it failed to adequately express the actual legal situation. Under the second approach, the beneficiary is the owner, but this was not recognized in case law on the basis of the Curran v. Davis case. Under the third approach, the settlor is the owner, but this would entail conditional ownership, and was therefore abandoned. Eventually a fourth version was approved, wherein the 'trust' is the owner. Although the trust is not an independent legal entity, the trust property is an independent entity as appropriated property.").

Taking these above approaches into account, the Québec Civil Code (1991) designed the ownerless trust,[92] which is based on Pierre Lepaulle's idea that "all that is necessary for the existence of a trust is a res (property) and an appropriation of that res to some aim."[93] Lepaulle understood the common law trust as "a legal institution that consists of a patrimony independent of any legal person, whose unity is defined by an appropriation."[94] Pursuant to this Code, a trust (fiducie)[95] involves the constitution of a patrimony by appropriation to a specific purpose.[96] To establish a Québec trust effectively, the settlor has to transfer his property into the trust as a separate patrimony.[97] Title of trust property is in the name of the trustee who acts as the administrator of such property.[98] Meanwhile, none of the trust parties, settlor, trustee, or beneficiary, owns the trust property.[99]

The Québec Civil Code's innovation with respect to trust property ownership is an adaptation to its civil law environment.[100] This approach does not conflict with the principle of absolute and indivisible ownership in the civil law system. It is acknowledged that "the logic of patrimony by appropriation in the Québec trust circumvents the pitfalls of dual ownership, and numerous clauus."[101] It also avoids the situation that any one of the trust

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[92] *See* Stavert, *supra* note 83, at 130 (stating that "until 1994, the law was amended to provide that the trust comprises a separate patrimony by appropriation").

[93] Pierre Lepaulle, *An Outsider's View Point of the Nature of Trusts*, 14 Cornell L.Q. 52, 55 (1928).

[94] Pierre Lepaulle, Traité théorique et pratique des trusts en droit interne, en droit fiscal et en droit international 31 (1931), Lionel Smith trans., *Trust and Patrimony*, 28 Est. Tr. & Pensions J. 332, 332 (2009).

[95] The French term *fiducie* is an institution analogous to the common law trust. Cumyn used "the French term *fiducie* for the transplants, adaptations and analogues of the trust within civil law jurisdictions." Madeleine Cantin Cumyn, *Reflections Regarding the Diversity of Ways in Which the Trust Has Been Received or Adapted in Civil Law Countries*, *in* Re-imagining the Trust 6-7 n.2 (Lionel D. Smith ed., 2012).

[96] *See id.* at 8.

[97] *See* Québec Civil Code, Article 1265 ("Acceptance of the trust divests the settlor of the property, charges the trustee with seeing to the appropriation of the property and the administration of the trust patrimony and is sufficient to establish the right of the beneficiary with certainty.").

[98] *See* Québec Civil Code, Article 1278 ("A trustee has the control and the exclusive administration of the trust patrimony, and the titles relating to the property of which it is composed are drawn up in his name; he has the exercise of all the rights pertaining to the patrimony and may take any proper measure to secure its appropriation. A trustee acts as the administrator of the property of others charged with full administration.").

[99] *See id.* Article 1261, *supra* note 79; *see also* Madeleine Cantin Cumyn, *The Québec Trust: a Civilian Institution with English Law Roots*, *in* Trusts in Mixed Legal Systems 76 (John Michael Milo & Jan Martien Smits eds., 2001) (further asserting that "[t]he trust is the owner of the property").

[100] *See* Cumyn, *supra* note 95, at 20.

[101] Clarry, *supra* note 24, at 917.

parties has excessive powers due to the owning of full civilian ownership.[102] As Article 1261 of the Code provides, the ownership of trust property is not vested in the settlor, trustee, or beneficiary.[103] Instead, the bundle of property rights is shared between the trustee and beneficiary according to their different roles in a trust.[104] Specifically, the trustee has the power of management whereas the beneficiary enjoys the beneficial right as well as being entitled to dispose such a right.[105]

Even though its approach is almost faultless, the ownerless Québec trust has a problem that must be addressed. In short, the patrimony by appropriation is associated to a purpose rather than a natural or legal person. The trust constituted by the impersonal patrimony has no legal personality.[106]

The patrimony by appropriation is an impersonal one. "[I]t is comprised of two masses of property: a set of assets impressed with a purpose, and a set of liabilities that arise in the pursuit of this purpose. Within this type of patrimony, the link between the property and obligations is no longer forged by their relation to a person, but rather by their common purpose."[107] This is very different from the classical concept that the "patrimony denotes the 'aggregate composed of a person's property'"[108] and "inseparably tied to personhood."[109] During the existence of trust, the absence of an owner and legal personhood raises the question: From whom was the property acquired from within a trust.[110] The answer to this question is ridiculous if it is no one. The possible solution is to recognize trust as a third type of "'sujet de droit'[111] [alongside human beings and legal persons] with respect to the rights and obligations encompassed by the fiducie patrimony."[112]

Since the recognition of legal personality was rejected, there is no owner of the trust property during the existence of the trust.[113] However, setting

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[102] *See* Ho, *supra* note 44, at 40-41.

[103] *See* Québec Civil Code, Article 1261, *supra* note 79.

[104] *See id.*

[105] *See* Québec Civil Code, Article 1278, supra note 98; *see also id.* Article 1284 ("While the trust is in effect, the beneficiary has the right to require, pursuant to the constituting act, either the provision of a benefit granted to him, or the payment of the fruits and revenues and of the capital or the payment of one or the other.") & Article 1285 ("The beneficiary of a trust constituted by gratuitous title is presumed to have accepted the right granted to him and he is entitled to dispose of it. He may renounce it at any time; he shall then do so by notarial act en minute if he is the beneficiary of a personal or private trust.").

[106] *See id*. at 37 (stating that "the *fiducie* does not have the status of being a legal person.").

[107] Yaëll Emerich, *The Civil Law Trust: A Modality of Ownership or an Interlude in Ownership?*, *in* The Worlds of the Trust, *supra* note 53, at 32.

[108] *Id.* at 31.

[109] *Id.*

[110] *Id.*

[111] "*Sujet de droit*" is "[a] bearer of private law rights and obligations." *Id.* n. 75.

[112] *Id.* at 37-38.

[113] *See* Maurizio Lupoi, Trusts: A Comparative Study 288 (2000).

aside ownership is only temporary since ownership will convey to the beneficiary once the trust terminates.[114] Yaëll Emerich suggests that the Québec trust could be considered as a bracketing of ownership or even as a new mode by which ownership is acquired.[115]

2. The Chinese Scholars' Evaluations

In China, some scholars hold a similar opinion that during the existence of a trust, the trust property is ownerless, not belonging to the settlor, trustee, or beneficiaries.[116] They think that the transfer of property begins from the creation of a trust and ends at the termination of a trust.[117] Because the trust property is uncertain during the existence of the trust and may change in form and value, the transfer process cannot be completed until the trust terminates.[118] That is to say, trust property is at the status of transferring from the settlor to the beneficiary and becomes ownerless between the period of creation and termination of the trust.[119]

For the ownerless Québec trust, some Chinese scholars do not view it as a successful model for China. For example, Zhang Ruiqiao mentions the difficulty of accepting the ownerless quality of the trust property after the creation of a trust.[120] Furthermore, Zhang states that the theory of patrimony behind the Québec ownerless trust is alien to the Chinese legal system.[121] "China cannot introduce [such a theory] due to a number of ingrained conceptual hurdles with Chinese law."[122] Zhang also points out that it is unnecessary to add the patrimony concept to the Chinese legal system since categories of real and personal rights that could essentially serve the same as dual ownership already exist.[123] She believes that the binary system of real rights and personal claims maybe a less invasive method for the Chinese legal system to indigenize the notion of dual ownership.[124]

Aside from the theoretical obstacles, there are some practical problems arising from this model. Zhang Ruiqiao summarizes that the trustee might not

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114 *See id.* at 39.
115 *Id.*
116 *See* Ruan Yuchen, *Qiantan Xintuo Caichan Suoyouquan* [*Discussion of Trust Property Ownership*], Fazhi Yu Jingji, no. 6, 81, 82 (2014). *See also* Li Yong, *Xintuo Caichan Suoyouquan Xingzhi zhi Zaisikao* [*Reconsideration on the Character of Trust Property*], Shidai Faxue, no. 5, 55, 60 (2005).
117 *See* Ruan, *supra* note 116, at 82.
118 *See id.*
119 *See id.*
120 *See* Zhang Chun, Xintuo Fa Zhexue Chulun [Discussion on the Philosophy of Trust Law] 188 (2014).
121 *See* Zhang, *supra* note 73, at 510 ("China has no history of patrimony, but does have categories of rights, i.e. real rights and personal claims.").
122 *Id.*
123 *See id.*
124 *See id*. at 509.

be able to manage the trust property effectively, since he is not the legal owner.[125] Compared with the model that the trustee is vested with the trust property ownership, his administration power will receive more restrictions from other law.[126] For example, it is common that in civil law jurisdictions, only the owner can dispose of the registered property in his own name.[127] For the administration of the trust, if the trustee does not have the trust property ownership, then he cannot dispose of the property in his own name.[128] Obviously, under the model of ownerless trust, the trustee is not the registered owner of trust property in law.[129] Thus, his power of administration, especially the right to dispose of property, is restricted.[130] Lusina Ho further identifies other practical issues of this model, including "to whom should the relevant property be registered," "to whom should tax be charged," and who has the right to raise an action to protect the trust property.[131]

C. The Trustee-owned Non-title Divided Trust

1. The Ownership Approach

Transfer of trust property ownership to the trustee is the most common approach for mixed and civil law jurisdictions to introduce the common law trust into their legal systems.[132] Under this approach, transferring the trust property from the settlor to the trustee is required. During the existence of the trust, the trustee manages the trust property for the interests of the beneficiary. The beneficiary is entitled to receive the trust income and sometimes trust principal. Since there is no conception of dual or split ownership in the civilian context, the situation is somewhat complicated. In short, there is no title divided in the trustee-owned civil law trust.

A number of non-common law jurisdictions in the world have adopted the approach of transferring the trust property to the trustee. For example, in Europe, Scotland is the first country to introduce the trust.[133] After a long time of development, Scotland now recognizes that "[the trust property] ownership is in the trustee, with the trust property constituting a separate trust patrimony segregated from the trustee's personal patrimony."[134] The law of

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125 *See* Zhang, *supra* note 120, at 188-89.
126 *See id.*
127 *See id.* at 189.
128 *See id.*
129 *See id.*
130 *See id.*
131 *See* Ho, *supra* note 44, at 41.
132 *See id.* at 37.
133 *See* Lupoi, *supra* note 113, at 292-96 (introducing the history of Scottish trust and different theories of ownership developed in Scotland).
134 Clarry, *supra* note 24, at 910.

Liechtenstein[135] defines the trust as a relationship where "the fiduciary (trustee) receives an asset or a right; this asset or right belongs completely to the fiduciary . . . [and] the trustee becomes the owner of the right to all effects and before all third parties, including the settlor."[136] The Luxembourg trust also entails the transfer of trust property ownership to the trustee for its creation.[137] In Latin America, Argentinian law provides that "a 'trust' (fideicomiso) exists where a person (fiduciante) transfers fiduciary ownership (propiedad fiduciaria) of certain assets to another person (fiduciario), broadly translated as a trustee, for the benefit of the person identified in the relevant contract (beneficario), with the title to property being registered in the name of the trustee."[138] The Panamanian trust also requires a transfer of trust property to the trustee.[139] Although the trust law does not directly stipulate that the ownership is vested in the trustee, it is a prevailing view that the trustee is the owner of trust property.[140] In Asia, China's neighbors, South Korea and Taiwan, both directly require the ownership of trust property to be transferred to the trustee.[141] It is worth noting that the Trust Act of Japan

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[135] *See* The Personen-und Gesellschaftsrecht [Liechtenstein Company Law], Jan. 20, 1926, Article 897 (Lie.) ("A trustee within the intendment of this law is a natural person, firm or legal entity to whom another (the settlor) transfers movable or immovable property or a right (as trust property) of whatever kind with the obligation to administer or use such property in his own name as an independent legal owner for the benefit of one or several third persons (beneficiaries) with effect towards all other persons.") [translated by Bryan Jeeves Obe; hereinafter PGR], *available at* http://www.icnl.org/research/library/files/Liechtenstein/liechcomp.pdf (last visited on Aug. 8, 2018).

[136] Lupoi, *supra* note 113, at 304.

[137] *See* Granducal Decree of 19 July 2003, Article 2 (Lux.) ("(1) For the operation of the Convention relating to the law applicable to the trust and its recognition in respect of assets which are the subject of a trust and which are situated in Luxembourg, the position of the trustee is determined by reference to that of an owner.

(2) The reference to the position of an owner is without prejudice to the principle of segregation between the property formed by the assets of the trust and the property made up by the personal assets of the trustee in accordance with article 11 of the Convention of 1st July 1985.") (on file with the author).

[138] Clarry, *supra* note 24, at 912.

[139] *See* Waal, *supra* note 12, at 69.

[140] *See* Clarry, *supra* note 24, at 912.

[141] *See* Wu Ying-Chieh, *Trust Law in South Korea: Developments and Challenges, in* Trust Law in Asian Civil Law Jurisdictions 48 (Lusina Ho & Rebecca Lee eds., 2013) ("Article 2 of the Korean Trust Act 2011 defines the trust as 'a legal relation whereby a person who creates a trust [i.e., the settlor] transfers a specified right…to a person who accepts the trust [i.e., the trustee] on the basis of the confidence reposed in the trustee by the settlor, and the trustee has to manage, dispose of, administer, develop those rights [i.e., the trust fund], or take steps necessary for the fulfillment of the interests of a specified person [i.e., the beneficiary] or certain purposes [i.e., serving private or charitable purposes].'"). *See also* Xintuo Fa [Trust Law], Article 1 (2009) (Lawbank) (Taiwan) ("For the purposes of this Law, the term 'trust' refers to the legal relationship in which the settlor transfers or disposes of a

(2006) does not expressly mandate the transfer of trust property to the trustee to create a trust.[142] However, it is implied that the ownership of trust property is vested in the trustee since this Act provides that trust property belongs to the trustee.[143]

By transferring trust property (ownership) to the trustee, the trustee will be treated as a real owner to the outside world.[144] The trustee can transact with third parties in his own name.[145] Since the trust property is under the control of the trustee, it enables the trustee to manage the trust effectively and independently.[146] However, the trustee's ownership of trust property is different with the civilian concept of full ownership.[147] The trustee owes a series of fiduciary duties to the beneficiary in civil law trusts.[148] The management of trust property is subject to the terms of the trust and trust law.[149] The trustee's ownership of trust property is considered an encumbered form of ownership[150] and is subjected to the trust terms and its obligations towards the trust beneficiary.[151] For example, Scottish law applies the theory of fiduciary ownership to its trust law.[152] In a Scottish trust, the trustee is the fiduciary owner of the trust property who manages the property under a fiduciary obligation.[153] The Argentinian Civil Code introduced the notion of

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right of property and causes the trustee to administer or dispose of the trust property according to the stated purposes of the trust for the benefit of a beneficiary or for a specified purpose.")

142 *See* Shintaku Ho [Trust Act], Act No. 108 of 2006, Article 2(1) (Japan) ("The term 'trust' as used in this Act means an arrangement in which a specific person, by employing any of the methods listed in the items of the following Article, administers or disposes of property in accordance with a certain purpose (excluding the purpose of exclusively promoting the person's own interests; the same shall apply in said Article) and conducts any other acts that are necessary to achieve such purpose."), *available at* http://www.japaneselawtranslation.go.jp/law/detail/?id=1936&vm=04&re=02 (last visited on Aug. 8, 2018).

143 *See id.* Article 2(3) ("The term 'trust property' as used in this Act means any and all property which belongs to a trustee and which should be administered or disposed of through a trust.").

144 *See* Ho, *supra* note 44, at 38.

145 *See id.*

146 *See id.*

147 *See* Clarry, *supra* note 24, at 912.

148 *See* Lusina Ho, *The Reception of Trust in Asia: Emerging Asian Principles of Trust?*, 2004 Sing J. Legal Stud. 287, 297 (2004) (stating that "the legislation in Japan, Taiwan, and South Korea … do prohibit the trustee from enjoying the benefits of the trust … at least the rudimentary form of the fiduciary duty has been put in place.").

149 *See* Clarry, *supra* note 24, at 912.

150 *See id*.

151 *See* Waal, *supra* note 12, at 70.

152 *See* Zhang, *supra* note 36, at 916 ("[F]iduciary ownership in Scots law arises when the owner of property is under a duty to use it for the benefit of another and not for himself.").

153 *See id.*

fiduciary ownership as one type of imperfect ownership,[154] and the term "fiduciary ownership" is used in the definition of Argentinian trust. This term describes the situation where "[ownership of] property is registered in the name of one person (the trustee) to be administrated for the benefits of another (the beneficiary)."[155]

In the trustee-owned civil law trust, another issue is the interpretation of the common law conception of equitable ownership within the civilian context. It is impossible for the trustee to hold legal ownership while the beneficiary holds equitable ownership of the trust property in a civil law trust. Otherwise, it would violate the civilian property principle of indivisible ownership. Principally, the trust beneficiary has obligatory rights against the trustee (rights in personam). As in the Scottish trust, the beneficiary's rights are classified as personal claims.[156] They are of obligatory nature.[157] In some jurisdictions, the beneficiary even has limited real rights in the trust property (right in rem).[158] For instance, the beneficiary in a Liechtenstein trust has a right of tracing, which means that the beneficiary can trace trust property into the hands of any third parties, unless the third party has acquired the property in good faith.[159] Thus, the beneficiary's rights are obligatory with limited proprietary effects.

2. The Chinese Scholars' Evaluations

Although the trustee-owned civil law trust is similar to the common law trust wherein both require the transfer of trust property (ownership) to the trustee, Lusina Ho insists that there are some differences between them. In common law jurisdictions, "the creation of trusts is very much a matter of property law."[160] The contract or a trust agreement is neither necessary nor

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[154] *See* Lupoi, *supra* note 113, at 273. *See also* Código Civil [Civil Code] (January 1, 1987), Article 2662 (Arg.) ("Fiduciary ownership is that acquired in a singular *fidei commissum*, to last only until the fulfillment of a resolutory condition, or until the expiration of resolutory term, the thing to revert then to a third person.") [translated by Frank L. Joannini], *available at* https://archive.org/stream/argentinecivilc00whelgoog/argentinecivilc00whelgoog_djvu.txt (last visited on Aug. 8, 2018).

[155] Clarry, *supra* note 24, at 912.

[156] *See* Zhang, *supra* note 36, at 916.

[157] *See* H.L.E. Verhagen, *Trusts in the Civil Law: Making Use of the Experience of 'Mixed' Jurisdictions*, 3 Eur. Rev. Private L. 477, 493 (2000).

[158] *See* Waal, *supra* note 12, at 71.

[159] *See* PGR, Article 912(3) ("Where third parties have acquired from the trustee property or rights which they knew were trust property and the trustee was not entitled to dispose of such property or rights, the settlor, a co- trustee or a beneficiary or, finally, a trustee appointed by the Princely Liechtenstein Court of Justice may, alone or as joint litigant with others, claim the surrender of such assets or take action on grounds of unjust enrichment for the benefit of the trust assets.").

[160] Ho, *supra* note 44, at 43.

sufficient to establish a trust.[161] Instead, the trust has been treated as a proprietary institution, which is created by a transfer of property.[162] A unilateral declaration may be enough.[163] However, civil law jurisdictions attach more importance to bilateral contracts or other writing documents when establishing a trust.[164] Ho explains that, unlike common law trusts where beneficiaries own equitable titles to the trust property, beneficiaries in civil law jurisdictions usually have to rely on the law of obligation to protect their interests.[165] However, she believes that "nothing will be lost in enforcing the trustee's duties through the law of obligations."[166] If the trustee's obligations and the beneficiary's remedies could be completed, there would be no significant difference between common law trusts and civil law trusts.[167] For example, the law of unjust enrichment has developed well in civil law systems, and it could act as a substitution for equitable remedies in common law jurisdictions.[168]

Some Chinese scholars disagree with the approach of vesting the ownership of trust property in the trustee. For instance, Li Qingchi believes that through unveiling the "dual ownership," the trustee's legal ownership over the trust property is essentially the power of management; the beneficial ownership is right in personam.[169] The main reason behind the trustee not having the trust property ownership is that the trustee's disposition and possession of trust property is not totally unrestricted.[170] For example, the trustee cannot destroy or enjoy the benefits from the trust property; the trustee cannot enter into a self-dealing transaction; and the trustee has to separate trust property from personal property.[171] Wen Shiyang and Feng Xinjun

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161 *See id.*

162 *See id.*

163 *See id.* (stating that "an express *inter vivos* trust of personality can be created by a unilateral declaration of trust by the settlor, which can be oral or in writing; there is no necessity for any contract between the settlor and the trustee").

164 *See id.* at 43-44.

165 *See id.* at 45.

166 *Id.* at 39.

167 *See id.* at 45.

168 *See id*.

169 *See* Li Qingchi, *Zuowei Caituan de Xintuo: Bijiaofa shang de Kaocha yu Fenxi* [*Trust as Patrimony: A Comparative Law Perspective*], 43(4) Beijing Daxue Xuebao (Zhexue Shehui Kexue Ban) 130, 133-34 (2006) (arguing that no trust parties have the ownership of trust property and the trust should be recognized as patrimony by appropriation). *See also* Zhang Chun, *Lun You Shoutuoren Xiangyou de Xintuo Caichan Suoyouquan* [*On the Trustee's Ownership of Trust Property*], Jianghai Xuekan, no. 5, 124, 127, 130 (2007) (having similar opinion that it is better to regard the trustee's rights over trust property as the power of management rather than the ownership within current civilian system, and suggesting that the civilian conception of ownership should be revised for civil law jurisdictions to adopt the approach of vesting the trust property ownership in the trustee).

170 *See* Li, *supra* note 169, at 133.

171 *See id.*

assert that the substance of beneficiaries' equitable ownership in the common law system resembles more the concept of ownership, a real right, in civil law system, while the trustee's legal ownership is largely the power of management.[172] Mao Weimin points out: first, the trustee's rights over the trust property do not include the beneficial right; second, the exercise of the trustee's rights is restricted by the fiduciary duties; and finally, these rights are terminable.[173] Thus the trustee should not be deemed as the owner of trust property.[174]

Some Chinese scholars hold a different view that the trustee owns the trust property. Yu distinguishes the beneficiary's beneficial right with the trustee's right to seek profits from the trust property.[175] The trustee has all the rights derived from the ownership to possess, use, seek profits from, and dispose of the trust property.[176] Yu concludes that the ownership of trust property is vested in the trustee, even though the trustee owes obligations to the beneficiary when managing the trust property.[177] Liu Lizhu argues that the right of disposition is the core of ownership.[178] In a trust, the trustee has the power to manage and dispose of trust property.[179] Thus, the ownership of trust property should be deemed in the trustee.[180]

III. Trust Law in China

A. Enactment Background

In China, the trust is neither "an indigenous part of its current legal system, nor had it ever taken root in ancient dynasty."[181] Around the end of

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[172] Wen Shiyang & Feng Xinjun, *Lun Xintuo Caichan Suoyouquan—Jianlun Woguo Xiangguan Lifa de Wanshan* [*On Ownership of Trust Property*], 58(2) Wuhan Daxue Xuebao (Zhexue Shehui Kexue Ban) 203, 208-09 (2005) (advocating the approach of vesting trust property ownership in the beneficiary).

[173] Mao Weimin, *Xintuo Caichan "Suoyouquan" Lun* [*On Ownership of Trust Property*], 13(3) Zhejiang Gongye Daxue Xuebao (Shehui Kexue Ban) 308, 310-12 (2014) (arguing that the civilian conception of absolute ownership does not exist in the context of trust).

[174] *See id.*

[175] *See* Yu, *supra* note 67, at 162.

[176] *See id.*

[177] *See id.*

[178] Liu Lizhu, *Lun Xintuo Caichanquan de Zhongguohua Jiegou* [*On the Sinicization of Trust Property Ownership*], Lilun Qianyan, no. 7, 128, 129 (2014).

[179] *See id.*

[180] *See id.*

[181] Lusina Ho, *Trust Laws in China: History, Ambiguity and Beneficiary's Rights, in* Re-Imagining The Trust *supra* note 95, at 183. *See also* Stephen Tensmeyer, Modernizing Chinese Trust Law, 90 N.Y.U.L. Rev. 710, 715-16 (2015) (arguing that "trust-like instruments have occasionally been seen throughout Chinese history. There is evidence of

Qing dynasty or the beginning of the Republican period, the concept of the trust was first introduced to China.[182] The Republican government used the modern trust to raise foreign capital in the 1920s,[183] but at that time, Republican China had no law governing the trust.[184]

After the founding of the new Chinese government, the trust business came to a halt for decades, except for the very short period between 1949 and 1955.[185] In 1979, the China International Trust & Investment Company was established, marking the renaissance of trust business in China. The China International Trust & Investment Company continues to be the largest trust company in China.[186] Owing to the open-door policy,[187] trust business and investment companies have developed rapidly since then.[188]

However, soon after their establishment, China's trust companies faced some serious problems, including "uncertainty of their business range and of their legal status, serious breaches of business regulations, the unsoundness of capital structure, the inefficiency in controlling market risk, and the grossly inadequate self-regulation that resulted in chaotic management."[189] Besides, most "trust businesses" operated by trust companies were actually deposit-taking activities.[190] They raised funds from individual investors and financial institutions to invest in high-risk high-return business or projects,

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financial arrangements similar to trusts as early as the Yuan Dynasty (1271-1368). More advanced forms occurred in the Qing Dynasty (1644-1911), and by the late Qing entire villages operated under complicated forms of real property ownership that were essentially trusts, with a council of village elders managing land for the benefit of the entire village.").

182 *See* Tensmeye, *supra* note 181, at 716; for the history of the development of the Trust Industry in Old and New China, *see Zhonguo Xintuoye Fazhan de Lishi Mailuo* [*Overall History of the Development of the Chinese Trust Industry*], at http://www.rf.hk/trustfund/knowledge/37762.html (last visited on Apr. 30, 2017).

183 *See* Tensmeye, *supra* note 181, at 716.

184 *See id.*

185 *See id*. at 716-17 (providing that, from 1949 to 1955, the new Chinese government's central bank set up a trust division in its Shanghai branch; two investment companies established in Tianjin City in 1951 and in Guangdong Province in 1955). *See also* Kai Lyu, *Re-Clarifying China's Trust Law: Characteristics and New Conceptual Basis*, 36 Loy. L.A. Int'l & Comp. L. Rev. 447, 447 (2015) ("When the Chinese Communist Party took over Mainland China in 1949 and promoted socialism thereafter, the trust institution was viewed as a manifestation of capitalist ideology and thereby blocked by the Party.").

186 *See* Tensmeye, *supra* note 181, at 716-17.

187 After President Deng Xiaoping took office in 1978, China adopted the open-door policy of opening up to foreign business that wanted to invest in the country. This set into motion the economic transformation of modern China.

188 *See* Zhou Xiaoming, Xintuo Zhidu: Fali yu Shiwu [Trust System: Legal Theory and Practice] 24 (2012).

189 Tan, *supra* note 23, at 225.

190 Jiang Ping & Zhou Xiaoming, *Lun Zhongguo de Xintuo Lifa* [*On Trust Legislation in China*], Zhongguo Faxue, no. 6, 53, 54 (1994).

which ultimately resulted in default and bankruptcy.[191]

With the aim to regulate and develop trust business, China decided to enact its own trust laws.[192] Since 2001, China has published three main laws and regulations regarding this field: the Trust Law of the People's Republic of China (2001),[193] Measures for the Administration of Trust Companies (2007),[194] and Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds (2009 Revision).[195] At the beginning, it was questionable whether the trust could adapt to and thrive in Chinese soil. However, since the enactment of these laws, the booming of trust business in China has dismissed any doubt. By the end of 2016, the total trust assets managed by Chinese trust companies amounted to RMB¥ 20,218.607 billion (about US $2.889 trillion), as compared to RMB ¥16,303.620 billion (US $2.470 trillion) in 2015, RMB¥ 13,979.910 billion (US $2.194 trillion) in 2014, RMB¥ 10,907.111 billion (US $1.712 trillion) in 2013, and RMB ¥7,470.555 billion (US $1.173 trillion) in 2012.[196]

B. The Chinese Model of Trust Property Ownership

Although the laws mentioned above provide the legal framework for the Chinese trust, some ambiguities remain. For China, the trust is an exotic

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[191] "After 1979, the number of trust and investment companies exploded. By 1992, there were 1000 of these companies in China. The bubble eventually burst and many of these trust companies went bankrupt or became dangerously leveraged, to the point that the industry as a whole had a debt burden between $12 billion and $20 billion in 2000." Tensmeyer, *supra* note 181, at 717. *See also* Geng Lihang, *Xintuo Caichan yu Zhongguo Xintuofa* [*Trust and Trust Law of China*], Zhengfa Luntan, no. 1, 94, 94-95 (2004) ("[T]he lack of regulation and law on asset management business caused harms to the investors' interests and financial order."). *See also* Cheng Sheng, *Woguo Xintuoye Lifa de Licheng Huigu* [*Review on the Legislation History of China's Trust Business*], Huadong Zhengfa Xueyuan Xuebao, no. 2, 71, 72-74 (2002) (providing a detailed statement about the chaotic or even illegal operating situation of trust business).

[192] *See* Rebecca Lee, *Conceptualizing the Chinese Trust*, 58 Int'l & Comp. L.Q. 655, 655 (2009).

[193] Zhonghua Renmin Gongheguo Xintuo Fa [Trust Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 28, 2001, effective Oct. 1, 2001) (Pkulaw) [hereinafter Trust Law of China]; for the enactment history of the Trust Law of China, *see* Zhou, *supra* note 188, at 24-28.

[194] Xintuo Gongsi Guanli Banfa [Measures for the Administration of Trust Companies] (promulgated by the China Banking Regulatory Comm., Dec. 28, 2006, effective Mar. 1, 2007) (Pkulaw) (China).

[195] Xintuo Gongsi Jihe Zijin Xintuo Jihua Guanli Banfa [Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds] (promulgated by the China Banking Regulatory Comm., Dec. 17, 2008, amended Feb. 4, 2009) (Pkulaw) (China).

[196] Statistics are available in China Trustee Association, at http://www.xtxh.net/xtxh/statistics/index.htm (last visited on Apr. 30, 2017).

concept imported from the "Anglo-American" law (common law) system.[197] A common law trust is created by the settlor whereby the trustee holds the legal ownership of trust property to manage for one or more beneficiaries who have equitable ownership to the trust property.[198] Therefore, there are both legal and equitable ownership of the trust property. However, in China, dual ownership is not recognized under its civil law-based system.[199] "[T]here is only one title to each property."[200] The Trust Law of China provides that "[t]rust in this Law refers to the act in which the settlor, on the basis of confidence on the trustee, entrusts certain property rights it owns to the trustee and the trustee manages or disposes of the property rights in its own name in accordance with the intentions of the settlor and for the benefit of the beneficiary or for specific purposes."[201] Such an ambiguous expression, especially the term "entrust," leaves the issue of trust property ownership open without stipulating the meaning of "entrust."[202] Some scholars believe that China's trust law and regulations "neither prevent a trustee from obtaining the ownership of trust property," nor require the settlor to reserve the ownership.[203] Some argue that a thorough reading of the Trust Law of China and the practices of trust business indicate that the ownership of trust property transfers to the trustee.[204]

Lusina Ho holds the view that the Chinese trust law has adopted the approach of reserving trust property ownership by the settlor.[205] Article 2 of the Trust Law of China uses the term "entrust" (in Chinese, "weituo") when

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197 *See* Frances H. Foster, *American Trust Law in a Chinese Mirror*, 94 Minn. L. Rev. 602, 607 (2010) (referring to "China's 2001 import of the classic 'Anglo-American' concept of trust").

198 *See* Dukeminier & Sitkoff, *supra* note 1, at 385.

199 *See* Kang Qiusha, *Dui Yiwu Yiquan Zhuyi de Sikao* [*Reflecting the Principle of One Property One Right*], Liaochen Daxue Xuebao (Shehui Kexue Ban), no. 2, 241-42 (2011). *See also* Lee, *supra* note 192, at 656 ("There is no division of dominium into legal and equitable ownership in China. Ownership is an interest which cannot be fragmented.")

200 Lyu, *supra* note 185, at 452.

201 Trust Law of China, Article 2.

202 *See* Zhang Ruiqiao, *Trust Law of China and its Uncertainties: Examination of the Rights and Obligations of Trust and Ownership of Trust Property*, 10 Ntu L. Rev. 45, 66 (2015).

203 *Id.* at 69. *See also* Ho, *supra* note 181, at 195 (stating that "such definition does not mandate the settlor to transfer his property rights to the trustee, nor does it prohibit any such transfer."); *see also* Lyu, *supra* note 185, at 450-51 (stating that the "indeterminate ownership" of trust assets is one of the distinguishing characteristics of China's Trust Law, which means that "the title to trust assets could be vested in either the settlor or the trustee" or not).

204 *See* Zhou, *supra* note 188, at 40-43. *See also* Lu Yongqing, *Woguo Xintuo Caichan Falu Zhidu Yanjiu* [*A Study of Chinese Laws and Institution with Regard to Trust Property*] 35-37 (2012) (published LL.M's thesis, Shanghai Shehui Kexueyuan), *available in* CNKI.

205 *See* Ho, *supra* note 44, at 41 ("A possibility that has never been considered, let alone adopted, is one whereby the settlor retains ownership over the trust property, and only enters into a trust agreement with the trustee whereby the latter manages the trust. This is the approach adopted in China's Trust Law.").

defining trust.[206] But, none of the following provisions in this law stipulates the meaning of "entrust" for the creation of a trust. In the General Principles of the Civil Law of the People's Republic of China,[207] "weituo" also has been used in establishing an agency relationship. Article 64 provides that "[a]gency shall include entrusted Agency, statutory Agency and appointed Agency. An entrusted agent shall exercise the power of Agency as entrusted by the principal . . . "[208] It is clear that under Chinese law, an agency relationship does not involve the transfer of ownership.[209] Therefore, Ho argues that the establishment of a trust does not require such a transfer either.[210] If the settlor does not transfer his property ownership to the trustee or the beneficiary when creating a trust, the ownership is still reserved by the settlor.

Furthermore, Article 8 of the Trust Law of China provides that "[w]here a trust is created in the form of trust contract,[211] the trust shall be deemed created when the said contract is signed. Where a trust is created in any other form of writing, the trust is deemed created when the trustee accepts the trust."[212] This provision also indirectly indicates that the settlor and the trustee could enter into a trust contract or use "other documents specified by laws and administrative regulations" to create a trust, without transferring ownership of trust property.[213] As discussed above, under current Chinese law and regulations, it is possible for the settlor to reserve trust property ownership to establish a trust. In other words, the settlor could choose to transfer trust property ownership to others, but it is unnecessary to do so.

A little differently, Zhang Chun opines that entrusting property rights to the trustee does not result in the transfer of trust property ownership to the trustee.[214] He quotes Articles 15, 28 and 29 of the Trust Law of China to demonstrate that the settlor reserves the trust property ownership after the

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206 *See* Trust Law of China, Article 2.

207 Zhonghua Renmin Gongheguo Minfa Tongze [General Principles of the Civil Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 12, 1986, effective Jan. 1, 1987, amended Aug. 27, 2009) (Pkulaw) [hereinafter GPCL].

208 *Id.* Article 64.

209 *See* Ho, *supra* note 181, at 199 (stating that "[i]n Chinese law, 'entrustment' is not a unique legal term for establishing a trust; rather, it is typically used for creating an agency relationship or a mandate, which do not require any transfer of property").

210 *See id.* at 195 ("Such a definition does not mandate the settlor to transfer his property rights to the trustee . . . it simply sates that he 'entrusts' them to the trustee.").

211 Trust contract is a contractual agreement between the settlor and the trustee which includes: "(1) purposes of the trust; (2) names and addresses of the [settlor], the trustee and the beneficiary; (3) the beneficiary or the scope of the beneficiary; (4) scope, type and status of the trust property; (5) ways and methods by which the beneficiary get the trust proceeds; [and others]." Trust Law of China, Article 9

212 *Id*. Article 8.

213 *Id.*

214 *See* Zhang, *supra* note 120, at 184-85.

creation of a trust.[215] Pursuant to Article 15, the trust property will become the settlor's estate or liquidation property after the termination of trust.[216] However, this provision does not stipulate that the trust property will transfer back to the settlor. It implies that the settlor is still the owner of trust property after the establishment of a trust, so that any return of trust property from the trustee is unnecessary.[217] Besides, the term "the trust property of different settlors" in Articles 28 and 29 shows that the trust property ownership still remains with the settlor during the existence of a trust.[218]

To sum up, the settlor is still the owner of trust property, and there is only one ownership of the trust property in the Chinese trust. Upon the creation of a trust, the trustee, according to the will of the settlor and in the name of the trustee, administers or disposes of such property for the benefit of a beneficiary or for any intended purposes.[219] This approach will not violate the principle of indivisible ownership in the Chinese civil law-based system.[220] However, this approach is unique. Except for China, nearly no other mixed or civil law jurisdictions, let alone common law countries, allow the settlor to retain ownership of the trust property when creating an effective trust.[221] Most civil law jurisdictions, like Liechtenstein and Luxembourg in Europe, Argentina and Panama in Latin America, and South Korea, Taiwan and Japan in Asia, mandate the transfer of ownership to the trustee. Québec, with a special approach, requires that the settlor transfer trust property to a separate patrimony.

In addition, as Lusina Ho has argued,[222] the Chinese trust, in which the ownership of trust property is still reserved by the settlor, may fail to meet the definition of trust in the Convention on the Law Applicable to Trusts and on Their Recognition (hereinafter Hague Trust Convention).[223] This Convention

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[215] *See id.*

[216] *See* Trust Law of China, Article 15 ("After the trust is established, if the settlor dies or disbands according to law, or is canceled or declared bankrupt according to law, and if the settlor is the only beneficiary, the trust shall terminate and the trust property shall be deemed as his heritage or liquidation property.").

[217] *See* Zhang, *supra* note 120, at 185.

[218] *See id.*

[219] *See* Trust Law of China, Article 2.

[220] *See* Zhang, *supra* note 202, at 66. ("In contrast to dual ownership under common law, ownership in China is absolute and indivisible, as it is in most civilian jurisdictions.").

[221] *See* Ho, *supra* note 44, at 41; the Israeli Trust Act of 1979 also allowed the settlor to retain the trust property ownership. However, in June 2001, the Israeli draft Civil Code was published to move Israeli trust law closer to Anglo-American trust law, which stipulated the trustee as the owner of trust property. *See* Adam Hofri, *Shapeless Trusts and Settlor Title Retention: An Asian Morality Play,* 58 Loy. L. Rev. 135, 135, 168-69 (2012).

[222] *See* Ho, *supra* note 44, at 42.

[223] Convention on the Law Applicable to Trusts and on Their Recognition (concluded July 1, 1985, effective Jan. 1, 1992) [hereinafter Hague Trust Convention], *available a*t

established conflicts of law rules on trusts and their recognition.[224] For China, the Convention only applies to the Special Administrative Region of Hong Kong, as a result of an extension[225] made by the United Kingdom.[226] However, the Convention could also influence trusts governed by the Trust Law of China.[227] For example, a Chinese trust will be recognized by a contracting state to the Convention if it follows the rules of this Convention. Otherwise, it will not be recognized.

Article 2 of the Hague Trust Convention provides that "the term 'trust' refers to the legal relationships created—inter vivos or on death—by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose."[228] Although this definition does not expressly stipulate the transfer of trust property ownership to the trustee or others, it does require assets to be controlled by the trustee. Someone may argue that Article 2 of the Hague Trust Convention allows the reservation of certain rights and powers by the settlor.[229] However, it is difficult to say that the reservation of certain rights and powers could extend to the reservation of trust property ownership. Even if the Hague Trust Convention allows the reservation of trust property ownership, it is still essential to examine whether Chinese trust law requires that the trust property should be placed under the control of the trustee.

In comparison with the Hague Trust Convention, the Trust Law of China provides that "allow[ing] the trustee to administer or dispose of such property according to the will of the settlor."[230] This fails to meet the requirement of gaining control of trust property.[231] Moreover, under the Chinese legal system, it seems impossible that trust property is under the control of the trustee when the ownership is still reserved by the settlor. The Property Law of the People's

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https://www.hcch.net/en/instruments/conventions/full-text/?cid=59 (last visited on Aug. 8, 2018).

[224] *See* Michele Graziadei, *Recognition of Common Law Trusts in Civil Law Jurisdictions Under the Hague Trusts Convention with Particular Regard to the Italian Experience*, *in* Re-Imagining the Trust, *supra* note 95, at 36.

[225] As a result of extension, the PRC's government recognized that the Convention is still effective in the Region of Hong Kong as before its return to China.

[226] *See* Hague Conference on Private International Law, Declaration/Reservation/Notification, available at http://www.hcch.net/index_en.php?act=status.comment&csid=917&disp=type (last visited on Apr. 30, 2017).

[227] Graziadei, *supra* note 224, at 37 ("These rules apply even when the trust is governed by the law of a non-contracting country.").

[228] Hague Trust Convention, Article 2(1).

[229] *See id*. Article 2 (3) ("The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.").

[230] Trust Law of China, Article 2.

[231] *See* Ho, *supra* note 44, at 42.

Republic of China[232] governs "the civil relationships generated from the ownership and utilization of properties. The term 'proeprty' . . . includes real estate (immovable property) and movable property."[233] "Trust Property" is within the definition of "property" in this Law. Thus, some general provisions of this Law will apply to trust property. Pursuant to the Property Law of China, ownership "refers to the exclusive right of direct control enjoyed by the [owner]."[234] The property owner "has the rights to possess, use, seek profits from and dispose of the real property or movable property according to law."[235] Since the settlor is the sole owner of trust property and there is indivisible and absolute ownership in China's civil law-based system, it is unlikely that the trustee could obtain independent control of the trust property after the creation of a trust. This violates the requirements of the Hague Trust Convention.

IV. Conclusion

The purpose of this Article is to present different approaches of trust property ownership adopted by non-common law jurisdictions when they imported the trust. China, as the only state that allows the settlor to retain the ownership of trust property, has its own considerations.[236] The drafting committee of China's trust law believed that Chinese citizens might not accept the trust institution if the law required them to transfer ownership to the trustee.[237] Moreover, if the law granted the ownership of trust property to the trustees, "the trustee's rights might become over expanded, which would

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[232] Zhonghua Renmin Gongheguo Wuquan Fa [Property Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., Mar. 16, 2007, effective Oct. 1, 2007) (Pkulaw) [hereinafter Property Law of China].

[233] *Id.* Article 2.

[234] *Id.*

[235] *Id*. Article 39.

[236] Actually, China's unique model of trust property ownership is the result of a last-minute change. All the earlier drafts of the Trust Law of China require the transfer of the settlor's property to the trustee. *See* Zhonghua Renmin Gongheguo Xintuo Fa Tiaowen Shiyi [Explanation of the Articles of the "Trust Law of the People's Republic of China] 19-20 (2001). *See also* Zhang, *supra* note 202, at 69 (providing that Professor Jiang Ping, the main drafter of the Trust Law of China, considered the indeterminate ownership of trust property ownership an innovation of Chinese trust law. He believed that "the Trust Law of China only needed to provide that a trustee is authorized to manage and administer trust properties, so as to draw an adequate balance between the need to grant trustee the right to dispose of trust property and to protect beneficiaries' rights.").

[237] *See* Yan Rongtao, *Zhongguo Xintuo Caichan Suoyouquan Guishu Fenxi yu Jiangou* [*Analysis and Reconstruction on the Internal Structure of Trust Ownership in China*], 9 KUNMING LIGONG DAXUE XUEBAO (SHEHUI KEXUE BAO), no. 9, 60, 62 (2009).

affect the settlors' rights to supervise"[238] and make the beneficiaries' rights less protected.[239] Admittedly, under this model, China avoids the tension between dual ownership and indivisible ownership since there is only one owner of the trust property.[240] It also does not infringe the numerus clausus principle[241] since the Chinese model of trust property ownership neither creates a new species of property rights nor new contents in existing property rights.[242] However, this model creates potential obstacles for future development. Since the ownership is still reserved by the settlor, the trustee will have the extra burden of proving powers to deal with third parties.[243] The settlor may interfere with the trustee's administration of trust property when the two parties have different opinions about the trust administration, which results in lowering efficiency and flexibility of the management scheme of the trust.[244] When the individual settlor passes away or the institutional settlor goes bankrupt, it would result in the absurdity that a deceased or bankrupt settlor continues to own trust property.[245] Later projects will further explore the problems of current Chinese model of trust property ownership and propose a roadmap with respect to the incorporation of common law trust into Chinese civil law-based legal system.

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238 Zhang, *supra* note 202, at 69.

239 *See* Ho, *supra* note 181, at 201.

240 *See* Zhang Chun, *Woguo Xintuo Caican Suoyouquan Guishu de Taidu Jiqi Fali Shenshi* [*The Approach of the Trust Law of China and the Law Science Theory Contemplation*], Gansu Zhengfa Xueyuan Xuebao, no. 94, 7, 9 (2007).

241 "The principle of *numerous classus* in civil law prohibits the creation of new species of property rights, as well as new contents in existing property rights." Ho, *supra* note 44, at 45.

242 *See* Zhang, *supra* note 240, at 12 (stating that "the trust property ownership retained by the settlor is still within the civilian conception of ownership."). Thus, the Chinese model does not create new property rights and does not violate the principle of *numerous clausus*.

243 *See* Ho, *supra* note 181, at 200.

244 *See* Lyu, *supra* note 185, at 455.

245 *See* Clarry, *supra* note 24, at 916.

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Regulating the Future of Finance and Money: An Integrated Regulatory Approach to Maximizing the Value of Cryptocurrencies and Blockchain Systems

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ABSTRACT

This article addresses the unique regulatory challenges that relate to crypto-assets and blockchain payment systems and explores the values and benefits that are inherently subsumed within the assets' practical use and application. The emergence of blockchain-backed technologies and its corresponding appli- cations has created an alternative financial infrastructure and caused massive disruptions to the traditional financial ecosystem. Due to the utilization of blockchain or a decentralized ledger to facilitate the decentralized exchange of value between market participants, the asset-class has attracted new actors and raised new problems. The legitimization and mass-adoption of such assets will depend on the ability of world regulators to properly manage the risks and novel issues associated with them. Pertinent regulatory interests -- including protecting consumers and ensuring a safe and efficient market -- must be balanced with the avoidance of causing harm or otherwise the stifling growth within the industry. The current «wild wild west» or «regulatory sandbox» approach is not sustainable. While the current U.S. regulatory approach has enabled many nations to bridge the gap between the early stages of blockchain to today's environment, steps must be taken to assure a safe, efficient and thriving marketplace. Crypto-assets should not be forced to fall within preex- isting categories of regulatory interest. Instead, this technology has sparked the emergence of a new asset-class, deserving of thoughtful and specifically tailored rules, standards, and regulatory consideration. The research and analysis contained within this article will provide market participants, regulators, service providers, scholars and speculators with the ingredients necessary to the achievement of a mature and developed marketplace surrounding these assets.

KEYWORDS: Crypto-Assets, Crypto, Cryptocurrency, Blockchain, Regulation, Securities Regulation, Blockchain Law, Cryptocurrency Regulation, SEC, Sexurities and Exchange Commission, FINRA, Financial industry Regulatory Authority, Blockchain Regulation, United States Blockchain Law.

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I. Introduction

The world of finance and money is transforming before our eyes. Ground-breaking digital assets like Bitcoin, Ethereum, and Ripple are creating "new paradigms for financial transaction[s,] and forging alternative conduits of capital."[1] A new financial ecosystem has emerged, causing "massive disruptions" to the payment services and banking industry.[2] The emerging cryptocurrency ("CC") market is flush with cash and is "composed of a diverse set of actors, [building] interfaces between public blockchains," and challenging the very existence of traditional finance.[3] CCs utilize a distributed ledger technology or a "blockchain" to record transactions securely and permanently.[4] CC miners, exchanges, virtual wallets, and similar services add significant value to the financial market as a whole, as they "provide the means for public blockchains and their native currencies to be used beyond in the broader economy."[5] CCs, or "blockchain payment

[1] Garrick Hileman and Michael Rauchs, *Global Cryptocurrency Benchmarking Study*, CAMBRIDGE CTR. FOR ALTERNATIVE FINANCE, UNIV. OF CAMBRIDGE, JUDGE BUS. SCH. (2017), available at https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf

[2] IMF Urges International Cooperation on Cryptocurrency Regulation, available at: https://www.ccn.com/imf-urges-international-cooperation-cryptocurrency-regulation/

[3] Garrick Hileman and Michael Rauchs, *Global Cryptocurrency Benchmarking Study*, CAMBRIDGE CTR. FOR ALTERNATIVE FINANCE, UNIV. OF CAMBRIDGE, JUDGE BUS. SCH. (2017), available at https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf

[4] Richard B. Levin et al, *Real Regulation of Virtual Currencies*, Handbook of Digital Currency, 328-31 (2015).

[5] *Id.*

systems" generally, are private information patterns that facilitate decentralized, peer-to-peer exchange of goods or value between individuals or entities.[6]

Thus, CCs often allow their users to "bypass traditional central clearinghouses" through the utilization of a "distributed ledger" powered by blockchain.[7] As stated above, the CC industry as a whole is made up by four main components: miners, exchanges, virtual wallets, and payment companies.[8] CC exchanges operate much like traditional ones, providing liquidity and allowing market participants to buy, sell, or exchange their tokens in accordance to the coin's current market value.[9] Wallets can take several forms: "virtual wallets" are supported by an internet or cloud-based platform that store the owner's coins, while "hard wallets" are physical devices that serve the same function.[10] The difference is inherent in the use and function of each type of wallet, as well as the advantages and disadvantages of each respective wallet type. By virtue of being able to physically hold and store your coins on your person or in a safe, hard wallets cannot be accessed by internet hackers on the web. Therefore, hard wallets provide maximum safety and security to their users. On the flip side, hard wallets are often difficult to use to make everyday transactions. While this could change in the future, hard wallets are typically utilized for long-term or "cold" storage. Those actively involved in the market, either trading or otherwise, will likely keep at least some portion of their coins on an exchange wallet or a similarly accessible internet-based wallet. Each of these components present regulators with distinct and delicate challenges. The surprisingly rapid rise of the CC market has left regulators across the globe scrambling to catch up.

The primary concerns tormenting lawmakers are: money laundering, terrorist financing, tax evasion, and fraud.[11] Criminals have gravitated

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[6] IMF Staff Team, *Virtual Currencies and Beyond: Initial Considerations*, Monetary and Capital Markets, Legal, and Strategy and Policy Review Departments, INTERNATIONAL MONETARY FUND (Jan. 2016), available at: https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf

[7] IMF Staff Team, *Virtual Currencies and Beyond: Initial Considerations*, Monetary and Capital Markets, Legal, and Strategy and Policy Review Departments, INTERNATIONAL MONETARY FUND (Jan. 2016), available at: https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf

[8] Garrick Hileman and Michael Rauchs, *Global Cryptocurrency Benchmarking Study*, CAMBRIDGE CTR. FOR ALTERNATIVE FINANCE, UNIV. OF CAMBRIDGE, JUDGE BUS. SCH. (2017), available at: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf

[9] *Id.*

[10] *Id.*

[11] Francine McKenna, *Here's How the U.S. and the World Regulate Bitcoin and Other Cryptocurrencies*, Dec 28, 2017 11:19 a.m. ET, available at:

towards virtual currencies to launder money due to the inherent difficulty in tracking CC cash flow. To appreciate the process of money laundering its essential understand the money laundering lifecycle:

> (1) Placement. The act of introducing illegal funds into a financial system. For example, [making] transactions into bank accounts or acquiring services in a virtual world.
> (2) Layering. Transferring and dispersing illegal funds [into] the financial system. In the ordinary financial system this is possible using a maze of complex transactions involving multiple actors such as banks and corporations. [I]n a virtual world the operation is quite simple making a series of unknown transactions to transfer digital currency.
> (3) Integration. This is one of the most critical stage[s]. [Whereby, the] "cleaned" funds are introduced again in the economic system, typically [by] reinvesting them in legitimate business.[12]

Here's how this works. The launderer would first create various virtual accounts using fraudulent information and fake names. This would first require that the criminal hides his or her cyber identity using a virtual private network ("VPN") or similar dark web navigation tool. A VPN is a system that is built using public internet connections to unite remote users to a private, encrypted network.[13] This type of network provides the hacker or cybercriminal with "a protected, encrypted tunnel in which to transmit the data between the remote user and the company network."[14] The VPN essentially allows the launderer to remain in an undetectable status throughout the entire laundering process. Once the launderer has safely set up the fake cyber accounts, the individual would then use these accounts to engage in a high frequency and complex pattern of transactions. Through these phony accounts, the money launderer can convert his or her proceeds into virtual currencies held in anonymous or fake names.[15] Next, the individual would

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https://www.marketwatch.com/story/heres-how-the-us-and-the-world-are-regulating-bitcoin-and-cryptocurrency-2017-12-18

[12] Pierluigi Paganini, *Bitcoin ... The New Paradise For Money Laundering*, SECURITYAFFAIRS (November 19, 2012), available at: http://securityaffairs.co/wordpress/10404/security/bitcoin-the-new-paradise-for-money-laundering.html

[13] Vangie Beal, *VPN – virtual private network*, WEBOPEDIA (2018), available at: https://www.webopedia.com/TERM/V/VPN.html

[14] *Id.*

[15] Pierluigi Paganini, Bitcoin … The New Paradise For Money Laundering, SECURITYAFFAIRS (November 19, 2012), available at: http://securityaffairs.co/wordpress/10404/security/bitcoin-the-new-paradise-for-money-laundering.html

re-direct these funds into a multitude of "collector" accounts.[16] By keeping the transaction amounts low, and diversifying their efforts, they can avoid government surveillance and suspicion. Then finally, the launderer can safely withdraw these funds in small portions over a period of time. Many have even made withdrawals directly to their bank account using anonymizing software like the TOR network, for example ("TOR" is a dark web platform).[17] There are no hard and fast regulatory solutions to this problem. Cyber criminals pride themselves on staying ten steps ahead of law enforcement and regulators. With that being said, there are certainly ways to reduce their access and limit easy opportunities. Namely, all exchanges with the ability to pair USD with cryptocurrency must strictly require identification and background checks.[18] This will not solve the problem entirely, however, because launderers will likely simply redirect their CCs to foreign exchanges without such requirements. Thus, in order to effectively stifle the crypto-related opportunities for fraud and misuse, there must be parody and cooperation between the world's financial regulators. But the major focus, for now, should be on FIAT currency pairs.[19] While it is highly difficult—and perhaps impossible—to prevent money launderers from illegally acquiring CC from foreign exchanges, by mandating strict identification processes for USD/crypto pairs, regulators can effectively create a "dead-end." However, as more and more businesses begin to accept CC as a method of payment for goods and services, money launderers will have more options. The more options money launderers have in the convertible value space, the greater their advantage. Therefore, law enforcement and financial regulators must make every effort to create dead-ends or traps to thwart prospective launderers.

Terrorist financing simply refers to the cross-border payment of virtual currencies for the purposes of supporting a terrorist organization.[20] This process could involve some of the steps mentioned above as part of a greater laundering scheme, but often the process is quite simple due to the anonymity capabilities of virtual currency holder. Once an individual has acquired Bitcoin or some other CC legally, he or she could move it from exchange to exchange and circulate the coins through various fake or anonymous accounts. After which, the terrorist financer can send the tokens to any wallet address controlled by a terrorist organization or an individual acting in terrorist

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[16] *Id.*

[17] *Id.*

[18] USD/CC pairing means that the user can directly exchange CCs for U.S. dollars in a straight line conversion

[19] "FIAT" currency refers to monies backed by a national government

[20] Resty Woro Yuniar, *Bitcoin, PayPal Used to Finance Terrorism, Indonesian Agency Says*, WALL STREET JOURNAL (Jan. 10, 2017), available at: https://www.wsj.com/articles/bitcoin-paypal-used-to-finance-terrorism-indonesian-agency-says- 1483964198

capacity. The terrorist organization would likely have similar layering and integration schemes in place. Therefore, the odds of tracking these funds to any known terrorist figure are slim to none without having prior intelligence on the individuals involved. Meaning, enforcement and detection likely depends on whether an anti-terrorist government agency has prior knowledge that a certain individual is likely to be involved in terrorist activities. Without such intelligence, success is not probable.

Tax evasion through CCs would again work much like the processes previously described. By layering and integrating funds through various bogus and anonymous holding entities and fraudulent accounts, an individual could make the funds disappear for all intents and purposes—obviously rendering the IRS incapable of ascertaining whether any taxable income has been unreported, let alone determining to whom the gains should be allocated to. However, due to the fact that the victim is the U.S. government and not an unsuspecting senior citizen, the consequences of tax evasion may be the least harmful to society. This is not to suggest that tax evasion is not a serious issue. Often times, tax evasion is the only criminal behavior law enforcement is able to prove occurred. Therefore, government actors seeking to effectively regulate the CC space must focus on the issue of tax evasion with the same fervor as the others previously described.

But despite the problems surrounding the potential for abuse surrounding virtual currencies, the market remains largely optimistic about its future. For example, Dax Hansen, a leading partner at law firm Perkins Coie within their Blockchain Technology & Digital Currency industry group stated, "Digital currencies, token sales and blockchain initiatives of all types have ignited a global phenomenon unlike anything I have ever seen." He continued, "As the technology underpinning these developments disrupts products and services in nearly every industry, law makers, regulators and law enforcement are scrambling to keep up".[21]

Indeed, the arrival of Bitcoin and the supporting CC industry has marked the "emergence of a business ecosystem," according to Dr. Garrick Hileman and Michael Rauchs from the Cambridge Centre for Alternative Finance.[22] In their comprehensive research project, the "Global Cryptocurrency Benchmarking Study" on alternative payment systems and digital assets, they

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[21] Francine McKenna, *Here's How the U.S. and the World Regulate Bitcoin and Other Cryptocurrencies*, Dec 28, 2017 11:19 a.m. ET, available at: https://www.marketwatch.com/story/heres-how-the-us-and-the-world-are-regulating-bitcoin-and- cryptocurrency-2017-12-18

[22] Garrick Hileman and Michael Rauchs, *Global Cryptocurrency Benchmarking Study*, CAMBRIDGE CTR. FOR ALTERNATIVE FINANCE, UNIV. OF CAMBRIDGE, JUDGE BUS. SCH. (2017), available at https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf

explain that "a multitude of projects and companies have emerged to provide products and services that facilitate the use of cryptocurrency for mainstream users and build the infrastructure for applications running on top of public blockchains."[23]

This article is dedicated to exploring the unique regulatory challenges associated with CCs and other blockchain powered fin-tech. In order to do so, we must first identify the best-uses and likely benefits of utilizing the technology. After all, if the risks and regulatory challenges associated with this technology outweighed the inherent benefits, it would probably be illogical to waste our time trying to formulate a fair and effective regulatory approach. For example, in a circumstance where that were in fact the case, the smart choice for regulators may be to simply respond with an out-right ban. While that conclusion is highly unlikely, and is certainly not mine, part of our analysis will be dedicated to evaluating the true value of blockchain powered fin-tech and CCs in our ever-changing financial industry and global market system. But before we dive straight into a discussion on valuation, we will need to gain a foundational understanding of what CCs are exactly.

II. Understanding Blockchain Payment Systems

Bitcoin, what? Ripple, who? Ethereum, how? The concept of digital or "decentralized" currencies has left millions of Americans baffled and confused, and for good reason. Blockchain is a relatively new technology with a variety of potential uses. Bitcoin, the most popular CC, is simply a product/currency/commodity that utilizes it. As you may have been able to glean from the last sentence, the precise legal definition/classification of a "cryptocurrency" or "virtual currency" is up for debate. In fact, the "currency" label itself is a bit of a misnomer—as Bitcoin and other popular blockchain payment systems have not been treated as such to this point. Instead, as we will discuss further in subsequent sections, Bitcoin and other CCs are treated as commodities for most legal purposes.[24]

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[23] Garrick Hileman and Michael Rauchs, *Global Cryptocurrency Benchmarking Study*, CAMBRIDGE CTR. FOR ALTERNATIVE FINANCE, UNIV. OF CAMBRIDGE, JUDGE BUS. SCH. (2017), available at https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf

[24] U.S. COMMODITY FUTURES TRADING COMMISSION, Bitcoin Index, available at http://www.cftc.gov/bitcoin/index.htm; *also see* U.S. COMMODITY FUTURES TRADING COMMISSION, RELEASE Number 7231-15*, CFTC Orders Bitcoin Options Trading Platform Operator and its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps without Registering* (September 17, 2015) (CFTC in the 2015 order against Coinflip, Inc.), available at: https://www.cftc.gov/PressRoom/PressReleases/pr7231-15

Amidst the confusion, the global rate of adoption remains astonishing. As of January 2018, the total market capitalization [hereinafter market-cap] of the entire CC market reached an all-time-high of approximately $796 billion.[25] That is a growth rate of approximately 3000% since 2017.[26] The total market-cap of CC globally is still modest in comparison to other dominant and analogous markets, however. To put that into proper perspective, it's helpful to have a few points of reference. For example, the global gold market has a market-cap is $7.7 trillion, the market-cap of the global stock market is around $73 trillion, and the global real estate market-cap is around $217 trillion.[27] Thus, while the number of individuals holding CCs is growing at breakneck speed, there is still a quite sizeable gap between CCs and other dominant commodities and assets like government issued legal tender ("FIAT"), precious metals, or securities. But try not to blink, things are changing fast. There are now over 1,500 separate and distinct blockchain payment systems or CCs actively trading on the market.[28] But since we will not have the time within this article to adequately evaluate and assess each of them individually, let's begin with the basics.

To conceptualize what CCs are, let's deploy a hypothetical. First, imagine a world where you have "programmable dollars" that cannot be destroyed or replicated. Imagine further, that these "programmable dollars" can be physically stored and irreversibly transferred to virtual "wallets" anywhere in the world. And finally, there is a set and finite amount of dollars (unlike the U.S. Federal Reserve which can simply print more). Now pretend that there were a variety of different "types" of these programmable dollars, each of which with slightly different attributes. For example, some programmable dollars, like Ripple, are lightning quick and enable their user/holder to safely send payments or transfer money globally in seconds or milliseconds. While others, like Bitcoin, may be slower (2-3 hours), but have a much more limited supply and are better sui ted for storing value (similar to gold). This hypothetical "programmable dollar" is a blockchain payment system, or if using the misnomer, a "cryptocurrency." Here is what is so valuable and beneficial about engaging in a peer-to-peer transaction:

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[25] COINMARKETCAP (available at https://coinmarketcap.com/all/views/all/; accessed: Feb 2018); CRYPTOCOINCHARTS has indexed thousands of cryptocurrencies (available at http://www.cryptocoincharts.info/coins/info; accessed: Feb 2018)

[26] Garrick Hileman and Michael Rauchs, *Global Cryptocurrency Benchmarking Study*, CAMBRIDGE CTR. FOR ALTERNATIVE FINANCE, UNIV. OF CAMBRIDGE, JUDGE BUS. SCH. (2017)

[27] *Id*.

[28] Joyce Chang and Jan Loeys, *J.P. Morgan Perspectives, Decrypting Cryptocurrencies: Technology, Applications, and Challenges*, JPM Global Research Unit (February 12, 2018) (this article has also been casually referred to as the JPMorgan "Bitcoin Bible")

(1) Avoiding Fraud

Digital currencies cannot be counterfeited or reversed subjectively by the sender (like credit card charge-backs, for example).[29] There are certainly opportunities for criminality (as discussed), but the sequence of events and transactions are immutably stored in a blockchain. Meaning, the technology is not the problem. The problem lies in the outdated method by which we are attempting to enforce and investigate financial crimes committed by individuals utilizing this technology. Eliminating anonymity and enacting stricter regulations is necessary.

(2) Immediate Settlement

Time is money, and the time value of money cannot be overstated. With Bitcoin, any financial transaction can occur almost instantaneously, with limited costs.[30] In a report called "Virtual Currencies and Beyond: Initial Considerations," Christine Lagarde, Managing Director at IMF writes, "virtual currencies and their underlying technologies can provide faster and cheaper financial services and can become a powerful tool for deepening financial inclusion in the developing world."[31] An example where this technology would be useful is in the context of buying a house. This process inherently takes a significant period of time, usually weeks or months. With virtual currency, the chain of title and corresponding payment can all be contained and permanently recorded within the token's blockchain.

While the speed of virtual currency transactions compared with traditional payment methods is undebatable and undeniable, there are risks associated with increased speed and immediate settlement. Take electric cars for example. One of the major advertised benefits of electric cars is that they are relatively silent in comparison to gas- fueled vehicles. But before long, car manufactures realized that silent cars cause potential safety concerns (if you cannot hear the vehicle, you may not be able to get out of the way, avoid a collision, etc.). Therefore, in response, car manufacturers began to build-in sounds that replicate the sound of a gas-fueled vehicle. The same argument can be made here. Perhaps the process of buying a house should take a few weeks. During the course of this time, both parties have an opportunity to think the decision over and conduct thorough due diligence process. Whereas, if the transaction takes a few seconds or an hour, perhaps there are concerns

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[29] Ameer Rosic, *7 Incredible Benefits of Cryptocurrency, HUFFINGTON POST, THE BLOG* (11/23/2016 9:48 AM ET), available at huffingtonpost.com/ameer-rosic-/7-incredible-benefits- of-_1_b_1360110.html

[30] *Id*.

[31] IMF Staff Team, *Virtual Currencies and Beyond: Initial Considerations*, Monetary and Capital Markets, Legal, and Strategy and Policy Review Departments, INTERNATIONAL MONETARY FUND (Jan. 2016), available at: https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf

that the buyer or seller could fail to raise or identify. Therefore, while technology increases convenience and time efficiency—perhaps some transactions should superficially require a built-in moment of pause.

(3) Lower Fees

There are typically no transaction fees if a transaction is completely peer-to-peer. That is, a truly decentralized transaction would utilize a global network of computers or "miners," that use blockchain technology to jointly manage and permanently record the transaction. However, most digital currency exchanges, like Coinbase, charge small transaction fees (exchanges like Coinbase are acting as an intermediary the same way that Paypal does).[32] But these fees are not substantial in comparison to traditional methods.

III. Exploring the Future of Cryptocurrency and the Disruption of the U.S. Banking Industry

CCs are an undeniable threat to our current U.S. banking business model. For example, on February 22, 2018, Bank of America ("BAML") admitted that CCs were "a threat to [its] business model."[33] The firm's 10-K report, filed with the U.S. Securities and Exchange Commission ("SEC") for the 2017 fiscal year "listed a range of economic, geopolitical, and operational risks that the [bank] faces as it heads into [2018,] [and] [f]or the first time, rising cryptocurrency adoption made the list."[34] In an effort to manage their risks, BAML, among other credit card companies, recently "barred its customers from using [its] credit cards to purchase cryptocurrencies."[35] BAML's 10-K report cites the following risks and concerns under Section 1A (Risk Factors):

[C]lients may choose to conduct business with other market participants who engage in business or offer products in areas we deem speculative or risky, such as cryptocurrencies… The widespread adoption of new technologies, including internet services, cryptocurrencies and payment systems, could require substantial expenditures to modify or adapt our existing products and services … Emerging technologies, such as cryptocurrencies, could limit our ability to track the movement of funds. Our ability to comply with these laws is dependent on our ability to improve

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[32] *Id.*

[33] *Bank of America Admits Cryptocurrencies Are a Threat to Its Business Model*, CCN (February 23, 2018) (citing BAML's annual report filed with the SEC), available at: https://www.ccn.com/bank-of-america-admits-cryptocurrencies-are-a-threat-to-its-business-model/

[34] *Id.*

[35] *Id.*

detection and reporting capabilities and reduce variation in control processes and oversight accountability.[36]

This should come as no surprise, as historically, U.S. banks have been openly skeptical of blockchain payment systems. For example, J.P. Morgan CEO Jamie Dimon stated in 2017 that "it is just a matter of time [before] cryptocurrencies will be wiped out of the financial system."[37] However, following the continued resilience and overwhelming public support for blockchain payment systems, J.P. Morgan has now substantially altered their stance. On February 12, 2018, J.P. Morgan's "Global Research Unit" published a report dedicated to exploring the future and current value of CCs and blockchain within the financial industry.[38] The report, entitled "Decrypting Cryptocurrencies: Technology, Applications and Challenges" [hereinafter JPM report] explains that the "extremely rapid growth" within the CC markets has forced J.P. Morgan and many other financial institutions to start taking the CC space seriously.[39] The JPM report essentially claims that digital currencies will play an integral role in the "diversification of global bond and equity portfolios."[40] The JPM report further states that "if [CCs] survive the next few years and remain part of the global market, then they will likely have exited their current speculative phase and would then have more normal returns, volatilities (both much lower) and correlations (more like that of other zero-return assets such as gold and JPY)."[41] The most famous quote pulled from the JPM report—not surprisingly—is the most positive one, in which the Authors state, "[CCs] are unlikely to disappear completely and could easily survive in varying forms and shapes among players who desire greater decentralization, peer-to-peer networks and anonymity, even as the latter is under threat."[42]

The Authors of the JPM report hedge their mostly-bullish opinions by explaining that while Bitcoin's "underlying blockchain technology will have a wide implication in areas where the current payment system is very slow," it

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[36] U.S. SECURITIES AND EXCHANGE COMMISSION FORM 10-K ANNUAL REPORT 1-6523, Bank of America Corporation (February 22, 2018), available at: https://www.sec.gov/Archives/edgar/data/70858/000070858518000009/bac-1231201710xk.htm#s56FE8F57D1F551E9AF8D375ECF1A891E

[37] Bhushan Akolkar, *JPMorgan's 'Bitcoin Bible': Cryptocurrencies 'Unlikely to Disappear'*, COINSPEAKER.COM (February 13, 2018), available at: https://www.coinspeaker.com/2018/02/13/jpmorgans-bitcoin-bible-cryptocurrencies-unlikely-disappear/

[38] *Id*.

[39] Joyce Chang and Jan Loeys, *J.P. Morgan Perspectives, Decrypting Cryptocurrencies: Technology, Applications, and Challenges*, JPM Global Research Unit (February 12, 2018) (this article has also been casually referred to as the JPMorgan "Bitcoin Bible").

[40] *Id.*

[41] *Id.*

[42] *Id.*

will be very difficult for CCs to replace FIAT currencies entirely. Notice, however, that even within JPM's more conservative estimations, there exists the actual possibility of FIAT being replaced entirely by blockchain payment systems. The fact that JPM used the term "very difficult" and not "absolutely insane" to describe the future of blockchain payment systems is highly significant due to the history surrounding JPM's opinions regarding CCs. In the past (over the last 6-12 months), JPM and the similarly situated powerhouse conglomerate of major U.S. banks have been outspoken critics and naysayers of Bitcoin and the CC market generally.[43] Thus, it is important to consider this within the appropriate context—considering that JPM has backtracked substantially from prior statements made in 2017. The JPM report also addresses the current CC market and cautions that this blockchain revolution may not happen right away. For example, the analysts at JPMorgan "issued a wake-up call to investors based on the technical charts while predicting that Bitcoin price can drop to 50% from the current levels to a low of around $4600 levels."[44]

In sum, JPM and BAML have basically remained "optimistic critics" of CCs—and for good reason. Other than seemingly posing a threat to their business model and having an enormous presence within the financial industry, CCs also pose a serious danger to their ability to abide by their own regulatory obligations. For example, Enhanced Due Diligence (EDD) and Know Your Customer (KYC) laws require banks to establish "appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures, and controls" that are reasonably designed to detect and report instances of money laundering through those accounts.[45] These laws require that banks make substantial efforts to know who their customers are and implement reasonable surveillance systems to detect and prevent fraud and money laundering. Thus, in consideration of the money laundering schemes described above, this poses potential problems. First, this will likely require that these banks revamp their supervisory systems and update their surveillance methods (which would/will be very costly). Second, in the event that a bank fails to properly detect criminal behavior occurring within their customers' accounts, they could be subject to liability and substantial

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[43] Lucinda Shen, *Bitcoin Traders Are Relieved at CFTC and SEC Cryptocurrency Senate Hearing Testimony*, FORBES (February 7, 2018) (JPM CEO states that Bitcoin is a "fraud"), available at: http://fortune.com/2018/02/06/bitcoin-price-cftc-sec-cryptocurrency-hearing/

[44] Aaron Hankin, *JPMorgan's Bitcoin Bible: Crypto 'unlikely to disappear*,' MARKETWATCH (Feb 12, 2018 3:31 p.m. ET), available at: https://www.marketwatch.com/story/jpmorgans-bitcoin-bible-crypto-unlikely-to-disappear-2018-02-12

[45] 31 U.S.C. 5318(i); Daniel Mulligan, *Know Your Customer Regulations and the International Banking System: Towards a General Self-Regulatory Regime*, 22 FORDHAM INT'L L.J. 2324 (1998), available at: https://ir.lawnet.fordham.edu/ilj/vol22/iss5/11

penalties. Third, much of these CC transactions may be occurring completely outside of the banks supervision, thus rendering them incapable of abiding by KYC laws. While these are major problems that must be addressed, the potential solutions to these problems are best considered within the context of a much broader regulatory strategy.

IV. U.S. Regulatory Approach

The CC market is currently being regulated from a variety of different angles. To this point, the U.S. regulatory strategy has largely consisted of a "regulatory sandbox" approach— meaning that regulators have focused on causing as little harm as possible while they attempt to gain a better working knowledge and understanding of the CC space. There is sound logic behind such an approach, the CC market remains in a "wild wild west" phase unless and until robust regulation and sophisticated compliance technology is implemented. While the CC market is garnering the attention and response of all major U.S. government financial regulatory agencies, the results to this point have not been entirely effective. The U.S. has yet to establish a reliable regulatory approach that would allow market participants to freely engage in the CC space without fear and uncertainty. This is partly due to the fact that the CC market is being regulated by several agencies at once, each with a different focus. The SEC approach has concentrated mainly on cracking-down on initial coin offerings ("ICOs"), while the CFTC has identified already-established blockchain payment systems, like Bitcoin, as a commodity subject to its anti- fraud rules.[46] For example, Republican Senator Mike Rounds of the Senate Banking Committee ("SBC"), believes that "there's no question about the fact that there is a need for a regulatory framework," and presented the idea that there may be an opportunity to regulate CCs as both a security and a commodity.[47] The quandary is that regulators have also highlighted their intention to proceed with cautiousness, as to not stifle growth and ingenuity. Thus, the method by which a robust and efficient regulatory system is to be achieved remains to be seen. But one thing is for certain, the process has only just begun.

The White House communicated in February 2018, that the U.S. will not

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[46] U.S. COMMODITY FUTURES TRADING COMMISSION, RELEASE Number 7231-15, CFTC *Orders Bitcoin Options Trading Platform Operator and its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps without Registering* (September 17, 2015) (CFTC in the 2015 order against Coinflip, Inc.), available at: https://www.cftc.gov/PressRoom/PressReleases/pr7231-15

[47] Annaliese Milano, *Crypto Regulation? Not Anytime Soon, Says White House Official*, COINDESK.COM (February 16, 2018), available at: https://www.coindesk.com/crypto-regulation- not-anytime-soon-says-white-house-official/

pursue CC regulation anytime soon.[48] In an interview with CNBC, White House Cybersecurity Coordinator and Special Assistant to the President, Rob Royce, stated, "I think we're still absolutely studying and understanding what the good ideas and bad ideas in that space are. So I don't think it's close."[49] Additionally, following the high-profile congressional committee hearings held in early February 2018, Reuters published a report citing a number of congressional lawmakers that support the implementation of new CC regulation.[50] Specifically, Carolyn Maloney, Democratic member of the House Financial Services Committee ("HFSC") stated, "A lot of people don't realize there's nothing backing these virtual currencies," moreover, Tom MacArthur, a Republican member of the HFSC stated that "[w]e have to look carefully at all of the cryptocurrencies and make sure individuals don't get taken advantage of."[51] To this point, much of the debate among U.S. regulators has surrounded whether CCs should be considered securities or commodities. As Peter Van Valkenburgh, Director of Research at the Coin Center, correctly put it, "Lawmakers need to distinguish between ICOs that operate like securities and other virtual currencies including bitcoin, which he described as a commodity like gold."[52]

As the following research and analysis will further emphasize, the U.S. government will likely need to dedicate an entirely new commission or agency to solely regulate virtual currencies. Regulating an entirely new asset class cannot be done effectively or efficiently by working in silos. While there are similarities between commodities and virtual currencies, Bitcoin may not actually be a commodity. Similarly, while there are similarities between securities and ICOs, they may not actually be securities. For example, the Winklevoss twins, in their proposal for a "Self-Regulatory Organization for the U.S. Virtual Currency Industry," noted the following:

The purchase and sale of commodities in the spot/cash markets has been historically exempt from the CEA and CFTC jurisdiction because cash market transactions, unlike derivative contracts, are: (i) traded for immediate delivery,

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[48] *Id.*

[49] *Id.*

[50] *US Lawmakers Build Appetite for Cryptocurrency Regulation*, Bitcoin Regulation, CCN (February 19, 2018), available at: https://www.ccn.com/us-lawmakers-build-appetite-cryptocurrency-regulation/; David Morgan, *Congress Sets Sights on Federal Cryptocurrency Rules*, REUTERS (February 19, 2018), available at: https://www.reuters.com/article/us-crypto-currencies-congress/congress-sets-sights-on-federal-cryptocurrency-rules-idUSKCN1G31AG

[51] *Id.*

[52] David Morgan, *Congress Sets Sights on Federal Cryptocurrency Rules*, REUTERS (February 19, 2018), available at: https://www.reuters.com/article/us-crypto-currencies-congress/congress-sets-sights-on-federal-cryptocurrency-rules-idUSKCN1G31AG

(ii) settle "on the spot," and (iii) are often underpinned by a commercial purpose (i.e., a farmer selling grain). As a result, these transactions are typically found to not be speculative in nature or readily susceptible to manipulation. Cash markets for virtual commodities, however, are unique inasmuch as: (a) the commercial use-cases for virtual commodities are still developing, (b) there is strong speculative interest, (c) these marketplaces involve a large number of individual participants, and (d) technology makes individual transaction costs exceptionally low (on a relative basis) as compared to other physical commodity spot markets.[53]

Therefore, due to the unique challenges presented by virtual currencies, the CFTC and the SEC have had their hands full. The current regulatory approach lacks a comprehensive understanding of the technology and lacks resources. Revolutionary technologies, like blockchain payment systems, cannot be regulated in the SEC/CFTC's spare time. The only realistic approach would require that the government: (1) create a Cryptocurrency and Blockchain Commission (or similar organization), (2) hire or utilize talented people who understand blockchain technology, and (3) begin the process of building a lasting regulatory framework that addresses the known risks while not hampering the technological benefits.

A. Securities and Exchange Commission

As previously stated, the U.S. Securities and Exchange Commission, like the UK and several other nations, has arguably taken a "regulatory sandbox approach" to CC regulation. The SEC has not adopted any specific rules or regulations, nor has the SEC provided substantive interpretative guidance with respect to the regulation of CCs.[54] As an alternative, the SEC has brought a plethora of enforcement actions that offer only a partial degree of regulatory guidance. The SEC's regulatory involvement has been largely limited to ICOs that appear to be unregistered securities. The definition of "security" under the Securities Act of 1933 (the "Securities Act") and Securities Exchange Act of 1934 (the "Exchange Act") is broad enough to cover CCs in some circumstances, but not all. Section 2(a)(1) of the Securities Act defines a "security" as: any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or

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[53] Tyler and Cameron Winklevoss, *A Proposal for a Self-Regulatory Organization for the U.S. Virtual Currency Industry*, Introducing the Virtual Commodity Association, GEMINI (March 13, 2018), available at: https://gemini.com/blog/a-proposal-for-a-self-regulatory-organization-for-the-u-s-virtual-currency-industry/

[54] Richard B. Levin et al, *Real Regulation of Virtual Currencies*, HANDBOOK OF DIGITAL CURRENCY, 328-31 (2015).

participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, ... or, in general, any interest or instrument commonly known as a "security."[55]

CCs often behave like securities, and often they do not. The definition of a security is broad enough to grant the SEC wide-ranging authority to regulate a variety of products as securities. The definition names several financial products by name, "any note, stock, treasury stock, security future, security-based swap, bond, [and] debenture." [56] However, as precedent surrounding "investment contracts" generally has shown us, the SEC will not hesitate to get involved in circumstances that, after applying the "Howey test," inherently invoke the same regulatory concerns.[57] In several cases, the SEC has argued that initial coin offerings were "investment contracts" under the Howey test.[58] In the U.S. Supreme Court case SEC v. W. J. Howey Co., the Court held that an investment contract is a contract, transaction, or scheme involving "(i) an investment of money, (ii) in a common enterprise, (iii) with the expectation that profits will be derived from the efforts of the promoter or a third party."[59] The Howey test provides for a broad regulatory scope and covers a wide range of offerings, investment schemes, and non-traditional asset classes not specifically foreseen at the time of its decision.[60] The astonishing speed at which blockchain payment systems technology is being adopted and utilized by investors poses a number of regulatory challenges for the industry. This has put increasingly high pressure on regulators to ensure that bad actors cannot find solace, or easy prey, within the CC space. While important, the technical definition of a "security" does not define the SEC's role within the financial regulatory industry. More generally, the SEC's duties are to: "(i) protect investors, (ii) maintain fair, orderly, and efficient markets, and (iii) facilitate capital formation."[61]

The SEC defines CCs broadly as tokens that "purport to be items of inherent value (similar, for instance, to cash or gold) that are designed to

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[55] Securities and Exchange Act of 1933 § 2(a)(1).
[56] *Id*.
[57] SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946)
[58] SEC v. Shavers, No. 4:13-CV-416; *see also* In the Matter of Voorhees, Securities Act Release No. 3-15902 (June 3, 2014), available at: https://www.sec.qov/litiqation/litreleases/2014/lr23090.html.
[59] SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).
[60] *Id*.
[61] Michael S. Piwowar, Acting Chairperson, SEC, Remarks at the "SEC Speaks" Conference 2017: Remembering the Forgotten Investor (Feb. 24, 2017), available at: https://www.sec.gov/news/speech/piwowar-rememberinq-theforqotten-investor.html.

enable purchases, sales and other financial transactions."[62] The SEC explains further that they are "intended to provide many of the same functions as long-established currencies such as the U.S. dollar, euro or Japanese yen but do not have the backing of a government or other body."[63] There are four factors that regulators have identified as being consistent attributes of CCs, including: "(1) the ability to make transfers without an intermediary and without geographic limitation, (2) finality of settlement, (3) lower transaction costs compared to other forms of payment and (4) the ability to publicly verify transactions."[64] Similarly, the Financial Action Task Force defines "virtual currency" as:

> [A] digital representation of value that can be digitally traded and functions as:
>
> a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency," "real money," or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.[65]

The SEC has indicated that, in most cases, CCs do not inherently appear to be securities.[66] However; simply calling a blockchain based product a "cryptocurrency" does not necessarily exempt the product from securities laws.[67] For example, the SEC has clarified that before launching "a cryptocurrency or a product with its value tied to one or more cryptocurrencies, its promoters must either (1) be able to demonstrate that the

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[62] SEC Chairperson Jay Clayton, *Public Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SECURITIES AND EXCHANGE COMMISSION (Dec. 11, 2017), available at: https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11

[63] *Id.*

[64] *Id.*

[65] FATF Report, *Virtual Currencies, Key Definitions and Potential AML/CFT Risks*, FINANCIAL ACTION TASK FORCE (June 2014), http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-keydefinitions-and-potential-aml-cft-

[66] SEC Chairperson Jay Clayton, *Public Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SECURITIES AND EXCHANGE COMMISSION (Dec. 11, 2017), available at: https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11

[67] *Id.*

currency or product is not a security or (2) comply with applicable registration and other requirements under our securities laws."[68] Furthermore, market participants that allow for payments in CCs or use CCs to enable securities transactions must exercise extreme caution and ensure that their activities are not "undermining their anti-money laundering and know-your-customer obligations."[69]

Therefore, while the SEC has delegated much of the responsibility for regulating CCs to the CFTC, they have yet to approve any "exchange-traded products (such as ETFs)" that hold CCs or other digital assets for listing or trading.[70] The SEC issued an investor bulletin about initial coin offerings in July 2017, stating that the Commission believes that CCs have the potential to be "fair and lawful investment opportunities" if regulated properly.[71] However, the SEC has aggressively prosecuted entities and individuals that have employed fraudulent or deceptive means to gain investors. For example, the SEC has issued several enforcement actions against "ICO sponsors," and the SEC Chairperson, Jay Clayton, has clearly "expressed concern about market participants who extend to customers credit in U.S."[72] The SEC has a clear dislike for ICOs, and this position was made clear by Clayton in February 2018 when he stated, "From what I have seen, initial coin offerings are securities offerings. They are interesting companies, much like stocks and bonds, under a new label."[73] He continued, "You can call it a coin, but if it functions as a security, it is a security."[74] Clayton's major concerns stem from the lack of regulatory oversight in the cryptomarkets and he believes that "many ICOs are being conducted illegally by not following securities laws."[75] He concluded by cautioning the ICO marketplace that "those who engage in semantic gymnastics or elaborate structuring exercises in an effort to avoid having a coin be a security are squarely within the crosshairs of our enforcement division."[76] However, Clayton was not negative on the cryptomarkets as a whole, as he also stated that he "think[s] this distributed ledger technology has enormous potential… [and he] hope[s] people pursue it

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[68] *Id.*

[69] *Id.*

[70] Francine McKenna, *Here's How the U.S. and the World Regulate Bitcoin and Other Cryptocurrencies*, Dec 28, 2017 11:19 a.m. ET, available at: https://www.marketwatch.com/story/heres-how-the-us-and-the-world-are-regulating-bitcoin-and- cryptocurrency-2017-12-18

[71] *Id.*

[72] *Id.*

[73] Andrew Nelson, *SEC and CFTC Give Testimonies at Senate Hearing on Virtual Currencies*, BITCOIN MAGAZINE, YAHOO FINANCE (February 6, 2018), available at: https://finance.yahoo.com/news/sec-cftc-testimonies-senate-hearing-015033442.html

[74] *Id.*

[75] *Id.*

[76] *Id.*

vigorously."[77]

Rightly so, the SEC is much more concerned with ICOs than traditional CCs like Bitcoin or Ethereum. An Initial Coin Offering ("ICOs") is an effective tool being used in conjunction with CCs to raise capital. Generally, these offerings involve an investment opportunity to exchange FIAT or CCs for a digital coin or token that will be developed—the expectation typically being that investor funds will be used to develop such digital coin. As made clear by the excerpts above, the major question for ICO investors, developers, and SEC regulators is whether the ICO a security. As I am sure you are expecting, the answer is: "it depends." The SEC published a public statement on their website entitled "Statement on Cryptocurrencies and Initial Coin Offerings" on December 11, 2017.[78] Within this statement, Chairperson J. Clayton provided the following guidance on how to determine whether a particular token should be considered a security for securities law purposes:

> token that represents a participation interest in a book-of-the-month club may not implicate our securities laws, and may well be an efficient way for the club's operators to fund the future acquisition of books and facilitate the distribution of those books to token holders. In contrast, many token offerings appear to have gone beyond this construct and are more analogous to interests in a yet-to-be-built publishing house with the authors, books and distribution networks all to come. It is especially troubling when the promoters of these offerings emphasize the secondary market trading potential of these tokens. Prospective purchasers are being sold on the potential for tokens to increase in value – with the ability to lock in those increases by reselling the tokens on a secondary market – or to otherwise profit from the tokens based on the efforts of others. These are key hallmarks of a security and a securities offering.[79]

Essentially, the main point that the SEC is making is that the fact that the technological structure behind a securities offering may be changing does not change the need to abide by applicable securities laws. Technology is constantly changing the way we do things, and the SEC understands the need to encourage and support technological growth and innovative projects surrounding the capital raising space. However, if that innovative activity involves an offering of a security it must be accompanied by the necessary "disclosures, processes and other investor protections that our securities laws require."[80] This represents the old regulatory adage that prioritizes substance

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[77] *Id.*

[78] SEC Chairperson Jay Clayton, *Public Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SECURITIES AND EXCHANGE COMMISSION (Dec. 11, 2017), available at: https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11

[79] *Id*.

[80] *Id.*

over form. From the perspective of the SEC, whether a company or individual is using a central ledger or recording securities interests through a distributed ledger using blockchain, the substance of the transaction remains the same. Thus, the SEC and other relevant government actors remain focused on identifying the underlying purposes behind each ICO or blockchain-backed transaction.

The SEC's interest surrounding ICOs and CCs relates most frequently to how the ICO attracts investors, the kind of investors that they attract, and the technical manner in which they facilitate fundraising.[81] The fear is that many ICOs may be enticing young, unsophisticated, and impressionable amateur investors into investing in something that may or may not have any real value. However, there is still some confusion as to the actual scope of the SEC's regulatory participation. When an investor buys Bitcoin on an exchange or through similar means, this would not typically implicate the SEC's involvement or any securities analysis. Instead, the SEC is concerned about the fundraising methods being performed by blockchain developers prior to the actual creation of that CC. For example, let's assume some Seton Hall University students launched a fundraising campaign for a CC called SetonCoin. If the students had not yet developed the SetonCoin blockchain but were instead soliciting investment in future tokens, this would likely be deemed a security by the SEC—it would be a transaction involving "(i) an investment of money, (ii) in a common enterprise, (iii) with the expectation that profits will be derived from the efforts of the promoter or a third party."[82] This type of transaction typically involves an investment pre-development in exchange for a discounted distribution of tokens or coins in the future. Additionally, there is an expectation that the value of such tokens will increase in the future, hence the application of securities laws. Thus, in the situation above, the students behind SetonCoin would need to register the securities offering with the SEC. However, there are several options available to these students.

1. Registered Public Offering (Initial Public Offering)

The students could register their coin as a public offering by filing a Form S-1 and drafting a prospectus. This is what a company typically does before going public and launching their Initial Public Offering (IPO).[83] The downside to this option are the costs. After calculating the costs associated with writing the prospectus and preparing the registration materials, the students would likely have a panic attack and abandon their project.

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[81] *Id*.
[82] SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).
[83] FORM S-1 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, available at: https://www.sec.gov/files/forms-1.pdf

2. Non-Public Offering (Reg D Private Placement)

The students may choose to file an exemption from registration with the SEC. This would require that the students make all the necessary disclosures and comply with all relevant Reg D rules. Most importantly, the students could only sell equity to accredited angel investors and venture capital funds. This would significantly reduce the scope of investors available to the students. However, this may be the best option if the students have a few angel investors in mind, or a rich uncle who has offered to help finance the project.[84]

3. Regulation CF (Crowdfunding Exemption)

Spoiler alert. This is probably the best option. Under Reg CF, the students can raise up to $1 million from both accredited and non-accredited investors.[85] Very recently, the JOBS Act added a new exemption to the Securities Act, Section 4(a)(6).[86] Reg CF would allow the students to raise funds without registration, but this exemption has a few conditions. Aside from the $1 million dollar cap and making various disclosures, "[i]f either the annual income or the net worth of the investor is less than $100,000, the investor is limited to the greater of $2,000 or 5% of the lesser of his or her annual income or net worth."[87] Furthermore, "[i]f the annual income and net worth of the investor are both greater than $100,000, the investor is limited to 10% of the lesser of his or her annual income or net worth, to a maximum of $100,000."[88] These conditions are in place to protect unaccredited investors from massive losses. All things considered, the Reg CF option should provide our students with enough capital to launch their SetonCoin with the least legal fees and registration costs. Additionally, this option allows the students to take advantage of the broad reach of internet platforms like StartEngine or Republic.[89] These platforms have access to an enormous range and variety of investors. Typically the minimum investment can be anywhere from $5 to $20, thus allowing for mass participation. With the advent of CC, the market has since realized the power of the small investor. While a single $10 investment may not get you far, if 2 million people invest $10 you have now raised $20 million. Therefore, the Reg CF option may provide the students with the most

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[84] *Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933*, 230.501 - 230.506, 47 FR 11262, (Mar. 16, 1982), available at: https://www.ecfr.gov/cgi-bin/text-idx?SID=e282de4f5c69b6a69c70dd05d5b92d39&mc=true&node=sg17.3.230_1498.sg11&rgn=div7

[85] *Regulation Crowdfunding Rules*, Blog, Crowdfunding, SEEDINVEST, available at: https://www.seedinvest.com/blog/crowdfunding/regulation-crowdfunding-rules

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] https://www.startengine.com/; *also see* https://republic.co/

flexibility and access to capital. However, the students may also want to take a look at some recent SEC precedent to learn what not to do. As stated above, the SEC has brought a plethora of enforcement actions that offer only a partial degree of regulatory guidance. However, in lieu of having such guidance, we must attempt to glean as much as possible from the growing number of enforcement actions being brought against CC market participants. Below, I have provided an analytical summary of a collection of recent and highly relevant SEC actions against ICOs.

(i) AriseBank

AriseBank purported itself to be the world's first "decentralized bank," supposedly offering an assortment of commercial banking products and services, and supporting "more than 700 different virtual currencies."[90] The sham entity claimed to be "one of the largest cryptocurrency platforms ever built," and was purportedly "focused on bringing cryptocurrency to the average consumer and using it to revolutionize banking."[91] AriseBank raised capital through an ICO of its own CC called "AriseCoin," through which AriseBank claimed to have raised more than $600 million.[92] AriseBank made several material misrepresentations in connection with their ICO, including announcing that it had "purchased a 100-year-old commercial bank" and claiming that AriseBank could now "offer FDIC-insured accounts and transactions," all of which being entirely fabricated.[93] The SEC charged AriseBank with securities laws violations due to the company's failure to disclose their financial information through securities registration with the SEC.[94] This was the SEC's dream case. Not only was this an unauthorized sale of securities, but company officials lied repeatedly in connection with their ICO. This is an example of an obvious attempt to take advantage of eager CC enthusiasts and inexperienced investors through fraudulent means. However, the lessons learned from this case are limited in terms of their application. It is generally known that making fraudulent statements in connection with an unregistered offering of securities is not allowed.

(ii) Plexcoin

On December 1, 2017, the SEC filed an emergency action to stop Lacroix and his partner Paradis-Royer from the further misuse of funds raised illegally through an unregistered ICO of securities called "PlexCoin" or

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[90] SEC v. Arise Bank, Civil Action No. [Filed under seal] (January 25, 2018), available at: https://www.sec.gov/litigation/complaints/2018/comp-pr2018-8.pdf

[91] *Id.*

[92] *Id.*

[93] *Id.*

[94] *Id.*

"PlexCoin Tokens."[95] Over a 6 month period, the defendants raised $15 million from thousands of investors through materially false and misleading statements.[96] Lacroix promised investors an ROI (return on investment) of 1,354% in less than a month. The defendants proceeded to "misappropriate investor funds and engage in other deceptive acts relating to investments in the PlexCoin." [97] For example, Lacroix claimed: "(a) that the PlexCorps' "team" consisted of a growing cadre of experts stationed around the world and with a principal place of business in Singapore; (b) that the identity of PlexCorps' executives had to be kept hidden to avoid poaching by competitors and for privacy concerns; (c) that the proceeds of the PlexCoin ICO would be used to develop other PlexCorps products; and (d) that investors could expect "enormous" and "real" returns on PlexCoin Token investments."[98] All of the above statements were later proven to be false. Furthermore, the defendants have misappropriated more than $200,000 of investor funds on "extravagant personal expenditures," while the rest was used to purchase Bitcoin.[99] Similar to the AriseBank case, these defendants committed fraud in connection with an unregistered sale of securities.

(iii) REcoin

On September 29, 2017, the SEC filed an emergency action against Zaslavskiy and his company, REcoin, for "engaging in illegal unregistered securities offerings and ongoing fraudulent conduct and misstatements designed to deceive investors in connection with the sale of securities in so-called [ICO]."[100] Zaslavskiy fraudulently raised at least $300,000 from hundreds of investors, through various material misrepresentations. In connection with the ICO, the defendant claimed: "(i) that investors were in fact purchasing digital "tokens" or "coins"; (ii) that Defendants had raised more than $2 million, and, later, nearly $4 million, from the REcoin ICO; (iii) that REcoin had a "team of lawyers, professionals, brokers, and accountants" that would invest REcoin's ICO proceeds into real estate and that Diamond had "experts" to select the best diamonds; (iv) that REcoin had to shut down because the U.S. Government had forced it to do so; and (v) that investors in the REcoin ICO could expect to make returns from REcoin's investments in real estate and that investors in the Diamond ICO could expect to make

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[95] SEC v. PlexCorps, Civil Action No. 17-7007 (December 1, 2017), available at: https://www.sec.gov/litigation/complaints/2017/comp-pr2017-219.pdf

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] SEC v. REcoin, Civil No. 17 Civ. ECF Case (September 29, 2017), available at: https://www.sec.gov/litigation/complaints/2017/comp-pr2017-185.pdf

10-15% returns from Diamond's operations."[101] All of these assertions were false. Furthermore, in an attempt to further "skirt the registration requirements of the federal securities laws," Zaslavskiy modified the sale of the supposed "Diamond interests as sales of memberships in a club and the Diamond ICO as an 'Initial Membership Offering' or IMO."[102] These attempts were unsuccessful. The SEC rightly recognized that the funds were still being raised fraudulently and in connection with "tokens" that did not actually exist, and thus, required SEC registration.[103]

The three cases above represent exactly what not to do as an ICO developer. Failing to register a sale or offering of securities is an easy way to put yourself on the SEC's chopping block. The guidance is simple: if you are selling discounted future interests in a product/token that you have yet to create, it is probably a security under the Howey test.[104] Whether ICO's should be treated as securities is a different question—which we will address later. The second problem that is frequent throughout recent SEC enforcement actions is lying and deceit in connection with their unregistered securities offering. Material misrepresentations are never a good idea and will almost always land your business in hot water. Guaranteeing profits and abnormally high returns is foolish at best, and a flagrant crime at its worst. The SEC wants accurate disclosures and a clear description of the ICO's business activity (aka "use-case"). ICO developers should have a well throughout use and purpose for their CC or smart token. The ICOs that have passed regulatory scrutiny with flying colors will typically have rock solid disclosures and use-cases that are easy to understand. MedChain for example, is a Reg CF registered ICO that seeks to revolutionize the storage and management of medical records.[105] The ICO is listed on StartEngine and has raised over $430,000.[106] Indeco is another positive example, a company that seeks to facilitate the growth of the solar energy sector within the commercial real estate space.[107] They have raised nearly $200,000.[108] The point is that there are ways to capitalize on the massive growth occurring in the blockchain space through an ICO without unduly burdensome registration and costly listing fees, but it must be done properly. Even ICOs that require funding in excess of the $1 million cap can supplement their Reg CF by using

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[101] *Id*.
[102] *Id.*
[103] *Id.*
[104] SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946)
[105] JD Alois, *ICO: MedChain Plans MedCoin in Blockchain Push to Fix Medical Record Management*, CROWDFUND INSIDER (Jan. 2, 2018), available at: https://www.crowdfundinsider.com/2018/01/126546-ico-medchain-plans-medcoin-blockcha in- push-fix-medical-record-management/
[106] MedChain, STARTENGINE (2018), available at: https://www.startengine.com/medchain
[107] Indeco, StartEngine (2018), available at: https://www.startengine.com/indeco
[108] *Id*.

some Reg D funding to fill the gaps. Thus, Reg CF remains among the most flexible and cost effective methods to raise funds for most small cap ICOs.

Fundraising methodology is not the major problem. The problem lies with the limited scope in which the SEC has evaluated potential ICOs. The "is it a security" analysis is both outdated and insufficient. There should be a specific analysis and regulatory process for ICOs due to the complex nature of blockchain technology. Even ICOs with valid registration and allegedly legitimate use-cases could be ripe with technical flaws. Due to the SEC's lack of industry-specific knowledge, the current regulatory practice is to simply accept exceedingly broad functional descriptions provided by ICO developers as true unless proven otherwise. Regulators must be mindful of "fraud at inception" issues that will undoubtedly arise. For example, the SEC currently has no way of verifying that the blockchain technology being developed by ICO managers will be technically sound and function the way it is being purported to function. Highly sophisticated computer scientists and software engineers are more than capable of designing a "rigged" blockchain that is programmed to wreak havoc without warning. The same issue has arisen with regard to algorithmic trading systems.[109] The "flash crash" of 2010 caused a total market loss of $1 trillion due to rogue algorithm that was poorly designed.[110] Essentially, recent MIT graduates and ex-software engineers for Google and Facebook, with no prior financial industry knowledge or experience, were being recruited by investment banks and hedge funds to program algorithmic trading machines.[111] As you can imagine, it did not always go well. At the direction of their superiors, many of these software engineers unknowingly programmed algorithms which committed securities violations.[112] In response, the SEC ratified NASD rule 1032(f), proposed by FINRA, which requires those primarily responsible for the development of algorithmic trading systems to be registered securities traders.[113] The lesson being: industry-specific knowledge is not only useful, but necessary to the proper regulation of complex machines and revolutionary technology. Therefore, the majority of accountability and responsibility should be placed on industry-experts.

Without an in depth knowledge of blockchain fundamentals and the

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[109] K. Braeden Anderson, *Regulating Robo-Finance: An Exposé On Recently Ratified SEC Rule Requiring Algorithmic Trading Developers to Register as Securities Traders*, [Unpublished] SETON HALL LEGISLATIVE JOURNAL NOTE (2017) (citing Tom C.W. Lin, The New Financial Industry, 65 ALA. L. REV. 567, 580-81 (2014))

[110] Tom C.W. Lin, *The New Financial Industry*, 65 ALA. L. REV. 567, 580-81 (2014)

[111] *Id*.

[112] Charles R. Korsmo, High-Frequency Trading: A Regulatory Strategy, 48 U. RICH. L. REV. 523, 532 (2014)

[113] Security Exchange Act, Release No. 34-77551 (April 7, 2016) SR-FINRA-2016-007 ("Regulatory Notice") (defining the NASD Rule 1032 rule change)

mechanics (coding language and programming) behind it, regulators are again forced to take a "wait and see" approach. If investors get ripped off, then the SEC will likely spring into action. But as we have learned from our earlier discussion regarding money laundering, fraud, and opportunities for misuse, there is very little than can be done after the fact. The SEC, understandably, has devoured the easy prey first—focusing on ICO managers who have told blatant falsehoods in connection with unregistered sales of securities. While this is indeed the expected consequence of a "regulatory sandbox" approach, it is crucial that we begin to lay a foundation for a scalable and intelligent regulatory system. Fearing technology and stifling growth is not the answer, but the potential for harm is too great to "wait and see."

B. Commodity Futures Trading Commission

As we briefly described earlier, the CFTC has officially characterized Bitcoin as a commodity,[114] and announced that "fraud and manipulation involving [B]itcoin traded in interstate commerce and the regulation of commodity futures tied directly to [B]itcoin is under its authority."[115] Generally speaking, the CFTC has taken a cautious and thoughtful approach to the regulation of CCs. In fall 2017, the CFTC allowed the CME and CBOE to launch bitcoin futures, and "approved a platform for the trading and clearing of virtual currency derivatives for LedgerX, LLC, a swap execution facility and derivatives clearing organization."[116] Allowing the bears and bulls to fight it out in the futures market resulted in increased selling pressure. Short positions, in conjunction with other factors, drove down the price of Bitcoin by over 50%.[117]

The increased societal involvement of U.S. citizens in the CC market has captured the attention of a diverse collection of U.S. government actors. Most notably, on February 6th 2018, the Senate Committee on Banking, Housing and Urban Affairs (the "Committee") heard joint testimony from the heads of both the SEC and the CFTC on the "potential dangers of digital currencies as

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[114] U.S. COMMODITY FUTURES TRADING COMMISSION, RELEASE Number 7231-15, CFTC *Orders Bitcoin Options Trading Platform Operator and its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps without Registering* (September 17, 2015) (CFTC in the 2015 order against Coinflip, Inc.), available at: https://www.cftc.gov/PressRoom/PressReleases/pr7231-15

[115] *Francine McKenna, Here's How the U.S. and the World Regulate Bitcoin and Other Cryptocurrencies,* (Dec 28, 2017 11:19 a.m. ET), available at: https://www.marketwatch.com/story/heres-how-the-us-and-the-world-are-regulating-bitcoin-and-cryptocurrency-2017-12-18

[116] *Id.*

[117] Bitcoin, Historical Data, COINMARKETCAP, available at: https://coinmarketcap.com/ (data indicating that the price has seen a decline of over 50% since the CME and CBOE provided Bitcoin support on futures trading)

investments."[118] This testimony was given "amid a crackdown on Bitcoin exchanges in China and South Korea," and many CC traders feared the worst.[119] However, these fears were quickly put to rest as U.S. regulators vowed to take a "no harm approach" to CC regulation.[120] For example, Giancarlo of the CFTC stated, "We owe it to this new generation to respect their enthusiasm for virtual currencies, with a thoughtful and balanced response, and not a dismissive one."[121] Giancarlo explained that businesses across the world are already utilizing this technology— and as an example, he cited a recent blockchain transaction that involved a U.S. company sending 76,000,000 tons of soybeans to China.[122] The CFTC Chairperson even went on to describe the term "HODL," which has become a popular word within CC trading culture and is a popular aphorism and hashtag on social media.[123] No, it is not just the word "hold" spelled wrong, although that would have been my first guess. Giancarlo casually explained that his niece is actually a Bitcoin "HODLER," and described that the term "HODL" means to "hold on for dear life."[124] CC traders were especially elated by the results of the SBC Hearing, and the markets reacted accordingly. For example, the price of Bitcoin rose from $6,000 to $7,650 in the hours following the Hearing.[125] As you can imagine, this caused millions of Americans to react in amusement. One cannot help but wonder whether we would have heard a different message from the CFTC if Giancarlo's niece was not a CC investor. The perception is that the "crypto revolution" has captured the hearts and minds of the younger generations, but older generations are largely still hesitant about this technology. Whether this trend will continue or soften in the future remains to be seen.

As mentioned previously, there have been some harsh criticizers and non-believers of CCs, one of the loudest skeptics being J.P. Morgan CEO Jamie Dimon, who sees the value in blockchain technology but stated that he believes Bitcoin a "fraud."[126] But in response to this line of criticism, Giancarlo strongly reminded Congress of a very important fact: "if there were no Bitcoin, there would be no distributed ledger technology" or "blockchain."[127] However, he continued, "We intend to be very aggressive, if

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[118] Lucinda Shen, *Bitcoin Traders Are Relieved at CFTC and SEC Cryptocurrency Senate Hearing Testimony*, FORBES (February 7, 2018), available at: http://fortune.com/2018/02/06/bitcoin-price-cftc-sec-cryptocurrency-hearing/

[119] *Id.*

[120] Id.

[121] *Id.*

[122] *Id.*

[123] *Id.*

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] *Id.*

nothing else, so that people like my niece can have some security that there aren't fraudsters and manipulators out there—and there are a lot, too many, far too many of them."[128] Therefore, while the CFTC has clearly taken a "no harm" approach to CC regulation, CC enthusiasts and HODLERs are not out of the woods yet—as there is still an obvious need to educate the investing public and pay close attention to all market participants.

For example, in January 2018, the CFTC published the following statement on their webpage:

CUSTOMER ADVISORY: RISKS OF VIRTUAL CURRENCY TRADING

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, or a store of value, but it does not have legal tender status. Virtual currencies are sometimes exchanged for U.S. dollars or other currencies around the world, but they are not currently backed nor supported by any government or central bank. Their value is completely derived by market forces of supply and demand, and they are more volatile than traditional fiat currencies. Profits and losses related to this volatility are amplified in margined futures contracts. This customer advisory is designed to inform the public of possible risks associated with investing or speculating in virtual currencies or recently launched Bitcoin futures and options.[129]

This advisory statement represents the common argument that CC has no inherent value; the idea being that FIAT currencies have value due to being backed by a national government. However, there is no inherent value in ink on special paper either. The blockchain technology provides the value associated with CC. The question is how much value the particular blockchain behind each CC is worth. This question requires that we evaluate each blockchain token individually and assess the value that its technology represents. In order to emphasize this, the CFTC issued a warning advising investors to conduct their own research before investing in CCs, "particularly ones that have small market caps and illiquid markets pump-and-dump schemes."[130] In part, the Customer Protection Advisory states the following:

Customers should not purchase virtual currencies, digital coins, or tokens based on social media tips or sudden price spikes. Thoroughly research virtual currencies, digital coins, tokens, and the companies or entities behind them in

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[128] *Id.*

[129] U.S. COMMODITY FUTURES TRADING COMMISSION, Bitcoin Index, available at http://www.cftc.gov/bitcoin/index.htm

[130] Josiah Wilmoth, *CFTC Issues Investor Warning on Cryptocurrency Pump-and-Dump Scams*, CCN (February 15, 2018), available at: https://www.ccn.com/cftc-issues-investor-warning-cryptocurrency-pump-dump-scams/

order to separate hype from facts … As with many online frauds, this type of scam is not new – it simply deploys an emerging technology to capitalize on public interest in digital assets … Pump-and-dump schemes long pre-date the invention of virtual currencies, and typically conjure the image of penny stock boiler rooms, but customers should know that these frauds have evolved and are prevalent online.[131]

The CC market is unusually susceptible to manipulation through the use of various schemes, including the classic "pump-and-dump."[132] This is achieved by creating a constant "buzz" about an asset through voluminous advertising and promotional materials, and then selling against this buy pressure in large quantities at opportune moments.[133] There are various Instagram and Facebook groups that conspicuously even label their page as a "pump group" or "pump and dump group." The prevalence and vulnerability of the highly speculative and volatile CC market has indeed caused some companies, including Facebook, to completely ban such advertising across all of its platforms.[134] As such, the CFTC also offered a cash reward in exchange for "original information that leads to a successful enforcement action that leads to monetary sanctions of $1 million or more."[135] The reward could potentially be over $100,000, as the CFTC stated that an individual who reports such information may be eligible for a "monetary award of between 10 percent and 30 percent."[136] This market has attracted many unsophisticated and impressionable investors, which has understandably grabbed the attention of regulators. The problem is that there are not clearly defines lines surrounding what type of promotion or "pumping" is prohibited. If the page creator is a genuine fan of the Coin or Token (for whatever reason), he or she may post favorable news about the coin and publish updates regarding positive developments in the CC space. There are undoubtedly thousands of such pages. But are these pages really engaging in a pump and dump scheme? It is a difficult question with no clear answers. If a coin promoter is also an

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[131] Customer Advisory: *Beware Virtual Currency Pump-and-Dump Schemes*, CFTC (February 15, 2018), available at: http://www.cftc.gov/idc/groups/public/@customerprotection/documents/file/customeradvisory_p umpdump0218.pdf

[132] *Id*.

[133] *Id*.

[134] Josiah Wilmoth*, CFTC Issues Investor Warning on Cryptocurrency Pump-and-Dump Scams*, CCN (February 15, 2018), available at: https://www.ccn.com/cftc-issues-investor-warning-cryptocurrency-pump-dump-scams/

[135] Edward Kelso, *CFTC Offers $100,000 Bounty to Crypto Pump-and-Dump Whistleblowers*, BITCOIN.COM (February 19, 2018), available at: https://news.bitcoin.com/cftc-offers-100000-bounty-to-crypto-pump-and-dump-whistleblowers/

[136] *Id.*

investor in the coin is it automatically a pump and dump scheme simply because he or she has chosen to take an active role in marketing the coin. Yes, the activity may be self-serving, but is this behavior misleading? Is this behavior really fraud? And if it is, does it matter if that the page's creator is a 12 year old who lives with his grandparents in Wyoming and only made $100? The CC industry is not like other areas of the financial industry. Therefore, the Customer Protection Advisory note above is somewhat misleading. The CC market has attracted much different players than the penny stocks in the 80s or even the stock market generally, thus, it cannot be evaluated in the same manner. Individuals who have invested their money in a coin are most likely going to promote their coin. Period. Attempting to single out certain individuals and YouTubers who have made more money than others is arbitrary and subjective. The only individuals who should be harshly prosecuted are those who misled the public by endorsing or promoting a coin in a misleading or fraudulent manner. Simply exercising your first amendment rights by voicing your support for a coin and then selling it when you've made profits should not amount to fraud. Instead, however, if a sophisticated individual preys on the uneducated and makes material misrepresentations in connection with their promotion, that— and that only—should rise to the requisite level of culpability. Therefore, my proposition is that there can certainly be both fraudulent and legally valid pumping and promotion of a coin. These criticisms aside, government regulators have correctly focused on encouraging market participants to do their own research and evaluation of a coin.[137] Consumer education is likely the most effective method by which to stop pump and dump schemes from succeeding.

C. Internal Revenue Service

The IRS says bitcoin must be treated as property for tax purposes.[138] That means a capital gain or loss should be recorded as if it were an exchange involving property.[139] It should be treated like inventory if it is held for resale, and therefore an ordinary gain or loss recorded. If it is used as payment, it should be treated like currency, but must be converted, and its fair market value checked on an exchange.[140] Therefore, if you use Bitcoin to buy groceries you would only be taxed on any increase in value that has

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[137] *Id.*

[138] Francine McKenna, *Here's How the U.S. and the World Regulate Bitcoin and Other Cryptocurrencies*, Dec 28, 2017 11:19 a.m. ET (information compiled by global law firm, Perkins Coi), available at: https://www.marketwatch.com/story/heres-how-the-us-and-the-world-are-regulating-bitcoin-and-cryptocurrency-2017-12-18

[139] *Id.*

[140] *Id.*

accumulated prior to its use for payment. This process can be complex, especially for those who are not accustomed to calculating capital gains tax and tracking their adjusted basis. Some exchanges, like Coinbase, provide a summary of your taxable gains/losses for that taxable year.[141] However, there are certainly loopholes. For example, if you use USD to purchase Bitcoin on Coinbase and then transfer it to a foreign exchange, any trading you perform outside the scope of Coinbase surveillance will not be included in your Coinbase taxable gains report. Therefore, by transferring digital assets out of Coinbase prior to realizing gains, you could theoretically avoid IRS detection of any failure to report any gains/losses you might have incurred. The solution to this problem is the same: limit opportunities for anonymity.

V. Enacting the Financial Regulatory Body of the Future

The U.S. government will likely need to dedicate an entirely new commission or agency to solely regulate virtual currencies. Regulating an entirely new asset class cannot be done effectively or efficiently by working in six different silos. Similarly, digital assets should not be forced to fall within preexisting categories of regulatory interest. Bitcoin is not a stock. Bitcoin is not a commodity. Bitcoin is a CC. A brand new asset class that deserves its own separate regulatory consideration. The blockchain industry deserves not only the attention of regulators, but their respect. Innovators behind this emerging technology and blockchain payment systems deserve to be regulated by a jury of their peers. By this I mean, the blockchain industry should be regulated by those with education and experience that is relevant to blockchain and CC. Teaching old dogs new tricks, if not impossible, is really hard to do. If CC regulation is to be taken seriously by its market participants, the government will need to gain the assistance of those who market participants take seriously. There is already extreme cultural resentment that exists between CC enthusiasts and government. In fact, many market participants see CC as their only hope of being freed from government shackles. We need to hire the right people. The ideologies of stock brokers from the 80s are not going to be effective leaders in this space. Therefore, to be effective and avoid backlash, our government needs to adapt and keep pace with the changing ideologies of younger generations.

Blockchain enthusiasts Cameron and Tyler Winklevoss, the Co-Founders of Gemini, recently proposed that the virtual currency industry should be

[141] COINBASE, available at: https://www.coinbase.com/

governed by a "self-regulatory organization."[142] The Winklevoss twins specifically advocate for the enactment of the Virtual Commodity Association (VCA), which would operate as an industry sponsored self-regulatory organization for the U.S. virtual currency industry.[143] Their proposal outlines a membership-based structural framework that would be available for all U.S. based "virtual commodity platforms, over-the-counter (OTC) trading firms, and other trading facilities acting as counterparties that: Provide an all-to-all platform or venue, available to U.S. participants, for transacting in the spot virtual commodity markets; or Provide OTC or off-exchange services, for transacting in the spot virtual commodity markets."[144] The VCA structural framework would consist of: "(i) a non-profit, independent regulatory organization that does not operate any markets, (ii) will not be a trade association, (iii) will not provide regulatory programs for security tokens or security token platforms, and (iv) will be in compliance with global standards and best practices for SROs."[145] The VCA very much embodies the virtues emphasized throughout this article: current regulators are too far behind the 8-ball to be effective. However, there are several counter arguments that cut against the VCA proposal, one of which being that due to the Winklevoss twins' direct participation in the market, they are an interested party—and thus prone to bias and a conflict of interests. There is some logic to that argument. The Winklevoss twins have certainly attained substantial riches as a direct result of their CC investments and market participation. Cameron and Tyler Winklevoss have amassed a CC fortune "worth about $1.3 billion," according to estimates from the New York Times.[146] However, the fact that Winklevoss twins are financially interested should not disqualify their proposal. As stated repeatedly throughout this article, in order to be more successful, regulators in this industry desperately need the assistance of "interested" parties like the Winklevoss twins. Such "interested" parties have a superior understanding of the blockchain industry's inner-workings and underpinnings. Thus, it would be absurd to frown upon the mere existence of financial interest. This would offend basic principles of efficient capital markets. Their interest in the space adds value to their perspectives. They are highly motivated to assure the blockchain and CC markets' overall success.

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[142] Tyler and Cameron Winklevoss*, A Proposal for a Self-Regulatory Organization for the U.S. Virtual Currency Industry*, Introducing the Virtual Commodity Association, GEMINI (March 13, 2018), available at: https://gemini.com/blog/a-proposal-for-a-self-regulatory-organization-for-the-u-s-virtual-currency-industry/

[143] *Id.*

[144] *Id.*

[145] *Id.*

[146] Nathaniel Popper*, How the Winklevoss Twins Found Vindication in a Bitcoin Fortune, Technology*, THE NEW YORK TIMES, (Dec. 19, 2017) available at: https://www.nytimes.com/2017/12/19/technology/bitcoin-winklevoss-twins.html?_r=0

It is clear that market regulators intend not to stifle the industry, but to help it flourish safely. As cited above, regulators vowed to take a no harm approach since day one, and the Winklevoss twins have done everything the right way since day one. Gemini and the Winklevoss twins worked with the New York State Department of Financial Services (NYSDFS) to obtain a trust company license for Gemini's exchange and custody business in 2014.[147] Then later, in 2017, Cameron and Tyler Winklevoss were heavily involved in the development of the CBOE Bitcoin (USD) Futures Contract.[148] They worked side by side with regulators and entered into an Information Sharing Agreement with the CBOE Futures Exchange (CFE).[149] Their wisdom and guidance enabled CC Futures Contracts to become registered with the Commodity Futures Trading Commission (CFTC), "to allow CFE to perform cross-market surveillance of Gemini's marketplace."[150] And finally, Gemini has enacted their own substantial regulatory policies within their own governing structure. Specifically, Cameron and Tyler have adopted an "internal Trading Policy with respect to material nonpublic information, as well as Marketplace Conduct Rules for all trading on [the Gemini] marketplace, in an effort to foster a rules-based marketplace."[151] Their assistance should be welcomed with open arms. Cameron and Tyler have meaningful credibility within the blockchain and CC space both as market participants and as regulatory collaborators.

The adoption of the VCA, or a Self-Regulatory Agency ("SRO") generally, would also cost less and be more efficient — similar to how the SEC leverages organizations like the Financial Industry Regulatory Authority ("FINRA") to effectively regulate broker-dealers, an SRO could perform the same function for CC exchanges, platforms, wallets, and ICOs. Many of the rules and regulatory frameworks are already in place. The enacting of the VCA would only add to the existing SEC and CFTC regulatory structure. Yes; the SEC would still have their enforcement powers regarding fraudulent ICOs. Yes; the CFTC would still otherwise regulate CCs to the extent that a particular CC is functioning as a commodity. There are still a whole lot of regulatory concerns that have yet to be adequately addressed (wholly outside the existing

SEC/CFTC scope). While the regulatory concerns may be similar to

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147 Tyler and Cameron Winklevoss, *A Proposal for a Self-Regulatory Organization for the U.S. Virtual Currency Industry,* Introducing the Virtual Commodity Association, GEMINI (March 13, 2018), available at: https://gemini.com/blog/a-proposal-for-a-self-regulatory-organization-for-the-u-s-virtual-currency-industry/

148 *Id.*

149 *Id.*

150 *Id.*

151 *Id.*

other financial products already under government jurisdiction, the differences are substantial. Regulating "commodities" and "securities" that involve multifaceted amalgamations of code requires a heightened understanding of the technology. For example, there are several gaping holes: (1) due diligence procedures, (2) financial management standards, (3) conflict of interest rules, (4) surveillance protocols, (5) cyber security requirements, and (6) enforcement.

1. Due Diligence Procedures

Consumers deserve a commercially adequate due diligence process whereby individuals with industry-relevant knowledge perform proper diligence and legal analysis with respect to ICOs, exchanges, wallets, and existing virtual currencies. No such process currently exists. Meaning, there is no way for investors (or regulators) to verify that a particular blockchain, CC, or ICO, will perform in the manner it is purported to. Instead, investors are forced to "wait and see," and in the event of fraud, hope that the SEC or CFTC can recover their funds after the fact. This is not an ideal regulatory framework. To encourage a transparent and honest industry, we need to have a proper due diligence process for emerging ICOs and blockchains.

2. Financial Management Standards

Any industry that involves finance requires transparent financial management standards. The blockchain and virtual currency industry is no different. We do not "wait and see" whether BAML or JP Morgan are engaging in fraudulent financial practices. We have mandatory continuous reporting and best practices that must be adhered to. The prevention of fraud and misappropriation of investor funds is just as important as the prosecution of such behavior. Therefore, any new regulatory organization should incorporate some form of universal fiscal management standards.

3. Conflicts of Interest

This is another common problem that must be addressed in any financial regulatory system. A competent regulatory organization must be tasked with assuring that the proper transparency protocols exist to avoid material conflicts of interest. The issues and concerns that conflicts of interest represent are widely known. Thus, an expansive definition is not necessary.

4. Cyber Security Requirements

The financial world is becoming more and more virtual—and it is becoming increasingly necessary to assure that market participants entrusted with sensitive information are taking the proper steps to prevent security breaches. Therefore, this would be additional area of importance with respect to blockchain and virtual currency regulation. The regulatory organization

would be tasked with both implementing and maintaining adequate cyber security prevention systems and threat mediation.

5. Surveillance Protocols

Active virtual currencies, ICOs, and market participants need to be continuously surveilled to avoid negligent, reckless, or intentional wrongdoing or manipulation. This regulatory organization would have the responsibility to detect, deter, and discipline problematic behavior. This process would require enhanced supervisory guidelines and administrative requirements to be upheld by those primarily responsible for quality assurance and regulatory compliance.

6. Enforcement

While the SEC and CFTC have made capable efforts in this area, it must be further augmented by an additional layer of regulatory enforcement. These major U.S. regulatory bodies have wide ranging responsibilities with regard to the financial industry as a whole. Much in the same way that FINRA (Financial Industry Regulatory Authority) focuses its attention on continuous reporting, member regulation, and enforcement with regards to broker-dealers, the blockchain and virtual currency market also requires their own regulatory enforcement body and related procedures. This would enable the market to begin to self-regulate itself through the imposition of sanctions, fines, suspensions, and expulsions for violative conduct committed by market participants.

There are certainly a number of ways by which to address the above missing areas of regulatory focus. The VCA or a similar entity is certainly an option to consider, but it is not the only one. Other options may include: (1) the SEC or the CFTC could create an additional sub-commission or sub-agency solely dedicated to CCs; (2) the SEC could delegate the continuous reporting and regulatory oversight to FINRA; (3) U.S. legislators could enact a wholly separate government entity; or finally (4) the CFTC and SEC can continue to work in silos. There is arguably not a meaningful difference between options 1 through 3, but option 4 should be strongly disfavored for obvious reasons. Generally, all of these options (with exception of tapping FINRA), will require additional resources and government spending. Therefore, to the extent that government leaders favor less costly approaches, perhaps it would make the most sense to support the adoption of the VCA. In the alternative, expanding FINRA's scope of authority may also be an effective option. FINRA has both the physical infrastructure and requisite quasi-governmental structure in place to hit the ground running in this space. In the broker-dealer space, FINRA has already proven itself as a highly effective regulatory presence in the financial industry. In fact, the SEC has already delegated some investigatory and consumer education tasks to

FINRA regarding ICOs.[152] Additionally, FINRA's 2018 Regulatory and Examination Priorities Letter states the following regarding their role and approach to ICOs and CCs:

> Initial Coin Offerings and Cryptocurrencies
>
> Digital assets (such as cryptocurrencies) and initial coin offerings (ICOs) have received significant media, public and regulatory attention in the past year. FINRA will closely monitor developments in this area, including the role firms and registered representatives may play in effecting transactions in such assets and ICOs. Where such assets are securities or where an ICO involves the offer and sale of securities, FINRA may review the mechanisms—for example, supervisory, compliance and operational infrastructure— firms have put in place to ensure compliance with relevant federal securities laws and regulations and FINRA rules.[153]

Perhaps FINRA's role should be expanded to not only continuously monitor broker-dealers within the financial industry, but "broker-dealers" and exchanges within the CC industry as well. By requiring CC market participants to be FINRA members, the U.S. government could easily address the aforementioned gaping holes. As a reminder: (1) due diligence procedures, (2) financial management standards, (3) conflict of interest rules, (4) surveillance protocols, (5) cyber security requirements, and (6) enforcement. FINRA is well suited for addressing these issues, as the organization already performs market regulation functions in all of the above areas. The subject matter is different, but the behavior is the same.

VI. Conclusion

The "wild wild west" or "regulatory sandbox" approach is simply not sustainable. While our current approach has enabled us to bridge the gap from the early stages of blockchain to today's environment, steps must be taken to assure a safe and efficient marketplace. As previously mentioned, the Winklevoss twins have proposed that a "self-regulatory" organization which

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[152] Investor Alerts, *Initial Coin Offerings: Know Before You Invest*, FINANCIAL INDUSTRY REGULATORY AUTHORITY ("FINRA") (August 31, 2017), available at: http://www.finra.org/investors/alerts/initial-coin-offerings-know-before-you-invest

[153] *2018 Regulatory and Examination Priorities Letter*, FINANCIAL INDUSTRY REGULATORY AUTHORITY ("FINRA") (Jan. 8, 2018), available at: http://www.finra.org/industry/2018- regulatory-and-examination-priorities-letter

may be well suited approach for the job.154 However, there are various options available to decision makers and government leaders. Therefore, for the aforementioned reasons, U.S. government actors should feel compelled to either: (1) support the Winklevoss proposal; (2) expand FINRA's scope of authority to include CCs and its market participants; or (3) enact a government agency with a similar function using the regulatory framework outlined in the above section.

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154 Tyler and Cameron Winklevoss, *A Proposal for a Self-Regulatory Organization for the U.S. Virtual Currency Industry*, Introducing the Virtual Commodity Association, GEMINI (March 13, 2018), available at: https://gemini.com/blog/a-proposal-for-a-self-regulatory-organization-for-the-u-s-virtual-currency-industry/

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CASES

Supreme Court en banc Decision 2015Do8335 Decided December 21, 2017

【Violation of the Aviation Security Act; Coercion; Interference with Business; Obstruction of the Execution of Official Duties by Fraudulent Means; Destruction of Evidence (Convicted Crime: Solicitation of Destruction of Evidence); Concealment of Evidence (Convicted Crime: Solicitation of Concealment of Evidence); Leakage of Secrets on Official Duties】

【Main Issues and Holdings】

[1] Meaning of "aviation route" as stipulated under Article 42 of the Aviation Security Act

Whether the ground passage along which an aircraft transits from the time all its doors close after the passengers board until the time all its doors open for their disembarkation is encompassed by the term "aviation route" (negative)

[2] In a case where the Defendant, Vice President of Airline Company "A," was indicted on charges of violation of the Aviation Security Act on grounds that she: (a) boarded one of the airline's planes scheduled to depart from a foreign airport for Korea; (b) was upset by the way the assigned flight attendant offered passenger services and verbally abused the flight attendant; (c) had the pilot alter the course of the aircraft on a pushback away from the boarding bridge in the ramp and return to the boarding gate to drop off the crew member; and (d) thereby caused the alteration of the aviation route of an aircraft in flight by force, the case holding that the Defendant's act of having the aircraft on a pushback phase return to the boarding gate does not constitute causing the alteration of the aviation route of an aircraft

【Summary of Decision】

[1] **[Majority Opinion]** (A) Article 42 of the Aviation Security Act provides, "Any person who impedes the normal flight of an aircraft by forcing the aircraft in flight (i.e., during navigation) to alter its course by fraudulent means or by force shall be punished by imprisonment with labor for not less than one year but not more than ten years." Article 2 subparag. 1 of the same Act defines "in flight (i.e., during navigation)" to mean "from the time all the doors of an aircraft close after passengers board until the time all its doors open for their disembarkation." However, there is no provision in the Aviation Security Act defining what "aviation route" means.

(B) The principle of no crime or punishment without the law requires crimes and punishments to be stipulated by the law to protect individual rights and freedom from the State's arbitrary exercise of penal authority. In view of such purport, penal provisions ought to be strictly construed. It is impermissible as against the prohibition of expansionist interpretation, which is the essence of the principle of no crime or punishment without the law, to interpret a penal provision against the Defendant's interest beyond the bounds of the possible meaning of a text and language. Statutory construction may well employ a systematic, logical method, taking into account the legislative intent and purpose, chronology of the statutory enactment and amendment, harmony with the entire legal order, and relationship with other statutes. However, insofar as the statutory text and language themselves consist of relatively clear concepts, such interpretive method is unnecessary or must be limited in principle. It is all the more so when interpreting penal provisions under the purview of the principle of no crime or punishment without the law.

(C) In cases where there is no definition clause on a statutory term, in principle, it should be interpreted according to the generally accepted meaning, such as its dictionary definition. The Standard Dictionary of Korean Language published by the National Institute of Korean Language defines aviation route to mean an "airway along which an aircraft transits." From a linguistic point of view, it is clear that the term aviation route connotes "aerial." No example could be found where the term "aviation route" is used as a term meaning a passage on the ground in relation to aircraft navigation.

(D) Aviation route was used in other laws to mean "air route." Article 115-2(2) of the former Aviation Act (repealed by Act No. 14116, Mar. 29, 2016) provided that when the Minister of Land, Infrastructure and Transport issues an air operator's certificate to an air transport business, he/she should specify the navigation conditions, including the "aviation route to be navigated." Article 90(2) of the Aviation Safety Act (Act No. 14116, Mar. 29, 2016), which succeeded to the terms of the aforementioned provision, changed "aviation route to be navigated" into "air route to be navigated." Thus, it is clear that here, "aviation route" has the same meaning as air route. The legal definition of air route is stipulated as a "route in the space indicated on the earth's surface as designated by the Minister of Land, Infrastructure and Transport as appropriate for the navigation of aircraft, etc." (Article 2 subparag. 13 of the Aviation Safety Act; definition under the former Aviation Act is the same). Thus, a route can only be an air route when it is used for aircraft flights. In view of the fact that aviation route as a legal terminology has been used interchangeably with air route, it can be viewed that legislators also perceived aviation route as a term with the connotation of "aerial."

(E) By contrast, no legislative material could be found to support the proposition that legislators used "aviation route" in this particular penal provision in deviation from its ordinary definition to include the meaning of ground passage.

This offense was first stipulated as a crime in Article 11 of the former Aircraft Navigation Safety Act (Act No. 2742, Dec. 26, 1974), the forerunner of the Aviation Security Act. The minutes of the National Assembly Legislation and Judiciary Committee meeting on November 26, 1974 for deliberation of the legislative bill in the run-up to the enactment of the former Aircraft Navigation Safety Act lack any discussion of the penal provision on this offence, and thus, can hardly offer any direct clues to the meaning of "aviation route." Yet the part explaining the reasons for the proposal reveals that the former Aircraft Navigation Safety Act was enacted to provide for the aggravated punishment of criminal offenders as an implementing legislation of Korea's international obligations under the international conventions aimed at deterring crimes against civil aircraft.

(F) The object of this offense is an aircraft "in flight (i.e., during navigation)." However, "aviation route" subject to the alteration of course by fraudulent means or by force is a separate element of the crime, and should by itself be interpreted conducive to the principle of no crime or punishment without the law. Aviation route has the connotation of "aerial," and there is no evidence to support the finding that legislators used the word to have a broader meaning than its dictionary definition. It exceeds the bounds of the possible meaning of a text and language to construe even the ground passage taken by an aircraft as an "aviation route" just because an aircraft transit on the ground constitutes "in flight (i.e., during navigation)."

(G) Clearly, recklessly altering the course of an aircraft in transit on the ground is a highly dangerous act, as it risks clashing with other aircraft or facilities. However, the mere need for criminal sanctions ought not to retract the principle of no crime or punishment without the law. Penal vacuum is unlikely to arise, since such an act not only can be punished as an interference with business against the pilot in command, but also may constitute an interference with the execution of duties under Article 43 of the Aviation Security Act, which may be subject to imprisonment with labor for not more than ten years, as in many cases the act would likely involve assault, intimidation, or fraudulent means.

[Dissenting Opinion by Justice Park Poe-young, Justice Jo Hee-de, and Justice Park Sang-ok] (A) The Standard Dictionary of Korean Language published by the National Institute of Korean Language defines: (a) aviation route as an "airway along which an aircraft transits; later modified into air

route"; (b) airway as an "air route"; and (c) air route as a "designated aerial channel for a regularly navigating aircraft." Yet the object of punishment under Article 42 of the Aviation Security Act is the act of causing an aircraft in flight (i.e., during navigation) to alter the course of its actual transit, not causing the alteration of an air channel itself as designated by the Minister of Land, Infrastructure and Transport.

(B) Depending on the context of a legal text, the expression "aviation route" may be construed to encompass an aircraft's passage on the ground. In fact, controversy over whether an on-the-ground course of aircraft transit is encompassed by the concept of "aviation route" seems to have prompted the revision of the term "aviation route" under the former Aviation Act into "air route" under the Aviation Safety Act to fit the context. Thus, the ground for the Majority Opinion on this part supports, rather than undermines, the Dissenting Opinion, which distinguishes between aviation route and air route.

(C) Aviation route (pronounced as "hang-ro" in Korean, written as "航路" in Chinese characters) can be construed based on its Chinese character to mean "a passage (路) for vessels or aircraft (航)." Whereas a vessel navigates along the sea route from port to port, an aircraft navigates from airport to airport. Although mostly aerial operation, aircraft navigation inevitably involves operation on the ground of an airport for takeoff and landing. Article 2 subparag. 1 of the Aviation Security Act provides that "in flight (i.e., during navigation)" means from the time all the doors of an aircraft close after passengers board until the time all its doors open for their disembarkation. Also, the Standard Dictionary of Korean Language published by the National Institute of Korean Language defines navigation to mean "a vessel's or an aircraft's comings and goings along a specific navigation route or between destinations." Thus, it is reasonable and natural to construe aviation route to mean "a passage along which an aircraft navigates."

(D) The fact that the term aviation route in the context of this offense is used in close relationship with navigation is also revealed through the structure and organization of the legal text. From the time of the former Aircraft Navigation Safety Act, the forerunner of the Aviation Security Act, the term aviation route was only used as an element of this offense out of the entire statutory provisions, and is qualified by the immediately adjacent phrase, "of an aircraft in flight (i.e., during navigation)." The omission of any separate definition clause on aviation route reveals that legislators considered the qualifying term "in flight (i.e., during navigation)" to be enough to clarify the meaning of aviation route to the general public.

In light of such interrelationship, the term "aviation route" in the context of this offense should be construed not separately as a stand-alone term, but rather in the context of the phrase, "aviation route of an aircraft in flight (i.e., during navigation)." Legislators expanded the meaning of the term "in flight (i.e., during navigation)" under the Aviation Security Act to a broader extent than its ordinary meaning, with the clear intention to protect also those aircraft on the ground from crimes. As such, it does not exceed the bounds of the possible meaning to broaden the definition of the term "aviation route," constituting a phrase in combination with "in flight (i.e., during navigation)," to include all "passages navigated by aircraft in flight (i.e., during navigation)," whether on the ground or in the air.

(E) Reckless alteration of the course of an aircraft in transit on the ground carries a high risk of massive disaster. Thus, the act must be subject to this offense, which is punishable by imprisonment with labor for not less than one year but not more than ten years, to support the legislative intent to heighten the punishment for any act threatening navigation safety. Whether on the ground or in the air, an aircraft ought to follow the optimal course under the judgment of the pilot in command and subject to the coordination of air traffic controllers for the sake of passenger safety, and any act obstructing this mandate needs to be deterred by an appropriate punishment. Interference with business under the Criminal Act is only punishable by imprisonment with labor for not more than five years or can be punished by a fine instead, which is not a proportional punishment for a serious crime involving aircraft navigation. Interference with the execution of duties under Article 43 of the Aviation Security Act cannot subsume the act either, since it omits "by force" as a means of interference.

(F) In conclusion, it should be construed that all passages on the ground along which an aircraft transits from the time all its doors close after the passengers board until the time all its doors open for their disembarkation are encompassed by "aviation route" under Article 42 of the Aviation Security Act.

[2] In a case where the Defendant, Vice President of Airline Company "A," was indicted on charges of violation of the Aviation Security Act on grounds that she: (a) boarded one of the airline's planes scheduled to depart from a foreign airport for Korea; (b) was upset by the way the assigned flight attendant served nuts to her, a first-class passenger, for its discrepancy with what she knew to be stipulated in the passenger cabin service manual, and verbally abused the flight attendant; (c) had the pilot alter the course of the aircraft on a pushback away from the boarding bridge in the ramp (where it was pushed by a vehicle toward the taxiway), and return to the boarding gate to drop off the crew member; and (d) thereby caused the alteration of the aviation route of an

aircraft in flight by force, the Court affirmed the lower judgment acquitting the Defendant of the said charges on the ground that the Defendant's act of having an aircraft in a pushback procedure return to the boarding gate does not constitute causing the alteration of the aviation route of an aircraft.

【Reference Provisions】 [1] Article 12(1) of the Constitution of the Republic of Korea, Articles 1(1) and 314(1) of the Criminal Act, Article 2 subparag. 2 and Article 11 of the former Aircraft Navigation Safety Act (Wholly Amended by Act No. 6734, Aug. 26, 2002 into the Act on Aviation Safety and Security; see Article 2 subparag. 1 and Article 42 of the current Aviation Security Act, respectively), Article 1, Article 2 subparag. 1, and Articles 42 and 43 of the Aviation Security Act, Article 2 subparag. 21 and Article 115-2(2) of the former Aviation Act (Repealed by Addendum Article 2 of the Aviation Safety Act, No. 14116, Mar. 29, 2016; see Article 2 subparag. 13 and Article 90(2) of the current Aviation Safety Act, respectively), Article 2 subparag. 13 and Article 90(2) of the Aviation Safety Act / [2] Article 2 subparag. 1 and Article 42 of the Aviation Security Act, Article 325 of the Criminal Procedure Act

Article 12 of the Constitution of the Republic of Korea

(1) All citizens shall enjoy personal liberty. No person shall be arrested, detained, searched, seized or interrogated except as provided by Act. No person shall be punished, placed under preventive restrictions or subject to involuntary labor except as provided by Act and through lawful procedures.

Article 1 of the Criminal Act (Criminality and Punishability of Act)

(1) The criminality and punishability of an act shall be determined by the law in effect at the time of the commission of that act.

Article 314 of the Criminal Act (Interference with Business)

(1) A person who interferes with the business of another by the method of Article 313 or by the threat of force, shall be punished by imprisonment for not more than five years or by a fine not exceeding fifteen million won. <Amended by Act No. 5057, Dec. 29, 1995>

Article 1 of the Aviation Security Act (Purpose)

The purpose of this Act is to prescribe standards, procedures, obligations, etc. to prevent any unlawful act in airport facilities, air navigation safety facilities, and on aircraft, and to ensure the security of civil aviation, in accordance with international conventions, such as the Convention on International Civil Aviation. <Amended by Act No. 11753, Apr. 5, 2013>

Article 2 of the Aviation Security Act (Definitions)

The terms used in this Act shall be defined as follows: Provided, That the Aviation Business Act, the Aviation Safety Act, and the Airport Facilities Act shall apply, except as otherwise provided for in this Act: <Amended by Act No. 11244, Jan. 26, 2012; Act No. 11753, Apr. 5, 2013; Act No. 14115, Mar. 29, 2016>

1. The term "in flight (i.e., during navigation)" means from the time all the doors of an aircraft close after passengers board the aircraft until the time all the doors of the aircraft open for their disembarkation[.]

Article 42 of the Aviation Security Act (Crime of Altering the Course of Aircraft)

Any person who impedes the normal flight of an aircraft by forcing the aircraft in flight (i.e., during navigation) to alter course by fraudulent means or by force shall be punished by imprisonment with labor for not less than one year but not more than ten years.

Article 43 of the Aviation Security Act (Crime of Interference with the Execution of Duties)

Any person who harms the safety of an aircraft and its passengers by interference in the legitimate execution of duties of the pilot in command, etc. by violence, intimidation or by fraudulent means shall be punished by imprisonment with labor for not more than ten years.

Article 2 of the Aviation Safety Act (Definition)

The terms used in this Act shall be defined as follows:

13. The term "air route" means the route in the space indicated in the earth's surface as designated by the Minister of Land, Infrastructure and Transport as appropriate for the navigation of aircraft, light weight aircraft, or super-light weight aviation equipment.

Article 90 of the Aviation Safety Act (Air Operator's Certificate for Air Transport Business)

(1) Before initiating navigation, air transport business shall obtain an air operator's certificate upon completion of inspection by the Minister of Land, Infrastructure and Transport on safe navigation system including personnel, equipment, facilities, navigation management support, and maintenance management support, in accordance with the standards set out under the Ordinance of the Ministry of Land, Infrastructure and Transport.

(2) In case of issuing an air operator's certificate under paragraph (1) above (hereinafter "AOC"), the Minister of Land, Infrastructure and Transport shall issue to the given air transport business, along with a written AOC, an operating standard on the air route to be navigated, airport, and aircraft maintenance method specifying navigation conditions and restrictions as set out

under the Ordinance of the Ministry of Land, Infrastructure and Transport.

Article 325 of the Criminal Procedure Act (Judgment of Not Guilty)

A finding of "not guilty" shall be pronounced by judgment if the facts against the criminal defendant do not constitute an offense or if the evidence of the criminal act is insufficient.

【Reference Cases】 [1] Supreme Court Decisions 2007Do2162 decided Jun. 14, 2007 (Gong2007Ha, 1118); 2006Da81035 decided Apr. 23, 2009 (Gong2009Sang, 724); and 2015Do17847 decided Mar. 10, 2016 (Gong2016Sang, 596)

【Defendant】 Defendant 1 and two others

【Appellant】 Defendant 2 and the Prosecutor

【Defense Counsel】 Yun & Yang LLC et al.

【Judgment of the court below】 Seoul High Court Decision 2015No800 decided May 22, 2015

【Disposition】 All appeals are dismissed.

【Reasoning】 The grounds of the appeal are examined.

1. Gist of the factual development

A. As Vice President of Nonindicted Company 1, Defendant 1 oversaw and supervised the airline's in-flight services. On Dec. 5, 2014, at 00:37 local time, at the John F. Kennedy International Airport in New York, New York, United States of America, she boarded Nonindicted Co. 1's ○○○○○ plane to be seated in the plane's first-class cabin, bound for the Incheon International Airport in the Republic of Korea and scheduled to depart at 00:50 the same day.

B. Defendant 1 became upset for the reason that the way flight attendant Nonindicted 2 served nuts to her, a first-class passenger, was different from what she knew to be instructed in the passenger cabin service manual. Defendant 1 yelled at chief purser (cabin manager) Nonindicted 3, demanding, "A flight attendant who does not even know the manual cannot be allowed to ride aboard. Have the captain stop the aircraft right now!" Repeating the demand, she hit Nonindicted 3 on the back of his hand with the passenger cabin service manual. She also verbally abused and physically assaulted Nonindicted 2 by hurling the manual at her, which hit her on the chest.

C. At that time, captain Nonindicted 4 disengaged the aircraft from the boarding bridge at the ramp area and was steering the aircraft in a pushback procedure (where a tug pushes the aircraft away from the ramp toward the taxiway). Upon being informed by Nonindicted 3 in an interphone call that "an abnormal situation has transpired and the aircraft has to go back," Nonindicted 4 halted pushback. Up to that point, the aircraft had been pushed back about 17 meters for about 22 seconds, but had not yet gone beyond the ramp area to enter the taxiway. Hearing Nonindicted 3's explanation that "the Vice President is upset about in-flight services and is demanding in abusive language that the

assigned flight attendant get off the plane," Nonindicted 4 turned the aircraft back toward the boarding bridge upon being cleared by the ramp control.

D. In the meantime, after rereading the part of the passenger cabin service manual at issue, Defendant 1 started yelling at Nonindicted 3 this time to get off the plane, because she said Nonindicted 2 served her nuts in compliance with the manual instructions after all, but it was Nonindicted 3's fault not to have adequately explained the matter to her. After handing over the duties to his deputy, Nonindicted 3 got off the aircraft at around 01:05 the same day.

E. The aircraft resumed pushback and took off at around 01:14 the same day, and arrived at the Incheon International Airport, 11 minutes delayed from its original schedule.

2. First, we examine the Prosecutor's grounds of appeal on Defendant 1's violation of the Aviation Security Act by alteration of the aviation route of an aircraft.

A. Procedural history on this part

For the foregoing actions by Defendant 1, the Prosecutor indicted Defendant 1 on the following charges: ① violation of the Aviation Security Act by an assault impeding the safe navigation of an aircraft; ② violation of the Aviation Security Act by alteration of an aircraft's aviation route; ③ interference with business against Nonindicted 4, 3, and 2; and ④ coercion of Nonindicted 3.

Both the first instance court and the lower court convicted Defendant 1 of violation of the Aviation Security Act by an assault impeding the safe navigation of an aircraft, interference with business, and coercion. Defendant 1 did not appeal, and the Prosecutor did not state the grounds of objection against the aforementioned guilty portion either in the notice of appeal or the appellate brief.

The first instance court convicted Defendant 1 of violation of the Aviation Security Act by altering the aviation route of an aircraft, but the lower court reversed the first instance judgment and acquitted Defendant 1 of the charge. The Prosecutor disputes the said lower judgment in this final appeal.

B. Issues

The issue in this part is whether Defendant 1's act of having an aircraft in a pushback procedure return to the boarding gate constitutes an alteration of "aviation route."

The lower court determined that Defendant 1's act does not constitute an alteration of "aviation route" on the following grounds: (a) dictionary meaning of aviation route is the passageway in the air taken by an aircraft; and (b) it is impermissible as against the principle of no crime or punishment without the law to groundlessly apply an expansionist interpretation against the defendant's interest.

The Prosecutor alleges as follows: (a) dictionary definition of aviation route fails to reflect the features of an aircraft that has to move on the ground before takeoff and after landing; (b) the Aviation Security Act provides for a definition clause aimed at protecting aircraft on the ground, by deeming an aircraft to be "in flight (i.e., during navigation)" from the point at which the passengers are on board and its doors are closed; and therefore, (c) under this definition, it is not inconsistent with the principle of no crime or punishment without the law to interpret all the routes "navigated" by an aircraft, including that on the ground, as "aviation route."

C. Statutory provisions and their interpretation

(1) Statutory provisions

Article 42 of the Aviation Security Act provides, "Any person who impedes the normal flight of an aircraft by forcing the aircraft in flight (i.e., during navigation) to alter its course by fraudulent means or by force shall be punished by imprisonment with labor for not less than one year but not more than ten years." Article 2 subparag. 1 of the same Act defines "in flight (i.e., during navigation)" to mean "from the time all the doors of an aircraft close after passengers board until the time all its doors open for their disembarkation." However, there is no provision in the Aviation Security Act defining what "aviation route" means.

(2) Interpretation

(A) The principle of no crime or punishment without the law requires crimes and punishments to be stipulated by the law to protect individual rights and freedom from the State's arbitrary exercise of penal authority. In view of such purport, penal provisions ought to be strictly construed. It is impermissible as against the prohibition of expansionist interpretation, which is the essence of the principle of no crime or punishment without the law, to interpret a penal provision against the Defendant's interest beyond the bounds of the possible meaning of a text and language (see, e.g., Supreme Court Decision 2015Do17847, Mar. 10, 2016). Statutory construction may well employ a systematic, logical method, taking into account the legislative intent and purpose, chronology of the statutory enactment and amendment, harmony with the entire legal order, and relationship with other statutes. However, insofar as the statutory text and language themselves consist of relatively clear concepts, such interpretive method is unnecessary or must be limited in principle (see Supreme Court Decision 2006Da81035, Apr. 23, 2009). It is all the more so when interpreting penal provisions under the purview of the principle of no crime or punishment without the law.

(B) In cases where there is no definition clause on a statutory term, in principle, it should be interpreted according to the generally accepted meaning, such as its dictionary definition. The Standard Dictionary of Korean Language published by the National Institute of Korean Language defines aviation route to mean an "airway along which an aircraft transits." From a linguistic point of

view, it is clear that the term aviation route connotes "aerial." No example could be found where the term "aviation route" is used as a term meaning a passage on the ground in relation to aircraft navigation.

(C) Aviation route was used in other laws to mean "air route." Article 115-2(2) of the former Aviation Act (repealed by Act No. 14116, Mar. 29, 2016) provided that when the Minister of Land, Infrastructure and Transport issues an air operator's certificate to an air transport business, he/she should specify the navigation conditions, including the "aviation route to be navigated." Article 90(2) of the Aviation Safety Act (Act No. 14116, Mar. 29, 2016), which succeeded to the terms of the aforementioned provision, changed "aviation route to be navigated" into "air route to be navigated." Thus, it is clear that here, "aviation route" has the same meaning as air route. The legal definition of air route is stipulated as a "route in the space indicated on the earth's surface as designated by the Minister of Land, Infrastructure and Transport as appropriate for the navigation of aircraft, etc." (Article 2 subparag. 13 of the Aviation Safety Act; definition under the former Aviation Act is the same). Thus, a route can only be an air route when it is used for aircraft flights. In view of the fact that aviation route as a legal terminology has been used interchangeably with air route, it can be viewed that legislators also perceived aviation route as a term with the connotation of "aerial."

(D) By contrast, no legislative material could be found to support the proposition that legislators used "aviation route" in this particular penal provision in deviation from its ordinary definition to include the meaning of ground passage.

This offense was first stipulated as a crime in Article 11 of the former Aircraft Navigation Safety Act (Act No. 2742, Dec. 26, 1974), the forerunner of the Aviation Security Act. The minutes of the National Assembly Legislation and Judiciary Committee meeting on November 26, 1974 for deliberation of the legislative bill in the run-up to the enactment of the former Aircraft Navigation Safety Act lack any discussion of the penal provision on this offence, and thus, can hardly offer any direct clues to the meaning of "aviation route." Yet the part explaining the reasons for the proposal reveals that the former Aircraft Navigation Safety Act was enacted to provide for the aggravated punishment of criminal offenders as an implementing legislation of Korea's international obligations under the international conventions aimed at deterring crimes against civil aircraft.

International conventions in this context refer to the following: the "Convention on Offences and Certain Other Acts Committed on Board Aircraft (Tokyo Convention)," the "Convention for the Suppression of Unlawful Seizure of Aircraft (The Hague Convention)," and the "Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation (Montreal Convention)." None of these conventions treat the act of having an aircraft moving on the ground alter its course as a separate element of a crime. There is

no evidence to support the proposition that our legislators instituted the penal provision on this crime with the intent to punish such act nonetheless. If they had such an intent, it is reasonable to suppose that they would have used some other terminology instead of "aviation route," which lack the meaning of a passageway on the ground, or instituted a definition clause stipulating that ground route is also included in the "aviation route" for purposes of this crime.

(E) As seen earlier, the Aviation Security Act provides for a definition clause stipulating that an aircraft is "in flight (i.e., during navigation)" from the point at which it has its passengers on board and closes its doors. This definition has been in place since when the former Aircraft Navigation Safety Act was enacted in compliance with the "Convention for the Suppression of Unlawful Seizure of Aircraft (The Hague Convention)," which expanded the scope of aircraft subject to protection by providing a clause that expands the meaning of "in flight."

The object of this offense is an aircraft "in flight (i.e., during navigation)." However, "aviation route" subject to the alteration of course by fraudulent means or by force is a separate element of the crime, and should by itself be interpreted conducive to the principle of no crime or punishment without the law. Aviation route has the connotation of "aerial," and there is no evidence to support the finding that legislators used the word to have a broader meaning than its dictionary definition. It exceeds the bounds of the possible meaning of a text and language to construe even the ground passage taken by an aircraft as an "aviation route" just because an aircraft transit on the ground constitutes "in flight (i.e., during navigation)."

(F) Clearly, recklessly altering the course of an aircraft in transit on the ground is a highly dangerous act, as it risks clashing with other aircraft or facilities. However, the mere need for criminal sanctions ought not to retract the principle of no crime or punishment without the law. Penal vacuum is unlikely to arise, since such an act not only can be punished as an interference with business against the pilot in command, but also may constitute an interference with the execution of duties under Article 43 of the Aviation Security Act, which may be subject to imprisonment with labor for not more than ten years, as in many cases the act would likely involve assault, intimidation, or fraudulent means. In the instant case as well, Defendant 1 is subject to punishment for interference with business against captain Nonindicted 4.

D. Determination on the instant case

Examining the instant case in light of the foregoing legal doctrine, Defendant 1's act of having the aircraft in a pushback procedure return to the boarding gate does not constitute an act of causing the alteration of the aviation rout of an aircraft. The lower court's determination is justified, and the Prosecutor's allegation in the grounds of appeal is without merit.

3. We examine the Prosecutor's remaining grounds of appeal and Defendant 2's grounds of appeal.

A. Procedural history on this part

(1) Regarding the series of attempts to cover up the crimes committed by Defendant 1 once the Ministry of Land, Infrastructure and Transport investigation was triggered by the aforementioned incidents that transpired on board the aircraft, the Prosecutor indicted the following defendants on the following charges: ① Defendant 2, then Managing Director of Nonindicted Co. 1, on charges of coercion, destruction of evidence, and solicitation of destruction and concealment of evidence; ② Defendants 1 and 2 on charges of obstruction of the execution of official duties by fraudulent means; and ③ Defendant 3, Aviation Safety Inspector with the Ministry of Land, Infrastructure and Transport, on charges of leakage of secrets on official duties.

(2) Regarding the charges of obstruction of the execution of official duties on which Defendants 1 and 2 were indicted together, both the first instance and the lower courts rendered acquittal, against which the Prosecutor appealed. Of the remainder of the charges against Defendant 2, the first instance and the lower courts acquitted the same of all the charges of destruction of evidence, and convicted the same of all the charges of solicitation of destruction and concealment of evidence and coercion, against which the Prosecutor and Defendant 2 appealed, respectively.

Of the charges against Defendant 3, the first instance court convicted the same of charges of informing Defendant 2 of the outcome of the Ministry of Land, Infrastructure and Transport investigation, and acquitted the same of charges of informing Defendant 2 of prospective investigation plans. Yet the lower court acquitted Defendant 3 of all the charges, against which the Prosecutor appealed.

B. On the Prosecutor's grounds of appeal

(1) On the obstruction of the execution of official duties by fraudulent means by Defendants 1 and 2

In the context of obstruction of the execution of official duties by fraudulent means, "fraudulent means" refers to causing misconception, mistake, or ignorance to the other party in order to achieve the behavioral purpose of the perpetrator, and taking advantage of that misconception, mistake, or ignorance. The offense is established only when the other party commits an erroneous act or renders an erroneous disposition based on the said misconception, mistake, or ignorance. Unless the action rises to the level of obstructing or practically frustrating the concrete execution of duties, the perpetrator cannot be punished for obstruction of the execution of official duties by fraudulent means (see Supreme Court Decision 2007Do1554, Apr. 23, 2009).

Notwithstanding their false statements, etc., the lower court acquitted Defendants 1 and 2 of the charges of obstruction of the execution of official

duties by fraudulent means on the ground that ultimately it is difficult to view that there was an erroneous act or disposition by the Ministry of Land, Infrastructure and Transport because the said Ministry discovered Defendant 1's act and filed a criminal complaint on charges of violation of the Aviation Security Act.

Examining the issue in light of the aforementioned legal doctrine and the record, the lower court's determination is justified. In so doing, it did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, or by misapprehending the legal doctrine.

(2) On the destruction of evidence by Defendant 2

The lower court acquitted Defendant 2 of the charges of destruction of evidence on the ground that it is difficult to recognize that Defendant 2 had the awareness that he/she was destroying the evidence on another person's criminal case because it was before either the case was reported on broadcast media or the Ministry of Land, Infrastructure and Transport commenced investigation when Defendant 2 received a written report by chief purser Nonindicted 3 on what transpired on board.

Examining the issue in light of the record, the lower court's determination is justified. In so doing, it did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules.

(3) On Defendant 3

The lower court acquitted Defendant 3 of all the charges of leakage of secrets on official duties on the following grounds: ① the evidence offered by the Prosecutor is not enough to find beyond a reasonable doubt that Defendant 3 informed Defendant 2 of the outcome of the Ministry of Land, Infrastructure and Transport investigation; and ② the prospective investigation plans of which Defendant 3 allegedly informed Defendant 2 were already distributed in a press release by the Ministry of Land, Infrastructure and Transport, and thus, can hardly be deemed secrets on official duties.

Examining the issue in light of the record, the lower court's determination is justified. In so doing, it did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, or by misapprehending the legal doctrine.

C. On Defendant 2's grounds of appeal

The lower court determined as follows: ① Defendant 2 intimidated chief purser Nonindicted 3 into writing reports containing details different from the latter's intent, and had Nonindicted 3 make or write false statements at the Ministry of Land, Infrastructure and Transport, thereby having the same perform a job for which he/she had no obligation; and ② Defendant 2 instructed twelve (12) of his/her subordinate team chiefs in passenger cabin crew department to delete the computer files, which were evidence of his/her

criminal case, from the office computer and replace the computer where the materials were saved, thereby soliciting destruction and concealment of evidence. In so determining, the lower court rejected all the allegations stated in the grounds of appeal by Defendant 2, including that there was no incentive for such solicitation of destruction and concealment of evidence and that this part of the charges was not specified.

Examining the issue in light of the duly admitted evidence, the lower court's determination is justified. In so doing, it did not err by misapprehending the legal doctrine on intent in coercion, the interpretation of intimidation and "job for which one has no obligation," specification of charges in solicitation of destruction and concealment of evidence, and establishment of the principal and the abettor. Nor did it err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules.

4. Conclusion

Therefore, all appeals are dismissed. It is so decided as per Disposition by the assent of all participating Justices, except there is a Dissenting Opinion by Justice Park Poe-young, Justice Jo Hee-de, and Justice Park Sang-ok on the violation of the Aviation Security Act by alteration of the aviation route of an aircraft.

5. Dissenting Opinion by Justice Park Poe-young, Justice Jo Hee-de, and Justice Park Sang-ok on the violation of the Aviation Security Act by alteration of the aviation route of an aircraft

A. The gist of the Majority Opinion is that an aircraft's ground route is not included in the "aviation route" under Article 42 of the Aviation Security Act, and thus, Defendant 1's act of having an aircraft on a pushback phase return to the boarding gate does not constitute a crime of violating the Aviation Security Act by altering an aircraft's aviation route. However, for the reasons stated below, we cannot agree with the Majority.

(1) Although it is impermissible in the statutory construction of a penal provision to apply an expansionist interpretation or interpretation by analogy against the defendant's interest, it is an interpretive method conducive to the principle of no crime or punishment without the law to clarify the meaning of a penal provision by taking into account the legislative intent and purpose, organization and structure of the entire statute in which the provision originated, and relationship with other statutes, within the scope of the possible meaning of a text and language (see Supreme Court Decision 2007Do2162, Jun. 14, 2007).

(2) Article 42 of the Aviation Security Act provides that any person who impedes the normal flight of an aircraft by forcing the aircraft in flight (i.e., during navigation) to alter its course by fraudulent means or by force shall be punished by imprisonment with labor for not less than one year but not more than ten years. Article 2 subparag. 1 defines "in flight (i.e., during navigation)"

to mean "from the time all the doors of an aircraft close after passengers board the aircraft until the time all the doors open for their disembarkation."

(3) The Majority: (a) understands aviation route to mean "air route," on the ground that (i) the Standard Dictionary of Korean Language published by the National Institute of Korean Language defines aviation route to mean "the airway along which an aircraft transits," and that (ii) it is clear that aviation route has the same meaning as "air route" in light of the amendment process of Article 90(2) of the Aviation Safety Act; (b) legally defines air route as "a route in the space indicated on the earth's surface as designated by the Minister of Land, Infrastructure and Transport as appropriate for the navigation of aircraft, etc."; and (c) determines that the passageway along which an aircraft moves on the ground does not constitute an aviation route.

The Standard Dictionary of Korean Language published by the National Institute of Korean Language defines: (a) aviation route as an "airway along which an aircraft transits; later modified into air route"; (b) airway as an "air route"; and (c) air route as a "designated aerial channel for a regularly navigating aircraft."

Yet the object of punishment under Article 42 of the Aviation Security Act is the act of causing an aircraft in flight (i.e., during navigation) to alter the course of its actual transit, not causing the alteration of an air channel itself as designated by the Minister of Land, Infrastructure and Transport. If we were to understand aviation route to mean "air route" exactly following the definition under the Standard Dictionary of Korean Language published by the National Institute of Korean Language, as the Majority does, Article 42 of the Aviation Security Act would be applicable to where a person causes "an aerial channel designated by the Minister of Land, Infrastructure and Transport" to be altered. This would bring about a perverse outcome, going beyond the legislative intent on the penal object.

(4) Regarding the "aviation route to be navigated" that the Minister of Land, Infrastructure and Transport needs to specify when issuing an air operator's certificate to an air transport business under Article 115-2(2) of the former Aviation Act, the Majority deems it clear that Article 90(2) of the Aviation Safety Act, which succeeded to the foregoing provision, replaced the aforementioned "aviation route to be navigated" with "air route to be navigated," and thus, "aviation route" under Article 42 of the Aviation Security Act has the same meaning as "air route." However, depending on the context of a legal text, the expression "aviation route" may be construed to encompass an aircraft's passage on the ground. In fact, controversy over whether an on-the-ground course of aircraft transit is encompassed by the concept of "aviation route" seems to have prompted the revision of the term "aviation route" under the former Aviation Act into "air route" under the Aviation Safety Act to fit the context. Thus, the ground for the Majority Opinion on this part supports, rather

than undermines, the Dissenting Opinion, which distinguishes between aviation route and air route.

(5) Aviation route (pronounced as "hang-ro" in Korean, written as "航路" in Chinese characters) can be construed based on its Chinese character to mean "a passage (路) for vessels or aircraft (航)." Whereas a vessel navigates along the sea route from port to port, an aircraft navigates from airport to airport. Although mostly aerial operation, aircraft navigation inevitably involves operation on the ground of an airport for takeoff and landing. Article 2 subparag. 1 of the Aviation Security Act provides that "in flight (i.e., during navigation)" means from the time all the doors of an aircraft close after passengers board until the time all its doors open for their disembarkation. Also, the Standard Dictionary of Korean Language published by the National Institute of Korean Language defines navigation to mean "a vessel's or an aircraft's comings and goings along a specific navigation route or between destinations." Thus, it is reasonable and natural to construe aviation route to mean "a passage along which an aircraft navigates."

(6) The purpose of the Aviation Security Act is to prescribe standards, procedures, obligations, etc. aimed at preventing any unlawful act in airport facilities, air navigation safety facilities, and on aircraft, as well as ensuring the security in civil aviation, pursuant to international conventions, such as the Convention on International Civil Aviation (Article 1). As seen earlier, in accordance with the meaning of "in flight" under the Convention for the Suppression of Unlawful Seizure of Aircraft, the Aviation Security Act defines an aircraft to be in flight (i.e., during navigation) "from the time all the doors of an aircraft close after passengers board until the time all its doors open for their disembarkation." The fact that aviation begins even before an aircraft starts moving may not be readily reconcilable with the tone in daily word usage or dictionary definition. The insertion of such special definition clause in the Aviation Security Act reflects the legislators' intent to expand the scope of aircraft to be protected, in compliance with the international effort to deter any threat to the safe navigation of aircraft.

(7) The fact that the term aviation route in the context of this offense is used in close relationship with navigation is also revealed through the structure and organization of the legal text. From the time of the former Aircraft Navigation Safety Act, the forerunner of the Aviation Security Act, the term aviation route was only used as an element of this offense out of the entire statutory provisions, and is qualified by the immediately adjacent phrase, "of an aircraft in flight (i.e., during navigation)." The omission of any separate definition clause on aviation route reveals that legislators considered the qualifying term "in flight (i.e., during navigation)" to be enough to clarify the meaning of aviation route to the general public.

(8) In light of such interrelationship, the term "aviation route" in the context of this offense should be construed not separately as a stand-alone term, but rather in the context of the phrase, "aviation route of an aircraft in flight (i.e., during navigation)." Legislators expanded the meaning of the term "in flight (i.e., during navigation)" under the Aviation Security Act to a broader extent than its ordinary meaning, with the clear intention to protect also those aircraft on the ground from crimes. As such, it does not exceed the bounds of the possible meaning to broaden the definition of the term "aviation route," constituting a phrase in combination with "in flight (i.e., during navigation)," to include all "passages navigated by aircraft in flight (i.e., during navigation)," whether on the ground or in the air.

(9) As the Majority also recognizes, reckless alteration of the course of an aircraft in transit on the ground carries a high risk of massive disaster. Thus, the act must be subject to this offense, which is punishable by imprisonment with labor for not less than one year but not more than ten years, to support the legislative intent to heighten the punishment for any act threatening navigation safety. Whether on the ground or in the air, an aircraft ought to follow the optimal course under the judgment of the pilot in command and subject to the coordination of air traffic controllers for the sake of passenger safety, and any act obstructing this mandate needs to be deterred by an appropriate punishment. Interference with business under the Criminal Act is only punishable by imprisonment with labor for not more than five years or can be punished by a fine instead, which is not a proportional punishment for a serious crime involving aircraft navigation. Interference with the execution of duties under Article 43 of the Aviation Security Act cannot subsume the act either, since it omits "by force" as a means of interference.

B. In conclusion, it should be construed that all passages on the ground along which an aircraft transits from the time all its doors close after the passengers board until the time all its doors open for their disembarkation are encompassed by "aviation route" under Article 42 of the Aviation Security Act. Pushback is an airport procedure during which an aircraft proceeds from the ramp area to a certain point on the taxiway. In that state, an aircraft is "in flight (i.e., during navigation)" in accordance with the definition under the Aviation Security Act. Defendant 1 had an aircraft on a pushback phase turn its direction and proceed back toward the boarding gate, and thus, it makes sense to view that Defendant 1 caused the alteration of "the aviation route of an aircraft in flight (i.e., during navigation)" by force.

C. Nevertheless, the lower court determined otherwise and acquitted Defendant 1 of the charges of violating the Aviation Security Act by altering an aircraft's aviation route. In so doing, it erred by misapprehending the legal doctrine on "aviation route" as defined under Article 42 of the Aviation Security Act, which affected the conclusion of the judgment. Therefore, the part of the lower judgment acquitting Defendant 1 should have been reversed. Yet

this part of the judgment constitutes a concurrent offense under Article 37 first sentence of the Criminal Act with the guilty portion transferred to this Court for a final review upon the Prosecutor's appeal, and thus, they shall be subject to a single punishment. Therefore, of the lower judgment, both the guilty portion and the aforementioned not-guilty portion on Defendant 1 should have been reversed, and these parts of the case should have been remanded to the lower court for further proceedings.

For the foregoing reasons, we respectfully dissent.

Chief Justice	Kim Myeongsu (Presiding Justice)
Justices	Kim Yong-deok
	Park Poe-young
	Ko Young-han
	Kim Chang-suk
	Kim Shin
	Jo Hee-de (Justice in charge)
	Kwon Soon-il
	Park Sang-ok
	Lee Ki-taik
	Kim Jae-hyung
	Cho Jae-youn
	Park Jung-hwa

Supreme Court Decision 2015Do12633 Decided November 9, 2017

【Violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Fraud); Violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Embezzlement); Violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust); Violation of the Act on External Audit of Stock Companies; Bribery; Violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Bribing, etc.)】

【Main Issues and Holdings】

Meaning of "act in violation of one's duty" as an element of breach of trust

Cases in which the lending of corporate funds to another person by a corporate director, etc. constitutes a breach of trust against the company, and whether this doctrine holds true even when the other person is an affiliate or subsidiary of the subsidizing company (affirmative)

Standard of determining whether the intent in breach of trust can be recognized on grounds of business judgment Factors to take into account when determining whether inter-affiliate subsidization within a business group was conducted within the discretionary scope of reasonable business judgment

【Summary of Decision】

The offense of breach of trust is established when a person administering another person's business either acquires or has a third party acquire pecuniary gain by committing an act in violation of one's duty to the detriment of the principal. Here, an "act in violation of one's duty" encompasses all acts in contravention of the fiduciary relationship with the principal, either by failing to perform an act that ought to be done or by performing an act that ought not to be done on statutory, contractual, or good faith grounds, in light of specific circumstances such as the content and nature of the business.

In lending corporate funds to another person, if a corporate director, etc. knew it would incur losses to the company due to the other person's lack of debt payment capacity but went ahead with the loan, or recklessly extended a loan without any reasonable debt recovery measures such as securing sufficient collateral, then the lending is an act benefiting another person to the company's detriment, constituting a breach of trust against the company. A corporate director cannot be exempted from the guilt of breach of trust solely on the

ground of business judgment. Such rationale does not change merely because the other person is an affiliate or subsidiary of the subsidizing company.

Yet, as fundamental risks inhere in corporate management, predictions may not always materialize and corporate losses may arise even when a manager has made a prudent, informed decision in good faith without intending any personal gain. Thus, a manager cannot be held criminally liable for occupational breach of trust even in such cases by relaxing the interpretive standard of intent. Here, whether intent of breach of trust can be recognized on grounds of business judgment should be determined on a case-by-case basis, depending on whether a given case is one in which the act at issue is deemed intentional with the knowledge that oneself or a third party is acquiring pecuniary gain to the detriment of the principal, in light of all the circumstances, including the development and motive leading up to the business judgment at issue, details of the business at issue, economic situation in which the company finds itself, and the likelihood of incurring losses and acquiring gain.

Meanwhile, even where a business group's pursuit of shared interests under a common purpose holds practical and economic significance, the individual affiliates and subsidiaries constituting the business group involve a number of stakeholders, including creditors and shareholders, as parties with separate and independent legal personality. Depending on the issue, they may well have unique interests of their own, divergent from the common interests of the business group. As such, even where inter-affiliate subsidization is for the sake of common interests on the business group level, there may well be cases where it entails the risk of pecuniary loss to the subsidizing affiliate. Thus, caution must be exercised when determining whether a cross subsidization between corporate affiliates and subsidiaries was performed within the discretionary scope of reasonable business judgment.

Therefore, in addition to the factors delineated earlier, the determination whether a cross subsidization was conducted within the discretionary scope of reasonable business judgment requires consideration of the following factors: (a) whether the subsidizing and subsidized affiliates are practically combined in terms of capital and operation to such an extent that they are geared toward common interests and synergy effect; (b) whether such cross subsidization is for the sake of common interests of all the affiliates and subsidiaries of a business group including the subsidizing affiliate, and not just for the interests of a specific person or company; (c) whether the decisions on the designation of a subsidizing affiliate and the scale of subsidization were objectively and reasonably made by fully taking into account such factors as the given affiliate's intent and capacity to subsidize; (d) whether the specific subsidization was implemented by a normal and lawful method; and (e) whether the subsidizing affiliate could have objectively expected an adequate reward commensurate with the burden or risk attendant on the subsidization. If comprehensive consideration of all these factors leads to the recognition that

the cross subsidization at issue was conducted within the discretionary scope of reasonable business judgment, then it is difficult to find it as an intentional act with the knowledge of detriment to the principal.

【Reference Provisions】 Articles 355(2) and 356 of the Criminal Act

Article 355 of the Criminal Act (Embezzlement and Breach of Trust)

(2) The preceding paragraph shall apply to a person who, administering another's business, obtains pecuniary advantage or causes a third person to do so from another in violation of one's duty, thereby causing loss to such person.

Article 356 of the Criminal Act (Occupational Embezzlement, Occupational Breach of Trust)

A person who commits the crime as prescribed in Article 355 in violation of the duties of one's occupation, shall be punished by imprisonment for not more than ten years or by a fine not exceeding thirty million won. <*Amended by Act No. 5057, Dec. 29, 1995*>

【Reference Cases】 Supreme Court Decisions 99Do4923 decided Mar. 14, 2000 (Gong2000Sang, 1011); 2002Do661 decided Jul. 8, 2004; 2004Do5742 decided Mar. 15, 2007 (Gong2007Sang, 569); 2009Do1149 decided Oct. 28, 2010 (Gong2010Ha, 2207); 2013Do5214 decided Sept. 26, 2013 (Gong2013Ha, 2021); and 2013Do10516 decided Jul. 10, 2014

【Defendant】 Defendant 1 and two others

【Appellant】 Defendants and the Prosecutor

【Defense Counsel】 Youjin Law Firm et al.

【Judgment of the court below】 Busan High Court (Changwon) Decision 2015No74 decided July 27, 2015

【Disposition】 The guilty portion of the lower judgment is reversed, and that part of the case is remanded to the Busan High Court. The Prosecutor's appeal is dismissed.

【Reasoning】 The grounds of appeal are examined.

1. Decision on the Defendants' grounds of appeal

A. As to the part on the Defendants' occupational embezzlement regarding the use of Nonindicted Joint Stock Company 1's corporate funds to purchase stocks

1) For occupational embezzlement to be established, a person professionally in custody of another person's property should have embezzled the property or refuse to return the same with the intent of illegal appropriation in violation of his/her occupational duties. Here, intent of illegal appropriation means the intent to dispose of another's property in one's custody as if it were his/her own, with the purpose of seeking the interest of one's own or a third party in violation of one's professional duty. Even when the person had the intent to subsequently return, compensate for, or protect the property, it is no

obstacle to recognizing the intent of illegal appropriation. Furthermore, a joint stock company is a separate holder of rights independent of its shareholder(s), with whom its interest does not necessarily coincide. Thus, in the event a shareholder or the representative director arbitrarily disposed of corporate property for private use, he/she cannot be exempt from the guilt of embezzlement regardless of whether there was a resolution of the shareholders' meeting or the board of directors' meeting on the disposition (*see*, *e.g.*, Supreme Court Decisions 2012Do2628, Jun. 28, 2012; and 2014Do11263, Dec. 24, 2014).

2) On the grounds indicated in its reasoning, the lower court determined as follows: (a) it is reasonable to evaluate Defendant 1's payment of KRW 26.1 billion in stock purchase price he/she personally owes to Nonindicted Private Equity Fund 2 by borrowing from Nonindicted Stock Company 1 (hereinafter "Nonindicted Co. 1") as an arbitrary use of Nonindicted Co. 1's corporate funds for private purposes by taking advantage of his/her position as the chairperson of the business group he/she controls, which encompasses Nonindicted Co. 1 (hereinafter said business group is referred to as "○○○ Group"); (b) as the officer and employee in charge of funds affiliated with ○○○ Group's Management Support Center, Defendant 2 and Defendant 3 functionally controlled conducts with the intent to jointly implement Defendant 1's embezzlement; and (c) thus, Defendant 1 should be convicted to this part of the charges of violation of the revised Act on the Aggravated Punishment, etc. of Specific Economic Crimes (hereinafter "Specific Economic Crimes Act") (embezzlement).

3) Examining the reasoning of the lower judgment in light of the foregoing legal doctrine and the duly admitted evidence, contrary to what is alleged in the grounds of appeal, in so determining, the lower court did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, or by misapprehending the legal doctrine on the criminal intent of embezzlement, intent of illegal appropriation, or co-principals.

B. As to the part on Defendant 1's occupational breach of trust regarding Nonindicted Joint Stock Company 3's integrated purchases

1) The offense of breach of trust is established when a person administering another person's business either acquires or has a third party acquire pecuniary gain by committing an act in violation of one's duty to the detriment of the principal. Here, an "act in violation of one's duty" encompasses all acts in contravention of the fiduciary relationship with the principal, either by failing to perform an act that ought to be done or by performing an act that ought not to be done on statutory, contractual, or good faith grounds, in light of specific circumstances such as the content and nature of the business (*see*, *e.g.*, Supreme Court Decision 2013Do10516, Jul. 10, 2014).

In lending corporate funds to another person, if a corporate director, etc. knew it would incur losses to the company due to the other person's lack of debt payment capacity but went ahead with the loan, or recklessly extended a loan without any reasonable debt recovery measures such as securing sufficient collateral, then the lending is an act benefiting another person to the company's detriment, constituting a breach of trust against the company. A corporate director cannot be exempted from the guilt of breach of trust solely on the ground of business judgment. Such rationale does not change merely because the other person is an affiliate or subsidiary of the subsidizing company (*see*, *e.g.*, Supreme Court Decisions 99Do4923, Mar. 14, 2000; and 2002Do661, Jul. 8, 2004).

Yet, as fundamental risks inhere in corporate management, predictions may not always materialize and corporate losses may arise even when a manager has made a prudent, informed decision in good faith without intending any personal gain. Thus, a manager cannot be held criminally liable for occupational breach of trust even in such cases by relaxing the interpretive standard of intent (*see* Supreme Court Decision 2004Do5742, Mar. 15, 2007). Here, whether intent of breach of trust can be recognized on grounds of business judgment should be determined on a case-by-case basis, depending on whether a given case is one in which the act at issue is deemed intentional with the knowledge that oneself or a third party is acquiring pecuniary gain to the detriment of the principal, in light of all the circumstances, including the development and motive leading up to the business judgment at issue, details of the business at issue, economic situation in which the company finds itself, and the likelihood of incurring losses and acquiring gain (*see*, *e.g.*, Supreme Court Decision 2009Do1149, Oct. 28, 2010).

Meanwhile, even where a business group's pursuit of shared interests under a common purpose holds practical and economic significance, the individual affiliates and subsidiaries constituting the business group involve a number of stakeholders, including creditors and shareholders, as parties with separate and independent legal personality. Depending on the issue, they may well have unique interests of their own, divergent from the common interests of the business group (*see* Supreme Court Decision 2013Do5214, Sept. 26, 2013). As such, even where inter-affiliate subsidization is for the sake of common interests on the business group level, there may well be cases where it entails the risk of pecuniary loss to the subsidizing affiliate. Thus, caution must be exercised when determining whether a cross subsidization between corporate affiliates and subsidiaries was performed within the discretionary scope of reasonable business judgment.

Therefore, in addition to the factors stated earlier, the determination whether a cross subsidization was conducted within the discretionary scope of reasonable business judgment requires consideration of the following factors: (a) whether the subsidizing and subsidized affiliates are practically combined

in terms of capital and operation to such an extent that they are geared toward common interests and synergy effect; (b) whether such cross subsidization is for the sake of common interests of all the affiliates and subsidiaries of a business group including the subsidizing affiliate, and not just for the interests of a specific person or company; (c) whether the decisions on the designation of a subsidizing affiliate and the scale of subsidization were objectively and reasonably made by fully taking into account such factors as the given affiliate's intent and capacity to subsidize; (d) whether the specific subsidization was implemented by a normal and lawful method; and (e) whether the subsidizing affiliate could have objectively expected an adequate reward commensurate with the burden or risk attendant on the subsidization. If comprehensive consideration of all these factors leads to the recognition that the cross subsidization at issue was conducted within the discretionary scope of reasonable business judgment, then it is difficult to find it as an intentional act with the knowledge of detriment to the principal.

2) On the ground that Defendant 1's aforementioned act was beyond the scope of reasonable business judgment, the lower court reversed the first instance judgment acquitting Defendant 1 of this part of charges of violation of the Specific Economic Crimes Act (breach of trust), and convicted Defendant 1, taking into account the following facts: ① Nonindicted Stock Company 3 (hereinafter "Nonindicted Co. 3"), having suffered a worsening financial condition since the end of 2008, concluded a financial structure improvement arrangement and an autonomous agreement with financial institutions around May 2010; ② subsidiaries that had been subsidized by Nonindicted Co. 3 in the form of integrated purchase had been in arrears in payment of the integrated purchase price since before the date indicated in this part of the charges, for reasons unlikely to be resolved in the short run; ③ it is reasonable to view that Defendant 1, chairperson of ○○○ Group, was at least willfully negligent of the fact that Nonindicted Co. 3 would incur losses if it were to rollover the subsidiaries' payment of the integrated purchase price; ④ even according to Defendant 1's statement, the actual amount of loss incurred by Nonindicted Co. 3 due to the instant integrated purchase is around KRW 88.6 billion; ⑤ it is reasonable to view that, in light of the financial structure of ○○○ Group's subsidiaries, the cost saving benefits available to Nonindicted Co. 3 by the instant integrated purchase were far outweighed by the disadvantages of difficult payment recovery; ⑥ nevertheless, Defendant 1 continued with economic subsidization by integrated purchase, with neither the resolution of the board of directors, nor the approval of, or report to, the Fund Management Board, nor any collateral from the subsidiaries; ⑦ the problem with the instant

integrated purchase is not the integrated purchase per se, but the prolonged, large scale transaction based on account receivables, and thus, it cannot be treated in the same way as integrated purchase in its ordinary sense; and ⑧ in the event of bad financial situation of the subsidiaries with which it engaged in integrated purchase, a more reasonable business judgment for Nonindicted Co. 3 would have been to secure an alternative supplier of vessel components and suspend the integrated purchase.

3) However, we cannot accept the lower judgment for the following reasons.

A) Review of the lower judgment and the record reveals the following facts and circumstances.

① Around Apr. 2009, as it was anticipated that demand for steel products would rise due to its subsidiaries' construction of plants, and that the purchase conditions, including the unit price, would not be in its interest if each subsidiary were to individually purchase steel products, ○○○ Group considered ways to engage in an integrated purchase of steel products on a group level for cost saving purposes by concentrating the purchasing power. Accordingly, around Dec. 1, 2009, Nonindicted Co. 3 concluded each integrated purchase agreements with Nonindicted Stock Company 4 (hereinafter "Nonindicted Co. 4"), Nonindicted Stock Company 5 (hereinafter "Nonindicted Co. 5"), Nonindicted Stock Company 6 (hereinafter "Nonindicted Co. 6"), and Nonindicted Stock Company 7 (hereinafter "Nonindicted Co. 7").

② Around the time of signing the integrated purchase agreements, Nonindicted Cos. 4, 6, and 7 were building plants. Nonindicted Co. 4 started commercial production in the newly built plant from around Nov. 2010, Nonindicted Co. 6 from around Jul. 2010, and Nonindicted Co. 7 from around Aug. 2010.

③ Nonindicted Cos. 4, 6, and 7 needed to run a trial production before embarking on a commercial production in earnest, and also needed to purchase raw materials for commercial production two to three months in advance. The subsidiaries engaged in the integrated purchase had originally paid the integrated purchase price in cash to Nonindicted Co. 3. But with the increased demand for fund due to the aforementioned plant construction, the subsidiaries began to settle with promissory notes one after another from Feb. 2010.

④ Upon finding out about Nonindicted Co. 3's integrated purchase around Apr. 2011, the Fund Management Board that was dispatched to Nonindicted Co. 3 under the autonomous agreement: (a) confirmed with Defendant 3 the developments leading up to the integrated purchase and gave instructions to seek measures to recover funds; (b) on May 4, 2011, sent out notice to subsidiaries engaged in integrated purchase, requesting them to report any

updates to the Fund Management Board on the settlement of integrated purchase price and repayment plans; and (c) on May 16, 2011 and Jul. 13, 2011, held a meeting of the Fund Management Board to consider ways to recover the integrated purchase price.

⑤ However, the Fund Management Board allowed the integrated purchase to continue for the time being without reporting to the creditors immediately upon finding out about it. The reason seems to be that at the time, there was no cash flow problem with Nonindicted Co. 3, as it held more than three months' worth of advance cash, and the Fund Management Board may have considered that an immediate suspension of integrated purchase might drive to bankruptcy those subsidiaries supplying Nonindicted Co. 3 with essential shipbuilding raw materials. Thereafter, the creditors held a meeting on Aug. 22, 2011, where they decided to suspend the integrated purchase.

⑥ Against the backdrop of an aggravated business environment, such as drop in demand for ships, canceled orders, delays in delivery and acquisition of completed ships, low-price orders, decrease in the rate of advance payment, and exchange loss and the attendant shortage in liquidity, which were driven by the global financial crisis and economic recession from the end of 2008, Nonindicted Co. 3 realized KRW 21.8 billion in operating income as of the end of 2009, but a spike in exchange rate caused a massive loss in derivatives, which in turn gave rise to an approximately KRW 149.1 billion-worth of cumulative deficit, eroding KRW 52.5 billion in capital. Likewise, it realized a KRW 29.7-worth of operating income at the end of 2010; however, for the foregoing reasons, it witnessed an approximately KRW 427 billion-worth of cumulative deficit on the accounting books, eroding KRW 250.1 billion in capital.

B) Examining the foregoing facts and the following circumstances in light of the aforementioned legal doctrine, it is reasonable to view that Defendant 1's having Nonindicted Co. 3 subsidize ○○○ Group's subsidiaries by way of integrated purchase was within the discretionary scope of reasonable business judgment for the sake of the common interest of ○○○ Group's subsidiaries. It is difficult to conclusively deem it an intentional act with the awareness of detriment to Nonindicted Co. 3.

① In light of the nature of subsidization, it is difficult to view that Nonindicted Co. 3's integrated purchase of raw materials, including steel products necessary for the productive activities of ○○○ Group's subsidiaries, and its supply of the same to said subsidiaries using promissory note settlement, were aimed at the private interest of a specific person or company. Rather, there is much room to view it as itself aimed at the common interest of ○○○ Group's subsidiaries engaged in the same or similar business.

② In particular, integrated purchase has been planned and implemented for cost saving purposes since before the conclusion of the autonomous

agreement with creditors, with a view to concentrating the purchasing power of the subsidiaries that supply raw materials to Nonindicted Co. 3. The gradual shift from cash settlement to settlement in promissory notes for the integrated purchase from around Feb. 2010 seems to have been prompted by said subsidiaries' shortage of capital due to new investments, such as that for plant construction. Thus, it is difficult to view that Nonindicted Co. 3's subsidization of the subsidiaries by integrated purchase or by settlement in promissory notes was beyond an objective, reasonable standard of determining the beneficiary and volume of support, or against the intent of Nonindicted Co. 3.

③ Although at the time Nonindicted Co. 3 was suffering from capital erosion on the accounting books, it realized KRW 21.8 billion in operating income in 2009, and KRW 29.7 billion in operating income in 2010. Moreover, as to the exchange loss causing massive accounting loss, it negotiated by an autonomous agreement, etc. to roll over the derivatives maturity to Dec. 31, 2012. In view of this, it is difficult to conclude that Nonindicted Co. 3 lacked the capacity to support the subsidiaries by integrated purchase solely because of its capital erosion on the accounting books. Thus, it is difficult to view this part of Nonindicted Co. 3's subsidization of the subsidiaries by integrated purchase to have exceeded its capacity.

④ In light of the fact that the Fund Management Board de facto knowingly acquiesced in the integrated purchase and settlement in promissory notes for a time without immediately suspending the practices, and that financial institutions and corporate assessment agencies positively evaluated the business prospects of Nonindicted Cos. 4, 7, etc., as will be seen *infra*, apparently Nonindicted Co. 3 could have objectively expected not only that the subsidiaries supported by the raw material purchase would settle the integrated purchase payment by their own production and sales, but also that their future business growth would help expand the business on the ○○○ Group level, thereby realizing a synergy effect.

4) Nevertheless, solely on grounds of its reasoning, the lower court convicted Defendant 1 to this part of the charges. In so doing, the lower court erred by misapprehending the legal doctrine on the intent in occupational breach of trust and on business judgment, which affected the conclusion of the judgment. Defendant 1's allegation in its grounds of appeal assigning this error is with merit.

C. As to the part on Defendant 1's occupational breach of trust regarding Nonindicted Co. 3's disposal of scrap metals to Nonindicted Co. 7

1) On the ground that Defendant 1's aforementioned act exceeded the scope of reasonable business judgment for having indirectly subsidized a subsidiary in financial difficulty in the form of account receivables at the expense of Nonindicted Co. 3's interest, the lower court reversed the first instance judgment acquitting Defendant 1 of this part of the charges of violation

of the Specific Economic Crimes Act (breach of trust), and convicted Defendant 1, taking into account the following facts: ① due to financial difficulty, Nonindicted Co. 3 signed a financial structure improvement arrangement and an autonomous agreement with the creditors around May 2010; ② also due to financial difficulty, Nonindicted Co. 7 began to issue promissory notes because it could not pay in cash for this part of the scrap metal price from around Jan. 2010; ③ since most of said promissory notes were not timely paid, it is reasonable to view that Defendant 1 as the chairperson of ○○○ Group was at least willfully negligent of the fact that the aforementioned scrap metal trade incurred loss; ④ the benefit that Nonindicted Co. 3 could have expected of the instant scrap metal trade was merely a vague "benefit on the business group level"; and ⑤ in conducting the scrap metal trade on account receivables without any collateral from Nonindicted Co. 7, Nonindicted Co. 3 neither obtained a resolution of the board of directors, nor reported to nor sought approval from the Fund Management Board.

2) However, we cannot accept the lower court determination for the following reasons.

A) Review of the lower judgment and the record reveals the following facts and circumstances.

① Nonindicted Stock Company 8 (hereinafter "Nonindicted Co. 8") was established around Apr. 2006 for the purpose of manufacturing ship equipment and collecting and selling scrap metals. It purchased scrap metals from Nonindicted Co. 3 from around Jan. 2008, for which it paid in cash until the end of 2009.

② Around 2009, as a part of ○○○ Group's profit diversification strategy, Defendant 1 added to Nonindicted Co. 8's business scope the manufacturing and sales of JCO LSAW pipes, which are used in oil pipes and construction industry, followed by the renaming of Nonindicted Co. 8 into Nonindicted Co. 7 in Oct. 2009.

③ Around Feb. 2010, △△△△ Corporate Assessment Agency evaluated Nonindicted Co. 7's business outlook, projecting its estimated revenues from the manufacturing and sales of JCO LSAW pipes and spiral pipes at approximately KRW 133.5 billion in 2010, KRW 239.5 billion in 2011, KRW 282.5 billion in 2012, and KRW 329.6 billion in 2013, while projecting its operating income ratio at around 10% or above from 2013, which would be four years into plant operation. Thanks to such positive business outlook, Nonindicted Co. 7 was able to take out a bank loan of KRW 20.5 billion.

④ From the end of 2009, Nonindicted Co. 7 saw an increase in spending due to the construction of a new plant for JCO LSAW pipes. Thus, it started paying in promissory notes to Nonindicted Co. 3, with which it had been engaged in scrap metal trade.

⑤ Around Aug. 2011, the creditors of Nonindicted Co. 3 found out that Nonindicted Co. 7 had been settling in promissory notes for the scrap metal transaction, and around that time, instructed Nonindicted Co. 3 to not sell any scrap metals without being paid in cash. Accordingly, Nonindicted Cos. 3 and 7 discontinued their scrap metal trade.

B) Examining the foregoing facts and the following circumstances in light of the aforementioned legal doctrine, it is reasonable to view that Defendant 1's act of having Nonindicted Co. 3 subsidize Nonindicted Co. 7 by means of this part of scrap metal trade was within the discretionary scope of reasonable business judgment for the sake of the common interest of ○○○ Group's subsidiaries. It is difficult to conclude this as an intentional act with the awareness of detriment to Nonindicted Co. 3.

① This part of the scrap metal transaction between Nonindicted Cos. 3 and 7 had been in place from around Jan. 2008, which is about one year and five months before the date of the offense indicated in the charges. There is much room to regard it to be not for the private interests of a specific person or company, but rather for the benefit of the common interest of, or synergy effect between, the subsidiaries engaged in similar or relevant businesses.

② It is difficult to conclude that, in engaging in this part of the scrap metal trade, Nonindicted Co. 3's subsidization in the form of rolling over the scrap metal payment maturity for Nonindicted Co. 7 was against Nonindicted Co. 3's intention or in excess of its capacity.

③ This part of the subsidization by Nonindicted Co. 3 was due to Nonindicted Co. 7's increased demand for funds arising from its new business investment such as construction of a new plant. In light of the positive outlook for the new business as projected by financial institutions and corporate assessment agencies, it appears that Nonindicted Co. 3 could have reasonably expected benefit and reward from its subsidization for Nonindicted Co. 7.

3) Nevertheless, solely on grounds of its reasoning, the lower court convicted Defendant 1 to this part of the charges. In so doing, the lower court erred by misapprehending the legal doctrine on the intent in occupational breach of trust and on business judgment, which affected the conclusion of the judgment. Defendant 1's allegation in its grounds of appeal assigning this error is with merit.

D. As to the part on Defendants' occupational breach of trust regarding Nonindicted Co. 5's financial loans to Nonindicted Co. 4

1) On the ground that the Defendants' aforementioned act exceeded the scope of reasonable business judgment, the lower court reversed the first instance judgment partly acquitting Defendant 1 of this part of the charges and partly convicting Defendant 1, and instead convicted Defendant 1 to the entirety of this part of charges of violation of the Specific Economic Crimes Act (breach of trust), taking into account the following facts: ① this part of the financial loans was extended not for the benefit of Nonindicted Co. 5, but was motivated to indirectly subsidize Nonindicted Co. 4; ② this part of the financial loans posed a direct, concrete property risk to Nonindicted Co. 5 commensurate with the loan amount, without any benefit whatsoever to offset the risk other than the vague reward of benefit on the ○○○ Group level; ③ even if suspending support for Nonindicted Co. 4 carried the risk of a bigger loss, the Defendants should have appealed to the creditors or the Fund Management Board on the situation and taken due procedural steps to make financial subsidization available; ④ Nonindicted Co. 5 had such financial difficulty since May 2010 that it had to delay the integrated purchase payment to Nonindicted Co. 3; ⑤ at the time, the Defendants were apparently aware of the fact that they were "subsidizing Nonindicted Co. 4 at a marginal situation without undergoing any such normal procedure as resolution by the board of directors, consultation with the Fund Management Board, or securing claim recovery measures"; and ⑥ even if Nonindicted Co. 5 could afford this part of the financial loans at the time, whether the victim company had financial capacity has no direct bearing on the establishment of breach of trust.

2) However, we cannot accept the lower court determination for the following reasons.

A) Review of the lower judgment and the record reveals the following facts and circumstances.

① Nonindicted Co. 5 is the parent company holding 62.9% shares in Nonindicted Co. 3, Nonindicted Co. 3 is the parent company holding 100% shares in Nonindicted Co. 1, and Nonindicted Co. 1 is the parent company holding 100% shares in Nonindicted Co. 4.

② Nonindicted Co. 4 was established around Jan. 2008 to manufacture forged products used in shipbuilding and in nuclear and wind power plants, in line with ○○○ Group's strategy to develop new growth engine. At the time of its establishment, it was planning to invest KRW 400 billion to build a three-stage forging plant and a plant for processing, steelmaking, and drawing, with a view to setting up a consolidated production system for steelmaking and forging.

③ Financed by the KRW 100 billion invested by Nonindicted Co. 1 in paid-in capital and the KRW 32 billion loaned from other subsidiaries, including Nonindicted Cos. 3 and 5, Nonindicted Co. 4 completed the construction of the first stage forging and processing plants around Nov. 2010, and started manufacturing forged products around that time.

④ To finance the construction of the second stage forging plant, Nonindicted Co. 4 applied for a loan with □□ Bank, and was extended a KRW 170 billion-worth of syndicated loan by □□ Bank, etc. around Mar. 2011.

⑤ Regarding the aforementioned loan, around Jan. 2011, △△△△ Corporate Assessment Agency commented on the outlook of forging business as pursued by Nonindicted Co. 4 as follows: "Major local forging companies seem to be bottoming out, as they are receiving more orders in 2010 from shipbuilding and wind power plant industries. The global policy trend toward low carbon, green growth is anticipated to drive more construction of wind and nuclear power plants, which in turn is likely to raise the demand for forged products." In addition, around Feb. 21, 2011, taking into account its evaluation of both positive and negative factors in extending loans to Nonindicted Co. 4, □□ Bank's Investment Finance Department applied for credit approval of a syndicated loan on the following ground: "Nonindicted Co. 4 has a high investment to net worth ratio, and sound profitability and corporate value are anticipated, as its installation of a consolidated production system of steelmaking and forging would likely give it cost competitiveness over the existing players. Notwithstanding the conclusion of an autonomous agreement by its parent Nonindicted Co. 3, Nonindicted Co. 4's robust operation based on the instant facilities investment would likely contribute to enhancing the corporate value of Nonindicted Co. 3 as well." The application was approved around Mar. 11, 2011.

⑥ Meanwhile, apart from the loan for the construction of the aforementioned second stage plant, Nonindicted Co. 4 had plans to attract foreign investment to raise the KRW 100 billion to finance the third stage plant construction. From around Dec. 2010, it engaged in investment negotiations with ◇◇◇◇, but □□ Bank refused the demand by ◇◇◇◇ for the joint and several guarantee by Nonindicted Co. 3, which was subject to an autonomous agreement, leading the investment negotiations to break down around May 2011. Since it failed to find a substitute investor, Nonindicted Co. 4's plans for third stage plant construction failed.

⑦ After the completion of the first stage forging plant, Nonindicted Co. 4 began commercial production in earnest. The high defect ratio in the early stages of production led to excessive production cost. The early 2011 Japanese earthquake that devastated nuclear power plants led to cancellation of many of

the new investments in nuclear power plants, which the company had expected to generate much demand. Meanwhile, the late 2011 European financial crisis led to a drop in demand for wind power plants. All these circumstances sharply aggravated the financial situation of Nonindicted Co. 4.

⑧ Because it reflected its subsidiary Nonindicted Co. 3's loss in derivatives caused by exchange loss as a valuation loss under the equity method, Nonindicted Co. 5 saw capital erosion of approximately KRW 56.1 billion as of the end of 2009, approximately KRW 46.9 billion as of the end of 2010, and KRW 46.9 billion as of the end of 2011. At the same time, however, it had consistently posted operating income since 2008. Specifically, it realized approximately 7.1 billion in operating income with approximately KRW 64.3 billion in revenues in 2008, approximately KRW 8 billion in operating income with KRW 59.1 billion in revenues in 2009, KRW 7.2 billion in operating income with KRW 99.4 billion in revenues in 2010, and KRW 10.1 billion in operating income with KRW 136.9 billion in revenues in 2011.

⑨ Nonindicted Co. 4 saw KRW 1.1 billion in operating loss in 2008, the first year of its establishment, KRW 1.9 billion in operating loss in 2009, and KRW 5.7 billion in operating loss despite KRW 10 billion in revenues, which led to KRW 9.3 billion in net loss for the term in 2010. In 2011 as well, its finances worsened as it realized approximately KRW 71.5 billion in revenues but KRW 57.4 billion in operating loss, which led to KRW 81.2 billion in net loss for the term, while its current liabilities exceeded its current assets by KRW 153.9 billion. Thereafter around Mar. 2012, ○○○ Group decided to sell off Nonindicted Co. 4, and around Apr. 20, 2012 obtained □□ Bank's approval of KRW 26.3 billion in working capital on the condition of a sell-off. Eventually, however, it applied for the commencement of rehabilitation procedure on May 29, 2012, but decided to abrogate the rehabilitation procedure on Apr. 16, 2013, and was declared bankrupt on Jul. 8, 2013.

B) Examining the foregoing facts and the following circumstances in light of the aforementioned legal doctrine, it is difficult to conclude the entirety of the Defendants' lending of approximately KRW 75.8 billion out of Nonindicted Co. 5's corporate funds to Nonindicted Co. 4 from around July 2010 to April 2012 as an intentional act with the awareness of detriment to Nonindicted Co. 5. Thus, the lower court should have divided the financial loans as enumerated in the Attachment 1 List of Crimes of the lower judgment into those for which the intent of occupational breach of trust is recognized and those for which it is not, and then determined whether occupational breach of trust is established.

① Nonindicted Cos. 5, 3, 1, and 4 were in a parent-subsidiary relationship through serial investments in each other. Moreover, Nonindicted Co. 5's loan to Nonindicted Co. 4, which was being nurtured on the ○○○ Group level as a next-generation growth engine, was a parent company's subsidization of its

subsidiary. There is enough reason to view it as aimed at the common interest of the financially connected subsidiaries of ○○○ Group.

② Nonindicted Co. 5's capital erosion since the end of 2009 was due to the reflection of its subsidiary Nonindicted Co. 3's derivatives loss arising from exchange loss as a valuation loss under the equity method. Given that the maturity of derivatives was postponed to the end of 2012 by the autonomous agreement with creditors, and Nonindicted Co. 5 had been consistently realizing significant revenues and operating income from 2008, it is difficult to conclude that Nonindicted Co. 5 could not afford the entirety of the KRW 75.8 billion-worth of unsecured loan extended over 37 instances from Jul. 5, 2010 to Apr. 5, 2012, as indicated in the Attachment 1 List of Crimes of the lower judgment. Namely, it seems clear that, out of the loan extended over 37 instances, there are parts that could be deemed cross-subsidization between subsidiaries within the bounds not exceeding Nonindicted Co. 5's financial capacity.

③ Corporate assessment agency positively projected the business outlook of Nonindicted Co. 4. There is also reason to believe that financial institutions' assessment of Nonindicted Co. 4's need for loans and their recoverability was positive to a certain extent, such that they decided to extend a KRW 170 billion loan to Nonindicted Co. 4 around Mar. 2011 and a KRW 26.3 billion loan around Apr. 2012. In light of these facts, it is difficult to view the entirety of Nonindicted Co. 5's loans to Nonindicted Co. 4 from around Jul. 2010 to around Apr. 2012 as an unreasonable subsidization for which repayment or appropriate reward could hardly be expected, solely for the reason that Nonindicted Co. 4 was accumulating deficits at the early stages of its business.

3) Nevertheless, solely for the grounds indicated in its reasoning, the lower court convicted the Defendants to the entirety of this part of the charges. In so doing, it erred by misapprehending the legal doctrine on the intent in occupational breach of trust and on business judgment, thereby failing to exhaust all necessary deliberation, which affected the conclusion of the judgment. The Defendants' allegation in their grounds of appeal assigning this error is with merit.

E. As to the Defendants' occupational breach of trust regarding Nonindicted Cos. 3 and 1's advance order for Nonindicted Co. 5

1) On the ground that the Defendants' subsidization of Nonindicted Co. 5 with the corporate funds of Nonindicted Cos. 3 and 1 in the form of advance order constituted a breach of trust against Nonindicted Cos. 3 and 1, the lower court affirmed the first instance judgment convicting the Defendants to this part of the charges of violation of the Specific Economic Crimes Act (breach of trust), excluding the part on which the first instance court judged not guilty in the reasons, taking into account the following facts: ① there is a huge gap

between the volume of Nonindicted Co. 5's actual supply and that of the advanced order, and it is difficult to view the instant advanced order contract as a normal contract for the sale of goods, taking account of the shipbuilding industry market at the time, shipbuilding process, and the types and specifications of cranes for vessels that differ by type of vessel; ② it was very unusual to go above and beyond simply concluding the instant contract on advanced order, to even make payments; ③ breach of trust is consummated at the point when payment is made for the advance order ahead of time, and whether Nonindicted Co. 5 actually manufactured and supplied cranes thereafter has no bearing on the establishment of breach of trust; and ④ Nonindicted Cos. 3, 1, and 5 were not in a good financial situation.

2) Taking into account such reasoning of the lower judgment, together with the following facts as revealed by the evidence duly admitted by the lower court, it is difficult to recognize that the Defendants' having Nonindicted Cos. 3 and 1 pay Nonindicted Co. 5 for the advance order was within the discretionary scope of reasonable business judgment for the sake of the common interest of ○○○ Group's subsidiaries. Thus, contrary to what is alleged in the grounds of appeal, in so determining, the lower court did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, by misapprehending the legal doctrine on the constituent elements and intent of breach of trust, by omitting any judgment, or by inconsistent reasoning, thereby affecting the conclusion of the judgment.

① Nonindicted Cos. 3 and 1's aforementioned subsidization of Nonindicted Co. 5 in the form of advance order was practically to support Nonindicted Co. 4, which was financially struggling at the time. As such, there is reason to regard it as a cross-subsidization for the common interest of ○○○ Group's subsidiaries.

② However, Nonindicted Cos. 3 and 1 paid Nonindicted Co. 5 in the name of advance payment through a contract with Nonindicted Co. 5 in the form of advance order, notwithstanding the lack of any real demand for cranes on vessels, and then had Nonindicted Co. 5 lend that money to Nonindicted Co. 4, the actual entity to be supported. This seems to have been an expedient means for Nonindicted Cos. 3 and 1 to bypass the prohibition against direct subsidization of Nonindicted Co. 4 due to the autonomous agreement they entered into with the creditors. Ultimately, it is difficult to view the foregoing subsidization to have followed objective and reasonable standards in designating the subsidizing company and deciding on the means and scale of subsidization. Thus, it is also difficult to evaluate that the subsidization was performed by normal and lawful means.

③ Thus, it appears to have been difficult for Nonindicted Cos. 3 and 1 to objectively expect reward or benefit commensurate with their indirect, secret subsidization of Nonindicted Co. 4. Namely, the Defendants were aware that the advance order payment that Nonindicted Cos. 3 and 1 made to Nonindicted Co. 5 would not be used for the production of cranes for vessels. For this reason, it appears that Nonindicted Cos. 3 and 1 had to assume the risk of the corresponding property damage, whereas the benefit they could expect from their subsidization of Nonindicted Co. 4 was indirect and meager.

F. As to the part on Defendant 1's occupational embezzlement regarding Nonindicted Co. 4's illegal use of the scrap metals in possession of Nonindicted Co. 3

1) On the ground that Defendant 1's having Nonindicted Co. 4 use the scrap metals of Nonindicted Co. 3 was an embezzlement of the scrap metals in Nonindicted Co. 3's possession, leveraging his/her position as the chairperson of ○○○ Group at the expense of Nonindicted Co. 3, the lower court affirmed the first instance judgment convicting Defendant 1 to this part of the charges of violation of the Specific Economic Crimes Act (embezzlement), excluding the part on which the first instance court judged not guilty in the reasons, taking into account the following facts: ① the person legally authorized to declare consent to the instant use of scrap metals on behalf of Nonindicted Co. 3 is the representative director Nonindicted Co. 9, whereas Defendant 1 is a mere shareholder with 31.1% shares in Nonindicted Co. 3. As such, Defendant 1's consent to the scrap metal use cannot be identified with a consent by the representative director; ② it is reasonable to view that at the time, Defendant 1 was aware of the fact that he/she was "allowing Nonindicted Co. 4 to use the scrap metals in possession of Nonindicted Co. 3, without the lawful consent of Nonindicted Co. 3"; and ③ since legal harm has already been done by Nonindicted Co. 4's use of the instant scrap metal at its discretion, facts such as that the scrap metal price has subsequently been paid or that the said company is in a parent-subsidiary relationship with Nonindicted Co. 3 do not have any bearing on the establishment of the offense.

2) Examining the reasoning of the lower judgment in light of the duly admitted evidence, contrary to what is alleged in the grounds of appeal, in so determining, the lower court did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, or by misapprehending the legal doctrine on the intent of a single shareholder of a sole proprietorship, intent of unlawful appropriation in occupational embezzlement, and damages.

G. As to the part on the Defendants' occupational breach of trust regarding Nonindicted Co. 1's financial loan to Nonindicted Joint Stock Company 10

1) On the ground that the Defendants' loan of KRW 18.3 billion out of Nonindicted Co. 1's funds to Nonindicted Stock Company 10 (hereinafter "Nonindicted Co. 10") from Jan. 15, 2010 to Apr. 23, 2010 exceeded the scope of reasonable business judgment, and thus constituted an occupational breach of trust against Nonindicted Co. 1, the lower court reversed the first instance judgment acquitting the Defendants of this part of the charges of violation of the Specific Economic Crimes Act (breach of trust), excluding the part on which the lower court judged not guilty, and convicted the Defendants, taking into account the following facts: ① amid its financial difficulty, Nonindicted Co. 1 entered into a financial structure improvement arrangement and an autonomous agreement with financial institutions in May 2010, while the loan repayment capacity of Nonindicted Co. 10 was also dubious, with its worsening financial structure, including the KRW 6.3 billion capital erosion as of the end of 2010; ② even though it did not stand to directly gain from the instant loan, Nonindicted Co. 1 extended a loan to Nonindicted Co. 10, which was financially struggling, without holding a board of directors meeting or taking any claim recovery measure; and ③ at the time, the Defendants were aware of the fact that they were "subsidizing Nonindicted Co. 10, from which loan recovery was unclear, without taking the ordinarily necessary steps, such as passing a resolution of the board of directors, or securing any claim recovery measures."

2) Taking into account such reasoning of the lower judgment, together with the following facts as revealed by the evidence duly admitted by the lower court, it is difficult to recognize this part of the Defendants' financial loans to have been within the discretionary scope of reasonable business judgment for the sake of the common interest of ○○○ Group's subsidiaries. Thus, notwithstanding some inappropriate part in the lower court's explanation of its reasoning, we can accept the foregoing conclusion of the lower judgment. Contrary to what is alleged in the grounds of appeal, in so determining, the lower court did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, or by misapprehending the legal doctrine on the constituent elements of breach of trust, intent, and the business judgment rule, thereby affecting the conclusion of the judgment.

① Nonindicted Co. 1 extended approximately KRW 18.3 billion in loan without collateral to Nonindicted Co. 10, in which Nonindicted 11, Defendant 1's second son, held 100% shares. According to Defendant 1 himself/herself as well, the loan was used for the purchase of equipment such as transporter, aerial working platforms, and forklift trucks.

② The benefit that Nonindicted Co. 1 could have expected from such unsecured lending appears to be logistics cost savings by insider trading between the subsidiaries. This can hardly be deemed an appropriate reward for this part of the subsidization by Nonindicted Co. 1. Nor can it be deemed that the subsidizing company was designated according to objective and reasonable standards.

③ Furthermore, taking into account the aforementioned financial circumstance of Nonindicted Cos. 1 and 10, as well as ○○○ Group's new business and the attendant asset demand on the business group level, it is difficult to deny that this part of the unsecured loan was for the benefit of Nonindicted 11, Defendant 1's second son, barring any other need for an urgent financial support.

H. As to the part on Defendants 1 and 3's violation of the Act on External Audit of Stock Companies

On the grounds as indicated in its reasoning, the lower court affirmed the first instance judgment convicting Defendants 1 and 3 to the charges of violation of the Act on External Audit of Stock Companies (excluding the part on which the first instance court judged not guilty in the reasons), because it could be found that Defendant 1, chairperson of ○○○ Group, and Defendant 3, in charge of Nonindicted Co. 4's funds, colluded to expand the appearance of revenues of Nonindicted Co. 4 by: (a) inserting Nonindicted Co. 4 in the transaction between Nonindicted Co. 5 and another entity; (b) thereby raising approximately KRW 3.9 billion in false product sales revenue; (c) reflecting the outcome on the financial statement; and (d) making it public.

Examining the reasoning of the lower judgment in light of the duly admitted evidence, contrary to what is alleged in the grounds of appeal, in so determining, the lower court did not err by exceeding the bounds of the principle of free evaluation of the evidence inconsistent with logical and empirical rules, or by misapprehending the legal doctrine on the party identification in a contract and intent.

2. Decision on the Prosecutor's grounds of appeal

A. On the grounds as indicated in its reasoning, of the charges against the Defendants, the lower court acquitted the Defendants of the charges of violation of the Specific Economic Crimes Act (breach of trust) regarding Nonindicted Co. 5's purchase of Nonindicted Co. 3's stocks, violation of the Specific Economic Crimes Act (bribing, etc.), and bribery.

Examining the reasoning of the lower judgment in light of the pertinent legal doctrine as indicated in the lower judgment and the record, contrary to what is alleged in the grounds of appeal, in so determining, the lower court did not err by misapprehending the legal doctrine on property damage in breach of trust, occupational relevance under Article 5 of the Specific Economic Crimes Act, and the constituent elements of bribery.

B. Meanwhile, the Prosecutor also appealed against the lower court's acquittal of the Defendants of the charges of violation of the Specific Economic Crimes Act (fraud) and acquittal of Defendant 1 of the charges of violation of the Specific Economic Crimes Act (breach of trust) for illegal wage raise. However, the Prosecutor failed to indicate the grounds of objection on these points either in the notice of appeal or the appellate brief.

3. Scope of reversal

As seen earlier, we reverse the parts of the lower judgment on Defendant 1's occupational breach of trust regarding Nonindicted Co. 3's integrated purchase, Nonindicted Co. 3's occupational breach of trust by disposal of scrap metals to Nonindicted Co. 7, and the Defendants' occupational breach of trust regarding Nonindicted Co. 5's financial loans to Nonindicted Co. 4. Since the lower court sentenced the aforementioned parts and the remainder of guilty portion of the Defendants to a single punishment on the ground that they constituted a concurrent offense under the former sentence of Article 37 of the Criminal Act, we decide to reverse the guilty portion of the lower judgment in its entirety.

4. Conclusion

Therefore, the guilty portion of the lower judgment is reversed, and that part of the case is remanded to the lower court for further proceedings consistent with this Opinion. The Prosecutor's appeal is dismissed. It is so decided as per Disposition by the assent of all participating Justices on the bench.

Justices Ko Young-han (Presiding Justice)
Jo Hee-de
Kwon Soon-il (Justice in charge)
Cho Jae-youn

Supreme Court en banc Decision 2017Do4027 Decided May 17, 2018

【Violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust); Violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Bribing)】

【Main Issues and Holdings】

[1] Where in a real estate sales contract performance of the contract has reached a stage where an intermediate payment has been made, whether from that moment a seller can be deemed "a person who administers another's business" as stated in the crime of breach of trust (affirmative) and where a seller in such a position, prior to transferring the ownership of real estate to a buyer in accordance with the contract, disposes of the said real estate to a third party and completes registration thereof in the name of the third party, whether a criminal breach of trust is established (affirmative)

[2] In a case where the Defendant, a seller of real estate: (i) signed a real estate sales contract with Buyer A; (ii) received earnest money and intermediate payment from Buyer A; (iii) sold the same real estate, the object of sales, to Buyer B shortly thereafter; and (iv) was indicted on the charge of violating the former Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust), the case holding that: (a) despite the recognition of the fact that the Defendant's act constituted occupational breach of trust by betraying the fiduciary relationship with Buyer A, and thereby establishing the crime of breach of trust, as well as the criminal intent of the Defendant to breach trust and to obtain unlawful profits therefrom; (b) the lower judgment deemed otherwise and acquitted the Defendant of the facts charged; and (c) in so doing, erred by misapprehending the legal principle regarding "a person who administers another's business" and criminal intent in the crime of breach of trust

【Summary of Decision】

[1] **[Majority Opinion]** Where in a real estate sales contract only earnest money is paid, parties to a real estate sales contract may escape from the binding force of the contract by relinquishing the earnest money or paying back twice of the amount of the earnest money. However, where performance of contract has reached a stage where an intermediate payment has been made, a seller may not be exempt from the obligation to transfer the ownership of the real estate to

a buyer unless the contract is made void or rescinded. Therefore, where a contract reaches this stage, a seller owes a fiduciary duty to a buyer, in which a seller is obliged to cooperate with a buyer in his/her preservation of property by protecting and managing the buyer's pecuniary advantage. From that moment, a seller becomes "a person who administers another's business" as stated in the crime of breach of trust. Where a seller in such a position, prior to transferring the ownership of real estate to a buyer in accordance with the contract, disposes of the said real estate to a third party and completes registration thereof in the name of the third party, such an act impedes a buyer's acquisition or preservation of the real estate, which undermines the fiduciary relationship between a seller and a buyer, thereby constituting the crime of breach of trust.

The reasons are as follows:

A. The crime of breach of trust is established when a person owing a fiduciary duty to protect and preserve another and his/her pecuniary advantage commits acts that violate another's trust and thereby infringing upon his/her pecuniary advantage. Determination on (i) a degree of trust between the parties to a contract needed for the formation of fiduciary relationship protected by the criminal law, and (ii) the types of acts to be recognized as constituting punishable occupational breach of trust should be made normatively by comprehensively taking into account: (i) the substance of contract and the degree of its performance; (ii) the degree of binding force of the contract; (iii) transaction practice; (iv) types and substance of fiduciary relationship; and (v) the degree of violation of trust, depending on whether the protection of another's pecuniary advantage was a typical and fundamental substance of the contract, and whether the degree of betrayal of the act in question necessitates the intervention of the criminal law. Therefore, when finalizing the scope of which the crime of breach of trust is established, it needs to be ensured that the protection of an individual's property rights is not weakened because the crime of breach of trust as a penal provision does not fulfill its function.

B. In the Republic of Korea, real estate serves as the foundation of people's basic livelihood, forming the backbone of economic activities, as evidenced by the fact that significant share of the value of property owned by the Korean people is accounted for by real estate. As such, the importance of real estate in people's economic lives and socioeconomic significance of a real estate trade is still high.

C. The purchase and sale price of real estate is generally paid in three installments: earnest money, intermediate payment, and outstanding payment. When a buyer delivers intermediate payment to a seller, it gives binding effect to a contract, which cannot be rescinded arbitrarily by either one of the parties to the contract (*see* Article 565 of the Civil Act). However, there is no universal and sufficient measure that could prevent double selling of a seller where a buyer makes earnest money and intermediate payment, which accounts for

significant portion of the purchase-price. Even in such absence of measures, a buyer makes an intermediate payment to a seller, trusting that a seller would complete the registration of ownership transfer. In other words, a buyer makes an intermediate payment based on the trust that a seller would complete the registration of ownership transfer, and a buyer receives the money, perceiving it being paid based on such trust. Therefore, from the very moment an intermediate payment is delivered, a fiduciary relationship, where a seller cooperates in the property preservation of a buyer, becomes a typical and fundamental substance of the relationship of the parties to the contract. A seller in such a fiduciary relationship manages a buyer's business regarding acquisition of ownership, and thus becomes "a person who administers another's business" as stated in the crime of breach of trust. Furthermore, if a seller in such a position willfully disposes of the real estate in question to a third party prior to transferring the ownership to a buyer, such an act is naturally prohibited in a contract of sale and by the good faith provisions, and may be deemed an occupational breach of trust as stated in the crime of breach of trust.

D. The Supreme Court of the Republic of Korea has been consistent in its decision on the cases of double selling of real estate that a seller has an obligation to cooperate with a buyer until the completion of the registration of ownership transfer, and that double selling of the real estate in question to a third party after a seller receives an intermediate payment constitutes the crime of breach of trust, and has been establishing such precedents. The legal principles in these precedents have sincerely served the role of restraining double selling of real estate and protecting a buyer from such practice, and they still hold validity in light of the current real estate purchase and sale practices. These legal principles neither distort nor confuse real estate transactions, and they do not place excessive limits on a seller's right to freedom of contract. Therefore, existing precedents should be maintained.

[Dissenting Opinion by Justice Kim Chang-suk, Justice Kim Shin, Justice Jo Hee-de, Justice Kwon Soon-il, Justice Park Jung-hwa] Putting too much emphasis on the importance of punishment to protect a buyer of real estate transactions, the Majority Opinion neglected the principle of legality, which is the broad principle of the criminal law, by either going against or unnecessarily expanding the meaning of the language and text of the Criminal Act to the disadvantage of the Defendant. Moreover, it does not accord with the Supreme Court decisions that have renounced the establishment of the crime of breach of trust against a buyer or an obligor in cases of double selling of movable assets and cases of a promise of an accord and satisfaction agreement.

In light of the ordinary meaning of the language and text, "another's business" in the crime of breach of trust refers to the affairs within the ambit of another, meaning that the main agent of the business should be that another person. In other words, it means administering business which is supposed to be managed by another on behalf of that person. Furthermore, considering that

the essence of the crime of breach of trust lies in violating one's duty to protect the principal's pecuniary advantage, which arises out of an internal relationship or a fiduciary relationship with the principal, and thereby infringing upon another's property rights, the crime of breach of trust requires administering "another's business" as stated above based on a fiduciary relationship, and the substance of the business itself or the essence of a fiduciary relationship must be protecting and managing another's pecuniary advantage. Therefore, even if one of the parties to a contract sincerely performs his/her contractual duty to the counterparty, who benefits from the satisfaction of contractual rights, where such performance of duty does not constitute "another's business" as stated above, it is merely "one's own business."

Upon signing of a real estate sale contract, the signing of the contract immediately takes effect for a seller with the emergence of obligation to transfer the ownership of real estate and for a buyer with the obligation to make payment of purchase-price. These obligations of a seller and a buyer, however, may not be considered "another's business"; rather, they are "their own business" under a sale contract. A seller's duty to transfer property rights or a buyer's duty to make payment of purchase-price arises from a sale contract, meaning that these duties are not the businesses to be disposed of by the counterparts and may not be deemed to have been entrusted to the counterparts based on a fiduciary relationship. Likewise, protection and management of pecuniary advantage of the counterparty of the contract cannot be deemed a typical and fundamental substance of a contract of sale. The parties to a sale contract are in a reciprocal transaction relationship in which each is obliged to fulfill a consideration to the other for the sake of satisfaction of contractual rights. Even though it is argued that a seller has a duty of cooperation in registration of real estate or a duty of cooperation in a buyer's business of property acquisition, the essence of such "duty of cooperation" is merely a different expression of a duty of ownership transfer, which renders it unreasonable to distinguish between the two.

Assuming that a seller has a duty of cooperation in preservation of a buyer's property, it would have to be matched by an assumption that the counterparty to a contract, a buyer, also has a duty of cooperation in preservation of a seller's property in light of the essence of a bilateral contract. However, Supreme Court precedents have dismissed such cases as where a buyer, who received ownership of real estate before making outstanding payment, did not perform the contract in which he/she promised to make outstanding payment by taking out a loan secured on the real estate, and instead established collateral security for different purposes, determining that a buyer (a defendant) was not liable for the crime of breach of trust. The Majority Opinion does not provide reasonable explanation regarding difference, for a buyer and a seller, in the view of the existence of a duty of cooperation in preservation of the counterparty's property in a bilateral contract premised on the assurance of equal legal status between the parties to a contract.

Also, according to the Majority Opinion, if a seller receives an intermediate payment from the second buyer, the seller and the second buyer enter into a fiduciary relationship in which the seller is obliged to cooperate in the preservation of property to protect and manage the second buyer's pecuniary advantage. However, the precedents held that a seller is deemed to have committed the crime of breach of trust against the first buyer in a case where a seller completed the registration of ownership transfer to the second buyer, whereas in a case where a seller completed the registration of ownership transfer to the first buyer, a seller is not deemed to have committed the crime of breach of trust against the second buyer even if the seller received an intermediate payment or outstanding payment from the second buyer. There are no logical grounds to distinguish the first buyer from the second buyer in terms of the degree of protection in the establishment of the crime of breach of trust, even though they are entitled to the equal legal status as a creditor.

In the meantime, as in the Majority Opinion, if a buyer is deemed "a person who administers another's business" who may be subject to punishment on charges of the crime of breach of trust on the ground that a seller has a duty of cooperation in preservation of a buyer's property, such view stands contrary to the Supreme Court decisions in the previous cases on double selling of movable assets.

[2] The Defendant, who is a real estate seller, (i) signed a contract of sale with Buyer A; (ii) received a earnest money and an intermediate payment from Buyer A thereafter; (iii) double-sold the real estate which is the object of purchase and sale to a third party, namely Buyer B, and completed the registration of ownership transfer to Buyer B; and (iv) was charged with violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust) (amended by Act No. 13719, Jan. 6, 2016). The lower court comprehensively took into account the following facts: (a) the sale contract reached an irreversible stage, where it is impossible to be arbitrarily rescinded, and the Defendant owed a fiduciary duty to Buyer A, and became a person who administers another's (in this case, Buyer A) business regarding the acquisition of ownership of real estate, from the time at which Buyer A made an intermediate payment in accordance with the contract; (b) the content of the notification, which was sent from Buyer A to the Defendant at the time when the real estate in question was not transferred after the lapse of the time for outstanding payment, may not be deemed as the declaration of intention to rescind the contract by itself, but rather, its intent was simply to demand the Defendant to accept the condition and if not, the contract may be rescinded; (c) the Defendant sold the real estate and completed the registration of ownership transfer to Buyer B in a state where the said purchase and sale contract was not yet lawfully rescinded, which was a violation of the duty premised on the fiduciary relationship he/she owed to Buyer A; (d) the fiduciary relationship may not be deemed to have rescinded even though the Defendant (i) was unable

to transfer the real estate because it was not returned from the tenant at the time of the dispute; and (ii) exchanged words with Buyer A regarding a damage suit for nonperformance of obligation, insofar as the purchase and sale contract was not lawfully rescinded and was still in effect. However, despite the fact that (i) the act of the defendant was committed in violation of his/her duty owed in a fiduciary relationship with Buyer A, leading to the establishment of the crime of breach of trust; (ii) the purchase and sale contract was not lawfully rescinded at the time; and (iii) there are no reasonable grounds to the Defendant's belief that the contract was lawfully rescinded, all of which serve as the grounds for recognizing the criminal intention of a criminal breach of trust and the intention to obtain illegal profits, the lower court determined that the Defendant was not guilty on the indicted charge. Thus, this case maintains that the lower judgment erred by misapprehending the legal principles regarding "a person who administers another's business" stated in the crime of breach of trust, and the criminal intention thereof.

【Reference Provisions】 [1] Article 12(1) of the Constitution; Articles 1(1) and 355(2) of the Criminal Act; Article 565 of the Civil Act [2] Article 355(2) of the Criminal Act; Article 3(1)2 of the former Act on the Aggravated Punishment, etc. of Specific Economic Crimes (amended by Act No. 13719, Jan. 6, 2016); Article 565 of the Civil Act

Article 12(1) of the Constitution of the Republic of Korea

All citizens shall enjoy personal liberty. No person shall be arrested, detained, searched, seized or interrogated except as provided by Act. No person shall be punished, placed under preventive order or subject to involuntary labor except as provided by Act and through lawful procedures.

Article 1 of the Criminal Act (Criminality and Punishability of Act)

(1) The criminality and punishability of an act shall be determined by the law in effect at the time of the commission of that act.

Article 355 of the Criminal Act (Embezzlement and Breach of Trust)

(2) The preceding paragraph shall apply to a person who, administering another's business, obtains pecuniary advantage or causes a third person to do so from another in violation of one's duty, thereby causing loss to such person.

Article 565 of the Civil Act

(1) If one of the parties to a contract of sale has delivered, at the time of entering into the contract, money or other things under the name of down payment, assurance deposit, etc. to the other party, unless otherwise agreed upon between the parties, the deliverer by giving up such money, and the receiver by repaying double such money, may rescind such contract before one of the parties has initiated performance of the contract.

(2) Article 551 shall not apply to the case mentioned in the preceding paragraph.

Article 3 of the current Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Aggravated Punishment for Specific Property Crime)

(1) Any person who commits crimes as prescribed in Article 347 (Fraud), Article 347-2 (Fraud by Use of Computer, etc.), 350 (Extortion), 350-2 (Special Extortion), 351 (limited to habitual offenders as prescribed in Articles 347, 347-2, 350, and 350-2), 355 (Embezzlement and Breach of Trust) or 356 (Occupational Embezzlement, Occupational Breach of Trust) of the Criminal Act shall be aggravatingly punished as follows if the value of the goods or profits on property which he/she gains or has another person gain (hereafter referred to as an "amount of profit" in this Article) is five hundred million won or more: *<Amended by Act No. 13719, Jan. 6, 2016; Act No. 15256, Dec. 19, 2017>*

2. If the amount of profit is not less than five hundred million won but less than five billion won: Imprisonment with labor for a limited term of not less than three years.

【Reference Cases】 [1] Supreme Court Decisions 74Do2215 decided Dec. 23, 1975 (Gong1976, 8956); 83Do2057 decided Oct. 11, 1983 (Gong1983, 1683); 84Do1814, Jan. 29, 1985 (Gong1985, 405); 86Do1112 decided Dec. 9, 1986 (Gong1987, 180); 92Do1223 decided Dec. 24, 1992 (Gong1993Sang, 661); 2005Do5713 decided Oct. 28, 2005 (Gong2005Ha, 1909); 2008Do3766, Jul. 10, 2008; 2008Do11722 decided Feb. 26, 2009 (Gong2009Sang, 401); Supreme Court en banc Decision 2008Do10479 decided Jan. 20, 2011 (Gong2011Sang, 482); Supreme Court Decisions 2011Do3247 decided Apr. 28, 2011 (Gong2011Sang, 1223); 2011Do1651 decided Jun. 30, 2011 (Gong2011Ha, 1574); 2011Do15179 decided Jan. 26, 2012; Supreme Court en banc Decision 2014Do3363 decided Aug. 21, 2014 (Gong2014Ha, 1923)

【Defendant】 Defendant

【Appellant】 Prosecutor

【Defense Counsel】 Attorneys Kim Sun-kwan et al.

【Judgment of the court below】 Seoul High Court Decision 2016No2860 Decided February 23, 2017

【Disposition】 The part of the lower judgment on the violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust) is reversed, and the case is remanded to the Seoul High Court. The rest of the Prosecutor's appeal is dismissed.

【Reasoning】 The grounds of appeal are examined.

1. Gist of the case and the key points

A. The major background of the case is as follows.

(1) On August 20, 2014, the Defendant signed a real estate sales contract (hereinafter "instant contract") with the victims to sell a real estate property located in Geumcheon-gu, Seoul (hereinafter "instant real estate"), which was jointly owned by the Defendant, Nonindicted A, Nonindicted B, and Nonindicted C, for KRW 1.38 billion. According to the contract, the Defendant was: (a) to receive earnest money of KRW 2 billion on the date the contract is signed, an intermediate payment of KRW 6 billion on September 20, 2014, and an outstanding payment of KRW 5.8 billion on November 30, 2014 in exchange for delivering documents necessary for the registration of ownership transfer; and (b) transfer the instant real estate to the victims by November 30, 2014.

(2) The Defendant received KRW 2 billion on the date the contract was signed, and an intermediate payment of KRW 6 billion on September 30, 2014 from the victims.

(3) The Defendant sold the instant real estate for sale-price of KRW 1.5 billion to Nonindicted D and Nonindicted Party E on April 13, 2015, and completed the registration of ownership transfer on April 17 2015.

B. The instant indictment argues that such act of the Defendant constitutes a violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust). The lower court held that the Defendant was not guilty on this part of the instant indictment on the ground that: (i) the Defendant cannot be deemed "a person who administers another's business"; and (ii) it is difficult to conclude that an intention of breach of trust or an intention to gain illegal profits is recognized.

C. The key point of the instant case is whether the crime of breach of trust is established for a seller who committed so-called "double selling of real estate."

2. As to whether the crime of breach of trust is established for a seller who double-sold a real estate property

A. The crime of breach of trust stipulated in Article 355(2) of the Criminal Act is established when a person who administers another's business commits acts in violation of his/her duty to acquire pecuniary advantage or abets a third party to acquire pecuniary advantage thereby resulting loss to the principal. The essence of the crime of breach of trust lies in undermining another's trust rooted in a fiduciary relationship and causing pecuniary loss to that person. As such, "a person who administers another's business" as the subject of the crime of breach of trust should be someone: (i) who owes a fiduciary duty to administer another's duty in accordance with the good-faith principle; and (ii) whose duty of protecting and managing another's pecuniary advantage based on a fiduciary relationship forms the typical and essential substance of the relationship he/she has with the counterparty. One can be deemed "a person who administers another's business" even where the administration of another's business concerns not only protection and management of another's interests but also

that of his/her own interests, insofar as the nature of another's business is not confined to subordinate and peripheral scope but forms the core of one's duty (*see, e.g.,* Supreme Court Decisions 2004Do6890, Mar. 25, 2005; 2010Do3532, May 10, 2012).

"An occupational breach of trust", which is the element of a criminal breach of duty, refers to any acts conducted in breach of a fiduciary relationship with the principal by either (i) omitting an act required to be done under the provisions of relevant Act, the terms of contract, and/or the good-faith principle in light of specific circumstances including the details and nature of the business to be disposed of; or (ii) committing an act naturally presumed to be not committed (*see, e.g.,* Supreme Court Decision 99Do457, Mar. 14, 2000).

B. Where in a real estate sales contract only earnest money is made, any party of a real estate sales contract may escape from the binding force of the contract by relinquishing the earnest money or paying back twice of the amount of the earnest money. However, where performance of contract has reached a stage where an intermediate payment has been made, a seller may not be exempt from the obligation to transfer the ownership of the real estate to a buyer unless the contract is made void or rescinded. Therefore, where a contract reaches this stage, a seller owes a fiduciary duty to a buyer, in which a seller is obliged to cooperate with a buyer in his/her preservation of property, and to protect and manage interests thereof. From that moment, a seller becomes "a person who administers another's business" as stated in the crime of breach of trust. Where a seller in such a position, prior to transferring the ownership of real estate to a buyer in accordance with the contract, disposes of the said real estate to a third party and completes registration thereof in the name of the third party, such an act impedes a buyer's acquisition or preservation of the real estate, which undermines the fiduciary relationship between a seller and a buyer, thereby constituting the crime of breach of trust (*see, e.g.,* Supreme Court Decisions 74Do2215, Dec. 23, 1975; 83Do2057, Oct. 11, 1983; and 84Do1814, Jan. 29, 1985).

C. The reasons are as follows.

(1) As seen earlier, the crime of breach of trust is established when a person owing a fiduciary duty to protect and preserve another and his/her pecuniary advantage commits acts that violate another's trust and thereby infringing upon his/her pecuniary advantage. Determination on (i) a degree of trust between the parties to a contract needed for the formation of fiduciary relationship protected by the criminal law, and (ii) the types of the acts of violating trust to be recognized as constituting punishable act in violation of one's duty should be made normatively by comprehensively taking into account: (i) the substance of contract and the degree of its performance; (ii) the degree of binding force of the contract; (iii) transaction practice; (iv) types and substance of fiduciary relationship; and (v) the degree of violation of trust, depending on whether the protection of another's pecuniary advantage was a typical and fundamental

substance of the contract, and whether the degree of betrayal of the act in question necessitates the intervention of the criminal law. Therefore, when finalizing the scope of which the crime of breach of trust is established, it needs to be ensured that the protection of an individual's property rights is not weakened because the crime of breach of trust as a penal provision does not fulfill its function.

(2) In the Republic of Korea, real estate serves as the foundation of people's basic livelihood, forming the backbone of economic activities, as evidenced by the fact that significant share of the value of property owned by the Korean people is accounted for by real estate. As such, the importance of real estate in people's economic lives and socioeconomic significance of a real estate trade is still high.

(3) The purchase and sale price of real estate is generally paid in three installments: earnest money, intermediate payment, and outstanding payment. When a buyer delivers intermediate payment to a seller, it gives binding effect to a contract, which cannot be rescinded arbitrarily by either one of the parties to the contract (*see* Article 565 of the Civil Act). However, there is no universal and sufficient measure that could prevent double selling of a seller where a buyer makes earnest money and intermediate payment, which accounts for significant portion of the purchase and sale price. Even in such absence of measures, a buyer makes an intermediate payment to a seller, trusting that a seller would complete the registration of ownership transfer. In other words, a buyer makes an intermediate payment based on trust that a seller would complete the registration of ownership transfer, and a buyer receives the money, perceiving it being paid based on such trust. Therefore, from the very moment an intermediate payment is delivered, a fiduciary relationship, where a seller cooperates in the property preservation of a buyer, becomes a typical and fundamental substance of the relationship of the parties to the contract. A seller in such a fiduciary relationship manages a buyer's business regarding acquisition of ownership, and thus becomes "a person who administers another's business" as stated in the crime of breach of trust. Furthermore, if a seller in such a position willfully disposes of the real estate in question to a third party prior to transferring the ownership to a buyer, such an act is naturally prohibited in a purchase and sale contract and by the good faith provisions, and may be deemed an occupational breach of trust as stated in the crime of breach of trust.

(4) The Supreme Court of the Republic of Korea has been consistent in its decision on the cases of double selling of real estate that a seller has an obligation to cooperate with a buyer until the completion of the registration of ownership transfer, and that double selling of the real estate in question to a third party after a seller receives an intermediate payment constitutes the crime of breach of trust, and has been establishing such precedents (*see, e.g.,* Supreme Court Decisions 74Do2215, Dec. 23, 1975; 83Do2057, Oct. 11, 1983;

84Do1814, Jan. 29, 1985; 2005Do5713, Oct. 28, 2005; 2008Do3766, Jul. 10, 2008; 2011Do1651, Jun. 30, 2011; 2011Do15179, Jan. 26, 2012). The legal principles in these precedents have sincerely served the role of restraining double selling of real estate and protecting a buyer from such practice, and they still hold validity in light of the current real estate purchase and sale practices. These legal principles neither distort nor confuse a real estate trade, and they do not place excessive limits on a seller's freedom of contract. Therefore, existing precedents should be maintained.

D. Meanwhile, if a seller of a real estate received an intermediate payment from a buyer, signed a new purchase and sale contract with a third party thereafter, and completed the registration of ownership transfer in the name of the third party, barring special circumstances that indicate: (i) the initial purchase and sale contract had been lawfully rescinded; or (ii) the seller believed that the purchase and sale contract had been lawfully rescinded and there was a reasonable grounds for such belief, it is recognized that the seller had an intent to commit a criminal breach of duty (*see, e.g.,* Supreme Court Decisions 90Do153, Nov. 13, 1990; 2006Do1140, May 12, 2006).

3. The lower judgment

The lower court dismissed the first instance judgment which upheld guilty verdicts on the part of the indictment regarding a violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust), and acquitted the Defendant.

A. In cases of double selling of a real estate, there are instances where, depending on specific cases, it is difficult to deem a seller a person who administers another's business, even if he/she received an intermediate payment from a buyer.

B. The Defendant, a seller, received an intermediate payment from the victims in accordance with the instant contract, and it is difficult to consider that the contract was lawfully rescinded. However, even so, considering the following circumstances, it is hard to conclude that (i) the seller was in a position where he/she administers another's business based on a fiduciary relationship with the victims at the time of double selling; and/or (ii) the seller had the intent to commit a criminal breach of duty or to acquire illegal profits.

(1) The victims signed the instant contract on the instant real estate in order to open a restaurant, the fact which was also known by the Defendant.

(2) At the time of double selling, the Defendant was unable to transfer the instant real estate to the victims due to the dispute with the tenant of the instant real estate. The victims demanded what was unacceptably high amount of compensation for damages for the Defendant, insisting that they would not accept transfer of ownership until their requirements were attended to.

(3) Therefore, it is hard to conclude that there remained trust, expectation, and fiduciary relationship between the Defendant and the victims, or, that the Defendant owed a fiduciary duty to cooperate with the victims in their

acquisition of ownership.

4. The Supreme Court judgment

A. According to the reasoning of the lower judgment and the evidence duly adopted, following things are revealed.

(1) Upon signing the instant contract with the victims, the Defendant received KRW 2 billion on the date of the signing of the contract, and an intermediate payment of KRW 6 billion on September 30, 2014. The instant real estate was not returned from a tenant to the Defendant after the lapse of the time for outstanding payment, November 30, 2014, and failed to transfer the instant real estate to the victims.

(2) The victims sent a notification (hereinafter "instant notification") to the Defendant on December 17, 2014 when they did not receive the instant real estate after the lapse of the time for outstanding payment. The notification stated (a) the requirement of the victims, demanding the Defendant to offer the victims an exemption of the amount of money in proportion to the monthly profits expected to incur for the 3 months of grace period until the Defendant transfers the instant real estate, which is estimated between KRW 20.25 million to 24.30 million, from the balance of the purchase price; (b) that they would rescind the contract if the Defendant did not accept the demand, and would claim the contract amount, intermediate payment, and special damages, and (c) demanded the Defendant to make a decision by December 31, 2014.

(3) On April 7, 2015, one of the victims, Nonindicted F, told the Defendant over the phone, "Will you complete the lawsuit with the tenant if you deliver the ownership?"; "I told the lawyer who sent the instant notification that he defer rescinding of the contract and wait, because the final target is purchase and sale of real estate, and the priority is to reach agreement."; and "I also pursue practical interests. If I were to break the contract, I would have done so already. I would have not waited until now."

(4) On April 13, 2015, the Defendant sold the instant real estate to Nonindicted D for KRW 1.5 billion, and completed the registration of ownership transfer on April 17, 2015.

(5) On April 14, 2015, when the Defendant already sold the instant real estate to Nonindicted D, had a phone call with Nonindicted F. While not telling that he did not sell the instant real estate to Nonindicted D, the Defendant told Nonindicted F that he wanted the instant contract to be rescinded. Nonindicted F said, "I already told you that such is not an option," and "Transfer the ownership next week, and give us KRW 60 million in settlement." On April 15, 2015, the Defendant said that he would return the money, which was rejected by Nonindicted F who retorted, "Haven't we agreed to exempt from the balance for the period we have waited on the condition that you transfer the ownership?"

(6) On April 21, 2015, the victims filed a lawsuit against the Defendant for the return of purchase and sale-price, and made a declaration of intent to rescind the instant contract by delivering the duplicates of the written complaint.

B. The following determination can be made examining these factual records in light of the legal principle *supra*.

(1) When the victims made an intermediate payment to the Defendant according to the instant contract, the instant contract reached an irreversible stage in which it cannot be arbitrarily rescinded, and the Defendant entered a fiduciary relationship with the victims, to whom he owed a duty to protect their pecuniary advantage, thus becoming a person who administers their business regarding the acquisition of the instant real estate.

(2) The instant notification demands that the Defendant accept the requirements, or otherwise the victims would rescind the instant contract. It may not be deemed containing a declaration of intention to rescind the contract *per se*.

(3) While the instant contract was not yet lawfully rescinded, the Defendant violated his/her fiduciary duty against the victims, sold the instant real estate to Nonindicted D and completed the registration of ownership transfer.

(4) Although the Defendant could not transfer the instant real estate to the victims because it was not returned from the tenant at the time, and exchanged words with the victims regarding compensation for damages due to nonfulfillment of the obligation, there is no grounds to view that the fiduciary relationship expired, insofar as the instant contract was not lawfully rescinded and remained in force.

(5) Thus, the crime of breach of trust is established for the Defendant's act, which was committed in violation of his/her fiduciary duty against the victims. Also, the instant contract was not lawfully rescinded at the time, and, even if the Defendant believed that the instant contract was lawfully rescinded, it is hard to conclude that there are reasonable grounds for such belief. As such, the Defendant's intent of a criminal breach of duty and of unjust enrichment is recognized.

C. However, the lower court cited the grounds contrary to the above, and acquitted the Defendant on the charge of violating the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust). Therefore, the lower judgment is erroneous in that it misapprehended the legal principles regarding "a person who administers another's business" in the crime of breach of conduct and criminal intention. The allegation contained in this part of the grounds of appeal is with merit.

Meanwhile, the Prosecutor appealed the violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Bribing), but the grounds of appeal on such violation are not written on either a petition for the final appeal or a written statement of grounds for the final appeal.

5. Conclusion

Therefore, the part of the lower judgment on the violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes (Breach of Trust)

is reversed, and the case is remanded to the lower court for further proceedings (consistent with this Opinion). The rest of the Prosecutor's appeal is dismissed. It is so decided as per Disposition by the assent of the participating Justices on the bench except the dissenting opinion by Justices Kim Chang-suk, Kim Shin, Jo Hee-de, Kwon Soon-il, and Park Jung-hwa, followed by a concurrence with the Majority Opinion by Justices Park Sang-ok and Kim Jae-hyung, and a concurrence with the Dissenting Opinion by Justice Kim Chang-suk.

6. Dissenting Opinion by Justice Kim Chang-suk, Justice Kim Shin, Justice Jo Hee-de, Justice Kwon Soon-il, and Justice Park Jung-hwa

A. The main point of the Majority Opinion is that a seller of real estate is not deemed "a person who administers another's business" at a stage where only a earnest money is delivered; however, when performance of a contract becomes full-fledged, with an intermediate payment being delivered, for example, a seller owes a fiduciary duty to protect and manage a buyer's pecuniary advantage. The seller becomes "a person who administers another's business" from that time, and if the seller of real estate in such position double-sells the real estate in question is deemed breach of a fiduciary relationship, constituting the crime of breach of duty.

Nevertheless, putting too much emphasis on the importance of punishment to protect a buyer of a real estate trade, the Majority Opinion neglected the principle of legality, which is the broad principle of the criminal law, by either going against or unnecessarily expanding the meaning of the language and text of the Criminal Act to the disadvantage of the Defendant. Moreover, it does not accord with the Supreme Court decisions that have renounced the establishment of the crime of breach of trust against a buyer or an obligor in cases of double selling of movable assets and cases of a promise of an accord and satisfaction.

B. There are a number of purposes of criminal trial, the most important of which would be to ensure, to the greatest extent possible, the rights of the people, including of the Defendant. Various provisions regarding human rights assurances, including the principle of legality, which are stated in the Constitution and Criminal Act of the Republic of Korea, is a landmark achievement secured by hard work and commitment of many people over the long term, and the constitutional value to be complied with at all costs.

According to the principle of legality, penal provisions must be strictly construed and applied with adherence to the language and text. An extensive interpretation or analogical interpretation of penal statutes to the disadvantage of the Defendant (*see, e.g.,* Supreme Court Decision 2012Do4230, Nov. 28, 2013; Supreme Court en banc Decision 2015Do8335, Dec. 21, 2017).

The principle of legality is premised on the principle of clarity. In other words, a crime and punishment, as their essence, should be regulated by the legislature's enactment of formal law. Furthermore, they necessitate a sufficient definiteness in the statement of elements of crime to allow people to foresee when a specific action is punishable and to conduct themselves accordingly.

For this reason, the principle of clarity in the interpretation of penal statutes can be ensured insofar as it takes into account the legislative intent, whole content, and structure of the statutes, which should provide reasonable standard of interpretation allowing the general public with the ability to think with discernment to standardize and confine the types of acts constituting elements of crime (*see, e.g.,* Supreme Court Decision 2003Do3600, Nov. 14, 2003). Penal statutes must be enacted and construed in accordance with the principle of clarity in order for them to comply with the principle of legality.

Also, the court should refrain from attempting to encompass what does not constitute elements of penal statutes under the pretext of the necessity of punishment under criminal policy; the policy needs to supplement the absence of a civil remedy; or public criticism.

C. Article 355(2) of the Criminal Act stipulates regarding a criminal breach of duty that "[t]he preceding paragraph shall apply to a person who, administering another's business, obtains pecuniary advantage or causes a third person to do so from another in violation of one's duty, thereby causing loss to such person." According to such provision, the core elements of a criminal breach of duty consist of "a person who administers another's business," "in violation of one's duty," and "loss." Each element should be strictly interpreted, barring from extensive interpretation or inferential interpretation.

(1) First, as to "an occupational breach of trust," the judicial precedents stated that "there is no need to examine the legal validity of any acts that violate a fiduciary relationship with the principal, either by omission of an act naturally expected of a person to do, under the legal provisions, contract terms, or good-faith principle; or by committing an act that are naturally expected of a person not to do" (*see, e.g,* Supreme Court Decisions 94Do3013, Dec. 22, 1995; 2009Do7783, Oct. 29, 2009). As seen from this, judicial precedents broadly define "an occupational breach of trust." Both "good-faith" and "fiduciary relationship" are abstract concepts, which are unable to be uniformly defined. Moreover, considering that the parties to a contract owe a duty of good-faith to the counterparty virtually in every contract relationship, a mere nonfulfillment of duty between parties to a contract, or a case which does not recognize the liability for nonperformance of obligation is likely to be simply established as the criminal breach of duty.

This is why the Majority states that determination on (i) a degree of trust between the parties to a contract needed for the formation of fiduciary relationship protected by the criminal law, and (ii) the types of the acts of violating trust to be recognized as constituting punishable act in violation of one's duty should be made normatively by comprehensively taking into account: (i) the substance of contract and the degree of its performance; (ii) the degree of binding force of the contract; (iii) transaction practice; (iv) types and substance of fiduciary relationship; and (v) the degree of violation of trust, depending on whether the protection of another's pecuniary advantage was a

typical and fundamental substance of the contract, and whether the degree of betrayal of the act in question necessitates the intervention of the criminal law. At the same time, the Majority Opinion adds that when finalizing the scope of which the crime of breach of trust is established, it needs to be ensured that the protection of an individual's property rights is not weakened because the crime of breach of trust as a penal provision does not fulfill its function. Such Majority Opinion, however, reduced the criminal elements of "an occupational breach of trust" and the scope of such act down to obscure concepts that are impossible to be clearly defined. Also, there is concern that such Majority Opinion might be understood as the court's declaration that it could make an arbitrary determination.

According to the recognition of facts by the lower court, the Defendant and the victims were extremely divided over the matters on ways of contract termination and the scope of compensation for damages, rather than over the matters on delivering the real estate or the transfer of ownership, as performance of the purchase and sale contract became difficult in the near future because of the tenant rejected to return the real estate property in question. The Majority Opinion is not immune from the criticism by stating that even in such relationship, the Defendant and the victims are deemed to be in a fiduciary relationship for the transfer of ownership.

(2) In the meantime, the Supreme Court stated that "the time at which [a person who administers another's business] caused loss to the principal" refers to the reduction of pecuniary value, including when he/she caused actual pecuniary loss and where he/she gave rise to the risk of actual loss; even where the amount of damages is not specifically fixed, it does not affect the establishment of a criminal breach of conduct," (*see, e.g.,* Supreme Court Decisions 2005Do3102, May 31, 2007; 2009Do3712, Jul. 23, 2009) applying broad standards to the establishment of the crime. This increases the likelihood of expanding the scope of application of the Act on Aggravated Punishment, etc. of Specific Economic Crimes, which provides the specific amount of pecuniary advantage corresponding to the loss as a weighted element of crime.

Since "an occupational breach of trust" and "loss" are broadly interpreted in the crime of breach of duty, there is increased need for strict interpretation of the concept of "a person who administers another's business" thereby restricting the likelihood of infinite expansion of the application of a criminal breach of duty, and the risk of punishing an innocent person.

(3) In light of the ordinary meaning of the language and text, "another's business" in the crime of breach of trust refers to the affairs under jurisdiction of another, meaning that the main agent of the business should be that another person. In other words, it means administering business which is supposed to be managed by another on behalf of that person. Furthermore, considering that the essence of the crime of breach of trust lies in violating one's duty to protect the principal's pecuniary advantage, which arises out of an internal relationship

or a fiduciary relationship with the principal, and thereby infringing upon another's property rights, the crime of breach of trust requires administering "another's business" as stated above based on a fiduciary relationship, and the substance of the business itself or the essence of a fiduciary relationship must be protecting and managing another's pecuniary advantage. Therefore, even if one of the parties to a contract sincerely performs his/her contractual duty to the counterparty, who benefits from the satisfaction of contractual rights, where such performance of duty does not constitute "another's business" as stated above, it is merely "one's own business."

On this perspective, Supreme Court has held that it is merely a contractual duty under civil law and rather than "another's business" in a number of cases regarding: (i) the obligation of a transferer to transfer the object of lease to a transferee in a case on double transfer of a tenant's right (*see, e.g.,* Supreme Court Decisions 86Do811, Sept. 23, 1986; 90Do1216, Sept. 25, 1990); (ii) the obligation under the contract of discharge of pecuniary obligations, where an obligor promised not to dispose of his/her real estate to other person but instead established mortgage on the real estate at a floating rate to a third party (*see, e.g.,* Supreme Court Decision 84Do2127, Dec. 26, 1984); (iii) the passive duty of an obligor to accept a creditor's sale of row houses and application of the paid price of row houses to the satisfaction of claim, in a case where an obligor signed a contract to transfer the right of sale of the newly-built row houses to a creditor for discharge of the purchase-price of construction works (*see* Supreme Court Decision 86Do2490, Apr. 28, 1987); and (iv) the obligation of an obligor, who signed a promise of accord and satisfaction on real estate as security for obligation, to fulfill his/her obligation under the promise, in a case where an obligor instead disposed of the real estate in question to a third party (*see* Supreme Court en banc Decision 2014Do3363, Aug. 21, 2014).

D. Upon signing of a real estate purchase and sale contract, the signing of the contract immediately takes effect for a seller with the emergence of obligation to transfer the ownership of real estate and for a buyer with the obligation to make payment of purchase-price of a sale. These obligations of a seller and a buyer, however, may not be considered "another's business"; rather, they are "their own business" under a purchase and sale contract. A seller's duty to transfer property rights or a buyer's duty to make payment of purchase-price arise from a purchase and sale contract, meaning that these duties are not the businesses to be disposed of by the counterparts and may not be deemed to have been entrusted to the counterparts based on a fiduciary relationship. Likewise, protection and management of pecuniary advantage of the counterparty to the contract cannot be deemed a typical and fundamental substance of a purchase and sale contract. The parties to a purchase and sale contract are in a reciprocal trade relationship in which each is obliged to fulfill a consideration to the other for the sake of satisfaction of contractual rights.

Even though it is argued that a seller has a duty of cooperation in

registration of real estate or a duty of cooperation in a buyer's business of property acquisition, the essence of such "duty of cooperation" is merely a different expression of a duty of ownership transfer, which renders it unreasonable to distinguish between the two. The Supreme Court held that "it should be strictly cautioned from the perspective of the legality principle to broadly interpret an obligor's act of betrayal as constituting a criminal breach of duty, under the condition that fulfillment of obligation involves another's advantage, without a reasonable explanation for narrowly interpreting the meaning of "a person who administers another's business" as the subject of a criminal breach of duty based on the nature of such business (Supreme Court en banc Decision 2008Do10479, Jan. 20, 2011).

The Majority argues that if performance of contract reached a stage where an intermediate payment has been made, a seller may not be exempt from the obligation to transfer the ownership of the real estate to a buyer unless the contract is made void or rescinded. Therefore, where a contract reaches this stage, a seller owes a fiduciary duty to a buyer, in which a seller is obliged to cooperate with a buyer in his/her preservation of property, and to protect and manage his/her pecuniary advantage. From that moment, a seller becomes "a person who administers another's business" as stated in the crime of breach of trust. In other words, when a contract reaches a certain stage, a seller becomes obliged with a duty of cooperation in a buyer's preservation of property.

Nevertheless, as seen earlier, a real estate seller's obligation of ownership transfer may not be deemed another's business; such obligation arises when a purchase and sale contract is signed, and continues to exist until the contract is either voided or fulfilled. There are no reasonable grounds for (i) viewing the nature of a seller's obligation of ownership transfer as having changed just because an intermediate payment has been delivered and a contract has reached a stage it cannot be arbitrarily rescinded by any one of the parties; or (ii) viewing a typical and essential substance of the relationship between the parties to the contract, which is to transfer ownership in return for purchase-price, as having changed into protection and management of a buyer's pecuniary advantage. That an intermediate payment has been delivered simply suggests that both parties to the contract may no longer exercise the right to rescind an agreement without paying separate damages, which was initially guaranteed for both. It should not be understood that (i) a seller is prohibited to dispose of his real estate property; (ii) the obligation of ownership transfer, which was initially a seller's own business, changed into a buyer's business; or (iii) the relationship between the parties to a contract, whose typical and essential substance consists of one party to transfer his/her ownership and the other party to deliver purchase-price in return, has changed. In fact, "the duty of cooperation in a buyer's preservation of property" is a different expression of prohibiting a seller from nonfulfillment of his/her obligation and thereby causing loss to a buyer. As such, it is no different from the argument that a seller who caused loss to a

buyer by not fulfilling his/her obligation under civil law must be punished on the charge of a criminal breach of duty. Such argument is contrary to the intent of Article 11 of the International Covenant on Civil and Political Rights stipulating "[n]o one shall be imprisoned merely on the ground of inability to fulfill a contractual obligation."

E. Assuming that a seller has a duty of cooperation in preservation of a buyer's property, it would have to be matched by an assumption that the counterparty to a contract, a buyer, also has a duty of cooperation in preservation of a seller's property in light of the essence of a bilateral contract. However, Supreme Court precedents have dismissed such cases as where a buyer, who received ownership of real estate before making outstanding payment, did not perform the contract in which he/she promised to make outstanding payment by taking out a loan secured on the real estate, and instead established collateral security for different purposes, determining that a buyer (a defendant) was not liable for the crime of breach of trust (Supreme Court Decision 2011Do3247, Apr. 28, 2011). The Majority Opinion does not provide reasonable explanation regarding difference, for a buyer and a seller, in the view of the existence of a duty of cooperation in preservation of the counterparty's property in a bilateral contract premised on the assurance of equal legal status between the parties to a contract.

Also, according to the Majority Opinion, if a seller receives an intermediate payment from the second buyer, the seller and the second buyer enter into a fiduciary relationship in which the seller is obliged to cooperate in the preservation of property to protect and manage the second buyer's pecuniary advantage. However, the precedents held that a seller is deemed to have committed the crime of breach of trust against the first buyer in a case where a seller completed the registration of ownership transfer to the second buyer, whereas in a case where a seller completed the registration of ownership transfer to the first buyer, a seller is not deemed to have committed the crime of breach of trust against the second buyer even if the seller received an intermediate payment or outstanding payment from the second buyer (*see, e.g.,* Supreme Court Decisions 86Do1112, Dec. 9, 1986; 92Do1223, Dec. 24, 1992; 2008Do11722, Feb. 26, 2009). There are no logical grounds to distinguish the first buyer from the second buyer in terms of the degree of protection in the establishment of the crime of breach of trust, even though they are entitled to the equal legal status as a creditor.

The Majority Opinion only emphasized the possibility of criticism or the necessity of punishment of double selling of real estate, thereby corrupting the concept of the obligation to register ownership of transfer, which is a seller's own business, into another's business, by exploiting the contrived concept of the obligation to cooperate in registration or the obligation to cooperate in preservation of property. This has resulted in a vague distinction with nonfulfillment of obligation, and unreasonable expansion in the scope of the

application of a criminal breach of duty.

F. In the meantime, as in the Majority Opinion, if a buyer is deemed "a person who administers another's business" who may be subject to punishment on charges of the crime of breach of trust on the ground that a seller has a duty of cooperation in preservation of a buyer's property, such view stands contrary to the Supreme Court decisions in the previous cases on double selling of movable assets. In other words, the Supreme Court clearly stated that: (a) in a real estate sale contract which takes effect by one of the parties agreeing to transfer a property right to the other party and the other party agreeing to pay the purchase-price to the former, (b) barring special circumstances, the obligation to be performed in accordance with the terms and conditions of a contract is deemed "one's own duty"; (c) where the object of sale is a movable thing, a seller completes performance of a contract by transferring a property right on the object of sale under the contract, and a buyer acquires the right to the object of sale; (d) thus, it cannot be deemed that a seller is obliged to cooperate in protection and/or management of a buyer's property, apart from a seller's business of the obligation to transfer movable assets; (e) as such, in movable property sale contract, a seller may not be deemed a person who administers a buyer's business, and (f) therefore, the crime of breach of duty is not established where a seller disposed of the object of sale to other party instead of transferring it to a buyer (Supreme Court en banc Decision 2008Do10479, Jan. 20, 2011).

There are no grounds for distinguishing between real estate and movables as the object of sale in applying the legal principle *supra*, for there is no difference between the two, and both cases employ the same legal structure in that: regardless of whether the object of sale is real estate or movables, (i) a seller's major duty under a contract is to transfer ownership on the object of sale in return for the purchase-price, and (ii) changes in the right to the object of sale take place by means of the agreement between the parties to a contract and the satisfaction of requirements for publication. Unless the Supreme Court decision *supra* is not changed, the reasoning of the Majority Opinion has no standing.

G. If one must find a difference, one can point to the fact that in case of a real estate sale, registration is a requirement for the real estate in question to be publicly announced as one's own. However, the Supreme Court has already determined that: (i) in a case where a debtor, having signed a promise of accord and satisfaction agreement with a creditor as a security for claim, disposed of the real estate to a third party, instead of transferring it to a creditor, whom he/she promised to offer the real estate in substitution, (ii) a debtor is not deemed "a person who administers another's business" (Supreme Court en banc Decision 2014Do3363, Aug. 21, 2014). Even though it is a case on the promise of accord and satisfaction agreement, it is no different, in terms of the content of violation, from double selling of the instant case in which the Defendant did

not complete the registration of real estate ownership transfer, in that the Defendant did not perform his/her obligation to take the procedure of registration of ownership transfer. In light of the principle of equal treatment, the instant case should also be treated with equal standard.

H. The Majority Opinion finds the grounds for treating double selling of real estate differently from double selling of movables considering: (i) the distinctive characteristics of real estate as property; (ii) socioeconomic significance of the real estate sale; (iii) the general practice of real estate sale in which the purchase-price is delivered in three installments (earnest money, intermediate payment, and outstanding payment), and (iv) the real estate transaction practice which lacks adequate measures to prevent double selling of a seller even after earnest money and intermediate payment have been made, which account for significant portion of the purchase-price of a sale, in that there is a policy need to deter double selling of real estate by punishing it on the charge of a criminal breach of duty.

However, as stated earlier, such attitude of the Majority Opinion is not a desirable way of interpreting a statute, not to mention being contrary to the principle of legality. Likewise, the payment of intermediate payment does not change a seller's obligation to transfer ownership into a buyer's business, or a typical and essential substance of the relationship of the contracting parties into protecting and managing a buyer's pecuniary advantage.

I. There is a legal maxim that says a contract must be upheld. Various legal relationships are built upon such legal maxim. It is a court's role to protect a party to a contract arguing for the compliance of a contract against the other party to a contract who intends not to perform the contract. In a real estate sale contract where a seller evades contractual performance whereas a buyer demands its performance, a court can protect the buyer and orders the seller to fulfill the contract or pay damages. That is the limit of a court's role.

The Majority intervenes in a case which can be dealt with as nonfulfillment of obligation under civil law by invoking the punitive authority of the State. It attempts to punish nonfulfillment of obligation through an analogical or extensive interpretation at the expense of the principle of legality. Nevertheless, the rationale employed by the Majority is either significantly insufficient or completely unreasonable.

The enforcement of penal statutes in the sphere of economic activities among private persons, which is governed by the principle of private autonomy, before seeking reasonable settlement of dispute by means of civil law is undesirable in light of the constitutional order of the Republic of Korea. The excessive intervention of the penal authority of the State is likely to infringe upon an individual's freedom. There is a policy need in every country to maintain (i) the pecuniary value and socioeconomic significance of real estate; and (ii) the stability of real estate property transactions by preventing double selling of real estate. Most of the countries have introduced institutional

structure such as the notaries public system to block the likelihood of double selling. Nevertheless, the Republic of Korea has been resorting to criminal punishment and never made an attempt for an autonomous settlement. Considering (a) the principle of market economy which pursues rationality and efficiency with maximum respect for autonomy in private sector; (b) Korea's economic development, and (c) strengthened citizen awareness, a desirable direction would be let the market economic order handle the problem of double selling of real estate, and phase out the State's intervention of penal authority. It is regrettable that the Majority rendered a determination that runs counter to the Supreme Court's efforts to protect people's human rights pursuant to the principle of legality, by being trapped in an outdated idea of the importance of real estate value.

For the foregoing reasons, we disagree with the Majority's opinion.

7. Concurrence by Justice Park Sang-ok and Justice Kim Jae-hyung regarding the Majority Opinion

A. Penal statutes should be strictly interpreted and applied in accordance with the language and text, and analogous interpretation and extensive interpretation to the disadvantage of the Defendant are prohibited. Nevertheless, the interpretation of penal statutes does not always exclude the teleological interpretation which considers legislative intent and purpose, and legislative history of penal statutes insofar as it does not go against the ordinary meaning of the legal text (*see, e.g.,* Supreme Court Decisions 2007Do22162, Jun. 14, 2007; 2009Do13332, May 13, 2010).

The degree of clarity required for the criminal elements set forth in penal statutes cannot be determined indiscriminately, and should comprehensively take into account the distinctiveness of individual elements, conditions that served as the cause of regulation, and the degree of punishment. Although the criminal elements employ the concept that is broad and requires supplementary interpretation of judges, that alone cannot be deemed contrary to the clarity requirement of the Constitution, insofar as there is no room for multiple interpretations in their application (see, e.g., Constitutional Court en banc Decision 2001Hun-Ka27, Apr. 25, 2002; Supreme Court Decision 2004Do810, Jul. 9, 2004).

If the criminal elements of penal statutes employ a concept requiring a judge's supplementary interpretation, it is a naturally required duty of a judge to find a reasonable standard that could either standardize or confine the types of acts constituting the criminal elements, by examining legislative purpose and the entire content and structure of the penal statutes, and it does not go against the principle of legality.

B. Article 355(2) of the Criminal Act on the criminal breach of duty stipulates that the crime of breach of duty is established when a person who administers another's business obtains pecuniary advantage or allow a third person to do so by committing an act in violation of his/her duty, thereby

causing a loss to the principal. It creates a room for a judge to decide on which elements to apply through interpretation and apply them to a specific criminal act, rather than enumerating or illustrating the subject of the criminal breach of duty or the types of acts. "[A] person who administers another's business" and "an occupational breach of trust", the elements of the crime of breach of duty, are normative elements whose genuine meaning cannot be grasped or whose scope cannot be fixed.

C. The essence of a criminal breach of duty lies in causing a pecuniary loss to another by committing an act undermining another's trust. Based on this essence, the Supreme Court has established the standard of interpretation in regard to the criminal elements of a breach of duty. Until recently, the Supreme Court determined that (i) "a person who administers another's business" refers to someone whose relationship with the counterparty should essentially be based on a fiduciary relationship in which he/she is obliged to protect and/or manage another's property; and (ii) "an occupational breach of trust" refers to an act undermining another's trust by either omitting an act required to be done under the provisions of relevant Act, the terms of contract, and/or the good-faith principle in light of specific circumstances including the details and nature of the business to be disposed of, or committing an act naturally presumed to be not committed.

The dissenting opinion did not present a specific standard of interpretation as to what constitutes the occupational breach of trust, and argued that the precedents have broadly defining the occupational breach of trust by employing an abstract concept like good-faith or fiduciary relationship. It also argues that the Majority's opinion, by insisting that whether a specific act constitutes the elements of a criminal breach of duty should be determined based on normative judgment, reduced down the content of the occupational breach of trust into a vague concept which cannot be finalized.

However, such dissenting opinion is unreasonable. As seen earlier, each element of the criminal breach of duty is a normative element whose precise meaning or purview cannot be finalized just by examining its dictionary definitions or textual meaning. The precedents have employed a rather normative and abstract concept (e.g. good-faith and fiduciary relationship) in interpreting the elements of the crime of breach of duty, because there are various types of businesses called into legal question, and different steps and situations require different practices, which should take into account the nature of that particular business or specific circumstance in order to decide on a duty to take on for the principal. There is no basis for claims that penal statutes must consist of a clear and univocal concept to the extent that they do not require interpretation by a judge. Considering a criminal breach of duty itself is a crime that infringes upon another's pecuniary advantage by committing an act undermining others' trust which arose out of a fiduciary duty, an act in violation of one's duty should be construed as an act undermining a fiduciary relationship,

which is also in compliance with the language and text of the law. As such, a natural interpretation of "a person who administers another's business" in the criminal breach of duty would be someone who protects and manages another's property based on a fiduciary relationship protected from the crime of breach of duty.

Nonetheless, it is clear that the crime of breach of duty does not intend to punish all acts in violation of trust resulting from social activities. It is unreasonable to apply a criminal breach of duty to a simple nonperformance of obligation in all types of contract. As such, the concept of "another's business" should be construed in a limited sense. Accordingly, the Supreme Court has maintained that the typical and essential substance of the relationship of the contracting parties should lie in protecting and managing another's pecuniary advantage, beyond a simple obligation under a claim-obligation relationship, thereby restricting the indefinite expansion of establishment of the criminal breach of duty. When applying such legal principles of the precedents to specific cases regarding the violation of a contract, such things as (i) terms and conditions of a contract; (ii) degree to which a contract has been performed; (iii) degree of binding force of a contract; (iv) transaction practice; (v) types and characteristics of a fiduciary relationship, and (vi) the degree to which trust has been violated should be taken into account, and render a normative judgment considering: (i) whether there has occurred a fiduciary relationship which requires protection of criminal law, and (ii) the act in question is an act of betrayal that justifies the intervention of criminal punishment. It is difficult to understand the reasoning of the dissenting opinion in regard to the standard and method of interpretation as to an occupational breach of trust, which, according to the dissenting opinion, has been made vague.

D. The dissenting opinion states that "another's business," one of the elements of a criminal breach of conduct, refers to (i) business belonging to another, and (ii) disposing of the business that should be taken care of by another on behalf of that person. According to the dissenting opinion, if these two elements are not satisfied, the business in question should be construed as "one's own business," and thus the criminal breach of duty cannot be established.

However, the nature of "business" itself cannot serve as a clear standard for distinguishing "another's business" from "one's own business." The Supreme Court is rendering a determination regarding "another's business" in cases on the types and nature of business or contract relationship, only by types of obligation or the appearance of an occupational breach of trust, but on the basis of whether the essence of one's obligation to another lies in protecting and managing another's property. Such tenor of the Supreme Court can be understood that the literal interpretation of the elements of criminal breach of duty is insufficient to finalize the meaning of "a person who administers another's business." There is no ground for limiting the interpretation of "a

person who administers another's business" to the business originally belonging to another and which is disposed of on behalf of that person.

It is difficult to distinguish whether a business belongs to "another's business", "one's own business", or "business for another person." For example, the dissenting opinion would not argue that a business dealt with by mandatary under a contract of a mandate is "another's business" in that a person is taking care of the affairs entrusted by a mandator, but at the same time it is "one's own business" in that a person manages the affairs distinct to him/her in order to obtain remuneration as agreed between a mandatory and a mandator.

The transfer of ownership of real estate in accordance with a real estate sale contract is deemed a a seller's own affairs as his/her obligation, but at the same time it is a buyer's affairs in that it is a matter of acquiring property from the buyer's side. As such, where a contract reaches a certain stage of implementation, a seller's obligation to transfer ownership bears the nature of important and essential business with the purpose of preserving a buyer's pecuniary advantage the real estate.

There are instances where a specific business belongs to both "one's own business" and "another's business" depending on the elements of a transactional relationship or transaction practice. As such, that a buyer and a seller are in a reciprocal transaction relationship is by itself insufficient to conclude that a business cannot be deemed belonging to another, as otherwise alleged by the dissenting opinion. The Supreme Court maintained in a case on the "Kye," a rotating credit association in which each member contributes a fixed amount on a regular basis, and receives his/her share on a rotating basis until all members have received it, that: (a) where a leader has not collected contributions from the members, a leader owes to the members the obligation to give a payout, which is simply an obligation under a claim-obligation relationship; however, (b) once a leader has collected contributions from the members, a leader owes a duty to make a payout to the designated members (*see* Supreme Court Decision 2009Do3143, Aug. 20, 2009); (c) such obligation of a leader belongs to his/her own affairs, but at the same time it is managing the others', in this case, the members' affairs; (d) as such, if a leader has collected contributions from all members, but did not make a payout to a designated member in violation of his/her duty without reasonable grounds, barring special circumstances, the crime of breach of duty is established in the relationship between the leader and the designated member (*see, e.g.,* Supreme Court Decisions 67Do118, Jun. 7, 1967; 93Do2221, Mar. 8, 1994). Also, based on the same premise, the Supreme Court held that: (a) not only in a case where a person manages affairs regarding another's property management, for example, in delegation or employment, where a person owes a duty of managing and preserving another's property under a contract, in which that person exercises a certain right for him/herself; (b) but also in a case where a person manages his/her own affairs while at the same time owes a duty to

cooperate in the preservation of the counterparty's property, such as in sale or establishment of security interests, both are deemed "another's business" (*see, e.g.,* Supreme Court Decisions 81Do3137, Feb. 8, 1983; 2004Do6890, Mar. 25, 2005).

From such point of view, on the premise that a number of different types of transactional relationship can be clearly categorized into either one's own affairs and another's, the dissenting opinion which denies a case where a specific business can be both one's own and another's at the same time serves as perfunctory interpretation of law that fails to capture the actual substance of various types of transactional relationship occurring in the real world.

Whether someone is a person who administers another's business depends on (i) whether a typical and essential part of the relationship of the contracting parties lies in protecting and managing another's pecuniary advantage; and (ii) whether the nature of the business in question is not confined to a subordinate and peripheral scope but forms the essential substance of the relationship. Furthermore, under what condition protection and management of another's property forms a typical, essential, and important substance of the relationship between the contracting parties should comprehensively take account of the terms and conditions and nature of a contract, and transaction practice, from the understanding and judgment of ordinary people.

E. The dissenting opinion argues that the obligation to complete the registration of ownership transfer constitutes "a buyer's own affairs" under a contract and not "a buyer (another)'s affairs," and that even if an intermediate payment has been made, the nature of the obligation does not change into a typical and essential substance of the relationship of the contracting parties.

However, it is hard for us to agree with the dissenting opinion in that a fiduciary relationship between a buyer and a seller, which arises out of a real estate sale contract, has been understood only in light of performance of a contract under civil law. The precedents recognized the establishment of a criminal breach of conduct in the case of double selling of real estate not on the ground of a simple nonperformance of a contract, in which a buyer did not transfer the ownership of the real estate under a sale contract. Rather, it is grounded upon the fact that a buyer willfully undermined a seller's trust and precluded the seller from acquiring the ownership of the real estate, even though the buyer had a duty to cooperate in the registration of the real estate in accordance with the principle of joint application in regard to real estate registration. A fiduciary duty of a buyer to a seller is not recognized at a stage where a real estate sale contract is signed, but, once a contract reaches a stage where a buyer faithfully performs his/her obligation under a sale contract, a buyer is deemed to have entered a fiduciary relationship to protect a buyer's pecuniary advantage (a duty to preserve and manage real estate ownership right for a buyer's acquisition of ownership of real estate). The precedents have merely recognized the criminal breach of duty, to a limited extent, in cases

where a buyer's complete acquisition of a right to the real estate in question has been rendered either impossible or significantly hindered, due to a seller's willful betrayal of the fiduciary relationship even when the contract has reached a phase of full-fledged implementation. The precedents have not argued for an indiscriminate punishment of a buyer's various nonperformance of obligation in a real estate sale on the charge of the criminal breach of duty.

The Supreme Court has consistently held a view as to contract other than a real estate sale contract that a fiduciary relationship is not recognized at a point of time where the signing of a contract is completed, but that once a contract reaches a certain level of fulfillment, a fiduciary relationship is formed between the contracting parties. The Supreme Court decisions seen above are the examples (Supreme Court Decisions 2009Do3143, Aug. 20, 2009; 93Do2221, Mar. 8, 1994).

In that regard, those decisions cannot be deemed to have violated the intent of Article 11 of the International Covenant on Civil and Political Rights stipulating "[n]o one shall be imprisoned merely on the ground of inability to fulfill a contractual obligation." Punishing an act which caused nonperformance of contract by means of willful betrayal should not be deemed "imprisonment merely on the ground of inability to fulfill a contractual obligation." Intervention of penal authority in the private sector must be restricted, but it should not be hastily concluded that a case belongs to nonperformance of contract under civil law cannot be punished by criminal law, or that punishment of such case goes against the legality principle or abuse of the State's penal authority. Ultimately, property crime shares common features with the nonperformance of obligation. Determination on when and to what action penal authority would intervene should be made within the distinct purview of the Criminal Act or special criminal legislation.

By the same token, the Supreme Court has maintained the following stance on the crimes of fraud which is a type of property crime. In general, commercial transaction may entail an overstatement or a false statement to some extent, and as far as it is acceptable in light of transaction practice in general and the good-faith principle, such transaction may be deemed having no intention of defraud. However, when someone falsely notifies the other of a specific fact regarding an important matter of transaction, through the methods that are culpable based on one's fiduciary duty, he/she is deemed to have committed fraud by an act of defraud (*see, e.g.,* Supreme Court Decision 2002Do4378, Oct. 11, 2002). Where an exaggeration or a deceit involved in a transaction is deemed unacceptable in light of transaction practice and the good-faith principle with understanding and judgment of ordinary people, it constitutes defraudation in the crime of fraud from a standpoint of criminal law. Likewise, where the degree of betrayal of trust is unacceptable, with understanding and judgment of ordinary people, in light of the (i) terms and conditions of a contract; (ii) degree to which a contract has been performed; and (iii) degree of binding force of a

contract, under transaction practice and the good-faith principle, it constitutes an occupational breach of trust in the crime of breach of duty from a standpoint of criminal law.

F. The dissenting opinion puts forward a rebuttal to the Majority's opinion based on the following cases, but none of these are acceptable reasons.

(1) The dissenting opinion argues that the criminal breach of duty must be rejected in the case of double selling of real estate on the ground that: (a) the Supreme Court has dismissed that a criminal breach of duty is not established in the cases of double selling of movables; (b) the major duty of a seller in the sale of both movables and real estate is transfer of ownership of the object of the sale; and (c) the legal structure in the case of the sale of both movables and real estate is the same in that the right to the object of sale comes into effect by the agreement between the contracting parties and the satisfaction of requirements for publication.

However, there are no inevitable grounds for dismissing the criminality of double selling of real estate as the criminal breach of duty, just because the Supreme Court did not recognize it in the case of double selling of movables. As seen earlier, it is unreasonable to understand a fiduciary relationship, the conceptual element of a criminal breach of duty, merely from the point of view of the types of obligation under civil law or the performance thereof. There is a significant difference between the sale of movables and the sale of real estate in terms of: (a) transaction practice in general and the good-faith expectation; and (b) whether to consider the protection of another's pecuniary advantage has become the typical and essential substance of a fiduciary relationship, with regard to the progress of a transaction. Determination on whether the degree of betrayal of a specific act is high enough to justify the intervention of criminal law should be made based on the actual situation on a normative basis. Similarity in some of the external attributes of legal systems, such as the types of obligation under a contract or the elements of the changes of rights, does not by itself guarantee that the outcome of a normative judgment would be the same.

(2) The dissenting opinion insists that the decision on the case of a promise of accord and satisfaction agreement (Supreme Court en banc Decision 2014Do3363, Aug. 21, 2014) and the instant case of double selling are the same in that in both cases the registration of ownership transfer was not completed, and thus, they should be treated equally.

The above decision dismissed the establishment of the criminal breach of duty on the ground that: (a) the ultimate objective of a promise of accord and satisfaction agreement is to ensure the performance of the obligation to return borrowed money; (b) a debtor's obligation to register the transfer of real estate ownership is required concomitantly for the achievement of the ultimate objective, which does not constitute another's business as stated in the crime of breach of duty. The fundamental characteristic of the relationship between the contracting parties of a promise of accord and satisfaction agreement lies in a

debtor's payment by substitution. On the other hand, in case of a contract of sale whose objective is to transfer the ownership of a specific real estate property, the essence of the relationship between the contracting parties lies in a buyer's acquisition of the right to the specific real estate property, and a seller's cooperation in this regard. As such, since there is a fundamental difference between a promise of accord and satisfaction agreement and a real estate sale contract in terms of the typical and fundamental substance of the contracting parties, the two cannot be considered equal.

(3) As to the case where (i) a buyer of real estate received the ownership before making outstanding payment; (ii) did not perform his/her obligation to make outstanding payment with a secured loan as agreed in a contract; and (iii) the Supreme Court denied the establishment of the criminal breach of duty, the dissenting opinion referred to it as lack of balance, since it distinguished between a seller and a buyer in terms of the obligation to cooperate in preservation of property.

Nevertheless, such dissenting opinion stands contrary to the fundamental difference between a real estate buyer's major duty of payment of money and a real estate seller's major duty of transfer ownership of the property right. In general, a person who owes a payment duty is deemed to have fulfilled his/her duty by delivering a certain amount of money in any form, and barring special circumstances, does not owe any obligation as to protection and management of the money *per se* as the object of the delivery. The performance of the obligation to pay the money is not made impossible because of the nonperformance of the obligation.

The dissenting opinion argues that: (a) in a case where a seller, who double sold his property, completed the registration of ownership transfer to the first buyer; (b) it is unreasonable that the judicial precedents disapproved the establishment of the criminal breach of duty of a seller to the second buyer, because (c) there is no logical ground for distinguishing between the first buyer and the second buyer in regard to the degree of protection.

However, in a case of double selling of real estate where a seller (a) received an intermediate payment from the first buyer, and thus owed a duty of cooperation in the registration of ownership transfer; (b) then sold the real estate to the second buyer and received a earnest money and an intermediate payment thereof, such act of a seller is close to a violation of the obligation to cooperate in the registration of ownership transfer owed to the first buyer, and is deemed to have reached the commencement stage for the commission of the criminal breach of duty (*see, e.g.,* Supreme Court Decisions 84Do691, Aug. 21, 1984; 2009Do14427, Apr. 29, 2010), and when the seller completed the registration of ownership transfer to the second buyer, the criminal breach of duty is deemed to have been consummated. Nevertheless, if a seller, without the intention to complete the registration of ownership transfer to the second buyer, received a earnest money and an intermediate payment from the second buyer, and

completed the registration of ownership transfer to the first buyer, the seller is deemed to have defrauded the second buyer. As such, in a case where a seller received a earnest money from the second buyer, what becomes a matter for concern is whether the criminal breach of duty is established against the first buyer or whether the crime of fraud is established against the second buyer. A fiduciary relationship and an act in violation of duty do not occur repetitiously every time a new sale of the same real estate is made. In sum, both the first buyer and second buyer are afforded with the same degree of protection, with some difference in form and phase of protection.

G. Where (a) a buyer faithfully performed his/her obligation to pay the purchase-price under a sale contract; (b) it is expected of a seller to faithfully perform his/her obligation in return; (c) a seller has no right to rescind a contract: if a seller is allowed to choose whether to perform his/her obligation under a sale contract or not by freely disposing of the real estate in possession at his/her will, such permission might result in a *de facto* nullification of the right to claim the performance of a buyer.

The Republic of Korea recognizes the right to claim compensation for damages and the right to claim the performance of an obligation as a basic remedy for nonperformance of an obligation. The right to claim the performance of an obligation is an important mark which demarcates the continental legal system and the common law. In a case where a seller disposed of a real estate through an act of betrayal, (i) a view that affirms an efficient annulment of a contract, or (ii) a view that considers it a simple nonperformance of an obligation and thus, compensatory damages in cash or a refund of the purchase-price in accordance with the annulment of a contract would be sufficient, does not fit the Korean legal system, which recognizes the right to claim the performance of an obligation as a basic remedy. This view is unreasonable, because it would allow a case where: (i) the appraised value of a real estate increases over the period between the buyer's payment of an intermediate payment and the payment date of outstanding payment; (ii) a seller disposes of the real estate to a third party at any time without any constraint; and (iii) thereby approving the nullification of a buyer's exercise of the right to claim the performance of an obligation under a sale contract.

A resolution of a dispute through compensatory damages is premised on the fact that a culpable actor is capable enough to carry out it. However, in most times a seller who has committed such acts of betrayal does not have self-sufficiency of money to pay compensatory damages. This is because such acts of betrayal are often committed when a seller is economically deprived. Even if a seller is economically self-sufficient, there might be cases where he/she may conceal the proceeds from the disposal of the real estate. As such, the right to claim refund of the purchase-price or the right to claim compensatory damages would not be efficient as a practical remedy of rights violations.

H. In a country like the Republic of Korea, where the legal system is based

on the statutory law, the binding effect of the judicial precedents is not as strong as law. However, having accumulated over a long period of time, the judicial precedents (i) have a normative effect in practice; (ii) serve as rules of the trial proceedings, and (iii) directly influences people's daily lives. The judicial precedents, which (i) views a double transfer or double selling of real estate as undermining a fiduciary relationship with a buyer, and (ii) curbs such practice by imposing criminal sanctions, dates back to the time when the Korean Civil Code was in effect. Under the Korean Civil Code adopting the principle of intention in regard to the change of real rights, the judicial precedents considered double selling of real estate as constituting the crime of embezzlement against the first buyer. Since January 1, 1960, when the Civil Act that adopted the principle of formalism as to the change of real rights, and until now, the judicial precedents have determined that the criminal breach of duty is established in a case where (i) a contract reached a stage where it cannot be arbitrarily rescinded with the payment of an intermediate payment, (ii) and shortly thereafter, a seller double sold the real estate to a third party. The essence of the crime of embezzlement and the crime of breach of duty lies in the fact that both infringe upon a fiduciary relationship. The difference between the two is that the crime of embezzlement deals with property whereas the crime of breach of duty deals with pecuniary advantage. In light of these circumstances, the judicial precedents, for a long time, maintained that criminal sanctions must be imposed on a seller who double sold the real estate as an object of sale to a third party, as such act violates a fiduciary relationship with a buyer. The legal principle in these judicial precedents is deemed a *de facto* legal norm that regulates transaction activities of our society.

Changing such judicial precedents firmly rooted in transactions of the Korean people and society may only provoke confusion, and do not contribute to the protection of the rights of the people. The reasonable reconciliation of the conflicting interests is required to protect the rights of the people in property transactions. The Supreme Court should not be negligent in protecting the rights of the people who suffered damages for the purpose of protecting the rights of the people who caused damages. There is no reasonable ground or practical need for changing the existing precedent that have punished double selling of real estate on the charge of the criminal breach of duty.

For the foregoing reasons, we concur with the Majority.

8. Concurrence by Justice Kim Chang-suk regarding the Dissenting Opinion

A. The precedents regarding the double selling of real estate which the Supreme Court wants to maintain have positive aspects in that they provide faithful interpretation for a buyer's protection. On the other hand, they also have negative aspects in that they make it easily accessible to infringe upon not only a seller's freedom of contract but also the right to physical freedom. The dissenting opinion does not argue that the protection of a buyer is unnecessary

by emphasizing these negative aspects.

Interpretation of criminal elements stated by the Criminal Act must ensure a balance between the two functions of the criminal law, protecting legal interests and ensuring freedom, instead of attaching conclusive importance on either one of the two. The interpretation that disproportionately protects the legal interest of one, which thereby violates freedom of the other, is prohibited. Rather, one must bear in mind that the principle of interpreting penal statutes forbids violation of an individual's freedom without express grounds in the criminal law, even at the price of the protection of legal interests to some extent. This is the core principle of *nulla poena sine lege* (no penalty without a law) underpinned by the Constitution.

B. Whether someone is "a person who administers another's business" under the crime of breach of trust should be determined based on whether that person is in a position whose typical and fundamental substance of the relationship between the contracting parties lies in protecting and managing another's pecuniary advantage, in light of the content of a contract and the type and characteristics of a fiduciary relationship. As such, an extensive interpretation of "a person who administers another's business" on the ground that the nature of a business for another transcends subordinate and peripheral scope to form critical elements, is forbidden, despite the fact that protection and management of another's pecuniary advantage does not form typical and fundamental substance of the relationship between the contracting parties. Just because a specific business has significance for the counterparty, that alone cannot support a claim that a person who disposes of the business in question has a position of protecting and managing the counterparty's pecuniary advantage. Whether someone is in a position to protect and manage the counterparty's pecuniary advantage is determined depending on the content of a contract or the type and characteristics of a fiduciary relationship.

A person who "shall manage the affairs entrusted to him with the care of a good manager in accordance with the tenor of the mandate" under a mandate contract (*see* Article 681 of the Civil Act) is someone who is in a position whose typical and fundamental substance of the relationship between the contracting parties lies in protecting and managing another's relationship, and may be deemed "a person who administers another's business" in the crime of breach of duty. A similar fiduciary relationship may be recognized in an employment contract or a labor contract.

On the other hand, in a real estate sale contract where "one of the parties agrees to transfer a property right to the other party and the other party agrees to pay the purchase-price to the former" (*see* Article 563 of the Civil Act), both parties try to maximize their own profits; a seller by selling the real estate in question at a higher price, and a buyer by purchasing the real estate at a lower price. In this regard, a seller and a buyer have a conflict of interest. Both a seller and a buyer may not be deemed as being in a position where typical and

fundamental substance of the relationship between the contracting parties lies in protecting and managing the counterparty's pecuniary advantage. A buyer's obligation to pay the purchase-price or a seller's obligation to transfer ownership of the real estate in question is not intended to protect or manage the counterparty's pecuniary advantage, but they are the obligations owed by each party in reciprocity for acquisition of either the ownership of the real estate or the purchase-price. This applies both to the time at which the contract is signed and to the time thereafter. Yet, the Majority Opinion does not recognize the legal status of which protection and management of the counterparty's pecuniary advantage consists typical and fundamental substance of the relationship between the contracting parties against a buyer, whereas the same is recognized against a seller from the time at which he/she received an intermediate payment.

C. According to the Majority Opinion, the criminal breach of duty is not established in a case of a real estate sale contract where a seller double sold a real estate to a buyer who paid 10% of the purchase-price as a earnest money. This is because a buyer can be freed from the binding force of a contract. However, when a buyer delivered 20% of the purchase-price as a earnest money, a seller may not be freed from the binding force of a contract, and double selling at this moment is deemed a criminal breach of duty. This logic of the Majority is to enforce the implementation of the obligation under a contract by means of criminal punishment. According to the Majority Opinion, a seller is denied his/her right to rescind a contract at risk of criminal punishment. The same applies to the case in which a seller sufficiently compensates the damage that may occur to a buyer. It is likened to allowing a violation of a seller's right to rescind a contract and his/her right to physical freedom for the sake of the protection of a buyer's rights. It is questionable if the intervention of the criminal law can be justified in such a case. The inability to exercise the right to rescind an agreement by receiving a earnest money may not be understood as a seller's disposal of the real estate in his/her possession is deemed a crime. This is because the ownership of real estate lies in a seller until a seller completes the registration of ownership transfer to a buyer, and the ownership includes the right of disposal in and of itself (*see* Article 211 of the Civil Act).

D. Upon signing a real estate sale contract: (i) a buyer of real estate pays the most of his/her property to a seller for the purchase-price of real estate in most cases; (ii) despite having paid a significant portion of the purchase-price to a seller, there are instances where the buyer does not receive the ownership of the real estate he/she purchased, and in some cases, restitution of what is already paid is not made, which causes immense damage to the buyer. Against this backdrop, the precedents regarding double selling of real estate have been formed, based upon a realistic recognition of the fact that civil remedy such as compensatory damages is insufficient to protect a buyer.

If a seller received the purchase-price including a earnest money or an

intermediate payment without either the intention to transfer the ownership or the ability to do so, it may be punished on the charge of the crime of fraud, the statutory punishment of which is much heavier than that of the crime of breach of duty, thereby mitigating concern about the insufficient protection of a buyer in double selling of real estate.

However, even in a case which does not meet the criminal elements of the crime of fraud, the legal principle adopted by the Majority Opinion: (i) significantly violates a seller's right to rescind a contract and the right to physical freedom; (ii) by applying extensive interpretation to the elements of a criminal breach of duty beyond the language and text thereof; (iii) in order to further the protection of a buyer. This strays from the principle of interpreting penal statutes stating that an individual's freedom shall not be violated without express grounds in the criminal law even at the price of the protection of legal interests to some extent. In that regard, it is unreasonable to construe "a person who administers another's business" in the crime of breach of duty by deeming a seller of real estate, who, according to the nature of a real estate sale contract is not in a position whose typical and fundamental substance of the relationship between the contracting parties lies in protecting and managing another's pecuniary advantage, as a person who disposes of a buyer's business. Eventually, the legal principle embedded in the Majority Opinion not only goes against the legality principle but also cannot be freed from a criticism that it is unconstitutional interpretation.

For the foregoing reasons, we point out the fundamental shortcomings of the legal principle of the Majority Opinion.

Chief Justice	Kim Myeongsu (Presiding Justice)
Justices	Ko Young-han
	Kim Chang-suk
	Kim Shin (Justice in charge)
	Kim So-young
	Jo Hee-de
	Kwon Soon-il
	Park Sang-ok
	Lee Ki-taik
	Kim Jae-hyung
	Cho Jae-youn
	Park Jung-hwa
	Min You-sook

Supreme Court Decision 2017Du48543 Decided April 24, 2018
【Revocation of Disposition Imposing Corporate Tax Act】

【Main Issues and Holdings】

[1] Meaning of "a withholding agent liable for tax due on interest income payable to a domestic corporation" under Article 73(1) of the former Corporate Tax Act

[2] In a case where: (a) Bank A, etc. concluded a checking account agreement with commercial paper (CP) issuers and distributed promissory notes to the CP issuers; (b) the notes that were issued at a discount were then deposited with the Korea Securities Depository (KSD); (c) subsequently, rather than following the ordinary promissory note settlement process, the CP holders withdrew the deposited notes prior to their maturity, went directly to their main commercial bank without going through the KSD, presented the notes to request payment, and was paid the respective amount; (d) however, the CP holders were exempt from paying withholding tax on the interest income accrued from the discount of notes by the KSD, etc.; and (e) accordingly, the competent tax authorities, on the grounds that Bank A, etc. (paying bank) was liable to withhold tax on the amount of discounted notes, rendered a disposition imposing additional tax for dishonest payment, etc., the Court affirming the lower judgment finding that Bank A, etc. did not constitute a withholding agent as prescribed by Article 73(1) and (5) of the former Corporate Tax Act

【Summary of Decision】

[1] Article 73(1)1 of the former Corporate Tax Act (amended by Act No. 10423, Dec. 30, 2010; hereafter the same) provides that, "When a person liable for withholding pays a domestic corporation interest income referred to in Article 127(1) of the Income Tax Act, he/she shall withhold corporate tax equivalent to the amount calculated by applying the tax rate of 14/100 to the amount payable." Here, the term "a person liable for withholding who pays a domestic corporation interest income" refers to a person who actually pays the amount of interest income as a performance of one's obligation under a contract, etc., barring special circumstances.

[2] In a case where: (a) Bank A, etc. concluded a checking account agreement with commercial paper (CP) issuers and distributed promissory notes to the CP issuers; (b) the notes that were issued at a discount were then deposited with the Korea Securities Depository (KSD); (c) subsequently, rather than following the ordinary promissory note settlement process, the CP holders withdrew the deposited notes prior to their maturity, went directly to their main

commercial bank without going through the KSD, presented the notes to request payment, and was paid the respective amount; (d) however, the CP holders were exempt from paying withholding tax on the interest income accrued from the discount of notes by the KSD, etc.; and (e) accordingly, the competent tax authorities, on the grounds that Bank A, etc. (paying bank) was liable to withhold tax on the amount of discounted notes, rendered a disposition imposing additional tax for dishonest payment, etc., the Court held as follows: (a) the *de facto* act of Bank A, etc. merely pertained to opening a checking account for CP issuers and processing payment by withdrawing the respective amount of notes deposited in the checking account when a request for payment is made upon maturity of the CPs, and furthermore, the interest income was not paid to perform an obligation; (b) as such, Bank A, etc. was not a withholding agent given that they did not constitute "a person who pays interest income referred to in Article 73(1) of the former Corporate Tax Act (amended by Act No. 10423, Dec. 30, 2010)"; (c) moreover, Bank A, etc. was only entrusted to handle the payment of the respective amount of notes (*de facto* act), and no express provision existed in regard to holding the entrusted party liable for withholding tax on interest income; (d) nevertheless, deeming the *de facto* act to fall under "a financial company […] trades bills, etc. issued by a domestic corporation on behalf of such corporation" pursuant to Article 73(5) of the former Corporate Tax Act constitutes either an expansive or analogical interpretation contrary to the principle of no taxation without representation; (e) in light of the above, the fact that Bank A, etc. handled the payment of the respective amount of notes upon entrustment by the CP issuers cannot be the sole basis for deeming such act to constitute Article 73(5); and (f) therefore, the lower court is justifiable to have determined that Bank A, etc. was not a withholding agent according to the aforementioned statutory provision.

【Reference Provision】 [1] Article 73(1)1 of the former Corporate Tax Act (Amended by Act No. 10423, Dec. 30, 2010 / [2] Article 73(1)1 and (5) of the former Corporate Tax Act (Amended by Act No. 10423, Dec. 30, 2010)

Article 73 of the former Corporate Tax Act (Withholding)

(1) When a person (hereafter referred to as "person liable for withholding" in this Article) pays a domestic corporation any of the following amounts (including revenues of a corporation that operates the financial insurance business, but excluding those prescribed by Presidential Decree, such as income payable to financial companies, etc. prescribed by Presidential Decree which is prescribed by Presidential Decree and income on which corporate tax is not imposed or exempt), he/she shall withhold corporate tax equivalent to the amount calculated by applying the tax rate of 14/100 (25/100 in the case of profits accruing from a non-business loan referred to in Article 16(1)11 of the Income Tax Act) to the amount payable and shall pay it at the tax office having jurisdiction over the place of tax payment, etc. by no later than the tenth day of

the month following the month in which the date of collection falls: <*Amended by Act No. 10423, Dec. 30, 2010*>

1. The amount of interest income referred to in Article 127(1)1 of the Income Tax Act[.]

(5) Where a financial company, etc. prescribed by Presidential Decree assumes or trades bills or debt certificates issued by a domestic corporation (including a resident; hereafter the same shall apply in this paragraph) or brokers or makes such transactions on behalf of the corporation pursuant to paragraph (1), the financial company, etc. shall be deemed to have the agency or commission relationship with the domestic corporation for purposes of paragraph (1). <*Amended by Act No. 10423, Dec. 30, 2010*>

【**Reference Case**】 [1] Supreme Court Decision 2011Du8246 decided Dec. 11, 2014

【**Plaintiff-Appellee**】 Woori Bank Co., Ltd. and five others (Yulchon LLC, Attorneys Kang Seok-hoon et al., Counsel for the plaintiff-appellee)

【**Defendant-Appellant**】 Head of National Tax Service Namdaemun District Office and four others

【**Judgment of the court below**】 Seoul High Court Decision 2016Nu62902 decided May 17, 2017

【**Disposition**】 All appeals are dismissed. The costs of appeal are assessed against the Defendants.

【**Reasoning**】 The grounds of appeal are examined.

1. Ground of appeal No. 1

A. Article 73(1)1 of the former Corporate Tax Act (amended by Act No. 10423, Dec. 30, 2010; hereafter the same) provides that, "When a person liable for withholding pays a domestic corporation interest income referred to in Article 127(1) of the Income Tax Act, he/she shall withhold corporate tax equivalent to the amount calculated by applying the tax rate of 14/100 to the amount payable." Here, the term "a person liable for withholding who pays a domestic corporation interest income" refers to a person who actually pays the amount of interest income as a performance of one's obligation under a contract, etc., barring special circumstances (*see*, *e.g.*, Supreme Court Decision 2011Du8246, Dec. 11, 2014).

B. The reasoning of the lower judgment and the record reveal the following.

1) The ordinary process involving the issuance and payment of commercial paper (CP) is elucidated as seen *infra*.

A) Companies issue CPs for the purpose of procuring short-term funds, and then request a discount from the par value at the time of issuance to securities companies as well as investment dealers and brokers (hereinafter "discount house").

B) A discount house deducts its commission from the discounted par value and pays the outstanding amount to the issuers. If a discount house were to directly purchase CPs, it can either hold on to the CPs until maturity or transfer the CPs to other investors in the form of a sale.

C) Investors generally do not possess the actual CPs but, instead, deposit them to the Korea Securities Depository (KSD) to whom the relevant rights are consigned. Upon maturity, the KSD presents the CP to request payment via its main commercial bank (hereinafter "presenting bank").

D) A presenting bank, through a clearing house, notifies the presentation for payment to a bank that opened the issuer's checking account (hereinafter "paying bank"). After confirming the outstanding amount in the checking account, the paying bank withdraws the amount and transfers said amount to the presenting bank via the clearing house's electronic wiring system.

E) The amount of CP issued is paid sequentially: presenting bank → KSD → discount house → investor.

2) The Plaintiffs are the paying banks that concluded a checking account agreement with the CP issuers and distributed promissory notes to such issuers.

3) Rather than following the ordinary settlement process, as seen above, the CP holders of the instant case withdrew (from the KSD) the deposited notes prior to their maturity, went directly to their presenting bank without going through the KSD, and was paid the respective amount. Accordingly, the CP holders were exempt from paying withholding tax on the interest income accrued from the discount of notes by the KSD, etc.

4) The Defendants issued the pertinent disposition imposing additional tax for dishonest payment and non-presentation of a statement of receipt on the grounds that the Plaintiffs (paying bank) were liable to withhold the respective amount of discounted notes in the instant case where financial companies, etc. purchased CPs from a discount house; withdrew the notes from the KSD prior to their maturity; and were paid the respective amount.

C. The lower court determined that the Plaintiffs did not constitute "a person who pays interest income" as prescribed under Article 73(1) of the former Corporate Tax Act and thus was not a withholding agent according to the statutory provision, on the following grounds: (a) the Plaintiffs merely performed such *de facto* acts as opening a checking account for CP issuers and processing payment by withdrawing the respective amount of notes deposited in the checking account when a request for payment is made upon maturity of the CPs; and (b) the Plaintiffs did not pay the interest income to perform an obligation.

D. Examining the provisions and legal principles, *supra*, the lower court did not err by misapprehending the legal doctrine on withholding tax under the Framework Act on National Taxes and the Corporate Tax Act.

2. Ground of appeal Nos. 2 and 3

A. According to the former Corporate Tax Act, financial companies, etc. shall be liable for corporate withholding tax on the interest income referred to in Article 127(1)1 of the Income Tax payable to a domestic corporation (*see* Article 73(1)) in cases where "a financial company, etc. assumes or trades bills or debt certificates issued by a domestic corporation or brokers or makes such transactions on behalf of the corporation pursuant to paragraph (1)" (*see* Article 73(5)).

B. Citing the following circumstances, the lower court held that the Plaintiffs were not a withholding agent according to the aforementioned statutory provision, inasmuch as deeming them to constitute Article 73(5), *supra*, is difficult solely on the basis that the Plaintiffs handled the payment of the respective amount of notes upon entrustment by the CP issuers.

1) The Defendants assert that the Plaintiffs, which were consigned to handle the payment of the issued notes under the relevant statute and contract, constituted "a financial company […] trades bills, etc. issued by a domestic corporation on behalf of such corporation" pursuant to Article 73(5) of the former Corporate Tax Act. However, deeming as such is difficult given that the Plaintiffs merely performed a *de facto* act, that is, payment of the respective amount of issued CPs.

2) Article 127(5) of the Income Tax Act and Article 73(6) of the Corporate Tax Act stipulate that, where a foreign corporation pays either a resident or a domestic corporation interest income, etc. accrued from bonds or securities it has issued, "a person who acts as an agent of the foreign corporation for such payment or a person to whom the authority for such payment is delegated or entrusted in the Republic of Korea shall withhold either income tax or corporate tax on such income." An express provision, as seen above, ought to exist to hold a person entrusted with handling the payment of the respective amount of notes liable for withholding tax on interest income. Even if that is not the case, deeming the Plaintiffs to fall under "a financial company […] trades bills, etc. issued by a domestic corporation on behalf of such corporation" pursuant to Article 73(5) of the former Corporate Tax Act constitutes either an expansive or analogical interpretation contrary to the principle of no taxation without representation.

3) According to Article 190 Subparag. 1 of the Enforcement Decree of the Income Tax Act (amended by Presidential Decree No. 24356, Feb. 15, 2013), the period for withholding tax on any income generated from the discount of notes was unified to the "discount sale date"; *provided*, however, that the foregoing shall apply only where any person who receives interest income equivalent to the discounted value of the relevant notes chooses to withhold on the discount sale date where said notes are deposited, from the date of issuance thereof to the date of maturity, in the KSD. The amendment was made to prevent the omission of the payment of withholding tax due. As alleged by the Defendants, if the Plaintiffs, as a matter of course, were subject to withholding

tax against the amount of discounted CPs, then there was no need to revise the aforementioned provision.

4) Information accessible by the Plaintiffs did not include information on the issuance of notes at a discount subject to withholding tax. Moreover, albeit such information could have been obtained through either an issuer or the KSD, inquiry as to the matter each time a promissory note is presented to request payment is impracticable. Furthermore, the same cannot be required as there is no basis under law or contract.

C. The allegations in this part of the grounds of appeal disputing such a determination by the lower court are nothing more than finding fault with the admission and exclusion of evidence and probative value judgment, which are the prerogative of the lower court as a fact-finder. Also, even if examining the reasoning of the lower judgment in light of the record, the lower court did not err by exceeding the bounds of the principle of free evaluation of evidence going against empirical and logical rules. Moreover, a review of the relevant legal principle and the record reveals that the lower court is tenable to have deemed that the Plaintiffs were not a withholding agent as prescribed under Article 73(5) of the former Corporate Tax Act. In so determining, the lower court did not err by misapprehending the legal doctrine as to Article 73(5) thereof.

3. Conclusion

Therefore, all appeals are dismissed and the costs of appeal are assessed against the losing parties. It is so decided as per Disposition by the assent of all participating Justices on the bench.

Justices Jo Hee-de (Presiding Justice)
Kim Chang-suk
Kim Jae-hyung
Min You-sook (Justice in charge)