

THE MATTER OF AN ARBITRATION  
UNDER THE UNCITRAL ARBITRATION RULES 1976

**SALUKA INVESTMENTS BV (THE NETHERLANDS)**

Claimant

v

**THE CZECH REPUBLIC**

Respondent

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**PARTIAL AWARD**

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*Arbitral Tribunal*

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## DEFINED TERMS

Allianz	Allianz AG
Bankovní	Bankovní Holding a.s. (see also Bivalence and České pivo)
Big Four banks	Česká spořitelna, a.s. (“CS”); Komerční banka, a.s. (“KB”); Ceskoslovenská obchodní banka a.s. (“CSOB”); and Investiční a Poštovní banka a.s. (later known as IP banka a.s., or “IPB”)
CI	Česká inkasní, s.r.o.
CNB	Czech National Bank
CS	Česká spořitelna, a.s., one of the Big Four banks
CSC	Czech Securities Commission
CSOB	Ceskoslovenská obchodní banka a.s., one of the Big Four banks
CZK	Czech Republic Koruny
GDP	Gross Domestic Product
Hypo- Vereinsbank	Hypo-und Vereinsbank AG
IPB	Investiční a Poštovní banka a.s./IP banka a.s., one of the Big Four banks
KB	Komerční banka, a.s., one of the Big Four banks
KBC	KBC Bank of Belgium NV
KoB	Konsolidační banka, s.p. ú v likvidaci, State-owned debt consolidation agency
NPF	National Property Fund
OJ	Official Journal of the European Communities
OPC	Office for the Protection of Economic Competition
PCA	Permanent Court of Arbitration
Saluka	Saluka Investments BV
SI	Slovenská Inkasní, spol, s.r.o.
Treaty	Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of The Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991
UniCredito	UniCredito Italiano Group

## I. INTRODUCTION

### A. Commencement of the Arbitration

1. This arbitration arises out of events consequent upon the reorganisation and privatisation of the Czech banking sector as it had formerly existed under the centralised banking system of the Communist period, which ended in 1990. The Czech Government privatised one of the major Czech banks, known as IPB (see below, paragraph 33), by selling the State's shareholding to a company within the Nomura group of companies. The Nomura Group (see below, paragraph 42) is a major Japanese merchant banking and financial services group of companies, which typically operates also through subsidiaries set up in various countries. The Nomura company which bought the shares in IPB transferred them to another Nomura subsidiary, Saluka Investments BV ("Saluka"), a legal person constituted under the laws of The Netherlands.

2. By a Notice of Arbitration dated 18 July 2001 Saluka initiated arbitration proceedings against the Czech Republic as the Respondent, under Article 8 of the Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of The Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991 ("the Treaty"). The Czech and Slovak Federal Republic was dissolved on 31 December 1992, and its two constituent parts became independent States as the Czech Republic and the Slovak Republic. The Czech Republic confirmed to the Kingdom of The Netherlands that, upon the separation of the Czech and Slovak Federal Republic into two separate Republics, the Treaty remained in force between the Czech Republic and the Kingdom of The Netherlands.

3. In accordance with Article 8(5) of the Treaty, the arbitration tribunal ("the Tribunal"), in determining its own procedure, has to apply the arbitration rules of the United Nations Commission for International Trade Law ("the UNCITRAL Rules"). Although, inevitably, at the time when the Notice of Arbitration was served the Tribunal had not been constituted, the Claimant's Notice of Arbitration was, as is usual in these circumstances, given to the Respondent pursuant to Article 3.1 of those Rules.

### B. Constitution of the Tribunal

4. Article 8 of the Treaty provides that the Tribunal will consist of three persons, each party appointing one member and those two members appointing a third person as Chairman of the Tribunal. Within the time-limits set out in that Article the three appointments were made, Mr Daniel Price being appointed by the Claimant, Professor Dr Peter Behrens being appointed by the Respondent, and Professor Sir Elihu Lauterpacht CBE QC being appointed as Chairman by agreement between the two previously-appointed members.

5. On 5 June 2002 Mr Price tendered his resignation. On 20 June 2002 the Claimant appointed in his place Maître L. Yves Fortier CC QC as a member of the Tribunal.

6. On 24 February 2003 Professor Sir Elihu Lauterpacht tendered his resignation. The two party-appointed members of the Tribunal agreed upon the appointment of Sir Arthur Watts KCMG QC in his place as Chairman of the Tribunal, and the parties were notified of this on 25 March 2003.

C. Procedural Timetable

7. At a Procedural Meeting held in London on 2 November 2001:

a. it was agreed that the UNCITRAL Rules were the applicable rules of procedure in this arbitration;

b. the parties accepted the Tribunal's proposal that registry services for the arbitration should be provided by the Permanent Court of Arbitration ("PCA"), and the PCA agreed to provide such services;

c. Geneva, Switzerland, was selected as the place of arbitration, although this did not preclude the Tribunal from holding meetings at any other place, including The Hague, for the sake of convenience;

d. English was agreed as the language of the arbitration;

e. arrangements were made for the discovery of certain documents;

f. the following timetable for the submission of written pleadings by the parties was laid down (it being agreed that it would be more appropriate to use the international nomenclature for the parties' written submissions rather than the terms used in the UNCITRAL Rules):

Claimant's Memorial – 5 March 2002, and  
Respondent's Counter-Memorial – 17 May 2002;

g. the possibility of there being a second round of written submissions was reserved for future decision by the Tribunal, but tentative deadlines were set as follows:

Claimant's Reply – 19 July 2002, and  
Respondent's Rejoinder – 13 September 2002; and

h. arrangements were made regarding questions of confidentiality.

8. The timetable laid down for the first round of written pleadings was subsequently amended from time to time, by agreement of the parties.

D. The Written Pleadings

9. Two days before the amended date fixed for the submission of the Claimant's Memorial, the Respondent on 13 August 2002 filed a Notice to Dismiss, by which it requested that the Tribunal dismiss the Claimant's claims.

10. At a Procedural Meeting in London on 10 September 2002 to consider this request, the Tribunal ruled that because the facts alleged in the Respondent's Notice to Dismiss were so closely related to the facts involved in the principal claim, the dismissal issue should be joined to the merits and ruled upon in the Tribunal's final award.

11. Meanwhile, in accordance with the amended timetable, the Claimant filed its Memorial on 15 August 2002.

#### E. The Respondent's Counterclaim

12. Before the amended deadline set for the filing of its Counter-Memorial, the Respondent submitted on 4 December 2002 a Notice of Counterclaim, setting forth a counterclaim against the Claimant in which it stated that it would elaborate in its Counter-Memorial.

13. By a letter dated 16 December 2002 the Claimant informed the Respondent of its view that the Tribunal lacked jurisdiction under the Treaty to hear a Counterclaim by the Czech Republic. In a subsequent exchange of correspondence, the Claimant proposed that the Tribunal hear its objections to jurisdiction prior to the filing of the Respondent's Counter-Memorial, while the Respondent suggested that any objections to the jurisdiction of the Tribunal to consider the Counterclaim be raised, and resolved by the Tribunal, after the filing of the Counter-Memorial.

14. In a "Direction by the Tribunal" ("Direction") issued on 15 January 2003 the Tribunal permitted the Respondent to proceed in the manner set out in its Notice of Counterclaim, by elaborating such claims within its Counter-Memorial (then due to be filed by 21 February 2003), and ordered the Claimant to respond by 31 March 2003 to the parts of the Counter-Memorial dealing with the Counterclaim by Objections limited to the question of the Tribunal's jurisdiction in that respect.

15. The Tribunal added that it expected the Respondent's elaboration to cover comprehensively the questions of the Tribunal's jurisdiction over the Counterclaim, and whether any connection is required between the Counterclaim and the Claimant's claim as submitted in its Memorial of 15 August 2002 and, if so, the nature and extent of such connection. The Direction reserved the question whether oral proceedings would be necessary on this issue, and suspended the proceedings in respect of the rest of the case until the question of the Tribunal's jurisdiction over the Counterclaim had been decided.

16. The Tribunal set, and at the request of the parties varied from time to time, a timetable for the submission by the parties of their pleadings on the issue of jurisdiction, and the parties duly complied with that timetable as amended.

17. In its Counter-Memorial, submitted on 7 March 2003, the Respondent both set out its response to the Claimant's claims and dealt with the question of counterclaims.

18. As regards its Counterclaim, the Respondent set out the various heads of its Counterclaim in the Counter-Memorial, and addressed separately the question of the

Tribunal's jurisdiction over the Counterclaim. On 15 May 2003 the Claimant filed its "Objections to Jurisdiction over the Czech Republic's Counterclaims" ("the Objections"). This was followed, on 29 September 2003, by the Respondent's "Response to the Claimant's Objections to Jurisdiction over the Czech Republic's Counterclaims" ("the Response"), and on 10 November 2003 by the Claimant's "Reply to the Czech Republic's Response to the Claimant's Objections to Jurisdiction over the Czech Republic's Counterclaims" ("the Reply").

19. On 11 November 2003 the Respondent requested a hearing on the issue of the Tribunal's jurisdiction over its Counterclaim. The Tribunal fixed 6 March 2004 for the hearing, and the Tribunal and the parties met in London on that date for the purpose of hearing oral argument on this issue.

20. On 7 May 2004 the Tribunal handed down its *Decision on Jurisdiction over the Czech Republic's Counterclaim* ("Decision on Jurisdiction over Counterclaims"). For the reasons set out in that Decision, the Tribunal decided

- a. that it was without jurisdiction to hear and determine the Counterclaim put forward by the Respondent in its Counter-Memorial;
- b. that that Decision was without prejudice to the issue raised by the Respondent's Notice to Dismiss of 15 August 2002, which had been joined to the merits by the Tribunal's ruling of 10 September 2002;
- c. that questions of costs arising as a result of the presentation by the Respondent of the Counterclaim set out in its Counter-Memorial were reserved until final consideration could be given to questions of costs in this arbitration as a whole; and
- d. that the Tribunal would separately set out a revised timetable for the remaining written pleadings of the parties.

21. In a letter dated 9 June 2004 the Claimant subsequently raised a question as to the effect of the Tribunal's Decision on Jurisdiction over Counterclaims, contending that Part IV of the Respondent's Counter-Memorial (in which the Respondent had set out its arguments on its counterclaims) was to be treated as struck out and that in consequence the Claimant need not in its Reply deal with the matters contained in that Part IV. After obtaining the views of the parties the Tribunal on 26 July 2004 conveyed to the parties its view that its Decision on Jurisdiction over Counterclaims had the consequence that Part IV of the Respondent's Counter-Memorial was no longer relevant to the arbitration in so far as it concerned the question of counterclaims, but that it did not necessarily follow that Part IV was also irrelevant to other questions which might still arise in the arbitration. Since the possible relevance of Part IV to such other questions was a matter to be argued by the parties as part of the further proceedings on the merits, the Tribunal was unable to agree to the Claimant's request that the Tribunal should now order that Part IV be struck out of the pleadings altogether.



F. Subsequent Procedural Timetable

22. Having already received the Claimant's Memorial and the Respondent's Counter-Memorial, the Tribunal on 9 June 2004 endorsed the parties' agreement to the following timetable for the submission of further written pleadings:

Claimant's Reply – 24 September 2004; and  
Respondent's Rejoinder – 4 February 2005.

Those further written pleadings were submitted by the parties within the time allowed for them.

G. Oral Hearings

23. In subsequent discussion with the parties, it was agreed that oral hearings would be held in London, at the International Dispute Resolution Centre, from Friday, 8 April 2005 to Wednesday, 20 April 2005. The hearings duly took place between those dates.

24. At those hearings, the Tribunal was addressed by:

On behalf of the Claimant: Mr Jan Paulsson  
Mr Peter Turner  
Professor James Crawford SC

On behalf of the Respondent: Mr George von Mehren

In addition, the Tribunal heard the following witnesses:

Called by the Claimant: Mr Randall Dillard  
Professor Hyun Song Shin

Called by the Respondent: Mr Michael Descheneaux  
Mr Pavel Racoča  
Mr Luděk Niedermayer  
Mr Jan Mládek  
Mr Pavel Mertlík  
Mr Kamil Rudolecký  
Mr Ivan Pilip  
Mr Pavel Kavánek  
Professor Joseph J. Norton  
Mr Brent Kaczmarek

25. After the conclusion of the oral hearings, the Tribunal allowed the parties, if they so wished, to file post-hearing briefs by 30 June 2005. Both parties filed post-hearing briefs within that deadline.

## II. THE FACTS

26. Saluka claims in this arbitration that the Czech Republic acted in relation to Saluka and its investment in a manner inconsistent with the Czech Republic's obligations under the bilateral investment treaty ("BIT") between The Netherlands and the Czech Republic. In particular, Saluka claims that it was deprived of its investment contrary to Article 5 of that treaty, and that, contrary to Article 3, its investment was not treated fairly and equitably.

27. While the parties differed as to some of the facts and as to the interpretation to be made of the facts (those differences will emerge later in this Award), it appears to the Tribunal that the essential facts underlying this dispute were as follows.

### A. The Banking System in Czechoslovakia during the Period of Communist Rule

28. As was the case in many sectors of the economy, the banking sector in Communist Czechoslovakia – more formally, the Czech and Slovak Federal Republic – was highly centralised: it was an integral part of central State economic planning. That Communist era came to an end in 1990.

### B. The Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic 1991

29. As a step towards encouraging the development of a market economy in this former Communist State, a number of Western States concluded BITs with the Czech and Slovak Federal Republic. One such treaty was the Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic 1991 concluded with The Netherlands on 29 April 1991. The Treaty entered into force on 1 October 1992.

### C. The Separation of the Czech Republic and Slovakia

30. Following the end of the Communist era, the Czech and Slovak Federal Republic separated into its two constituent parts on 31 December 1992, and in its place the two independent States of the Czech Republic and Slovakia were created.

31. The Treaty had been concluded with the former State, the Czech and Slovak Federal Republic. By letter of 8 December 1994, the Minister of Foreign Affairs of the Czech Republic confirmed to the Minister of Foreign Affairs of the Kingdom of The Netherlands that the Treaty remained in force between the two States. No question of State succession in relation to the Treaty has been raised by the parties in this arbitration. The Tribunal, and the parties, have therefore proceeded on the basis that the Treaty applies to the situation which has given rise to the present dispute.

#### D. The Reorganisation and Privatisation of the Banking System in the Czech Republic

32. With the end of the period of Communist rule in 1990 and the subsequent establishment of the Czech Republic, the Czech authorities also took various steps to transform the economy into a more market-based system. This involved amongst other things attracting investment from abroad in order to provide the expertise to assist with this transformation. In particular it was necessary to reorganise the previously centralised banking sector.

33. By about 1994, the distinct segments of the former centralised banking system which revolved around the State Bank of Czechoslovakia had separated into four large State-owned commercial banks which dominated the banking sector in the Czech Republic. These “Big Four” banks were Česká spořitelna, a.s. (“CS”), Komerční banka, a.s. (“KB”), Československá obchodní banka a.s. (“CSOB”), and Investiční a Poštovní banka a.s. (later known as IP banka a.s., or “IPB”). The Czech banking sector was administered and regulated by the Czech National Bank (“CNB”).

34. IPB was the result of a merger in December 1993 between a bank known as “IB” (which had been formed in 1990 from part of the State Bank of Czechoslovakia) and the Post Office Bank: this merger gave IPB a right to provide banking services at 3,500 branches of Czech Post Offices until 2008 – the country’s largest retail banking network. IPB, however, did not just conduct a banking operation. By early 1996 it also managed a varied industrial portfolio, which included a substantial (83%) holding of shares in Plzeňský Prazdroj, the company that produces Pilsner Urquell beer. IPB’s corporate structure involved a Management Board of Directors (responsible for the day-to-day management of the bank) and a Supervisory Board (appointed and/or elected by IPB’s shareholders and employees, and responsible for general supervision and control), together with a General Assembly of shareholders. There was also a Chief Executive Officer.

35. With the end of the Communist period of control, the Czech Republic sought to transfer large parts of its hitherto State-owned economy into private ownership. It wanted to do this as rapidly as possible, and embarked upon a system of “mass voucher” privatisation – a system whereby State-owned firms were converted into joint stock companies, the shares in which were sold to Czech citizens for vouchers which they purchased for a nominal price. This process was substantially completed in two waves, and was concluded by 1995. In the case of larger and more strategic enterprises, however, only part of the share ownership was distributed through this mass privatisation procedure. A State agency known as the National Property Fund (“NPF”) retained a significant stake in these strategic enterprises, which included the Big Four banks – IPB, CSOB, CS and KB. The Czech State retained (directly or indirectly) a significant minority stake in and control over these banks: while the precise degree of the State’s shareholdings varied over time, at the times relevant to these proceedings, the State’s stake in CS amounted approximately to 45%, in KB to 48.75%, in IPB to 36%, and in CSOB to 46%. The final sale of the State’s remaining stakes in the banks and their privatisation was to follow in the period 1998-2001.

## E. The Czech Banking Sector's "Bad Debt" Problem

36. One of the legacies from the Communist era was a large level of outstanding debt, much of which included non-performing loans granted to large State enterprises which were insolvent. A large proportion of this bad debt problem found its way to the balance sheets of the Big Four banks. From them it was passed to the State-owned debt consolidation agency, Konsolidační banka, s.p. ú v likvidaci ("KoB"), which bought specific loans from the banks, whereby the purchase price exceeded the value of the loans. By 1995 most Communist-era bad debts had fed through the system.

37. However, economic practices in the post-Communist period created a substantial further bad debt problem in relation to new loans. It was government policy to continue the supply of credit to newly privatised firms, not necessarily on commercial terms, in order to keep the firms operating while they undertook the necessary restructuring; this liberal credit policy was applied even when, in truth, the firms being assisted were floundering and had ceased to service their loans. The Big Four banks (in which the State retained a significant stake) assisted in the carrying out of this policy. The balance sheets of the Big Four banks were once again seriously affected. By the end of 1999 the stock of non-performing loans in the portfolios of commercial and special institutions associated with the transformation of the economy amounted to one third of total loans or the equivalent of 26% of the Czech Republic's gross domestic product ("GDP"): a World Bank study in 2000 noted that this was one of the highest ratios in the new market economies of Central and Eastern Europe.

38. The problem was exacerbated by the absence at the time in the Czech legal system of an effective procedure to enable creditors to enforce payment of debts owing to them: moreover, collateral security for loans could not be sold without the debtor's consent. The CNB reported in 1997 that "[t]he balance between the rights and obligations of debtors and creditors is, on the long-term basis, tilted in favour of the debtors."<sup>1</sup> Some improvements in the legal regime regarding creditors' rights were made by new legislation, but this only entered into force on 1 May 2000.

39. This combination of relatively liberal credit policies and inadequate creditors' rights created a new "bad debts" or "bad loans" problem for the Czech banking system. By 1998 the Big Four banks again had a large non-performing loan problem, estimated at 34% for KB, 23.3% for CS, 16.6% for CSOB, and 21.75% for IPB.

40. A new Social Democratic Government which came to power in June 1998 sought to address these problems by action directed at business enterprises, through what was referred to as a "Revitalisation Programme"; both the Prime Minister and Minister of Finance expressly rejected the provision of further State aid directly to the banks. The new Government also claimed that it would improve creditors' rights, thereby helping creditor banks to recover their loans, but these promises either were not fulfilled, or were only fulfilled belatedly.

41. Given the continuing inadequacies in the legal regime of creditors' rights, the CNB felt obliged to take tough regulatory action in mid-1998 to protect the stability of the banking system. This action seriously affected the performance of the major banks, which had to

allocate a substantial part of their operating profits to additional provisions and reserves, causing some to return substantial losses for 1998.

F. Nomura's Acquisition of Control over IPB on 8 March 1998

42. Meanwhile, from mid-1996, Nomura began negotiations for the purchase of the State's shares in IPB. At this point the Tribunal must observe that "Nomura" is, in these proceedings, something of a *portmanteau* term. The Nomura Group, as a major international provider of banking and financial services, operates through a complex of associated and subsidiary companies, and it is not always easy to distinguish the separate capacities in which they act. For present purposes, it is convenient to distinguish between (1) the overall Nomura enterprise (which will be referred to as "the Nomura Group", "Nomura International" or sometimes simply "Nomura"), (2) an English-incorporated Nomura subsidiary known as Nomura Europe plc ("Nomura Europe" or sometimes simply "Nomura"), and (3) the Dutch-incorporated Nomura subsidiary known as Saluka Investments BV ("Saluka") and the Claimant in these arbitration proceedings. It is not, however, always possible to distinguish between these various emanations of Nomura, particularly since neither party has consistently made the necessary distinctions, much of the correspondence tendered in evidence is on writing paper headed "Nomura International PLC" even when dealing with the consequences of the Nomura/Saluka shareholding in IPB, and the Respondent indeed avowedly uses the term "Nomura" and "Saluka" interchangeably, in keeping with its view that as a practical matter Saluka is a mere shell used by Nomura for its own purposes.

43. The Nomura Group had had considerable direct experience of the Czech economy since about 1990, including advising the Czech Government on the privatisation of Czech breweries, and experience of the Czech banking sector, having previously advised both the Government and the Big Four banks in general as well as IPB in particular (with whom it had a long-standing relationship); it had also invested in Czech enterprises, and had an office in Prague since 1992.

44. In April 1996 IPB appointed Nomura to manage an equity offering, but ultimately this offering was abandoned. On 26 September 1996 Nomura offered to purchase the Government's shareholding in IPB at the price of CZK 300 per share, and to provide CZK 9 billion of new capital to the bank. The Government's shareholding consisted of 31.5% of IPB's shares held through the NPF, and a further 4.8% through other sources, in particular Czech Post – a total Government holding of some 36.3%.

45. A Nomura delegation led by Mr Yoshihisa Tabuchi (a Director and Counsellor at Nomura) met Mr Václav Klaus (Prime Minister), Mr Ivan Kočárník (Minister of Finance), Mr Josef Tošovský (Governor of the CNB) and others, including the management of IPB, at the end of October 1996 to discuss Nomura's offer. By about that time, Nomura reached an understanding with IPB's management that control over IPB would be exercised through shareholders agreements between Nomura and the management of IPB.

46. On 27 November 1996 the Government announced its intention to sell its shareholding in IPB through a public tender process, and therefore rejected Nomura's offer to buy the shares.

47. An internal Nomura analysis of December 1996 concluded that the viability of IPB as an investment depended on State support. Even so, on 23 December 1996, Nomura, through various subsidiaries, purchased approximately 5% of IPB shares (and by April 1997 had acquired almost 10% of IPB's shares). In or about December 1996 Nomura retained the firm later known as Price Waterhouse Coopers (after the merger of Price Waterhouse and Coopers & Lybrand in July 1998) to conduct due diligence of IPB: previously Nomura, as an "insider" working for IPB's management, had conducted extensive due diligence in connection with the abandoned equity offering of April 1996.

48. On 24 March 1997 the tender for the sale of up to 36% of the shares in IPB was announced by the NPF. The next day, Nomura International wrote to the Vice-Chairman of the NPF to declare its interest (the only other bidder to respond was ING Financial Services International). On 17 April 1997 Nomura presented a proposal to the Government for the purchase of the NPF's minority stake at CZK 300 per share (subject to due diligence and documentation).

49. As it was already a (minority) shareholder in IPB, Nomura then on 16 April 1997 entered into a shareholders agreement with other IPB shareholders whereby Nomura affiliates would offer to purchase the State's interest in IPB, and Nomura and the IPB management would jointly exercise control of IPB. On the same day, a second shareholders agreement which gave certain employment benefits to some of IPB's senior officials was also concluded.

50. On the next day, 17 April 1997, Nomura presented the NPF with a proposal to purchase its IPB shares and strengthen IPB's capital, and it informed the NPF that it had entered into shareholders agreements which gave it a strong position in IPB.

51. On 29 April 1997 Mr Jiří Tesař and Mr Libor Procházka, two senior members of IPB's Managing Board, were detained on charges of embezzlement. They were subsequently released, but nevertheless (and against a background of generally low public confidence in the banking sector) IPB's share price fell and clients began withdrawing funds. The NPF suggested to Nomura that, as a mark of confidence in IPB, a Nomura employee should join IPB's Management Board. Accordingly, in May 1997, Mr Eduard Onderka, a Director within Nomura's Merchant Banking Group, was appointed to IPB's Management Board; Nomura also provided a CZK 5 billion liquidity line to IPB following the drain on its liquidity caused by the outflow of deposits.

52. After receiving a provisional report on IPB from Price Waterhouse Coopers in June 1997, and a further Nomura internal analysis, both of which drew attention to IPB's poor financial position, Nomura International submitted a further proposal to the Government on 16-17 June 1997 whereby Nomura and the NPF would together have a controlling majority of IPB's shares. The Government rejected this proposal as not being consistent with Government policy, and requested Nomura to submit a further proposal on the lines of an outright purchase of the NPF's shareholding.

53. On 7 July 1997 Nomura submitted a new proposal for the purchase of up to 36.29% of IPB's share capital at CZK 285 per share (subject to due diligence and documentation); Nomura also proposed to subscribe a new issue of not more than 60,000,000 shares in IPB

(totalling CZK 6 billion), and an issue of 10-year subordinated bonds with a total face value not exceeding CZK 6 billion, with another similar issue if needed; and Nomura required a 10-year extension of IPB's franchise agreement with the Czech Post Office.

54. On 23 July 1997 this proposal was accepted by the Government. The purchase price was subject to adjustment based on IPB's net asset value (with the transaction capable of being unwound if the adjusted share price was below CZK 100 per share).

55. Matters appear to have rested there for several months. During that time (and particularly in July and August 1997) Nomura conducted further studies of IPB's financial position. These forecast that Nomura's anticipated profit from its IPB transaction would be US\$50-88 million, but also made it clear that IPB was in a serious financial state and without a large and immediate injection of capital, IPB could face forced administration, and that there were serious risks to investing in IPB.

56. In September-October 1997 Nomura sought an assurance from Mr Ivan Pilip (then Minister of Finance) that others of the Big Four banks would not be privatised under conditions more favourable to their investors than the conditions being offered to Nomura. Mr Pilip said that if he remained Finance Minister he would privatise other large banks in the same way as IPB, *i.e.* sell them in the condition they were in and without helping them to solve their debt problems prior to their sale, but added that he could not give Nomura any assurance that the privatisation of the other banks would proceed in the same way as the privatisation of IPB, since he could not bind a different future government which might adopt a different policy. Nor was any such assurance included in the eventual Share Purchase Agreement.

57. On 18-19 January 1998 Nomura and the NPF agreed to submit two alternative versions of their prospective share purchase agreement to the Government for approval, each based on different valuations of IPB's shares. The first provided for a share price of CZK 117 plus a commitment by Nomura to subscribe to CZK 6 billion of new share capital in IPB and an underwriting commitment for CZK 6 billion of subordinated debt; the second provided for a share price of CZK 147 and the same commitment to subscribe to CZK 6 billion of new share capital but only a "reasonable efforts" commitment for the issue of the CZK 6 billion of subordinated capital for the bank. On 2 February 1998 IPB's auditors Ernst & Young (on the basis of whose audit the Government insisted on working) confirmed that the net asset value of IPB shares was (as at 31 July 1997) CZK 147 per share. Price Waterhouse Coopers were unable to finalise a parallel audit of IPB on behalf of Nomura. The Government, in choosing between the two alternative versions of the prospective share purchase agreement, selected the alternative with the higher purchase price, namely CZK 147 per share.

58. From 3-4 February 1998, a Nomura International representative, Mr David Thirsk, met with a representative of IPB's senior managers to discuss Nomura's plans for IPB, which linked Nomura's purchase of IPB shares with Nomura's purchase of a shell company to hold IPB's Pilsner Urquell shares (as to which, see below, paragraphs 68-69). On 6 February 1998 Nomura wrote to the NPF emphasizing that Nomura was not entering into IPB as a strategic partner (*i.e.* an investor who acquires a company with a view to integrating the acquisition into its operations), but rather that it intended its role to be that of a limited recourse equity investor in IPB, or portfolio investor (*i.e.* an investor who acquires shares in a company as an investment, with a view to their eventual sale at, it would be hoped, a profit). Consistent with

this view of its position, Nomura Europe limited its shareholding in IPB to less than 50%, holding most (and eventually all) of its shares through Saluka, and allowing Nomura personnel to act only as shareholder representatives on IPB's Supervisory Board, and not as executive directors on IPB's Management Board.

59. At about this time, Nomura had agreed with certain significant counterparties an option – the so-called “Put Option” – whereby Nomura Europe could put its shares in IPB (at an initial price of CZK 115 per share) towards the purchase of other assets (notably IPB's holding of Pilsner Urquell shares), clearing the way for Nomura Europe's eventual acquisition in March 1998 of the NPF's shares in IPB. During this period the complex series of transactions regarding the acquisition and sale of Pilsner Urquell shares taking place (see below, paragraphs 68-69).

60. On 16 February 1998 and 2 March 1998 Nomura Europe submitted to the Czech authorities a paper on a “Strategy of Nomura Europe plc for IPB” in support of its application for CNB approval for its purchase of IPB shares: that approval was required by section 16 of the Czech Banking Act 1998. Nomura Europe did not disclose in this paper the Put Option which it had negotiated, nor its objectives in relation to the Pilsner Urquell shares. On 20 February 1998 Nomura filed for approval by the Office for the Protection of Economic Competition (“OPC”) of its acquisition of IPB shares; it did not inform the OPC that Nomura indirectly controlled the Radegast brewery and that IPB indirectly controlled the Pilsner Urquell brewery (the OPC's approval was given on 13 May 1998).

61. On 4 March 1998 the Government approved the sale of the IPB shares held by the NPF to Nomura Europe. On 7 March 1998 Nomura entered into a new shareholders agreement with the other parties to the shareholders agreement of 16 April 1997.

62. On 8 March 1998 Nomura Europe signed a Share Purchase Agreement with the NPF for the purchase of its approximately 36% holding of 20,620,083 IPB shares for about CZK 3 billion. The Agreement contemplated that Nomura Europe could transfer its shares to any special purpose company, trust, foundation, *Anstalt* or other entity, and provided also for a capital increase in IPB by a subscription of 60,000,000 further shares at CZK 100 per share, and for Nomura to reasonably endeavour to procure the underwriting of CZK 6,000,000 of subordinated debt. The total strengthening of IPB's balance sheet was thus some CZK 12 billion (about US\$348 million). The Agreement also gave the NPF pre-emption rights for a period of 5 years over the shares sold to Nomura Europe. The issue of the 60,000,000 shares was approved the next day at an extraordinary general meeting of IPB. Nomura Europe subscribed to all of those shares, at CZK 100 per share.

63. Certain important personnel changes were also made at the same time: Mr Randall Dillard and Mr Eduard Onderka were appointed to the Supervisory Board of IPB, Mr Jiří Tesař resigned as Chairman of the Board of Directors and moved to the advisory level of the Supervisory Board, Mr Libor Procházka resigned as Chief Executive Officer and became Deputy Chief Executive responsible for investment banking, and Mr Jan Klacek was appointed Chairman and Chief Executive Officer. Later, on 12 June 1998, Mr Daniel Jackson was appointed to the Supervisory Board of IPB.



64. On 10 July 1998 Nomura provided IPB with access to a US\$70 million revolving credit facility.

65. With its existing holding of about 10%, Nomura Europe now held, as a result of these transactions and the acquisition of the further 36%, some 46% of IPB's shares, thus giving Nomura Europe effective (although still minority) control over IPB.

66. The sale to Nomura Europe of the NPF's shareholding in IPB was the first situation in which the Czech Republic had fully disposed of its holding in a major bank. To some extent, therefore, it was a precedent for the projected privatisation of the whole banking sector.

#### G. Acquisition and Sale of Pilsner Urquell Brewery

67. In September 1997 IPB filed a merger notification with the OPC regarding Radegast and Pilsner Urquell breweries, but the merger was disapproved by the OPC on 10 December 1997 – a decision against which IPB appealed on 17 December 1997, and in which Nomura itself intervened on 19 January 1998 in support of IPB's appeal. That 10 December decision was cancelled on 5 June 1998. Further enquiries were ordered, but the merger was again disapproved on 12 August 1998, and again Nomura appealed but the merger notification was withdrawn on 22 November 1998, and the OPC closed the proceeding on 23 December 1998.

68. An internal "Transaction Structure" paper was prepared on 3 February 1998 by Nomura for its proposed purchase of IPB shares. In that paper IPB's shareholding in the company producing Pilsner Urquell beer was identified as IPB's most valuable strategic holding, and the paper indicated an intention, first, to buy 62.8 million shares in IPB for an amount which would be equal to the purchase price of the Pilsner Urquell shares, and, second, to sell those shares later to an international brewery company for a much greater price. On 3-4 February 1998, a Nomura International representative, Mr David Thirsk, met with a representative of IPB's senior managers to discuss Nomura's plans for IPB, which linked Nomura's purchase of IPB shares with Nomura's purchases of a shell company to hold IPB's Pilsner Urquell shares. On 5 February 1998 Nomura concluded a Cooperation Agreement with IPB's management. Under this agreement IPB would contribute its Pilsner Urquell shares, and Nomura would contribute its substantial (59.22%) interest in Radegast Brewery (which a Nomura affiliate had purchased from IPB on 19 September 1997) to a new entity. As already noted (above, paragraph 60), in its paper on a "Strategy of Nomura Europe plc for IPB" which Nomura Europe submitted to the Czech authorities in support of its application for CNB approval for its purchase of IPB shares, Nomura Europe did not disclose the Put Option which it had negotiated, nor its objectives in relation to the Pilsner Urquell shares. Similarly, in filing on 20 February 1998 for the OPC's approval of its acquisition of IPB shares, Nomura did not inform the OPC that Nomura indirectly controlled Radegast and that IPB indirectly controlled Pilsner Urquell. The OPC's approval was given on 13 May 1998. On 25 February 1998 Bankovní Holding a.s. ("Bankovní" – an affiliate of and controlled by IPB) purchased Bivalence, renamed the next day České pivo, a special purpose company whose only shareholder was Bankovní and whose only assets proved to be the Pilsner Urquell shares it purchased (with deferred payment) from IPB on 26 February 1998 and which it was to administer (Nomura appears never to have transferred its Radegast brewery shares to České pivo as originally planned). On 26 February 1998 České pivo signed an agreement with IPB to buy the bank's majority shareholding in Pilsner Urquell brewery.

69. On about 4 March 1998 Nomura set in motion a complex series of transactions which by June 1998 resulted in Pembridge Investments BV (“Pembridge”), a Nomura controlled entity, having the right to pay for the České pivo shares (*i.e.* holding Pilsner Urquell) with IPB shares. A further series of complex transactions between 31 May 1999 and 3 June 1999 involving three Cayman Islands companies – referred to as Torkmain, Levitan and Tritton – led to Nomura acquiring 84% of the shares of the Pilsner Urquell brewery with the right to pay for them by the delivery of IPB shares. These various transactions successfully operated the Put Option which Nomura had negotiated earlier (above, paragraph 59). In December 1999 Nomura International entered into an agreement which combined the Pilsner Urquell shares and Radegast shares, and then transferred all of those shares to a Dutch company, Pilsner Urquell Investments BV, and then sold that company to South African Breweries for a sum greatly in excess of the amount originally paid by Nomura for the Pilsner Urquell shares.

#### H. The Transfer of Nomura Europe’s IPB Shares to Saluka

70. Meanwhile, Saluka Investments BV (“Saluka”) had been established on 3 February 1998 as a special-purpose vehicle for the express purpose of holding the shares in IPB the purchase of which Nomura Europe was contemplating at the time. Saluka was incorporated in The Netherlands on 3 February 1988, and was owned by a Dutch charitable trust, Stichting Saluka Investments, and was managed by Nationwide Management Services BV

71. With its purchase of IPB shares completed, Nomura Europe, pursuant to the Share Purchase Agreement and with the approval of the CNB, transferred its IPB shares to Saluka in two tranches. In this way Saluka acquired ownership of 51,315,283 shares of Nomura Europe’s IPB shareholding on 2 October 1998, and Nomura Europe’s remaining 10,465,421 shares on 24 February 2000. Saluka bought these shares by issuing promissory notes to Nomura Europe, those notes being secured by a pledge over the shares; that pledge provided that Nomura Europe had the right to vote on the IPB shares. At the same time, Saluka entered into an agreement with Nomura International plc whereby the latter became Saluka’s sole sales agent for the IPB shares.

72. Saluka thus became the registered holder of the 61,780,704 shares in IPB which are the subject matter of this arbitration. Saluka subsequently agreed with Nomura Europe in June 2000 to sell the shares in return for the cancellation of the promissory notes which had been issued to pay for them. However, by the time of the hearings in this arbitration and still, so far as the Tribunal is aware, at the date of this Award, Saluka continues to hold the shares pending an instruction from Nomura Europe as to whom to transfer them: no such instruction has been given because of certain unresolved disputes. Consequently, at the time this arbitration was initiated, Saluka continued to be the registered holder of the IPB shares.

73. It is thus apparent that ownership of the controlling shares in IPB – and with it control over IPB’s other assets – vested in Saluka. In reality and in substance, however, it is equally apparent that Saluka’s rights of ownership seem to have been exercised in accordance with directions given by Nomura Europe or other elements of the Nomura Group. This duality of ownership and control is reflected in the parties’ pleadings, which in general do not distinguish carefully or consistently between Saluka and Nomura (whether Nomura Europe or other elements of the Nomura Group).

74. Upon acquiring effective control of IPB, Nomura set about various reorganizations of IPB's senior personnel, its banking strategy, its portfolio activities, its customer relations, its loan and loan recovery strategies, and its operational arrangements – all in the interests of strengthening IPB's market position in the Czech banking sector. These measures had considerable success, and IPB's position improved markedly.

#### I. The Government's Assistance to the Banking Sector (1998-2000)

75. While IPB is the Czech bank of principal importance for this arbitration, it was, as already noted, just one of the Big Four Czech banks, together with CSOB, CS and KB. In addition was the State-owned bad debt agency, KoB.

76. By mid-1998 the Czech banking sector was in serious difficulties, mainly as a combined result of the existence of a large bad debt problem, inadequate provision for creditors to enforce the rights to recover their loans, and the tough new regulatory steps taken by the CNB. One of the banks' particular problems was their ability or otherwise to maintain a capital adequacy ratio above the 8% minimum limit fixed by the CNB; if the ratio fell below that level, the CNB would have to take remedial measures, possibly involving revocation of a bank's banking licence.

77. The Czech Government embarked on a process of finally privatizing the Big Four banks which had previously only been partially privatised (above, paragraph 35). From early 1998 onwards the Government took a number of steps to assist one or other of the Big Four banks to overcome the difficulties with which they were faced. These varied forms of assistance mainly included, but were not necessarily limited to, those types mentioned hereunder.

78. As regards KB, the CNB at first saw no need for State participation in efforts to resolve KB's bad debt problem. However, in October 1998, the CNB itself proposed State participation in the light of recent developments in the financial markets. State participation in strengthening KB's capital participation was seen as necessary, especially given KB's dominant position in the Czech banking sector and the wider economic destabilisation to which serious weakening in its position could lead. The Czech Government decided by Resolution No. 820 of 28 July 1999 to arrange the purchase of major stocks of non-performing loans which were on KB's balance sheet. Accordingly, in August 1999, KoB purchased CZK 23.1 billion of KB's non-performing loans (at 60% of their face value) amounting to a capital injection into KB of CZK 9.5 billion. From December 1999-January 2000 the NPF subscribed to an increase of CZK 6.77 billion in the share capital of KB, thereby increasing the NPF's shareholding in KB from 48.74% to 60%. Despite these injections of State funds, KB reported a loss of CZK 9.2 billion for 1999. On 16 February 2000 the Government resolved to transfer a further CZK 60 billion of KB's non-performing loans, this time to a subsidiary of KoB but again at 60% of face value, amounting to a capital injection into KB of CZK 36 billion. By 2000 its share price had nearly trebled compared with its low point in 1999. The Government renewed its attempt fully to privatise KB by selling its now-majority stake in the bank. To facilitate a sale, KoB guaranteed a portfolio of KB's classified loans up to CZK 20 billion: this guarantee was signed on 29 December 2000, thereby avoiding the need for approval by the Czech Parliament under a new law which came into force on 1 January 2001. The net value of State assistance to KB in the period 1998-2000 thus amounted to some CZK 75 billion (with a further tax break to KB of CZK 4 billion

which only recently came to light). On 28 June 2001 the Czech Republic sold its 60% share in KB to Société Générale S.A. for CZK 40 billion (or EUR 1.19 billion).

79. CS, too, had a major bad debt problem. Its significance as a major element in the Czech banking sector made its continued viability important to the Czech Government. Its ability on its own to maintain the required 8% capital ratio was in doubt, but its private investors were unwilling to participate in any capital injections. The Government stepped into the breach. On 27 May 1998 the Government resolved to transfer CZK 4.1 billion to CS to cover losses of CS related to its deposits in the failed “AB banka.” On 9 December 1998 the Government resolved that CZK 10.5 billion of CS’ classified loans should be transferred to KoB at a price of CZK 4 billion (although their security value was much less). In December 1998 CS and KoB concluded an agreement for a ten-year loan for subordinated debt amounting to CZK 5.5 billion, which was fully funded by KoB on 23 December 1998. On 10 March 1999 the Government resolved to double CS’ share capital from CZK 7.6 billion to CZK 15.2 billion. On 8 November 1999 the Government approved the purchase of CZK 33 billion of CS’ non-performing loans by KoB at 60% of their face value, up to a maximum of CZK 20 billion. Meanwhile, in October 1999, the Government had embarked on the privatisation of CS by way of a sale of the NPF’s substantial stake in CS to Erste Bank of Austria, to whom the Government gave an exclusive negotiating position. To facilitate the conclusion of this sale the Government gave on 2 February 2000 a State guarantee until 2005 against losses from non-performing loans which were on the balance sheet of CS at the end of 1999 (the guarantee covered a portfolio of loans with a book value of CZK 88 million) and sold its (the NPF’s) shares in CS to Erste Bank for CZK 19 billion.

80. In relation to CSOB, the situation was for various largely historical reasons somewhat different from that at the other Big Four banks; in particular it did not suffer in quite the same way from the bad debt problem which afflicted the other banks. CSOB’s ability to ride out the economic crisis which affected the other banks was in considerable part due to various Government guarantees which had earlier been given to CSOB in relation to Česká inkasní, s.r.o. (“CI”), and then, on 14 April 1998, in relation to Slovenská Inkasna, spol. s.r.o. (“SI”), for which the Government indemnified CSOB from any liability resulting from Slovakia’s refusal to continue to fund that company. On 24 February 1999 the Government resolved to compensate CSOB for loans to industrial borrowers worth CZK 2.3 billion. On 31 May 1999 the Government resolved to assume CSOB’s liability on a loan made to failed Banka Bohemia in 1994. CSOB was privatised by virtue of the Government’s approval on 31 May 1999 of the sale, for CZK 40 billion, of the State’s 65.69% shareholding in CSOB (held through the NPF, the CNB, and the Ministry of Finance) to KBC Bank of Belgium NV (“KBC”) (which would eventually come to acquire 80% of CSOB).

81. In addition to these various forms of State assistance to CSOB, the relationship between CSOB and IPB gave rise to a special series of events involving further assistance to CSOB. In circumstances which will become apparent below (paragraph 143 and following), and which lie at the heart of the Claimant’s claims in this arbitration, IPB was sold to CSOB in June 2000. That transaction was complex, but a major element of it was the need for CSOB to be “held harmless” for any negative value associated with its purchase of IPB. The Tribunal sees no need for present purposes to set out the relevant provisions in all their complexity, since the main elements are clear and uncontested. These are that (1) CSOB had to pay a symbolic CZK 1 for its purchase of IPB; (2) CSOB benefited from arrangements which enabled it to avoid any downside risks arising from its purchase of any particular

assets of IPB; and (3) a substantial element of State aid was involved in the transaction, estimated at CZK 160-200 billion by the Ministry of Finance in June 2000 and audited by KPMG on 1 June 2001 at 159.9 billion. The acquisition of IPB made CSOB the leading bank in the Czech Republic.

82. Various measures of State assistance to KB, CS and CSOB have been described in the preceding paragraphs. With respect to IPB, assistance given to it by the State appears to have involved certain loss-producing loans worth CZK 16.1 billion being transferred to KoB in early 1998 (before Nomura Europe's purchase of IPB shares in March 1998), and the extension of IPB's past post office franchise when Nomura Europe bought the IPB shares, thereby giving it exclusive access to over 1,000 sales counters across the country. However, when the Government's Revitalization Programme (above, paragraph 40) for industrial enterprises finally received formal approval by the Government on 14 April 1999, its terms excluded IPB from the Programme, and IPB was excluded as a beneficiary.

83. The Big Four banks were of comparable strategic importance for the Czech economy as a whole; they also shared exposure to the bad debt problem, and to the inadequacies of the legal regime relating to creditors' rights. Collectively, these problems threatened the collapse of the Big Four banks, but they were too big to be allowed to fail: State assistance to avert collapse was necessary. The State assistance provided to KB, CS and CSOB amounted to 19% of the Czech Republic's GDP for 1999. It appears from various statements made by the banks and by the Government and the NPF in April-May 1998 that State assistance was given to KB, CS and CSOB on the basis that they were banks in which the State had a major shareholding interest, while IPB was not given such assistance as (after Nomura's investment in March 1998) it was regarded as a private institution whose fate was a matter for its private shareholders.

#### J. Developments in Respect of IPB (August 1999-end May 2000)

84. Following growing concerns at the CNB during 1998 with regard to IPB's banking practices, and CNB information-finding visits to IPB from mid-April 1999 to end-June 1999, the CNB began a regulatory inspection of IPB on 30 August 1999 which lasted until 5 November 1999. Serious financial deficiencies and irregularities were apparent.

85. In October 1999 Nomura began the search for a strategic partner for IPB. The involvement of the Czech Government was needed in this connection, in order to ensure the necessary level of State support for IPB's financial position (without which private sector investors would not find IPB an attractive proposition). In any event, the Czech Government would need to be involved since the approval of the Czech regulatory authorities would be required for any strategic partnership, and in the event of a merger with any other of the Big Four banks, the Government, as (directly or indirectly) a shareholder in those banks, would also have to give its consent.

86. During the autumn of 1999 it was clear that IPB needed an increase of capital to provide for its bad loans. In October, the CNB requested a significant increase in IPB's equity capital.

87. On 16 November 1999 IPB's General Assembly resolved to increase IPB's share capital, but this resolution was subsequently blocked by a minority shareholder on technical grounds. Another General Meeting was called for 19 February 2000 to seek approval for a capital increase of CZK 2.6 billion, to CZK 13.3 billion.

88. As a result of the CNB's August-November 1999 inspection of IPB, the CNB concluded both that IPB was not performing prudently, and that IPB needed to create at least CZK 40 billion of provisions – an amount the size of which made it clear that a major crisis was possible.

89. Discussions subsequently took place between representatives of the CNB and Ministry of Finance and representatives of IPB and Nomura to seek to identify possible solutions.

90. Meanwhile, IPB's management focussed on securing State aid, while Nomura concentrated on seeking a foreign strategic partner for IPB. A number of institutions showed interest, including in particular Allianz AG ("Allianz") and Hypo-und Vereinsbank AG ("Hypo-Vereinsbank"), with which Nomura signed a confidentiality agreement on 24 November 1999. However, on 26 January 2000 Hypo-Vereinsbank pulled out of the consortium with Allianz, and was later replaced by the UniCredito Italiano Group ("UniCredito").

91. In December 1999 Nomura (with reservations on the part of IPB's management) proposed a merger with CS. Nomura was able to make progress with an offer from Allianz for both IPB and CS, and the parties agreed on a framework for the transaction by 21 January 2000. These arrangements, however, came to nothing: the State had already issued a public tender for its interest in CS, the deadline for bids had passed, the proposal to merge IPB with CS was not specific enough in any event to comply with the rules of the tender, and the State was in the final stages of negotiations with Erste Bank of Austria (to which CS was eventually sold) (above, paragraph 79).

92. IPB's bid for CS attracted some media publicity and in January 2000 this led in turn to media criticism of the CNB, its Governor (Mr Josef Tošovský), and the Minister of Finance (Mr Pavel Mertlík). Mr Tošovský and Mr Mertlík blamed IPB's management for instigating these criticisms, which IPB's management strongly denied. On 4 January 2000 Mr Tošovský informed Mr Mertlík of the gravity of the situation at IPB.

93. On 10 January 2000 Mr Pavel Kavánek of CSOB met Mr Mertlík and expressed CSOB's interest in an acquisition to expand its share of the retail banking market, with IPB amongst possible targets.

94. On 20 January 2000 media reports of a statement by a CNB official, Mr Pavel Racoča, relating to the CNB's investigation of IPB, raised speculation as to the possibility of IPB being subjected to forced administration. Ten days later, on 30 January 2000, the CNB issued a press release stating that the inspection was a routine regulatory matter and had not yet been completed, and that suggestions that IPB's forced administration was under discussion were unfounded.

95. During February and March 2000 IPB and Nomura developed a proposal for a merger between IPB and KB, and later made presentations regarding it to the Government and the CNB, but this proposal came to nothing and was rejected.

96. In mid-February 2000 representatives of Nomura had several meetings with officials from the CNB. During these meetings, the CNB is said to have requested the resignation of two people from their senior positions on IPB's Supervisory and Management Boards – respectively, Mr Jiří Tesař (Chairman of the Supervisory Board) and Mr Libor Procházka (Deputy CEO of the Management Board) (they both resigned on 25 April 2000) – and also asked Nomura to provide the additional capital which IPB needed (*i.e.* for Nomura to take on the role of a strategic investor at IPB), failing which the CNB would seek to denigrate Nomura internationally. For his part, Mr Randall Dillard (Nomura's representative on IPB's Supervisory Board, and Vice-Chairman of that Board) and his colleagues claimed that, in the Share Purchase Agreement, the Czech Republic had agreed not to sell the State's interest in the other major banks on more favourable terms than its sale of IPB shares (a claim denied by the Respondent) (above, paragraph 56), and consequently that Nomura would not act to rescue IPB (*i.e.* provide the necessary additional capital) without State assistance (a position repeated in April 2000) – assistance which the Czech Republic was in the circumstances unwilling to provide.

97. Also during February 2000 Mr Daniel Jackson (Deputy Managing Director, Nomura, and member of the IPB Supervisory Board) began negotiations with Mr Luděk Niedermayer (Vicegovernor of the CNB) for a Memorandum of Understanding intended to establish a framework for their future. Although by the first week in March agreement had seemed close, ultimately the initiative came to nothing.

98. On 19 February 2000 IPB's General Assembly approved a capital increase of CZK 2.6 billion to CZK 13.3 billion.

99. On 25 February 2000 the CNB delivered its formal report regarding its previous year's inspection of IPB and, in March and April 2000, IPB, in accordance with the law, submitted written objections to specific parts of the report. Subsequent legal procedures could not be concluded because IPB's financial condition deteriorated too quickly.

100. In late February 2000 there was renewed and sustained media speculation about the CNB's review of IPB. The earlier rumours of IPB's possible forced administration (above, paragraph 94) persisted. In the week of 28 February 2000 IPB suffered a run on the bank (which was to prove to be the first of two major runs on IPB), and customers withdrew CZK 30 billion in deposits. Banks cut their credit lines to IPB, and froze or restricted their dealings with it. Meetings with high-level official Czech personnel during the week of the bank run led to a statement by IPB denying rumours of forced administration and emphasizing the strength of the bank, and the Minister of Finance, Mr Pavel Mertlík, and a senior official of the CNB, Mr Pavel Racoča, also made public statements seeking to calm depositors. The bank run stopped.

101. It seems that, at about this time, the course of the discussions between Czech officials and Nomura led to the Ministry of Finance and the CNB asserting their loss of trust in Nomura. The Minister of Finance refused to meet Nomura representatives. In mid-March

2000 the Minister of Finance and the Governor of the CNB appointed deputies (respectively, Mr Jan Mládek and Mr Luděk Niedermayer) to deal with Saluka/IPB. Thereafter, it appears that Czech officials had only a “soft mandate” in dealing with Saluka/IPB, and Mr Randall Dillard (then Head of the Merchant Banking Group at Nomura International, and who would later become Chairman of IPB’s Supervisory Board upon the resignation of Mr Jiří Tesař) could only have unofficial meetings off Ministry premises with the Deputy Finance Minister, Mr Mládek.

102. On 6 March 2000 the CNB obtained an expert study which showed that the macroeconomic costs which would be associated with IPB’s collapse (if it were to occur) would directly lead to a fall of about 4% in nominal GDP, and would probably cause a systemic crisis in the Czech financial sector.

103. On 14 March 2000 Mr Miloš Zeman, the Prime Minister of the Czech Republic, told Mr Dillard that discussions on the provision of State aid to IPB and on a merger between IPB and KB were conditional on Nomura injecting new capital into IPB.

104. Also in March 2000 CSOB approached Nomura for discussions with respect to IPB.

105. On 22 March 2000 Ernst & Young (IPB’s auditors) informed the CNB of the possibility that IPB might not comply with the required capital adequacy requirements, as a result of which the CNB formally asked IPB to prepare alternative methods for strengthening its capital should the minority shareholders block an increase in equity capital.

106. On 25 April 2000 the personnel changes at IPB requested by the CNB in February 2000 were made (above, paragraph 96). Mr Jiří Tesař resigned as Chairman of the IPB Supervisory Board and became instead Vice-Chairman, and Mr Libor Procházka resigned from his position as Deputy CEO of the IPB Board of Directors. Mr Randall Dillard took over as Chairman of the Supervisory Board.

107. In mid-April 2000 IPB submitted to the CNB some draft proposals to stabilise IPB, and submitted a further draft to the Government in May 2000, but the proposals were not acceptable as they did not give the State sufficient control over the restructuring process.

108. Nomura continued its attempts to find a strategic partner for IPB. Progress was made with the Allianz/UniCredito consortium. On 4 April 2000 a term sheet was signed providing for a capital increase for IPB and UniCredito’s entry as a strategic partner for the bank. By the middle of May active steps were being taken to follow through with this arrangement and on 22 May 2000 UniCredito began its due diligence enquiries on IPB. On 26 May 2000 UniCredito was in a position to propose the purchase of IPB at an opening bid of CZK 25-30 billion (twice its book value, subject to agreement on that book value) with a possibility of paying more.

109. At the same time as these discussions were taking place, Nomura’s representatives had since March 2000 also been meeting with representatives of CSOB to discuss CSOB’s potential entry into IPB as a Czech domestic partner. These discussions did not proceed smoothly, with CSOB, for example, refusing to sign a confidentiality agreement as a condition for access to IPB’s commercially-sensitive information, and insisting on taking



over IPB first and only thereafter negotiating the acquisition. CSOB's attitude by 5 May 2000 was that if IPB wanted Government support, then IPB needed CSOB.

110. The Government had also in April 2000 begun discussions with the potential investors in IPB which had been identified by Nomura, namely Allianz/UniCredito and CSOB. Both wanted to purchase IPB's assets rather than its shares, and both were unwilling to take over IPB without a guarantee and promise of indemnity from the State. Allianz/UniCredito moreover wanted several months to conduct due diligence, so only CSOB was able to take over IPB and continue its banking operations immediately.

111. Discussions between the Government and CSOB led to the preparation of a written presentation of CSOB's plans for IPB, dated 26 April 2000.

112. In May 2000 IPB, at the CNB's request, submitted a revised draft document to the CNB entitled "Measures for the stabilisation of IPB, a.s." This document became available to the press, leading ultimately to a second bank run in June 2000 (below, paragraph 126 and following).

113. On 2 May 2000 the Governor of the CNB, Mr Josef Tošovský, wrote to the Minister of Finance, Mr Pavel Mertlík, indicating the seriousness of IPB's capital position, its need for new capital, the impossibility of finding a strategic investor without State support, IPB's inability (as set out in the "Measures for the stabilisation of IPB, a.s.") to address the problem of capital adequacy without State assistance, and the imminence of the bank's collapse. The Governor saw the options as either stabilising the bank with a private investor and with State support, or nationalising the bank, or imposing forced administration, or revoking the bank's licence.

114. On 5 May 2000 (with follow-up letters on 8 and 9 May), and at the request of the CNB, Nomura wrote to the Ministry of Finance requesting discussions on the entry of a strategic partner into IPB, and stated its willingness to arrange for up to CZK 13.2 billion of new capital on reasonable commercial terms. No reply to these letters was received.

115. On 18 May 2000 Mr Jan Mládek, the Deputy Finance Minister, informed Mr Randall Dillard that the Ministry of Finance wanted to nationalise IPB, and proposed to buy Nomura's shares (*i.e.* by this time, Saluka's shares) at a symbolic price of 1 euro: to this end Mr Mládek wanted Nomura to obtain an additional 5% in IPB.

116. On 24 May 2000 Nomura informed the CNB that, because of the timing of IPB's auditor's statement and the IPB's General Assembly in late June 2000, the deadline for finding a solution was mid-June. Mr Pavel Racoča, for the CNB, explained that if neither IPB nor IPB's shareholders resolved IPB's problems, the CNB would have to impose forced administration on IPB. On 26 May 2000 Ernst & Young, IPB's auditors, informed the CNB that IPB needed provisions of CZK 21 billion.

117. Also on 24 May 2000 Mr Dillard submitted to the Prime Minister a further proposal entitled "Securing future for IPB", involving Nomura assuring a CZK 20 billion capital increase, a sale of 51% of IPB shares to Allianz/UniCredito and CSOB/KBC, and a KoB guarantee of IPB's balance sheet; on 25 May 2000 he gave the same presentation to the

Deputy Finance Minister, Mr Mládek. On 29 May 2000 Mr Mládek replied, rejecting that proposal (because it involved direct aid to IPB without the State having any control over the use of the funds), and reiterating the Government's offer to buy Nomura/Saluka's shares in IPB for a symbolic price of 1 euro. Nomura responded by asking how its proposal might be made acceptable. By 31 May the Ministry of Finance had refused to meet officially with Nomura or to consider any solution relating to IPB.

118. While those various developments were taking place, and despite the Government's appearance of co-operation with Nomura and IPB, the discussions between the Government and CSOB which began earlier in the year (above, paragraphs 109-111) to explore the possibility of CSOB gaining control of IPB should IPB run into serious difficulties, continued. These discussions were to lead to important developments at a meeting at which Mr Mertlík (Minister of Finance) and Mr Tošovský (Governor of the CNB) agreed to meet Mr Pavel Kavánek (CEO and Chairman of the Board of CSOB, aided by Mr Zdeněk Bakala, a well-known political lobbyist) and Mr Remi Vermeiren (President/CEO of KBC, a Belgian bank which was CSOB's largest shareholder): this meeting was to be held on 30 May 2000 in Paris where those concerned would be attending a banking conference.

#### K. Developments in Respect of IPB (end May 2000-7 June 2000)

119. In anticipation of that Paris meeting on 26 May 2000 Mr Kavánek wrote to Mr Tošovský and Mr Mertlík with certain proposals regarding the future of IPB, describing CSOB's proposed takeover of IPB and CSOB's readiness to act immediately. He enclosed two documents which emphasised the potential advantages of a merger between IPB and CSOB, and setting out CSOB's plan for the integration of IPB and CSOB. Further documents were to be delivered personally on the evening of 29 May 2000. These various documents have been together referred to by the Claimant as "the Paris Plan". It envisaged two possible alternatives for CSOB's takeover of IPB – a negotiated solution, or forced administration. The forced administration solution was presented as having fewer risks (although it appears that later the CNB would have preferred the more co-operative, negotiated solution, while also preparing for forced administration in case of an emergency). A detailed proposal for the carrying out of the forced administration solution was set out in the documents provided by Mr Kavánek, involving only a limited role for the Forced Administrator over the business activities of IPB and a transfer of IPB's day-to-day business to CSOB as quickly as possible.

120. On 30 May 2000 that meeting took place in Paris, to discuss CSOB's entry into IPB, or at least to allow the Government representatives the opportunity to listen to CSOB's proposals as part of their efforts to explore possible solutions to the IPB crisis. Mr Mertlík denied at the time that he participated in the meeting, and denied it also to the Czech Parliamentary Commission which subsequently investigated these matters. He also denied that KBC's entry into IPB was on the agenda of the Paris talks, and stated that, at the meeting, issues related to CSOB were primarily discussed.

121. On 1 June 2000 Ernst & Young, IPB's auditor, informed Mr Dillard that IPB was not a going concern because it was not meeting the CNB's capital adequacy requirements, and this triggered the CNB's obligation to revoke IPB's banking licence. On the same day the Government informed Nomura that State assistance would only be forthcoming if Nomura acquired a 51% stake in IPB (*i.e.* if it acquired a further 5%, since, as already explained, Nomura, through Saluka, already owned 46% of IPB's shares).

122. On 2 June 2000 the Government again repeated its 1 euro proposal. Nomura investigated ways of accommodating that proposal and, on 4 or 5 June 2000, presented three alternative proposals for the sale of IPB to the Government. None of these proposals was acceptable to the Government.

123. By about 6 June 2000 Nomura was focussing on asset sale as a solution.

124. On 7 June IPB's auditor informed the CNB that IPB needed to create provisions of at least CZK 20 or 21 billion, and possibly as much as CZK 40 billion. This meant that IPB could not meet capital adequacy requirements without external support. On 7 June 2000 Mr Mládek told Mr Dillard that IPB would be "toast" if it did not accept the 1 euro offer.

125. At about this time, Mr Mertlík met representatives of Allianz and UniCredito, who made proposals which, in their basic principles, were similar to that made by CSOB. Both banks wished to purchase IPB's assets, and both required a guarantee.

#### L. The Second Bank Run on IPB and its Aftermath

126. Statements apparently made by CNB officials and reported in the media on 8 June 2000, and a statement on 9 June 2000 by Mr Ladislav Zelinka, Deputy Finance Minister, raised speculation that IPB might be put into forced administration, and media speculation increased the following day (10 June 2000 – a Saturday). On Monday, Tuesday and Wednesday, 12-14 June 2000, there were mass withdrawals from IPB, amounting to CZK 17 billion. Reassuring statements by Government officials that were reported on 15 June had little or no effect.

127. The Parliamentary Commission which later enquired into these matters (below, paragraphs 144-147) found that by Monday, 12 June, documents before the CNB already set out a detailed time schedule of the steps to be taken to sell the enterprise, and that the Friday to Sunday period was essential to avoid the risk of legal actions being filed against the Forced Administrator. The Commission also noted that the CNB had already indicated the need to identify an individual to accept the appointment as Forced Administrator, and to ensure that he was familiar with the proposed measures and the proposed timetable as well as his contemplated role.

128. On 14 June 2000 Mr Kavánek (CSOB) wrote to Mr Niedermayer (CNB) with a detailed proposal for accepting the operations of IPB, which he had been asked to submit at a meeting held the previous day. A written proposal was also received on the same day from Allianz/UniCredito.

129. During the run on IPB, Nomura (on behalf of Saluka) had been involved in intensive negotiations regarding the stabilisation of IPB with strategic investors, officials at the CNB and Ministry of Finance, and the Prime Minister. On 14 June 2000 IPB submitted a proposal to the Ministry of Finance, the CNB and the Prime Minister. The proposal involved a transfer of IPB's banking business to KoB for CZK 1 for on-sale to a long-term commercial banking partner acceptable to the Government (with arrangements for the distribution of such sale proceeds), accompanied by an expressed readiness on IPB's part to execute the proposal on or before Friday, 16 June 2000.

130. Representatives of the CNB and Ministry of Finance met on 15 June 2000 to discuss the 14 June proposal. Discussions lasted into the evening and, after the meeting closed, there was an e-mail exchange. The final e-mail (to IPB's lawyer, Mr Tomáš Brzobohatý) concluded by saying that the Ministry of Finance team was "now leaving for home and will continue tomorrow in the morning". With that e-mail, Nomura's representatives were under the impression (which proved to be mistaken) that the detailed heads of terms to implement their proposal had been substantially agreed and that negotiations would continue the following day. IPB notified both the Ministry of Finance and the CNB that its Supervisory Board had approved, and had recommended the Management Board to approve, this transaction. However, the proposal was seen by the Czech authorities to involve serious economic, legal and organizational risks for the Czech Republic.

131. After the bank run had started the Government and CNB held meetings with Allianz/UniCredito and CSOB on proposals for the takeover of IPB. Allianz/UniCredito's proposal was such that it was not in a position to take over IPB's enterprise quickly.

132. On Wednesday, 14 June 2000, the CNB prepared a report for the Government on IPB's situation and possible solutions, which included forced administration and, in that eventuality, the need for any subsequent sale to a strategic investor to be accompanied by a State guarantee, since otherwise no investor would be interested.

133. Also on that day, IPB wrote to the CNB (the letter being received on 15 June) stating that IPB's liquidity had seriously deteriorated and that its solvency was threatened. On Thursday, 15 June, withdrawals from IPB continued. Representatives of the Government and CNB met those from IPB and Nomura, who were told that, if IPB did not immediately get CZK 10 billion from the State, it would revoke IPB's banking licence. That afternoon Mr Petr Staněk – the prospective Forced Administrator (*i.e.* a sort of trustee in bankruptcy) – was approached by the CNB.

134. On the night of Thursday, 15 June 2000, the Government met to consider the IPB situation. The Governor of the CNB and the Minister of Finance explained the gravity of the situation, with Nomura unwilling to invest the necessary capital and unable to identify a strategic partner and with IPB's failure to comply with capital adequacy requirements leading to the withdrawal of its banking licence with consequential threat to the stability of the banking sector. They presented as solutions either a cooperative solution involving IPB's shareholders, or forced administration coupled with a quick sale accompanied by State guarantees. The Government decided not to adopt the IPB proposal but instead to impose forced administration coupled with a quick sale to a strategic investor, with CSOB as the only bank which could quickly take over IPB. Resolution No. 622 of 15 June 2000 approved the forced administration of IPB with the objective of a subsequent sale to CSOB as the strategic investor, the provision of a government guarantee for the assets of IPB in favour of CSOB, and the issue of guarantees by the CNB to CSOB.

135. Also on 15 June, the Czech Securities Commission ("CSC") applied a preliminary injunction which imposed an immediate suspension of trading in IPB shares.

## M. The Forced Administration of IPB and its Aftermath

136. On Friday, 16 June 2000, the CNB put IPB into forced administration. Although IPB considered that it had sufficient liquidity to survive a bank run, the CNB's stated reasons for imposing forced administration were that there was a considerable risk of the bank not being able to make payments (*i.e.* to survive a bank run) and that the CNB had to avoid a situation where panic among the bank's depositors permanently destabilised its operations. Moreover, the CNB explained that IPB's financial situation threatened the stability of the Czech banking system, and that the CNB was entitled to impose forced administration to remedy the bank's shortcomings which the bank's shareholders had failed to take the necessary measures to correct.

137. Late on the morning of Friday, 16 June 2000, the CNB informed IPB of its decision to introduce forced administration upon IPB and appointed Mr Petr Staněk as the Forced Administrator of IPB. The Forced Administrator thereupon assumed the powers of IPB's Board of Directors (*i.e.* took over the management of IPB), and all the powers of all corporate governing bodies of IPB were immediately suspended. The Forced Administrator was to do what was necessary to secure its unproblematic operations and to achieve an accelerated sale of IPB to CSOB, being its strategic partner. His monthly remuneration was also specified, with mention of a special bonus ("extraordinary reward") for the implementation of the sale to CSOB (the figures for the remuneration and the bonus were, however, removed by the Respondent from the copy of the document submitted in evidence). The CNB issued an irrevocable guarantee for all IPB creditors on that day, to prevent any panic.

138. Also on Friday, 16 June, IPB requested a short-term loan of CZK 10 billion from the CNB to maintain its liquidity – a request which was received after the appointment of the Forced Administrator. On that same day, CSOB also informed the Forced Administrator of its interest in purchasing IPB's enterprise.

139. Armed police entered IPB's headquarters and effected the physical removal from the premises of all bank managers.

140. On Saturday, 17 June 2000, and Sunday, 18 June 2000, the Forced Administrator discussed IPB's financial situation with Ernst & Young, IPB's auditor, who, on 18 June, told the CNB that IPB's capital adequacy ratio was in fact negative. The Forced Administrator informed the CNB of this (as required by the Czech Banking Act), whereupon the CNB (also as required by that Act) began the process of revoking IPB's banking licence.

141. In response to an expression of interest by CSOB in purchasing IPB's enterprise, the Forced Administrator engaged in extensive discussions with CSOB and its majority shareholder, KBC (a Belgian bank), on 17-18 June 2000; CSOB and KBC also had discussions with the CNB and the Ministry of Finance. The Forced Administrator, who had only limited options, decided to pursue the sale of IPB's enterprise to CSOB, for which on 18 June 2000 he sought the CNB's approval, which was granted. CSOB, however, had insisted on receiving a State guarantee from the Ministry of Finance, and a promise of indemnity from the CNB.

142. As the State guarantee and the CNB's promise of indemnity to CSOB involved State aid, the approval of the OPC was required. The OPC was accordingly involved in the final stages of the transaction, and reached a preliminary conclusion that State aid under the Sale Agreement and State Guarantee should be exempted from the general prohibition against State aid, characterised as restructuring aid and aid to remedy a serious disturbance in the Czech economy. On around 14 June Mr Kamil Rudolecký (Director of State Aid Department of the OPC) was first officially informed by his superior, Dr Jiří Buchta, of the plans to offer financial assistance to IPB, and, on Sunday, 18 June, he and Dr Buchta met with representatives of CSOB, including Mr Kavánek, to discuss the aid package about to be given to IPB. Subsequently, on the evening of Sunday, 18 June 2000, the OPC informed the Ministry of Finance of its approval of the aid packages under certain conditions, and delivered its formal decision to that effect on Monday, 19 June 2000. This decision (which was in some respects in terms identical with elements in the Paris Plan) had the appearance of retrospectively granting an exemption for the aid given to CSOB in the sale agreed over the weekend.

143. IPB was transferred to CSOB on Monday, 19 June 2000, and the Ministry of Finance signed the State guarantee to CSOB while the CNB signed its promise of indemnity to CSOB.

144. On 3 July 2000 the Ministry of Finance and the CNB prepared a report which was submitted to the Czech Parliament (Chamber of Deputies) to inform the public about the circumstances leading to the forced administration of IPB and its sale to CSOB. The next day the Chamber, at the instigation of the opposition parties, set up an Investigation Commission to clarify the State's decisions. The opposition parties had eight of the ten seats on the Commission. Its findings were summarised in a report submitted to the Chamber of Deputies on 11 August 2001.

145. The circumstances in which the sale of IPB to CSOB was effected were such as to raise questions as to its lawfulness under Czech law. The Parliamentary Investigation Commission appointed a legal expert to consider the matter who, in his report of 10 May 2001, concluded that the CNB was not entitled to put IPB into forced administration, that the Forced Administrator had not (particularly at the speed with which he disposed of IPB) fulfilled his responsibilities correctly, that the CNB's irrevocable guarantee for all IPB creditors of 16 June 2000 was null and void, and that CSOB had provided no consideration for IPB's banking business and accompanying State aid. The Commission itself found that by instructing the Forced Administrator to sell IPB's business to CSOB as quickly as possible the CNB had exceeded its legal powers, and that the way in which the strategic partner had been selected between 16 and 19 June was "unprecedented and non-transparent". The Commission also found that the CSOB Transaction Document signed on 19 June 2000 gave IPB to CSOB "effectively as a gift", that CSOB "obtained an undeserved benefit of many tens of billions of Czech crowns to the detriment of the state budget", and that the Minister of Finance, had he acted as he should have done, would have ensured that CSOB paid an appropriate price.

146. The Commission further found that the CNB had issued instructions to the Forced Administrator and in so doing had acted unlawfully, and that his testimony, in denying that he was acting under the instructions of the CNB, was false. In mid-September 2000 the Chairman of the Parliamentary Commission filed a criminal complaint against Mr Mertlík

and the Forced Administrator in respect of false testimony. The Commission concluded that the Forced Administrator “did not administer the bank. He only fulfilled his task to take over and sell the bank without having an idea of what he was actually selling”. In several respects it appears that the Forced Administrator, in selling IPB to CSOB as quickly as possible, may have acted inconsistently with his statutory and fiduciary duties under Czech law. The Commission did not, however, conclude that the Ministry of Finance or the CNB had done anything illegal. Its findings, in the view of the Respondent, were largely speculative and a politically motivated attempt to discredit the Government.

147. Apart from raising questions as to the lawfulness of the transaction under Czech law relating to aspects of the forced administration, the circumstances also raised similar questions as regards the granting of State aid in connection with the transaction. Under Czech law the Public Assistance Act generally prohibited the grant of State aid unless the aid had been notified to the OPC and granted a formal exemption by it: that Act came into force on 1 January 2000, and brought Czech domestic law on State aid into line with the Czech Republic’s international obligations under the Agreement of 4 October 1993 establishing an Association between the European Communities and their Member States, of the one part, and the Czech Republic, of the other (“the Europe Agreement”).<sup>2</sup> The various guarantees and indemnities which formed part of the transaction whereby CSOB acquired IPB could be regarded as State aid, under both the relevant Articles of the Treaty Establishing the European Community (“EC”) (“EC Treaty”)<sup>3</sup> and the parallel provisions of the Public Assistance Act.

148. In various respects, it was questionable whether the legal requirements for the granting of State aid were complied with in respect of, in particular, the guarantee announced on 19 June 2000, the Ministry of Finance’s non-compliance by the stipulated deadline with certain conditions imposed by the OPC in relation to the exemption granted for that guarantee, the indemnity given by the CNB to CSOB, the agreement of 19 June 2000 between the Ministry of Finance and CSOB whereby the Ministry undertook to compensate CSOB for all of the purchase price which CSOB would become obligated to pay to IPB for the IPB enterprise, and the conclusion, without the OPC’s approval, of a restructuring agreement of 31 August 2001 granting to CSOB an asset management contract over IPB’s former assets.

149. Nevertheless, the sale of IPB to CSOB went ahead on the basis of the Forced Administrator’s actions.

150. On 21 June 2000 the Government approved the provision of a State guarantee to CSOB for the assets of IPB provided that that guarantee would be replaced by a restructuring agreement whereby KoB would assume the security for IPB’s assets, and also approved the Ministry of Finance’s guarantee to the CNB to cover losses ensuing from the CNB’s promise to indemnify CSOB.

151. On 23 June 2000 Ernst & Young, IPB’s auditor, reported to the CNB that it had been unable to complete IPB’s audit for 1999 because IPB had failed to provide the auditor with necessary information.

152. On 30 June 2000 Saluka transferred 61,780,694 IPB shares back to Nomura. On 7 July 2000 Saluka submitted a Transfer Notice to the NPF, but on 21 July 2000 the NPF informed Saluka that it did not consider the document served to have been a proper Transfer Notice.

153. On 24 August 2000 the OPC approved the exemption of the State aid arising from the indemnity given to CSOB by the CNB.

154. On 6 September 2000 the CSC made a decision on the merits of the suspension of trading in IPB shares which hitherto had been based only on a preliminary injunction (above, paragraph 135). This decision became binding on 25 September 2000 and extended the suspension in trading which had previously been based on the preliminary injunction. The reasons given by the CSC for the actions it took were in the Claimant's view of questionable accuracy but, in the Respondent's view, were in no way improper. So far as the Tribunal is aware, the suspension of trading in IPB's shares still continues, as a result of further successive "temporary" injunctions issued by the CSC. Saluka's appeal to the Presidium of the CSC against the CSC's decision of 6 September 2000 and its imposition of a "new" temporary suspension on 11 October 2000 were rejected by two decisions of 18 January 2001.

155. On 16 January 2001 the CSC, acting under a new amendment to the Czech Securities Act, issued a Notice of Loss of Position as a Participant against Saluka, having the effect that Saluka was no longer considered a party to the "new" suspension proceedings commenced on 11 October 2000, or any other suspension proceedings commenced after 1 January 2001. Shareholders were thereby excluded from challenging suspensions of trading in shares owned by them.

156. On 26 October 2000 a Police Order was issued, at the request of CSOB, which required the CSC permanently to suspend Saluka's right to dispose of its shares in IPB. Saluka appealed against this Police Order to the State Prosecutor and this challenge was upheld on 5 February 2001. However, the Czech police issued a new suspension Order over IPB's shares, which the Securities Centre registered on 31 January 2001. Following a request from Saluka on 1 November 2001 (*i.e.* after the present arbitration had been initiated) for the removal of the suspension Order, and the police's refusal to do so, the Public Prosecutor's Office in Prague ruled on 23 April 2002 that there was no legal basis for the suspension Order against the shares, but ordered that Saluka's IPB shares be held in the custody of the District Court of Prague. On appeal to the Supreme Public Prosecutor's Office on 16 May 2002 the Public Prosecutor's custodial order over Saluka's shares was quashed. The Supreme Public Prosecutor's Office, however, also held – on a point which was not part of Saluka's appeal, and on which Saluka had not been heard – that it was still justifiable to secure Saluka's shares in IPB by suspending trading in them. Since the Supreme Public Prosecutor's Office was the final appellate instance, Saluka lodged a petition with the Czech Constitutional Court on 18 July 2002 seeking an appropriate remedy.

157. On 30 January 2001, the Czech police carried out a search of Nomura's Prague Representative Office and seized documents belonging to Nomura. This police search was subsequently held by the Constitutional Court on 10 October 2001 (*i.e.* after the present arbitration had been initiated) to have violated Nomura's fundamental rights, and the Court ordered the return of the documents seized during the search.



158. On 19 March 2001, the OPC reopened the proceedings which led to its decision of 19 June 2000 (above, paragraph 142) approving the Agreement for the sale of IPB to CSOB and the associated State Guarantee Agreement. On 23 August 2001, *i.e.* after the present arbitration had been initiated, the OPC disapproved the payment to CSOB for the costs of the forced administration, but, in a further decision of 15 December 2003, the OPC approved that item and approved the Sale Agreement and State Guarantee.

159. On 18 July 2001 Saluka filed its Notice of Arbitration initiating the present arbitration against the Czech Republic. All subsequent events (to some of which attention has already been drawn) therefore post-date the commencement of this arbitration.

160. On 16 June 2002 the forced administration of IPB ended and Nomura resumed control over IPB. IPB subsequently filed several claims against the Czech Republic, CSOB and JP Morgan. On 4 December 2002 the Czech Republic and the NPF initiated the NPF arbitration against Saluka and Nomura, and later that month an arbitration tribunal ordered Nomura to transfer the IPB shares to CSOB.

161. On 16 December 2003 and in January 2004 the European Commission (“EC”) made decisions which had the effect of establishing that it would not review the compatibility of all State measures towards KB and CS with EC State aid rules.

162. At the end of January 2004 the Board of Directors of IPB (controlled by Nomura) and Mr Petr Beneš (former director of IPB) separately filed for IPB’s bankruptcy. On 5 February 2004 IPB was declared bankrupt.

163. On 16 February 2004 the CSC registered CSOB as the new owner of Saluka’s IPB shares.

### III. THE PARTIES’ ARGUMENTS AND SUBMISSIONS

164. On the basis of the facts and the law as it saw them, the Claimant considered that the Czech Republic had acted in a way which was discriminatory, unfair, inequitable and expropriatory, and was thus in breach of its obligations under the Treaty, in particular those arising under Articles 3 and 5.

165. In its Memorial, the Claimant requested the following relief:

- (a) a declaration that the Czech Republic has breached Article 3 of the Treaty by failing to accord Saluka’s investment fair and equitable treatment;
- (b) a declaration that the Czech Republic has breached Article 5 of the Treaty by depriving Saluka of its investment unlawfully and without just compensation equal to the genuine value of the investment;
- (c) an order that the Czech Republic pay Saluka compensation for the damages that it has suffered as a result of the breaches of the Treaty, such damages to be determined by the Tribunal based on further submissions;

- (d) interest on the compensation to be awarded to Saluka, in an amount to be determined by the Tribunal; and
- (e) an order that the Czech Republic pay the costs of these arbitration proceedings, including the costs of the Tribunal and the legal and other costs incurred by Saluka, on a full indemnity basis.

166. The Claimant's subsequent pleadings, both written and oral, did not vary those requests.

167. For its part, the Respondent, on the basis of the facts and the law as it saw them, denied that there had been any breach of its obligations under the Treaty and, in any event, challenged the entitlement of Saluka to invoke the arbitration provisions of the Treaty.

168. In its pleadings, the Respondent requested the following relief:

- (a) In its Notice to Dismiss, "that the Tribunal dismiss with prejudice the arbitration filed by Saluka and award the Czech Republic its attorneys' fees and costs";
- (b) In its Counter-Memorial,
  - (i) a declaration that Saluka breached the Agreement and engaged in other unlawful acts;
  - (ii) an order that Saluka pay the Czech Republic compensation for the damages suffered as a result of Saluka's unlawful acts presently estimated to be approximately CZK 100 billion to CZK 260 billion (approximately US\$3.22 billion to US\$8.38 billion);
  - (iii) interest on the compensation awarded to the Czech Republic, in an amount to be determined by the Tribunal; and
  - (iv) an order that Saluka pay the costs of these arbitration proceedings, including the costs of the Tribunal and the legal and other costs incurred by the Czech Republic, on a full indemnity basis;
- (c) In its Rejoinder (*i.e.* after the Tribunal's Decision on Jurisdiction over the Respondent's Counterclaims), "that the Tribunal render a final Award determining that the Czech Republic has not violated Articles 3 and 5 of the Treaty"; and
- (d) At the conclusion of its oral submissions, the Respondent asked that the Tribunal "render an award determining that there was no violation of either Article 3 or Article 5 of the Treaty" and, in its Post-Hearing Brief, "that the Tribunal issue a Final Award determining that the Treaty was not violated".

169. The Claimant in its Memorial stated that it was “appropriate and efficient to postpone precise issues of the quantification of Saluka’s loss to a separate phase of the proceedings when the Tribunal’s decision on liability is known”. In its Counter-Memorial, the Respondent stated that “[l]ike Saluka, the Czech Republic concludes that it is appropriate and efficient to postpone precise issues of the quantification of the Czech Republic’s loss to a separate phase of the proceedings”.

170. The parties developed their respective arguments fully in their written pleadings, which were submitted in the manner set out in Part I of this Award, the Introduction. They also refined their positions and put forward further arguments in support of their respective cases in the course of the oral hearings which were held in April 2005, as also set out in Part I of this Award.

171. The Tribunal considers that it will be more convenient if, rather than attempting to summarise the parties’ arguments as a whole, it instead summarises their contentions separately in the course of its consideration of each of the various particular issues which it is called upon to determine, and so far as they may be relevant to those issues.

#### IV. THE TRIBUNAL’S JURISDICTION

172. The Tribunal must first address the issue of its jurisdiction to hear and decide the dispute which Saluka has submitted to it.

##### A. The Parties’ Arguments

173. The Claimant’s Memorial was due to be filed on 15 August 2002. Two days earlier, on 13 August 2003, the Respondent filed a Notice to Dismiss, by which it requested that the Tribunal dismiss the Claimant’s claims.

174. By its Notice to Dismiss, the Respondent argued that (a) Nomura did not buy IPB shares in order to invest in IPB’s banking operations, but instead its true purpose was to facilitate its acquisition of Czech breweries in which IPB held a controlling shareholding; (b) Nomura did not disclose that true purpose to the Czech authorities at the time of its purchase of IPB shares; (c) Nomura had thus not acted in good faith and had violated the principle of non-abuse of rights, and was therefore not a *bona fide* investor; and (d) therefore Saluka, to whom Nomura had transferred its IPB shareholding, was precluded from having recourse to arbitration under the Treaty.

175. The filing of such a Notice had not been envisaged in the timetable fixed by the Tribunal, nor is it envisaged in the UNCITRAL Rules.

176. Article 21.3 of those Rules provides:

A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence or, with respect to a counter-claim, in the reply to the counter-claim.

177. Article 21.4 of the UNCITRAL Rules provides:

In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question. However, the arbitral tribunal may proceed with the arbitration and rule on such a plea in their final award.

178. At a Procedural Meeting in London on 10 September 2002 to consider the Respondent's request, the Tribunal ruled that, because the facts alleged in the Respondent's Notice to Dismiss were so closely related to the facts involved in the principal claim, the dismissal issue should be joined to the merits and ruled upon in the Tribunal's final award (above, paragraph 20, Part I.E. of the Decision on Jurisdiction over Counterclaims).

179. Nevertheless, the issue surfaced again in the context of the Respondent's Counterclaims. In the Notice of Counterclaim which the Respondent volunteered on 4 December 2002 the Respondent set out its proposed "counterclaim against Saluka" and stated that it would elaborate on such claims when it filed its Counter-Memorial. The Respondent stated in paragraph 380 of its Counter-Memorial that by its Counterclaim the Czech Republic sought relief on account of the manner in which Saluka (*sic*) handled its "purported investment". Although it thus appeared that the Counterclaim was intended to be directed against the Claimant, under each of the more specific heads of its Counterclaim, the Respondent's Counter-Memorial identified Nomura as the defendant (essentially Nomura Europe, which is a legal person constituted under the laws of England), whereas the Claimant in this arbitration is Saluka (which is a legal person constituted under the laws of The Netherlands).

180. The Claimant attached overriding weight to the fact that Nomura Europe on the one hand and Saluka on the other were separate legal persons constituted under the laws of different States, that only Saluka was the Claimant in this arbitration and within the jurisdiction of the Tribunal, that Nomura Europe could not be brought within the scope of the Czech-Netherlands Treaty, and that a counterclaim against Nomura Europe could not therefore be brought in these arbitration proceedings instituted by Saluka. The Respondent, however, maintained that, in the context of the circumstances which gave rise to this arbitration, the relationship between Nomura and Saluka was so close that they were in effect interchangeable as parties in these proceedings; indeed, in the Respondent's submission, such was the closeness of the relationship that the real party in interest was Nomura, and that Saluka was not a *bona fide* "investor" under the Treaty, for which reason the Respondent requested that the proceedings initiated by Saluka be dismissed.

181. The Tribunal did not, however, find it necessary to touch on those issues for the immediate purpose of reaching a decision on its jurisdiction to hear and determine the counterclaim advanced in this case by the Respondent. For that purpose, the Tribunal found it appropriate to proceed in the first place on the basis that the question of the relationship between Saluka and Nomura was assumed to be determined on the basis most favourable to the Respondent (see Decision on Jurisdiction over the Czech Republic's Counterclaim, paragraphs 41-44 and 81-82). Accordingly, the Tribunal initially proceeded on the assumption, but without deciding, that the relationship between Saluka and Nomura Europe was sufficiently close to enable the Tribunal's jurisdiction in proceedings instituted by Saluka to extend to claims against Nomura. The Tribunal then on that hypothetical basis addressed the several heads of the Counterclaim put forward by the Respondent, and concluded that the

disputes which had given rise to the Respondent's Counterclaim were not sufficiently closely connected with the subject-matter of the original claim put forward by Saluka to fall within the Tribunal's jurisdiction under Article 8 of the Treaty.

182. It followed from that conclusion that the Tribunal did not find it necessary in the context of its decision on its jurisdiction over counterclaims to reach any decision as to the nature of the relationship between Saluka and Nomura Europe and the consequences of that relationship, whatever it may be. Accordingly, the Tribunal's decision that it was without jurisdiction to hear and determine any of the heads of counterclaim put forward by the Respondent was without prejudice to the eventual consideration of that issue, involving in particular Saluka's standing as an "investor" under the Treaty. That issue remained to be considered at the merits phase of these proceedings, as originally decided by the Tribunal in its ruling of 10 September 2002.

183. In its Counter-Memorial and in subsequent pleadings, the Respondent elaborated its "dismissal" arguments, and added further arguments contesting the Tribunal's jurisdiction. In particular:

(a) The Respondent repeated its contention that Nomura had not made its investment in IPB in order to keep IPB viable but to facilitate the acquisition of two valuable Czech breweries through control of IPB's stake in them: Nomura's real objective was not to invest in IPB's banking operations but, by way of a Put Option scheme which in effect eliminated all downside risk from Nomura's purchase of the IPB shares, to acquire and then sell on IPB's shareholding in the brewery companies, which made Nomura's real objective something other than a *bona fide* investment in IPB. The investment had not been lawfully made (as was generally required for investment protection), but was part of a "dishonest scheme to secure enormous benefits". Czech law required Nomura to file a business plan for its investment in IPB, and a false filing was a breach of that legal requirement. Nomura's failure, in its filed business plan, to disclose its true objectives to the Czech authorities had led them to approve the purchase of IPB's shares, which they would not otherwise have done. Nomura had not acted in good faith and had violated the principle of non-abuse of rights, for which reason Saluka was precluded from relying on the international arbitral process provided by the Treaty.

(b) In any event, the Respondent contended that Saluka did not have any real and continuous *bona fide* social or economic factual links to The Netherlands, and should therefore be disqualified from being considered as an "investor".

(c) Moreover, the Respondent maintained that, in the context of the circumstances which gave rise to this arbitration, the relationship between Nomura and Saluka was so close that they were in effect interchangeable as parties in these proceedings and that the terms "Nomura" and "Saluka" could be used interchangeably, Saluka being nothing more than a shell used by Nomura for its own purposes. Indeed, in the Respondent's submission, such was the closeness of the relationship that the real party in interest was Nomura, and Nomura was not an eligible claimant under the Treaty.

(d) Saluka was not, so the Respondent contended, a *bona fide* “investor” as defined in the Treaty and was thus unable to have recourse to arbitration under it. The Respondent accordingly requested that the proceedings initiated by Saluka be dismissed.

184. In its subsequent pleadings (Rejoinder, oral argument, and Post-Hearing Brief), the Respondent contended principally that:

(a) Saluka had not made an investment in the Czech Republic since it had invested nothing, acting merely as a conduit for Nomura’s investment: Nomura retained the voting rights associated with the IPB shares, participated in the management of IPB, and conducted all the dealings with the Czech authorities. Saluka was a mere surrogate for Nomura, and a claim under an investment treaty could not be brought by an entity which was a surrogate for another entity which, like Nomura, was not covered by the Treaty. Saluka was an agent for Nomura, not a true investor.

(b) While a simplistic or literal view of Article 1 of the Treaty might suggest that Saluka was a qualified investor, the Treaty had to be interpreted in light of the realities of the situation, and they showed that Nomura and Saluka had not conducted themselves as true investors.

(c) “Piercing the corporate veil” was permissible as an equitable remedy where corporate structures had been utilised to perpetrate fraud or other malfeasance. Nomura had used corporate structures to realise profit and put the banking sector at risk, and to perpetrate fraud against the Czech Republic. The corporate veil should therefore be pierced, the real interest at stake should be recognised to be Nomura’s, and, as Nomura was not within the Treaty definition of an “investor”, the Tribunal was without jurisdiction.

(d) The Nomura Group had acted fraudulently and dishonestly throughout the events to which the case related. Nomura’s circular financing arrangements, the Czech beer deal, the Put Option and the establishment of the “Tritton Fund” (in the Cayman Islands) had all been conducted contrary to international *bonos mores*. This continuing failure to act in good faith and the abuse of process required that Saluka – which had never even been a *bona fide* holder of an investment which might have been injured – should be denied protection under the Treaty. Allegations of harm suffered by Nomura (rather than Saluka), and allegations based on the period before October 1998 when Saluka acquired its IPB shares, were outside the Tribunal’s jurisdiction.

(e) Moreover, the Claimant was acting in abuse of rights in instituting the arbitration since its purpose in doing so was to take advantage of the delay which would thereby be occasioned so that Nomura might gain advantage from the running of statutes of limitation in relation to civil or criminal proceedings which might be instituted by the Czech Republic in other fora.

185. In the Claimant’s Memorial, the Claimant simply relied on the fact that the Claimant was established under Dutch law for the express purpose of holding the IPB shares which Nomura had purchased, and that consequently it was an “investor” as defined in the Treaty and its shareholding was an “investment” as also so defined. The facts surrounding the purchase of the IPB shares showed that Saluka had fulfilled the requirement of Article 2 of

the Treaty that investments be lawfully made, and this was borne out by the approval given to the share purchase agreement by the Czech authorities. In its more specific written responses to the Respondent's more detailed exposition of its arguments on the question of the Tribunal's jurisdiction over counterclaims (*i.e.* in its Objections to Jurisdiction over the Czech Republic's Counterclaims and its Reply to the Czech Republic's Response to the Claimant's Objections to Jurisdiction over the Czech Republic's Counterclaims), the Claimant attached overriding weight to the fact that Nomura Europe on the one hand and Saluka on the other were separate legal persons constituted under the laws of different States, that only Saluka was the Claimant in this arbitration and within the jurisdiction of the Tribunal, and that Nomura Europe, as an English company, could not be brought within the scope of the Czech-Netherlands Treaty.

186. In its subsequent pleadings (Reply, oral argument, and Post-Hearing Brief), the Claimant repeated its view that Saluka was a Dutch legal entity and thus an "investor" and that its ownership of IPB shares was an "investment". The Claimant added further argument, in particular:

(a) Saluka's shareholding was not negated by allegedly not being "lawfully made" and therefore not *bona fide*; the only illegality which had been alleged concerned the Put Option, for which there was no basis and which in any event had already been held to be valid in an associated arbitration. In connection with obtaining the CNB's approval for the Share Purchase Agreement, Nomura had duly filed its business plan, which had only to relate to its intentions regarding the future conduct of IPB's banking operations.

(b) There was no need to consider whether or not Saluka had any factual links with The Netherlands, since the Treaty adopted the place-of-incorporation test and there was no basis for adding a "factual link" test.

(c) Saluka's investment in IPB was a real investment.

(d) Nomura did not mislead the Czech authorities as to the nature of its investment in IPB, having made clear its role as a portfolio investor all along.

(e) Nomura's acquisition of the brewery shares was a commercial and financial transaction which was not tainted by any impropriety.

(f) Nomura was a *bona fide* investor.

187. At the close of the oral hearings, the Tribunal asked the parties to address, in their post-hearing briefs, the following question:

[T]o what extent, if at all, (1) can the Tribunal consider and make findings about the conduct of Nomura? (2) is Nomura a necessary party to these proceedings in relation to that conduct?

188. The Claimant's response was that the Tribunal had jurisdiction to consider and make factual findings about the conduct of Nomura in so far as such findings might be relevant to

Saluka's positive case or the Czech Republic's defence, and that the possibility that the Tribunal had to make findings of fact with respect to Nomura's conduct did not require Nomura to be joined as a party to the proceedings.

189. The Respondent's answer to the Tribunal's question was that (1) the Tribunal might make findings of fact regarding Nomura's conduct without considering Nomura to be a "necessary party" to the proceedings, such an approach being typical in BIT arbitrations, and (2) although the Tribunal might make findings of fact regarding Nomura's conduct, Saluka could not recover any damages on the basis of Nomura's alleged loss – and since Saluka's alleged claims for damages were in fact Nomura's claims, Saluka's claims could be dismissed because Saluka is not seeking to recover for any losses that it had itself sustained.

190. In considering the various issues of jurisdiction and admissibility which have been raised, the Tribunal first notes that the Respondent's Notice to Dismiss in substance argues that the Tribunal should decline to entertain the proceedings initiated by the Claimant on the ground that the Claimant is not qualified to bring arbitration proceedings under the Treaty.

191. Accordingly, although the Notice to Dismiss is not worded as an objection to the Tribunal's jurisdiction, it may be assimilated to an objection that the Tribunal is without jurisdiction. As such, it was permissible (although perhaps procedurally unorthodox) for the Respondent to file its Notice making that objection. Doing so by way of the Notice to Dismiss filed on 13 August 2003 was within the time limit prescribed by Article 21.3 of the UNCITRAL Rules. So too was the further elaboration of the Respondent's arguments in its Counter-Memorial.

192. The Tribunal will now address the substantive arguments advanced by the Respondent by which it sought to show that the Tribunal was without jurisdiction to entertain the present proceedings.

#### B. Relevant Terms of the Treaty

193. The Tribunal's jurisdiction is governed by the terms of the Treaty. The immediately relevant terms of the Treaty are Article 8.1 and Article 1.

194. In relevant part, Article 8.1, to which Article 8.2 refers back, relates to "[a]ll disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter . . .".

195. In these proceedings, the Czech Republic is the relevant "Contracting Party" with which the Claimant claims a dispute exists.

196. In accordance with Article 8, the competence to make use of the arbitral process provided for in Article 8 of the Treaty is possessed by "investors" in respect of their "investments". Those terms are defined in Article 1 of the Treaty.

197. An investor of the "other" Contracting Party (in these proceedings, The Netherlands) must in the first place satisfy the definition of "investors" in Article 1(b)(ii) of the Treaty.



Under that definition, for the purposes of the present proceedings, that term comprises “legal persons constituted under the laws of [The Netherlands]”.

198. In the second place, the dispute between the Czech Republic and such an investor must be one “concerning an investment of [the investor]”. The term “investments” is defined in Article 1(a) as follows:

The term “investments” shall comprise every kind of asset invested either directly or through an investor of a third State and more particularly, though not exclusively:

- (i) movable and immovable property and all related property rights;
- (ii) shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom;
- (iii) title to money and other assets and to any performance having an economic value;
- (iv) rights in the field of intellectual property, also including technical processes, goodwill and know-how;
- (v) concessions conferred by law or under contract, including concessions to prospect, explore, extract and win natural resources.

### C. The Respondent’s Challenges to the Tribunal’s Jurisdiction

199. Although the Respondent did not always articulate the various grounds on which it challenged the Tribunal’s jurisdiction with the utmost clarity or consistency, and given its contention that Nomura and Saluka were interchangeable, the principal jurisdictional contentions put forward by the Respondent may be considered under the following headings:

- (a) the purchase of IPB shares was not an investment since Nomura/Saluka had invested nothing in IPB;
- (b) in so far as the purchase of IPB shares was an investment, it had not been lawfully made;
- (c) the real party in interest in the arbitration was not the Claimant, Saluka, but Nomura, which was not an eligible claimant under the Treaty;
- (d) the relationship between Nomura and Saluka was so close as to make them interchangeable;
- (e) Nomura/Saluka was not a *bona fide* investor in IPB;
- (f) Nomura/Saluka did not act in good faith in purchasing the IPB shares;

- (g) Nomura/Saluka acted in abuse of rights in the purchase of IPB shares;
- (h) Saluka had no real and continuous social and economic links with The Netherlands.

200. The Tribunal has concluded that the Claimant's shareholding of IPB shares is an "investment" within the meaning of the Treaty, that the Claimant is in respect of that investment an "investor" within the meaning of the Treaty, and that the Tribunal has jurisdiction to hear claims brought before it by the Claimant.

201. The Tribunal will now address each of the Respondent's contentions.

D. The Purchase of IPB Shares as an Investment and Compliance with Legal Requirements

202. Under a Share Purchase Agreement of 8 March 1998, Nomura Europe bought a controlling (but not majority) holding of shares in the Czech bank IPB. Most of Nomura Europe's shareholding in IPB was transferred to Saluka on 2 October 1998, with the balance being transferred on 24 February 2000. Saluka instituted these present proceedings by a Notice of Arbitration dated 18 July 2001, at a time when it was still the registered owner of the shares, alleging various Treaty breaches in respect of its holding of IPB shares.

203. The first question to be addressed is whether Saluka's holding of IPB shares is an "investment" for purposes of the Treaty. "Investments" are defined in the Treaty very widely. They comprise "every kind of asset invested directly or through an investor of a third State", certain of the more usual kinds of investments then being identified by way of illustration. These illustratively identified assets include in particular "shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom".

204. The Tribunal notes in passing that, although not in terms part of the definition of an "investment", it is necessarily implicit in Article 2 of the Treaty that an investment must have been made in accordance with the provisions of the host State's laws. In relevant part, Article 2 stipulates that "[e]ach Contracting Party . . . shall admit such investments in accordance with its provisions of law". Accordingly, and as both parties acknowledge, the obligation upon the host State to admit an investment by a foreign investor (*i.e.* in the present context, to allow the purchase of shares in a local company) only arises if the purchase is made in compliance with its laws.

205. There seems no room for doubt that a qualified investor's holding of shares in a Czech company such as IPB constitutes an investment within the scope of the definition.

206. The Respondent challenges that conclusion on a variety of grounds, notably on the basis that it was not an investment since Saluka had in reality invested nothing in IPB, and that, in so far as the purchase of IPB shares was an investment, it had not been lawfully made.

207. The argument that Saluka had invested nothing in IPB and for that reason the purchase of IPB shares could not be considered an "investment" seems to be based on two

considerations. The first is that Nomura, in making the original purchase of IPB's shares, and Saluka, in subsequently acquiring them, had no intention to make any true investment in the Czech Republic or in IPB's banking operations. The acquisition of IPB shares was never intended, so it is said, to be anything more than a short-term holding of shares with a view to the making of a large profit from the sale of major assets controlled by IPB, to be followed by the sale of the shares at an appropriate moment; Nomura and Saluka, so it is said, showed by their conduct throughout the events to which this case relates that they were not true investors.

208. The Tribunal first notes that the original purchase of IPB shares in March 1998 was not the act of Saluka but of Nomura Europe. Until 2 October 1998 only Nomura Europe held those IPB shares. It is consequently only the subsequent acquisition and holding of those shares by Saluka, from 2 October onwards, in respect of which the Respondent's arguments are relevant.

209. The Tribunal does not believe that it would be correct to interpret Article 1 as excluding from the definition of "investor" those who purchase shares as part of what might be termed bare profit-making or profit-taking transactions. Most purchases of shares are made with the hope that, in one way or another, the result will in due course be a degree of profit on the transaction. It is relevant in this context that, throughout the many discussions which took place between Nomura and the Czech authorities, Nomura insisted that it was only a portfolio investor in IPB and not a strategic investor. Even if it were possible to know an investor's true motivation in making its investment, nothing in Article 1 makes the investor's motivation part of the definition of an "investment".

210. The second consideration which is said by the Respondent to undermine any determination that the purchase of IPB's shares was an "investment" appears to be that Saluka itself invested nothing in IPB but was merely a conduit for the investment made by Nomura, which retained the voting rights associated with the IPB shares, participated in the management of IPB, and conducted all the dealings with the Czech authorities. Saluka was a mere surrogate for Nomura, being no more than an agent for Nomura and not itself a true investor.

211. To a considerable extent, this argument seeks to replace the definition of an "investment" in Article 2 of the Treaty with a definition which looks more to the economic processes involved in the making of investments. However, the Tribunal's jurisdiction is governed by Article 1 of the Treaty, and nothing in that Article has the effect of importing into the definition of "investment" the meaning which that term might bear as an economic process, in the sense of making a substantial contribution to the local economy or to the well-being of a company operating within it. Although the *chapeau* of Article 2 refers to "every kind of asset *invested*", the use of that term in that place does not require, in addition to the very broad terms in which "investments" are defined in the Article, the satisfaction of a requirement based on the meaning of "investing" as an economic process: the *chapeau* needs to contain a verb which is apt for the various specific kinds of investments which are listed, and since all of them are being defined as various kinds of investment it is in the context appropriate to use the verb "invested" without thereby adding further substantive conditions.

212. So far as concerns the lawfulness of the original purchase of IPB shares by Nomura Europe, the Respondent has argued that that shareholding cannot be regarded as a capital

investment through the purchase of IPB shares. These were that Nomura was not investing in IPB in order to support IPB's banking operations and keep IPB viable but to facilitate the acquisition of two valuable Czech breweries through control of IPB's stake in them: this was to be achieved by way of a Put Option scheme which in effect eliminated all downside risk from Nomura's purchase of the IPB shares, so enabling Nomura to acquire and then sell on IPB's shareholding in the brewery companies. This, so it was contended, made Nomura's real objective something other than a *bona fide* investment in IPB: the purchase of IPB's shares was part of a "dishonest scheme to secure enormous benefits". Czech law required a prospective purchaser of controlling shares in a bank to obtain the consent of the Czech authorities for that purchase, which meant that Nomura was required to file a business plan for its investment in IPB, and a false filing was a breach of that legal requirement. Nomura's failure, in its filed business plan, to disclose its true objectives to the Czech authorities had led them to approve the purchase of IPB's shares, which they would not otherwise have done.

213. In this context, the Respondent has invoked the requirements of Section 16(1)(a) and (e) of the Czech Banking Act. This provides (in the translation submitted by the Respondent):

Prior approval of the Czech National Bank shall be required

(a) for the establishment of an ownership interest by foreign a person in an existing bank,<sup>4</sup>

...

(e) acquisitions or transfers of registered capital amounting to more than 15% of a bank's registered capital, in the course of one or more transactions, by/to an individual or several persons acting in concert, unless due to inheritance.

While that provision of the Czech Banking Act establishes the need to obtain the CNB's approval, it says nothing about the investor's obligation to disclose its long-term plans and ultimate objectives.

214. The Respondent has in that respect invoked the provisions of the CNB's Official Communication 23/1995, Article III(2)(c) of which provides:

The investor shall submit the application to the CNB together with the following documents:

2. if the investor is a legal entity

...

(c) a business plan (in the event that the required volume of shares represents 10% and more of the registered capital of the bank).

While that provision requires the submission of a business plan, the Tribunal has seen nothing to suggest that it imposes a legal obligation upon an investor to disclose its future

long-term plans and objectives going far beyond the immediate purposes of its investment in the bank whose shares are being purchased. A “business plan” is inherently a label of considerable generality, and a Tribunal such as this must hesitate before reading into that label such a particular and far-reaching content.

215. The Respondent has not identified any other specific legal requirements relating to the filing obligation which have allegedly been violated. And although Mr Pavel Racoča (Executive Director of the Banking Supervision Department at the CNB) has testified that, had he been aware of the full story, he would not have approved Nomura’s share purchase, the Tribunal does not see in that statement anything to transform full disclosure of future long-term plans and objectives into a legal obligation for the investor.

216. So far as concerns any alleged illegality involved in the creation or operation of the Put Option, the Tribunal notes, and sees no reason to dissent from, the decision of the tribunal in the first arbitration under the Put Option agreement in *Torkmain Investments Ltd et al. v. Pembridge Investments BV et al.*,<sup>5</sup> in its second interim award, that the Put Option agreement was valid, as was the Put Option itself. Moreover, the Tribunal notes that, in the second such arbitration, it was accepted by CSOB (apparently acting on behalf of the Czech Republic) that those two matters were *res judicata* as a matter of Czech law.

217. The Tribunal is accordingly unable to conclude that the circumstances surrounding the original purchase of the shares by Nomura Europe have been shown to involve any breach of the law by Nomura Europe such as to warrant its purchase of IPB shares being considered an unlawful investment and so not entitled to protection under the Treaty. In this connection, the Tribunal notes that, throughout the events giving rise to this arbitration, the Czech authorities have never questioned either the legality of the original transaction by which Nomura acquired the IPB shares, or the legality of Saluka’s subsequent ownership of them: on the contrary, the Czech authorities took many steps explicitly acknowledging Saluka’s status as properly the owner of those shares after October 1998.

218. In any event, the Tribunal again observes that any illegality allegedly involved in Nomura Europe’s conduct at the time of its purchase of the IPB shares would be a failing by Nomura, not by the Claimant in these proceedings, Saluka. To be relevant to the present proceedings, Nomura’s failings (if any) at the time of purchasing the IPB shares in March 1998 need also to be in some way attributable to Saluka in relation to its acquisition and subsequent holding of the shares after October 1998.

219. So far as concerns the subsequent transactions by which those shares were transferred to Saluka, the Respondent appears to address this aspect of the matter by arguing that since, as it submitted, Nomura had not lawfully acquired any investment in IPB shares, therefore Saluka, which subsequently acquired the IPB shares from Nomura, was precluded from having recourse to arbitration under the Treaty, possibly (although this is not specified by the Respondent) either on the ground that the original purchase being unlawful, that illegality taints the subsequent holder’s title to the shares, or on the ground that since Nomura and Saluka are in effect interchangeable (as to which, see below), Nomura’s unlawful conduct is at the same time Saluka’s unlawful conduct.

220. Given the Tribunal's finding in paragraph 42 above, the Tribunal has no need to consider these arguments further.

221. The Tribunal accordingly concludes that there are no good reasons for declining to consider the Claimant's holding of IPB shares in issue in this case to be an "investment" within the meaning of the definition of that term in Article 1 of the Treaty.

E. Saluka's Qualification as an "Investor" Entitled to Initiate the Arbitration Procedures under the Treaty

222. The question which must next be considered is whether Saluka is a qualified "investor" for purposes of the Treaty.

223. There is no doubt that Saluka meets the only requirements expressly stipulated in Article 1 of the Treaty for qualification as an investor, namely that it be a "legal person", and be "constituted under the law of [The Netherlands]".

224. The Respondent, however, advances several arguments why Saluka should nevertheless not be considered an "investor" entitled to invoke the arbitration provisions of the Treaty in respect of Saluka's holding of IPB shares. These have been summarised in paragraph 199(c-h) above:

225. The six separate grounds there summarised amount, in substance, to three main arguments involving, first, the closeness of the relationship between Nomura and Saluka, second, the lack of good faith involved in the acquisition of IPB shares, and third, Saluka's lack of real links with The Netherlands.

1. The Corporate Relationship between Saluka and Nomura

226. As regards the first of these main lines of argument, the essential facts regarding the relationship between Saluka and Nomura have already been set out. In brief, "Nomura" or "the Nomura Group" is the convenient group name of a major Japanese merchant banking and financial services group of companies. It typically operates through subsidiaries set up in various countries. One element of the Nomura Group was Nomura Europe plc, a company constituted under the laws of England. (For convenience, where this company needs to be separately identified, it is referred to as "Nomura Europe".) Another part of the Nomura Group was Saluka, the Claimant in this arbitration. Saluka was constituted under the laws of The Netherlands for the sole and express purpose of holding the shares in IPB which Nomura Europe was at the time in the process of purchasing. Saluka was wholly controlled by Nomura Europe.

227. In those circumstances, the Respondent contended that, in the context of the circumstances which gave rise to this arbitration, the relationship between Nomura and Saluka was so close that they were in effect interchangeable as parties in these proceedings, Saluka being nothing more than a shell used by Nomura for its own purposes. Indeed, in the Respondent's submission, such was the closeness of the relationship that the real party in interest was Nomura (which was not eligible to present claims under the Treaty), and that

therefore Saluka was not a *bona fide* “investor” under the Treaty (a use of “*bona fide*” which, in this context, the Tribunal takes to mean something like “genuine” or “real”) and was therefore not entitled to have recourse to arbitration under it: Saluka was, in effect, a mere surrogate for Nomura, and a claim under an investment treaty could not be brought by an entity which was a surrogate for another entity which, like Nomura, was not covered by the Treaty. Although this involved looking behind the formal corporate structures of Nomura and Saluka, such “piercing the corporate veil” was permissible as an equitable remedy where corporate structures had been utilised to perpetrate fraud or other malfeasance. Nomura had used corporate structures to realise profit and put the banking sector at risk, and to perpetrate fraud against the Czech Republic. The corporate veil should therefore be pierced, the real interest at stake should be recognised to be Nomura’s, and as Nomura was not within the Treaty definition of an “investor”, the Tribunal was without jurisdiction.

228. The Tribunal accepts – and the parties have made no attempt to conceal, either from the Tribunal or, in the Claimant’s case, from the Czech authorities – the closeness of the relationship between Nomura and Saluka. In that respect, the companies concerned have simply acted in a manner which is commonplace in the world of commerce.

229. In dealing with the consequences of that way of acting, the Tribunal must always bear in mind the terms of the Treaty under which it operates. Those terms expressly give a legal person constituted under the laws of The Netherlands – such as, in this case, Saluka – the right to invoke the protection of the Treaty. To depart from that conclusion requires clear language in the Treaty, but there is none. The parties to the Treaty could have included in their agreed definition of “investor” some words which would have served, for example, to exclude wholly-owned subsidiaries of companies constituted under the laws of third States, but they did not do so. The parties having agreed that any legal person constituted under their laws is entitled to invoke the protection of the Treaty, and having so agreed without reference to any question of their relationship to some other third State corporation, it is beyond the powers of this Tribunal to import into the definition of “investor” some requirement relating to such a relationship having the effect of excluding from the Treaty’s protection a company which the language agreed by the parties included within it.

230. While it might in some circumstances be permissible for a tribunal to look behind the corporate structures of companies involved in proceedings before it, the Tribunal is of the view that the circumstances of the present case are not such as to allow it to act in that way. The Respondent acknowledges that this possibility presents itself as an equitable remedy where corporate structures had been utilised to perpetrate fraud or other malfeasance, but, in the present case, the Tribunal finds that the alleged fraud and malfeasance have been insufficiently made out to justify recourse to a remedy which, being equitable, is discretionary.

## 2. The Alleged Lack of Good Faith and Abuse of Rights

231. As regards the bundle of arguments which are said to involve in one way or another considerations of the alleged lack of good faith shown by Nomura/Saluka in the acquisition of the IPB shares, it seems that the Respondent relies on a variety of circumstances in support of its contention. Principal among these is that Nomura Europe did not, at the time of purchasing the IPB shares, disclose to the Czech authorities that its true purpose in doing so was not to invest in IPB’s banking operations, but rather, by way of the Put Option, to

facilitate its acquisition of Czech breweries in which IPB had a controlling interest, and that, by such non-disclosure, Nomura had not acted in good faith and had violated the principle of abuse of rights and was therefore not a *bona fide* investor. Expressed more generally (as set out above in paragraph 184), the Respondent maintained that the Nomura Group had acted fraudulently and dishonestly throughout the events to which the case related. Nomura's circular financing arrangements, the Czech beer deal, the Put Option and the establishment of the Tritton Fund had all been conduct contrary to international *bonos mores*. This continuing failure to act in good faith and the abuse of process required that Saluka – which had never even been a *bona fide* holder of an investment which might have been injured – should be denied protection under the Treaty.

232. The Tribunal does not consider that an investor – and particularly a portfolio investor – shows a lack of good faith in failing to disclose to the seller of shares, or to the host State's regulatory authorities, its ultimate objectives in entering into a share purchase transaction. The seller of shares, and the regulatory authorities, must be taken to be aware that a portfolio investor, particularly one forming part of a very large international financial group, will be making investments as part of a much wider corporate strategy than is involved in the purchase of shares in one particular company. In the Tribunal's view, it is both unreasonable and unrealistic to posit an obligation upon an investor to disclose its ultimate objectives in making a particular investment, whether through the purchase of shares or otherwise. Ultimate objectives will, in any event, often be highly speculative and not susceptible to precise articulation, and will be subject to change over time. An investor may choose to make its long-term plans known to a greater or (in the absence of a clearly legal requirement to the contrary) lesser degree, but that is quite different from establishing an obligation to that effect such as to make non-disclosure a head of "bad faith".

233. The Tribunal has already addressed the Respondent's further argument that Nomura's non-disclosure of its long-term intentions regarding its plans for the acquisition of Czech breweries and the construction of the Put Option involved a breach of the Czech law.

234. So far as specifically concerns the alleged abuse of rights by the Claimant, the right allegedly being abused could be either the right to acquire the shares in IPB, or the right to be regarded as an investor entitled to invoke the Treaty's arbitration provisions: the Respondent appears to assert that the circumstances are in either case sufficient to deprive the Claimant of its standing as an investor entitled to avail itself of those provisions. Those circumstances on which the Respondent relies appear to be Nomura's non-disclosure of its true long-term intentions with regard to its investment in IPB, and its alleged wish to use the delays which would be occasioned by recourse to arbitration so that Nomura might gain advantage from the running of statutes of limitation in relation to civil or criminal proceedings which might be instituted by the Czech Republic in other fora.

235. The Tribunal has already addressed the argument based on non-disclosure, and concluded that an investor – and particularly a portfolio investor – shows no lack of good faith in failing to disclose to the seller of shares, or to the host State's regulatory authorities, its ultimate objectives in entering into a share purchase transaction. Similarly, the Tribunal cannot see in such non-disclosure any circumstance which it could regard as an abuse of the right to acquire the shares or of the right to initiate the Treaty's arbitration procedures.



236. As regards the Respondent's allegation that the Claimant had in mind ulterior litigation motives in instituting the arbitration procedures provided by the Treaty, the Tribunal has to observe that, even if such an ulterior motive could be such as to involve an abuse of the right to invoke the arbitration procedures, that allegation is unsubstantiated and cannot be the basis for a decision by the Tribunal which would deprive it of jurisdiction to proceed with the arbitration which the Claimant has initiated.

237. In any event, the Tribunal again observes that the illegality, lack of good faith, or abuse of rights allegedly involved in Nomura Europe's conduct at the time of its purchase of the IPB shares would be a failing by Nomura, not by the Claimant in these proceedings, Saluka. To be relevant to the present proceedings, Nomura's failings (if any) at the time of purchasing the IPB shares in March 1998 need also to be in some way attributable to Saluka in relation to its acquisition and subsequent holding of the shares after October 1998.

238. The Respondent addresses this aspect of the matter by arguing that since, as it submitted, Nomura was not a *bona fide* or lawful investor, therefore Saluka, which subsequently acquired the IPB shares from Nomura, was precluded from having recourse to arbitration under the Treaty. Since the Tribunal is not persuaded that the original conduct of Nomura involved any illegality, lack of good faith, or abuse of rights, the Tribunal does not find it necessary to examine further the extent to which, had it made any findings of that kind, they might have affected Saluka's right to initiate arbitration proceedings under the Treaty.

### 3. Saluka's Lack of Factual Links with The Netherlands

239. The Respondent also argues that Saluka did not have *bona fide* (which term again seems to connote genuineness rather than any issue of bad faith), real and continuous links to The Netherlands, and for that reason did not satisfy the requirements which are necessary to qualify as an "investor" able to benefit from the provisions of the Treaty.

240. The Tribunal has some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure, and to practices of "treaty shopping" which can share many of the disadvantages of the widely criticised practice of "forum shopping."

241. However that may be, the predominant factor which must guide the Tribunal's exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal's jurisdiction. In the present context, that means the terms in which they have agreed upon who is an investor who may become a claimant entitled to invoke the Treaty's arbitration procedures. The parties had complete freedom of choice in this matter, and they chose to limit entitled "investors" to those satisfying the definition set out in Article 1 of the Treaty. The Tribunal cannot in effect impose upon the parties a definition of "investor" other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add.

242. The Tribunal is confirmed in the appropriateness of the view which it has taken by the consideration, in the particular circumstances of the present case, that it was always apparent to the Czech authorities that it was Nomura's intention to transfer the IPB shares it was purchasing to another company within the Nomura Group, and that that other company would be a special-purpose vehicle set up for the specific and sole purpose of holding those shares. The Share Purchase Agreement contained express provision to that effect. By applying the provisions of the Treaty in conformity with their express terms, no violence is done to the positions knowingly adopted by the parties at all relevant times.

#### F. The Tribunal's Conclusions as to Jurisdiction

243. Having thus considered the various challenges to its jurisdiction which the Respondent has advanced, the Tribunal concludes that the Claimant's shareholding of IPB shares is an "investment" within the meaning of the Treaty, and that the Claimant is in respect of that investment an "investor" within the meaning of the Treaty. Accordingly, the Tribunal is satisfied that it has jurisdiction to hear the claims brought before it by the Claimant under the arbitration procedure provided for in Article 8 of the Treaty.

244. In reaching that conclusion, however, the Tribunal wishes to emphasise that, in accordance with the Treaty, its jurisdiction is limited to claims brought by the Claimant, Saluka, in respect of damage suffered by itself in respect of the investment represented by its holding of IPB shares. It follows, therefore, that the Tribunal does not have jurisdiction in respect of any claims of Nomura, or any claims in respect of damage suffered by Nomura and not by Saluka, or any claims in respect of damage suffered in respect of the IPB shares before October 1998 when the bulk of those shares became vested in the Claimant. Although Nomura is not a party to these proceedings, the Tribunal nevertheless has jurisdiction to consider and make factual findings about the conduct of Nomura in so far as such findings might be relevant to the Tribunal's consideration of arguments advanced by the Claimant or the Respondent.

### V. SALUKA'S CLAIMS UNDER ARTICLE 5 OF THE TREATY

#### A. The Treaty

245. Article 5 of the Treaty reads as follows:

Neither Contracting Party shall take any measures depriving, directly or indirectly, investors of the other Contracting Party of their investments unless the following conditions are complied with:

- a. the measures are taken in the public interest and under due process of law;
- b. the measures are not discriminatory;
- c. the measures are accompanied by provision for the payment of just compensation. Such compensation shall represent the genuine value of the investments affected and shall, in order to be effective for the claimants, be paid and made transferable, without undue delay, to the country designated

by the claimants concerned and in any freely convertible currency accepted by the claimants.

B. The Parties' Principal Submissions

246. The Claimant asserts that Saluka has been deprived of the value of its shares in IPB by the Czech Republic's intervention which culminated in the forced administration of IPB.

247. The Claimant further maintains that, in this context, the only issue before the Tribunal is whether this deprivation was unlawful in accordance with the criteria of Article 5.

248. The Claimant concludes that the Czech Republic is liable under Article 5 if it can establish that one or more of the conditions set out in Article 5 has not been complied with, *i.e.* that:

- (a) the measures depriving Saluka of its investment were not taken in the public interest and under due process of law; or that
- (b) the measures were discriminatory; or that
- (c) the measures were not accompanied by payment of just compensation.

249. In support of its main contention, Saluka, in brief, maintains that the evidence before the Tribunal demonstrates the following:

- (a) The IPB proposal, rejected by the Czech Government, would have cost Czech taxpayers far less than the forced administration option. That option, says Saluka, was thus not in the public interest;
- (b) The Respondent's fact and expert witnesses were unable to point to a precise regulation with respect to a bank's liquidity requirements which had been breached by IPB. There was thus, argues Saluka, no due process;
- (c) The Forced Administrator never exercised truly independent judgment. Again, says Saluka, the forced administration measure was not taken under due process and was discriminatory;
- (d) The Czech Government granted State aid to IPB's competitors, thus infringing, says Saluka, the non-discrimination provision of Article 5;
- (e) The Czech Government resorted to its regulatory power unlawfully for the sole purpose of transferring IPB's business to CSOB. The measure, argues Saluka, was thus clearly discriminatory;
- (f) The Czech Government never paid any compensation to Saluka after having deprived Saluka of its investment.

250. The Czech Republic denies that it has violated Article 5 of the Treaty. In essence, it submits that the measures which it resorted to in order to address the IPB situation in the spring of 2000 and which culminated in the decision by the CNB to put IPB into forced administration were “permissible regulatory actions” which cannot be considered as expropriatory.

251. In support of its principal defense, the Czech Republic also avers that each of the measures cited by Saluka in its attempt to demonstrate that the Czech Republic’s actions were not genuine regulatory measures were indeed authorised by Czech law.

252. Subsidiarily, the Czech Republic argues that, since Saluka sold its IPB shares back to Nomura after June 2000 for the same amount as it purchased them, Saluka “has failed to establish a deprivation of sufficient magnitude to form the basis of an expropriation claim”.

### C. The Law

253. The Tribunal agrees with Saluka that the principal, if not the sole, issue which it must determine in the present chapter of its Award is whether the actions by the Czech Republic complained of by the Claimant are lawful or unlawful measures.

254. The Tribunal acknowledges that Article 5 of the Treaty in the present case is drafted very broadly and does not contain any exception for the exercise of regulatory power. However, in using the concept of deprivation, Article 5 imports into the Treaty the customary international law notion that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order. In interpreting a treaty, account has to be taken of “any relevant rules of international law applicable in the relations between the parties”<sup>6</sup> – a requirement which the International Court of Justice (“ICJ”) has held includes relevant rules of general customary international law.<sup>7</sup>

255. It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.

256. Nearly forty-five years ago, the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (“Harvard Draft Convention”),<sup>8</sup> which instrument is relied upon by the Czech Republic, recognised the following categories of non-compensable takings:

An uncompensated taking of an alien property or a deprivation of the use or enjoyment of property of an alien which results from the execution of tax laws; from a general change in the value of currency; from the action of the competent authorities of the State in the maintenance of public order, health or morality; or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful.

257. As Saluka correctly reminded the Tribunal, the above-quoted passage in the Harvard Draft Convention is subject to four important exceptions. An uncompensated taking of the sort referred to shall not be considered unlawful provided that:

- (a) it is not a clear and discriminatory violation of the law of the State concerned;
- (b) it is not the result of a violation of any provision of Articles 6 to 8 [of the draft Convention];
- (c) it is not an unreasonable departure from the principles of justice recognised by the principal legal systems of the world;
- (d) it is not an abuse of the powers specified in this paragraph for the purpose of depriving an alien of his property.

258. These exceptions do not, in any way, weaken the principle that certain takings or deprivations are non-compensable. They merely remind the legislator or, indeed, the adjudicator, that the so-called “police power exception” is not absolute.

259. The Tribunal further recalls that, in an accompanying note to the 1967 OECD Draft Convention on the Protection of Foreign Property,<sup>9</sup> it is provided that measures taken in the pursuit of a State’s “political, social or economic ends” do not constitute compensable expropriation.

260. Similarly, the United States Third Restatement of the Law of Foreign Relations in 1987<sup>10</sup> includes *bona fide* regulations and “other action of the kind that is commonly accepted as within the police power of State” in the list of permissible – that is, non-compensable – regulatory actions.

261. It is clear that the notion of deprivation, as that word is used in the context of Article 5 of the Treaty, is to be understood in the meaning it has acquired in customary international law.<sup>11</sup>

262. In the opinion of the Tribunal, the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are “commonly accepted as within the police power of States” forms part of customary international law today. There is ample case law in support of this proposition. As the tribunal in *Methanex Corp. v. USA* said recently in its final award, “[i]t is a principle of customary international law that, where economic injury results from a *bona fide* regulation within the police powers of a State, compensation is not required”.<sup>12</sup>

263. That being said, international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States and, thus, non-compensable. In other words, it has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law.

264. It thus inevitably falls to the *adjudicator* to determine whether particular conduct by a state “crosses the line” that separates valid regulatory activity from expropriation. Faced with the question of *when, how and at what point an otherwise valid regulation becomes, in fact*

and effect, an unlawful expropriation, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.<sup>13</sup>

265. In the present case, the Tribunal finds that the Czech Republic has not “crossed that line” and did not breach Article 5 of the Treaty, since the measures at issue can be justified as permissible regulatory actions.

#### D. Analysis and Findings

266. Saluka’s shares in IPB were assets entitled to protection under the Treaty. Pursuant to Article 5 of the Treaty, the Czech Republic was prohibited from taking any measures depriving, directly or indirectly, Saluka of its investment in IPB unless one or more of the cumulative conditions set out in that Article were complied with. If the Tribunal finds that the Czech Republic has adopted such measures without having complied with one or more of these conditions, the conclusion will inevitably follow that the Respondent has breached Article 5 of the Treaty.

267. There can be no doubt, and the Tribunal so finds, that Saluka has been deprived of its investment in IPB as a result of the imposition of the forced administration of the bank by the CNB on 16 June 2000.

268. In Part III of the present Award, the Tribunal has reviewed in considerable detail the facts which led the CNB, on 16 June 2000, to “introduce forced administration” of IPB pursuant to Section 26(1)(d) of the Czech Banking Act.<sup>14</sup>

269. A translation of the CNB decision of 16 June 2000 has been produced as an exhibit before the Tribunal. It sets forth the many reasons which convinced the CNB, as the Czech banking regulator, to decide that the time had come to impose forced administration of IPB and appoint an administrator to exercise the forced administration. The decision also refers to the Czech legislation on which the CNB relied.

270. Rather than attempting to summarise the CNB’s decision, the Tribunal reproduces it here *in extenso*, in translation supplied by the Respondent:

#### Decision

On the basis of the establishment that INVESTIČNÍ A POŠTOVNÍ BANKA, akciová společnost, with its registered office in Praha 1, Senovážné nám. 32, IČO (Identification No.): 45 31 66 19 (the “Bank”) continually fails to maintain payment ability both in Czech currency and in foreign currencies and, accordingly, fails to comply with its obligation under Section 14 of Act No. 21/1992 Coll., the Banking Act, as amended (the “Banking Act”), the Czech National Bank has decided, pursuant to the provision of Section 26(1)(d), in accordance with the provisions of Section 30, Section 26(2), Section 26(6) and Section 26(3)(b) and with regard to the provisions of Section 27(1)(a) and (b) of the Banking Act, as follows:

- I. Forced administration shall be introduced in the Bank as of June 16, 2000.

- II. The administrator exercising the forced administration shall be Mr. Petr Staněk, birth number 670725/0847.

### Reasoning

Under the provisions of Section 14, of the Banking Act, banks are obligated to continually maintain payment ability both in Czech currency and in foreign currencies. The Czech National Bank has evaluated, on the basis of the findings set forth below, the state of matters as of the date of issue of this Decision with the result that the Bank is in breach of said provision.

In its letter Ref. No. 277/520, dated March 2, 2000, the Czech National Bank requested data on liquidity condition and payment ability of the Bank to be provided by the Bank on a daily basis. In accordance with the Czech National Bank's requirement, the Bank provided, on a daily basis, tables showing the development of primary deposits (deposits from clients) in the preceding two weeks, the development of monitored items of financial market (the so-called liquidity cushion securing the Bank's payment ability) in the preceding two weeks and a summary of the development of primary deposits (deposits from clients) since February 20, 2000. On the basis of the documents provided, the Czech National Bank regularly monitored the development of the Bank's payment ability whose deterioration is shown by the data for the period from February 20, 2000, to June 11, 2000, and further from June 12, 2000 to June 14, 2000.

From the table "Development of primary deposits in the past two weeks in millions of CZK" provided by the Bank in its letter dated June 12, 2000, Ref. No. 1107/00/3-1, the Czech National Bank ascertained that in the period from February 20, 2000, to June 11, 2000, the amount of primary deposits (deposits from clients) decreased in the aggregate from CZK 237,966 million to CZK 204,155 million, i.e., by CZK 33,811 million. At the same time, the Czech National Bank ascertained from the table "Development of monitored items of the financial market in the past two weeks in millions of CZK" provided by the Bank in its letter dated March 6, 2000, Ref. No. 451/2000/3-1 and its letter dated June 12, 2000, Ref. No. 1107/00/3-1 that due to the decrease in the primary deposits (deposits from clients), the financial market balance (the so-called liquidity cushion) decreased from CZK 64,452 million to CZK 38,658 million in that same period.

From the table "Development of primary deposits in the past two weeks in millions of CZK" provided by the Bank in its letter dated June 15, 2000, Ref. No. 1143/00/3-1, the Czech National Bank ascertained that on June 12, 2000, the amount of primary deposits (deposits from clients) decreased in the aggregate from CZK 204,153 million to CZK 199,628 million, i.e., by CZK 4,525 million, on June 13, 2000, it decreased from CZK 199,628 million to CZK 193,664 million, i.e., by CZK 5,964 million, and on June 14, 2000, from CZK 193,664 million to CZK 187,173 million, i.e., by CZK 6,491 million. At the same time, the Czech National Bank ascertained from the table "Development of monitored items of the financial market in the past two weeks in millions of CZK" provided by the Bank in its letter dated June 15, 2000, Ref. No. 1143/00/3-1 that due to the decrease in the primary deposits (deposits from clients) in that period, the financial market balance (the so-called liquidity cushion) decreased on June 12, 2000, from CZK 39,385 million to CZK 34,926 million, i.e., by CZK 4,459 million, on June 13, 2000, it decreased from CZK 34,926 million to CZK 25,446 million, i.e., by CZK 9,480 million, and on June 14, 2000, from CZK 25,446 million to CZK 16,625 million, i.e., by CZK 8,821 million.

The Bank's Board of Directors addressed, in accordance with Section 26b of the Banking Act, a letter dated June 14, 2000, Ref. No. GR 202/2000 to the Czech National Bank stating that as a result of intensified cash and cash-free withdrawals in the last days, the Bank's liquidity condition had significantly deteriorated and a risk existed that if the current trend continued, the Bank could get into a situation where it would no longer be able to maintain the amount of the mandatory minimum reserves and consequently to comply with its obligations under debit clearing transactions, i.e., it would not be able to perform its clients' payment instructions.

The development in the deposits and liquidity cushion at the Bank constitutes a considerable risk from the point of view of a threat to its payment ability since, as established by the Czech National Bank, the current amount of the liquidity cushion that is constantly decreasing is not adequate for the current and constantly increasing requirements of the clients for deposit withdrawals. All factual findings made as of the date of issue of this Decision evidence that the current trend is continuing.

The Czech National Bank is entitled to introduce forced administration pursuant to Section 26(1)(d) of the Banking Act only after it has established deficiencies in a bank's operation. Under the provisions of Section 26(3)(b) of the Banking Act, "deficiencies in a bank's operation" means, among other things, a breach of the Banking Act. It has been unambiguously established on the basis of the aforementioned findings that the Bank has failed to comply with its obligation under Section 14 of the Banking Act. Accordingly it is in breach of that law, and a fundamental deficiency has been ascertained in its operation which deficiency continues.

Pursuant to the provisions of Section 30 of the Banking Act, the Czech National Bank is entitled to introduce forced administration in a bank if the deficiencies in such bank's operation endanger the stability of the banking system. According to the findings made by the Czech National Bank, this legal condition is fulfilled on the following grounds.

In 1999, the Bank ranked second within the interbank payment system of the Czech Republic in terms of the amount of payments processed – the Bank received and dispatched 2.3 million transactions totaling CZK 2,000 billion.

Second, according to the data stated in the statement "Bil 1-12. Monthly statement of assets and liabilities" as at April 30, 2000, the Bank's share in the amount of deposits from the public within the banking sector of the Czech Republic is 22% while its shares in the aggregate amount of assets within the banking sector of the Czech Republic amounts to 13.2% and the number of its clients is over 2.9 million.

In addition, the Bank is a major shareholder of two other banks operating in the Czech Republic, namely Českomoravská stavební spořitelna, akciová společnost, the leading building and loan association in the building loan market in the Czech Republic, and Českomoravská hypoteční banka, a.s., the leading bank in the mortgage-backed loan market in the Czech Republic. The severe financial condition of the Bank contests its position as the major shareholder or shareholder with the decisive controlling influence of these banks and is a threat to these banks' position.

On the basis of the above, the Czech National Bank holds as evidenced that the Bank directly endangers the stability of the banking system of the Czech Republic.

The Bank is a significant debtor of other banks, consequently its lower payment ability is liable to adversely affect the payment ability of the banks that are its



creditors. In addition, the Bank administers funds of many entities whose inability to pay caused by the Bank (the Bank's low liquidity) would result in serious consequences, whether direct or indirect, for the creditors of such entities including, without limitation, other banks constituting the banking system. Given the above, the Bank participates to a significant extent in the functioning of the entire banking system. The fact that, according to the notice given by its own statutory bodies, it may not be able to maintain its payment ability endangers the stability of the banking system in its entirety.

All the above facts with respect to the Bank's share in the interbank payment system, in the amount of deposits from the public within the banking sector, in the aggregate amount of assets within the banking sector, the number of its clients and its significant position as a shareholder evidence that the serious difficulties in the Bank's payment ability endanger the stability of the banking system in the Czech Republic to a considerable extent.

Pursuant to the provisions of Section 30 of the Banking Act, the Czech National Bank is entitled to introduce forced administration in a bank if such bank's shareholders have failed to take necessary measures to correct deficiencies. The effect of such measures may be measured only by the result, i.e., improvement in such bank's payment ability. According to the data ascertained with respect to the Bank's payment ability, it is evident that the situation of the Bank necessitates an immediate solution. The constant deterioration of the Bank's payment ability demonstrates that either the Bank's shareholders have failed to take appropriate measures securing the permanent payment ability of the Bank or such measures have been insufficient and ineffective as the Bank's payment ability is markedly deteriorating. The foregoing is implied both by the Czech National Bank's own findings and by the information contained in the letter from the Bank's Board of Directors, dated June 14, 2000, delivered to the Czech National Bank on June 15, 2000.

Based on the above, the Czech National Bank holds as evidenced that the conditions for the introduction of forced administration in the Bank, as set forth in the provisions of Section 26(1)(d) and Section 30 of the Banking Act with respect to the introduction of forced administration in a bank, are fulfilled.

Pursuant to the provisions of Section 2 of Act No. 6/1993 Coll., the Czech National Bank Act, as amended (the "Czech National Bank Act"), the responsibilities of the Czech National Bank include the management of monetary circulation and payments including banking clearance, maintaining the continuity and efficiency thereof, exercise of supervision over banking activities and maintaining the safe functioning and purposeful development of the banking system in the Czech Republic.

In addition, the Czech National Bank is responsible, under the provisions of Section 44(1)(a) of the Czech National Bank Act, for the exercise of supervision over banking activities and the safe functioning of the banking system. Given the critical financial condition of the Bank and with regard to the threat to the stability of the banking system constituted by the aforementioned deficiency in the Bank's operations as well as the failure of the Bank's shareholders to take necessary measures to correct such deficiencies, the Czech National Bank must avoid a situation where a panic among the Bank's depositors would result in a permanent destabilization of its operations and consequently in undermined confidence in the banking system in its entirety. By the introduction of forced administration, the Czech National Bank prevents further gradation of the Bank's critical situation.

Pursuant to the provisions of Section 26(2) of the Banking Act, the Czech National Bank is obligated to decide on the introduction of forced administration upon a bank's failure to correct deficiencies on the Czech National Bank's demand made pursuant to Section 26(1)(a) of the Banking Act. However, pursuant to Section 26(2) of the Banking Act, the Czech National Bank may introduce forced administration without a demand for correcting measures under Section 26(1)(a) of the Banking Act if the matter cannot withstand delay.

On the basis of the information ascertained by the Czech National Bank, it is incontestable that the Bank's payment ability is rapidly and significantly deteriorating and, consequently, the Czech National Bank considers the introduction of forced administration to be a matter that cannot withstand delay.

The Czech National Bank has requested, in accordance with the provisions of Section 30 of the Banking Act, the standpoint of the Ministry of Finance with respect to the introduction of forced administration. In its standpoint dated June 16, 2000, the Ministry of Finance consented to the introduction of forced administration.

Pursuant to the provisions of Section 28(1) of the Banking Act, the Banking Board has the obligation to appoint the administrator charged with the exercise of forced administration and determine the amount of his remuneration. However, pursuant to the provision of Section 27(1)(b) of the Banking Act, the decision on the introduction of forced administration must include, in addition to the grounds for the introduction of forced administration, also the name, surname and birth code of the administrator.

#### Advice on Appeal

An appeal may be lodged against this Decision pursuant to Section 61(1) of Act No. 71/1967 Coll., the Administrative Procedural Code (the Administrative Code), as amended, with the Czech National Bank, Na Příkopě 28, Praha 1, PSČ 115 03, within 15 days of the delivery hereof. In accordance with the provisions of Section 41(1) of the Banking Act, the Banking Board of the Czech National Bank decides on the appeal. An appeal lodged has no suspensive effect.

(Circular Seal)

(signature)

Ing. Pavel Racoča, MIA  
Senior Director

(signature)

Ing. Vladimír Krejča  
Director of the Banking Supervision Section

This Decision is addressed to:  
INVESTIČNÍ A POŠTOVNÍ BANKA, akciová společnost  
Senovazné nam. 32  
Praha 1

271. As will be seen, the CNB's decision is fully motivated. Having reviewed the totality of the evidence which the CNB invoked in support of its decision, the Tribunal is of the view that the CNB was justified, under Czech law, in imposing the forced administration of IPB and appointing an administrator to exercise the forced administration.

272. The Czech State, in the person of its banking regulator, the CNB, had the responsibility to take a decision on 16 June 2000. It enjoyed a margin of discretion in the

exercise of that responsibility. In reaching its decision, it took into consideration facts which, in the opinion of the Tribunal, it was very reasonable for it to consider. It then applied the pertinent Czech legislation to those facts – again, in a manner that the Tribunal considers reasonable.

273. In the absence of clear and compelling evidence that the CNB erred or acted otherwise improperly in reaching its decision, which evidence has not been presented to the Tribunal, the Tribunal must in the circumstances accept the justification given by the Czech banking regulator for its decision.

274. The Tribunal notes, additionally, that the decision of the CNB was confirmed by the CNB Appellant Board and subsequently upheld by the City Court in Prague on two occasions, firstly on an appeal lodged by three members of IPB’s Board of Directors and later on an appeal lodged by Saluka itself.

275. The CNB’s decision is, in the opinion of the Tribunal, a lawful and permissible regulatory action by the Czech Republic aimed at the general welfare of the State, and does not fall within the ambit of any of the exceptions to the permissibility of regulatory action which are recognised by customary international law. Accordingly, the CNB’s decision did not, fall within the notion of a “deprivation” referred to in Article 5 of the Treaty, and thus did not involve a breach of the Respondent’s obligations under that Article.

#### E. Conclusion

276. In summary, the Tribunal finds, based on the totality of the evidence which has been presented to it, that in imposing the forced administration of IPB on 16 June 2000 the Czech Republic adopted a measure which was valid and permissible as within its regulatory powers, notwithstanding that the measure had the effect of eviscerating Saluka’s investment in IPB.

277. Having so determined, it is not necessary for the Tribunal to address the Respondent’s subsidiary argument that, because Saluka sold its IPB shares back to Nomura after June 2000 for the same amount as it purchased those shares, the Claimant has failed to establish a deprivation of sufficient magnitude to form the basis of an expropriation claim.<sup>15</sup>

278. The Tribunal, in this Chapter of the present Award dealing with Saluka’s claim that the Czech Republic breached Article 5 of the Treaty, does not consider the Claimant’s allegations that the Czech Republic was an accessory to CSOB’s alleged plan to take over IPB, that the Forced Administrator did not exercise truly independent judgment or that the Czech Government discriminated against IPB by granting State aid to Saluka’s competitors. In the view of the Tribunal, these allegations, even if proven, would not rise to the level of a breach of Article 5. They will in any event be considered in the next Chapter of this Award that addresses the alleged breach by the Respondent of Article 3 of the Treaty.

## VI. SALUKA'S CLAIMS UNDER ARTICLE 3 OF THE TREATY

279. The way in which events unfolded with respect to Saluka's shareholding in IPB amounted, in the Claimant's view, to a breach by the Czech Republic of its obligation under Article 3 of the Treaty. The Respondent has denied that it breached Article 3 of the Treaty.

280. Article 3, paragraphs 1 and 2 of the Treaty provided that:

1. Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.
2. More particularly, each Contracting Party shall accord to such investments full security and protection which in any case shall not be less than that accorded either to investments of its own investors or to investments of investors of any third States, whichever is more favourable to the investor concerned.

281. For reasons set out below, the Tribunal finds that the treatment accorded to Saluka's investment by the Czech Republic

- (a) was in some respects unfair and inequitable, and
- (b) impaired, by certain unreasonable and discriminatory measures, the enjoyment of such investment by Saluka,

and that the Czech Republic has therefore violated Article 3 of the Treaty.

### A. The Content of the Czech Republic's Obligations under Article 3 of the Treaty

282. Article 3.1 of the Treaty requires the signatory governments to treat investments of investors of the other Contracting Party according to the standards of "fairness" and "equity" and to avoid impairment of such investments by measures which are not in compliance with the standards of "reasonableness" and "non-discrimination". It is common ground that such general standards represent principles that cannot be reduced to precise statements of rules.

283. Even though Article 3.2 sets out, "more particularly", obligations to accord "full security and protection" as well as national and most-favoured-nation treatment, these formulations are merely indicative and are not exhaustive of the scope of the general standards laid down in Article 3.1. Furthermore, a violation of the national and most-favoured-nation treatment obligations is not at issue here, and "full security and protection" is not less general a formulation than the standards set out in Article 3.1.

284. This does not imply, however, that such standards as laid down in Article 3 of the Treaty would invite the Tribunal to decide the dispute in a way that resembles a decision *ex aequo et bono*. This Tribunal is bound by Article 6 of the Treaty to decide the dispute on the

basis of the law, including the provisions of the Treaty. Even though Article 3 obviously leaves room for judgment and appreciation by the Tribunal, it does not set out totally subjective standards which would allow the Tribunal to substitute, with regard to the Czech Republic's conduct to be assessed in the present case, its judgment on the choice of solutions for the Czech Republic's.<sup>16</sup> As the tribunal in *S.D. Myers* has said, the "fair and equitable treatment" standard does not create an "open-ended mandate to second-guess government decision-making".<sup>17</sup> The standards formulated in Article 3 of the Treaty, vague as they may be, are susceptible of specification through judicial practice and do in fact have sufficient legal content to allow the case to be decided on the basis of law. Over the last few years, a number of awards have dealt with such standards yielding a fair amount of practice that sheds light on their legal meaning.<sup>18</sup>

## B. Fair and Equitable Treatment

### 1. Meaning of the Standard

#### a) The Parties' Arguments

285. There is agreement between the parties that the determination of the legal meaning of the "fair and equitable treatment" standard is a matter of appreciation by the Tribunal in light of all relevant circumstances. As the tribunal in *Mondev* has stated, "[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case".<sup>19</sup> There is disagreement between the parties, however, about the limits of such appreciation. These limits are reflected in the threshold that is relevant for the determination of the unlawfulness of the Czech Republic's conduct in the present case.

286. The Claimant argues that the standard is a specific and autonomous Treaty standard. Since it is not in any way qualified, it should be interpreted broadly. The Claimant relies, *inter alia*, on *Pope & Talbot, Inc. v. The Government of Canada*, where the arbitral tribunal stated that guarantees similar to those contained in Article 3 of the Treaty do not limit an investor's recourse to protection only against conduct that is "egregiously unfair", but rather are meant to ensure "the kind of hospitable climate that would insulate them from political risks or incidents of unfair treatment".<sup>20</sup>

287. According to the Claimant, Article 3.1 does not refer to any high threshold of unreasonableness or flagrancy of the conduct constituting a breach and it must be interpreted broadly enough to translate into real and effective protection of the type that would encourage investors to participate in the economy of the host State.

288. The Claimant endorses, however, and commends as a useful guide, even in the present context, the threshold defined by the Tribunal in *Waste Management, Inc. v. United Mexican States*, which held that the fair and equitable treatment standard in Article 1105(1) of the North American Free Trade Agreement ("NAFTA")<sup>21</sup> is infringed if the conduct of the State

is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest

failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.<sup>22</sup>

289. The Respondent argues that the standard laid down in Article 3.1 conforms in effect to the “minimum standard” which forms part of customary international law. The Respondent relies, *inter alia*, on the *Genin* award where the tribunal interpreted the “fair and equitable treatment” standard indeed as “a minimum standard”. The *Genin* tribunal held that:

acts that would violate this minimum standard would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.<sup>23</sup>

290. For the determination of the relevant threshold, the Respondent also refers the Tribunal to the historical development of the customary minimum standard and, in particular, to the *Neer* case where it was held that the treatment of aliens, in order to constitute an international delinquency,

should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would recognize its insufficiency.<sup>24</sup>

The Respondent therefore argues that it is for the Tribunal to determine whether, under the circumstances,

the governmental action in question was willfully wrong, actually malicious, or so far beyond the pale that it cannot be defended among reasonable members of the international community.

291. Whatever the merits of this controversy between the parties may be, it appears that the difference between the Treaty standard laid down in Article 3.1 and the customary minimum standard, when applied to the specific facts of a case, may well be more apparent than real. To the extent that the case law reveals different formulations of the relevant thresholds, an in-depth analysis may well demonstrate that they could be explained by the contextual and factual differences of the cases to which the standards have been applied.

292. Also, it should be kept in mind that the customary minimum standard is in any case binding upon a State and provides a minimum guarantee to foreign investors, even where the State follows a policy that is in principle opposed to foreign investment; in that context, the minimum standard of “fair and equitable treatment” may in fact provide no more than “minimal” protection. Consequently, in order to violate that standard, States’ conduct may have to display a relatively higher degree of inappropriateness.

293. Bilateral investment treaties, however, are designed to promote foreign direct investment as between the Contracting Parties; in this context, investors’ protection by the “fair and equitable treatment” standard is meant to be a guarantee providing a positive incentive for foreign investors. Consequently, in order to violate the standard, it may be sufficient that States’ conduct displays a relatively lower degree of inappropriateness.

294. Whichever the difference between the customary and the treaty standards may be, this Tribunal has to limit itself to the interpretation of the “fair and equitable treatment” standard as embodied in Article 3.1 of the Treaty. That Article omits any express reference to the customary minimum standard. The interpretation of Article 3.1 does not therefore share the difficulties that may arise under treaties (such as the NAFTA) which expressly tie the “fair and equitable treatment” standard to the customary minimum standard.<sup>25</sup> Avoidance of these difficulties may even be regarded as the very purpose of the lack of a reference to an international standard in the Treaty.<sup>26</sup> This clearly points to the autonomous character of a “fair and equitable treatment” standard such as the one laid down in Article 3.1 of the Treaty.

295. Moreover, the Tribunal is not convinced that, as the Respondent suggests, Article 3.1 at least implicitly incorporates the customary minimum standard. The *Genin* case on which the Respondent relies does not support this suggestion. The *Genin* tribunal merely held that a BIT standard of “fair and equitable” treatment provides “a basic and general standard which is detached from the host States’ domestic law”.<sup>27</sup> This standard is characterised by the *Genin* tribunal as “an” international minimum standard, not as “the” international minimum standard. Far from equating the BIT’s standard with the customary minimum standard, the *Genin* tribunal merely emphasised that the “fair and equitable treatment” standard requires the Contracting States to accord to foreign investors treatment which does not fall below a certain minimum, this minimum being in any case detached from any lower minimum standard of treatment that may prevail in the domestic laws of the Contracting States. Also, the way the *Genin* tribunal defined the threshold for the finding of a violation of the “fair and equitable treatment” standard<sup>28</sup> does not incorporate the traditional *Neer* formula<sup>29</sup> which reflects the traditional, and not necessarily the contemporary, definition of the customary minimum standard, at least in certain non-investment fields.

b) The Tribunal’s Interpretation

296. In order to give specific content of the Czech Republic’s general obligation to accord “fair and equitable treatment” to Saluka’s investment in IPB shares, this Tribunal, being established under the Treaty, has to interpret Article 3 in accordance with the rules of interpretation laid down in the 1969 Vienna Convention on the Law of Treaties (the “Vienna Convention”).<sup>30</sup> These rules are binding upon the Contracting Parties to the Treaty,<sup>31</sup> and also represent customary international law. Article 31.1 of the Vienna Convention requires that a treaty is interpreted

in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

i) The Ordinary Meaning

297. The “ordinary meaning” of the “fair and equitable treatment” standard can only be defined by terms of almost equal vagueness. In *MTD*, the tribunal stated that:

In their ordinary meaning, the terms “fair” and “equitable” [...] mean “just”, “even-handed”, “unbiased”, “legitimate”.<sup>32</sup>

On the basis of such and similar definitions, one cannot say much more than the tribunal did in *S.D. Myers* by stating that an infringement of the standard requires

treatment in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.<sup>33</sup>

This is probably as far as one can get by looking at the “ordinary meaning” of the terms of Article 3.1 of the Treaty.

ii) The Context

298. The immediate “context” in which the “fair and equitable” language of Article 3.1 is used relates to the level of treatment to be accorded by each of the Contracting Parties to the investments of investors of the other Contracting Party. The broader “context” in which the terms of Article 3.1 must be seen includes the other provisions of the Treaty. In the preamble of the Treaty, the Contracting Parties

recognize[d] that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment is desirable.

The preamble thus links the “fair and equitable treatment” standard directly to the stimulation of foreign investments and to the economic development of both Contracting Parties.

iii) The Object and Purpose of the Treaty

299. The “object and purpose” of the Treaty may be discerned from its title and preamble. These read:

Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic

The Government of the Kingdom of the Netherlands

And

The Government of the Czech and Slovak Federal Republic,

hereinafter referred to as the Contracting Parties,

Desiring to extend and intensify the economic relations between them particularly with respect to investments by the investor of one Contracting Party in the territory of the other Contracting Party,

Recognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment is desirable.



Taking note of the Final Act of the Conference on Security and Cooperation in Europe, signed on August, 1st 1975 in Helsinki.

300. This is a more subtle and balanced statement of the Treaty's aims than is sometimes appreciated. The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations.

301. Seen in this light, the "fair and equitable treatment" standard prescribed in the Treaty should therefore be understood to be treatment which, if not proactively stimulating the inflow of foreign investment capital, does at least not deter foreign capital by providing disincentives to foreign investors. An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable.

302. The standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations<sup>34</sup> which is the dominant element of that standard. By virtue of the "fair and equitable treatment" standard included in Article 3.1 the Czech Republic must therefore be regarded as having assumed an obligation to treat foreign investors so as to avoid the frustration of investors' legitimate and reasonable expectations. As the tribunal in *Tecmed* stated, the obligation to provide "fair and equitable treatment" means:

to provide to international investments treatment that does not affect the *basic expectations* that were taken into account by the foreign investor to make the investment.<sup>35</sup>

Also, in *CME*, the tribunal concluded that the Czech authority

breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon which the foreign investor was induced to invest.<sup>36</sup>

The tribunal in *Waste Management* equally stated that:

In applying [the "fair and equitable treatment"] standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.<sup>37</sup>

303. The expectations of foreign investors certainly include the observation by the host State of such well-established fundamental standards as good faith, due process, and non-discrimination.<sup>38</sup> And the tribunal in *OEPC* went even as far as stating that

[t]he *stability* of the legal and business framework is thus an essential element of fair and equitable treatment.<sup>39</sup>

304. This Tribunal would observe, however, that while it subscribes to the general thrust of these and similar statements, it may be that, if their terms were to be taken too literally, they would impose upon host States' obligations which would be inappropriate and unrealistic. Moreover, the scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness *in light of the circumstances*.

305. No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. As the *S.D. Myers* tribunal has stated, the determination of a breach of the obligation of "fair and equitable treatment" by the host State

must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.<sup>40</sup>

306. The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.

307. A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment.

308. Finally, it transpires from arbitral practice that, according to the "fair and equitable treatment" standard, the host State must never disregard the principles of procedural propriety and due process<sup>41</sup> and must grant the investor freedom from coercion or harassment by its own regulatory authorities.

#### iv) Conclusion

309. The "fair and equitable treatment" standard in Article 3.1 of the Treaty is an autonomous Treaty standard and must be interpreted, in light of the object and purpose of the Treaty, so as to avoid conduct of the Czech Republic that clearly provides disincentives to foreign investors. The Czech Republic, without undermining its legitimate right to take measures for the protection of the public interest, has therefore assumed an obligation to treat a foreign investor's investment in a way that does not frustrate the investor's underlying

legitimate and reasonable expectations. A foreign investor whose interests are protected under the Treaty is entitled to expect that the Czech Republic will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (*i.e.* unrelated to some rational policy), or discriminatory (*i.e.* based on unjustifiable distinctions). In applying this standard, the Tribunal will have due regard to all relevant circumstances.

## 2. Application of the Standard

310. In applying Article 3 of the Treaty to the present case, the Claimant contends that the Czech Republic has violated the “fair and equitable treatment” standard in Article 3.1 of the Treaty in a number of ways. The Claimant principally contends that

(a) the Czech Republic gave a discriminatory response to the systemic bad debt problem in the Czech banking sector, especially by providing State financial assistance to the other Big Four banks to the exclusion of IPB, and thereby created an environment impossible for the survival of IPB;

(b) the Czech Republic failed to ensure a predictable and transparent framework for Saluka’s investment;

(c) the Czech Republic’s refusal to negotiate with IPB and its shareholders in good faith prior to the forced administration was unreasonable and discriminatory;

(d) the provision by the Czech Republic of massive financial assistance to IPB’s business, once the beneficiary of such assistance had become CSOB following the forced administration, was unfair and inequitable; and

(e) the Czech Republic’s failure to prevent the unjust enrichment of CSOB at the expense of the IPB shareholders, including Saluka, upon the transfer of IPB’s business to CSOB and the aforementioned State aid following the forced administration was equally unfair and inequitable.

311. The Tribunal will examine each of these claims separately.

### a) The Czech Republic’s Discriminatory Response to the Bad Debt Problem

312. The Claimant contends that, whereas the “systemic” bad debt problem which contributed to the serious difficulties of the Czech banking sector from 1998 to 2000 equally affected the Big Four banks (*i.e.* IPB, KB, CS and CSOB), the Czech Republic, in assisting these banks to overcome the problem, treated IPB differently in an unreasonable way which made it impossible for IPB to survive, especially by excluding IPB from the state assistance that was granted to its competitors, and which resulted in Saluka’s loss of its investment.

313. State conduct is discriminatory, if (i) similar cases are (ii) treated differently (iii) and without reasonable justification.

i) Comparable Position of the Big Four Banks regarding the Bad Debt Problem

314. According to the Claimant, the Big Four banks were in a comparable position in terms of their macroeconomic significance in the transitional period of the Czech Republic and their resulting share of the systemic bad debt problem.

315. By 1998 all of them had large non-performing loan portfolios and they were equally suffering from inadequacies of the legal regime for the enforcement of collateral rights. The impact of these bad debts was felt by all of the Big Four banks, although to different degrees. IPB, KB and CS suffered heavily, and only CSOB was relatively better off.

316. Another factor that the Big Four banks had in common was that they were all equally exposed to the increasingly rigorous banking supervision by the CNB and to the prudential standards that were drastically tightened by the CNB in order to bring them into line with the norms of the European Union. These measures resulted in major increases in loan loss provisions which caused losses that, in the longer term, none of these banks was able to absorb by drawing upon shareholder equity. Beyond a certain point the survival of all the banks was dependent upon some form of assistance from the Czech State.

317. The Claimant has put much emphasis on the “systemic” nature of the bad loan problem that affected the Big Four banks from 1998 to 2000. The Claimant has referred in this context to an International Monetary Fund (“IMF”) Report, defining a problem as “systemic” where the affected banks hold, in the aggregate, at least 20% of the total deposits of the banking system.<sup>42</sup>

318. The Respondent has denied that IPB’s position was comparable with the position of the other three of the Big Four banks. Much emphasis is put by the Respondent on the fact that IPB had already been privatised, whereas the State still held large blocks of shares in KB, CS and CSOB. Furthermore, the financial difficulties with which IPB was faced are said to have been caused by mismanagement and irresponsible lending practices. The Respondent has, *inter alia*, referred to a CNB inspection report of 25 February 2000 which had identified serious deficiencies regarding IPB’s internal organisation and operation.

319. The Tribunal is not convinced that the increasing financial difficulties with which IPB was faced and that finally resulted in its forced administration were predominantly due to bad banking management and organisational deficiencies. Even though the irregularities identified in the CNB inspection report of 25 February 2000 were serious and must have to some extent contributed to IPB’s problems, it can hardly be disputed that the bad debt problem still lay at the heart of IPB’s difficulties. In the autumn of 1999 it became abundantly clear that IPB needed more than a correction of the irregularities identified by the CNB. The CNB itself requested a significant increase in IPB’s equity capital. It is therefore not plausible that, had IPB solved the organisational problems identified by the CNB, it would no longer have suffered from its large non-performing loan portfolio and from the insufficiency of its regulatory capital.

320. The expert witnesses introduced by the Respondent have reported a number of differences between IPB and its competitors as far as liquidity, credit rating and business

strategies are concerned. The expert witnesses introduced by the Claimant have, however, questioned the validity of these findings and have arrived at the opposite conclusions. The Tribunal does not find that the evidence placed before it enables it to conclude that IPB differed sufficiently drastically from the other Big Four banks with regard to the risks involved in its lending policies so as to warrant a finding that the financial problems with which IPB was faced could not be attributed predominantly to the bad debt problem that plagued all the Big Four banks equally.

321. The Respondent also disagrees with the Claimant's characterisation of the bad debt problem as being "systemic". According to the Respondent, a "systemic" crisis is one affecting the entire commercial banking industry. The Claimant had not shown, however, that this had been the case. More than fifty of the other Czech commercial banks holding more than 30% of the country's banking assets had not at all been taken into consideration by the Claimant.

322. The Tribunal finds that, irrespective of whether the bad debt problem with which the Big Four banks were faced from 1998 to 2000 may properly be characterised as "systemic" or not, these banks were in a sufficiently comparable situation: All of them had large non-performing loan portfolios resulting in increased provisions and consequently in insufficient regulatory capital. None of them was able to absorb the losses by calling on shareholder equity. The survival of all of them was sooner or later seriously threatened unless the Czech State was willing to provide financial assistance. On the other hand, due to the macroeconomic significance of the Big Four banks, the Czech State apparently could not afford to let any one of these banks fail. And, as set out below, the Czech State did in fact sooner or later provide such assistance to all of them, including IPB after it had been acquired by CSOB. The Czech Government therefore has implicitly recognised that all the Big Four banks were in a comparable situation.

323. Consequently, as far as the Claimant is concerned, Nomura (and subsequently Saluka) was justified in expecting that the Czech Republic, should it consider and provide financial assistance to the Big Four banks, would do so in an even-handed and consistent manner so as to include rather than exclude IPB.

ii) Differential Treatment of IPB Regarding State Assistance

324. In 1997 and 1998 the Czech Government began to develop a strategy of dealing with the bad debt problem at the enterprise level. According to this strategy, the Government would directly finance the forgiveness of the indebted companies and provide guarantees for new loans (the so-called "Revitalisation Programme"). Consequently, the Government took a negative position towards financial assistance for the banking sector. This approach was clearly stated by the Czech Government at the time IPB was privatised (by way of the sale of the State's 36% shareholding to Nomura on 8 March 1998). The Czech Government was, however, careful not to give Nomura any assurance that this policy would never be changed by future Governments with regard to the privatisation of one or other of IPB's competitors.

325. Since the bad debt problem became worse, however, the Czech Government changed its policy and did in fact take a number of steps to assist the other of the Big Four banks to

overcome the financial difficulties with which they were faced. These measures were also deliberately taken in order to prepare IPB's competitors for privatisation. CSOB was privatised in 1999 (by way of a sale of the State's 65.69% shareholding to KBC of Belgium), CS was privatised in 2000 (by way of a sale of the State's 53.07% shareholding to Erste Bank of Austria), and KB was privatised in 2001 (by way of a sale of the State's 60% shareholding to Société Générale S.A.). All three banks had received considerable financial assistance from the Czech Republic before privatisation took place. Without such assistance, privatisation would clearly not have been possible.

326. IPB had also received some financial assistance before its privatisation. After Nomura had acquired its IPB shareholding, however, IPB was excluded as a beneficiary from the Revitalisation Programme as well as from the Czech Government's strategy to solve the bad debt problem of IPB's competitors by the provision of direct financial assistance to the banks. Only in the course of CSOB's acquisition of IPB's business during IPB's forced administration was considerable financial assistance from the Czech Government forthcoming. It follows that IPB has clearly been treated differently.

iii) Lack of a Reasonable Justification

327. The Respondent has argued that this differential treatment of IPB was justified for a number reasons.

328. Firstly, the Respondent argues that Nomura was not given any assurance that its competitors would be privatised in the same way as IPB, *i.e.* without previous support allowing them to get rid of the problems involved in the non-performing loan portfolios.

329. The Tribunal finds that the Claimant's reasonable expectations to be entitled to protection under the Treaty need not be based on an explicit assurance from the Czech Government. It is sufficient that Nomura (and subsequently Saluka), when making its investment, could reasonably expect that, should serious financial problems arise in the future for all of the Big Four banks equally and in case the Czech Government should consider and provide financial support to overcome these problems, it would do so in a consistent and even-handed way.

330. Secondly, the Respondent argues that Nomura (and subsequently Saluka) had no reason to expect that the Czech Government would be willing to alleviate IPB's future problems by providing State financial assistance, since Nomura, having gone through an extensive due diligence, had been aware of the risks involved in acquiring the shareholding in IPB. Nomura is even said to have known before it made its investment that the Czech Government planned to give aid to the other three of the Big Four banks during their privatisation. Nomura had therefore voluntarily assumed these risks and they were reflected in the share price paid by Nomura. Once these risks had materialised, Nomura (and subsequently Saluka) should not be allowed to ask for assistance.

331. On the basis of the available evidence, the Tribunal finds that the Czech Government changed its policy of non-assistance only after Nomura had acquired the shareholding in IPB on March 8, 1998. The earliest hint of such policy change was contained in a letter from the

head of the NPF, Mr Ceska, to the chairmen of the boards of directors of KB, CS and CSOB dated 21 April 1998 which contained the following statement:

We further confirm that, during the period prior to the full privatisation of the banks as aforesaid, we are ready to take such steps within our authority and power as shareholder of each of the banks [to ensure that the banks] comply with all regulatory requirements applicable to them, including capital adequacy and liquidity.

On 27 May 1998 the Government passed the following resolution:

The Government states that it is aware of its responsibility for the financial stability of the joint stock companies CSOB, KB and CS and that it is ready to secure such financial stability until the completion of the privatisation of those joint-stock companies.<sup>43</sup>

332. Furthermore, whatever the scope of Nomura's due diligence may have been, it could not possibly lead to a reliable forecast as to which policies future governments would adopt should an aggravation of the bad debt problem occur as it did after Nomura had made its investment. Therefore, the Claimant cannot be said to have assumed the risk of being treated differently when the Czech Government in fact decided to step in with financial assistance.

333. Thirdly, the Respondent argues that the Claimant was the dominant shareholder of IPB and should therefore itself have rescued IPB by providing the necessary additional capital. The Czech Republic therefore considers itself justified in expecting that the Claimant would have acted as a responsible strategic investor. Also, by providing the necessary financial support to IPB's competitors, the Czech Republic considers itself to have in fact done no more than act as a responsible shareholder. In doing so, the Czech Republic considers itself to have been justified in limiting its assistance to its own banks.

334. The Tribunal finds that Nomura cannot be said to have entered IPB as a strategic investor. Nomura has made it sufficiently clear from the beginning that it came as a portfolio investor acquiring a considerable block of shares with a view to selling it once IPB had improved and the value of its shares had appreciated. The Claimant as a private investor could not reasonably be expected to provide new capital unless this could be done on commercial terms. In this respect the Claimant was in a position similar to an investor acquiring a shareholding in IPB's still-to-be-privatised competitors: unless the bad debt problem was taken care of by financial assistance from the State, no new (or additional) private investment could reasonably be expected in any of the Big Four banks. The Czech Government implicitly recognised this when it provided considerable support to IPB's business upon the acquisition of IPB's business by CSOB.

335. Furthermore, it is less than plausible that, by granting State aid to one or other of the Big Four banks, the Czech Republic acted exclusively as a shareholder. Even though the Government may have expected to secure a better price for the shares when the other banks were privatised, this would not have been a commercially rational conduct. If that had been the motivation, the Czech Republic could just as well have saved the financial resources used for the provision of State aid and sold the shares at a lower price. Recovering the State aid by selling the shares at a higher price would have merely caused additional transaction costs. Anyway, even when acting in its role as a shareholder of IPB's competitors, the Czech

Republic could not at the same time disregard its role as the regulator of the banking sector who was responsible for somehow resolving the bad debt problem with which all the Big Four banks were faced. Consequently, by insisting on its role as shareholder in the other three banks the Czech Republic cannot reasonably justify the differential treatment of IPB. Also, once IPB's business was acquired by CSOB in the course of IPB's forced administration, the Czech Government abandoned its position and did in fact provide considerable financial assistance for IPB's business.

336. Fourthly, the Respondent argues that the financial assistance granted to IPB's competitors was closely linked to the Czech Government's privatisation strategy. The Czech State still held large blocks of shares in KB, CS and CSOB which could have been privatised either on an "as is" basis or after clearing of the non-performing loan portfolios. It is said to have been in the discretion of the Czech State to make this policy choice.

337. It is clearly not for this Tribunal to second-guess the Czech Government's privatisation policies. It was perfectly legitimate for the Government to sell its stakes in the remaining banks only after they had been relieved from the bad debt problem. This, however, did not at the same time relieve the Czech Government from complying with its obligation of non-discriminatory treatment of IPB. The Czech Republic, once it had decided to bind itself by the Treaty to accord "fair and equitable treatment" to investors of the other Contracting Party, was bound to implement its policies, including its privatisation strategies, in a way that did not lead to unjustified differential treatment unlawful under the Treaty.

338. Fifthly, the Respondent argues that, had IPB also received financial assistance, the benefits from clearing the non-performing loan portfolio would have accrued to IPB's private shareholders, whereas in case of the other three of the Big Four banks the benefits accrued to the Czech State itself which at the time was their dominant shareholder. This position is belied by the fact that at the time the Czech Republic granted financial assistance to CSOB after its acquisition of IPB's business, CSOB had already been privatised (by way of a sale of the State's 65.69% shareholding to KBC of Belgium). The policy on which the Respondent relies was therefore at least not consistently implemented and cannot therefore justify IPB's differential treatment.

339. Sixthly, the Respondent has asserted that IPB did not disclose its desire to receive State financial assistance until April 2000. Consequently, Saluka, and indeed IPB, could not now claim that it has been negatively affected by the Czech Republic's failure to provide such assistance.

340. It is undisputed, however, that at least during the autumn of 1999 it was clear that IPB needed an increase of capital to provide for its bad loans and that the CNB expressly requested a significant increase in IPB's equity capital. Also, in the context of the negotiations that took place during the spring of 2000 in order find a solution for IPB, the Czech Government made it known to Nomura on 14 March 2000 that the provision of State aid to IPB was conditional on Nomura injecting new capital into IPB. Nomura, on the other hand, made it known in the course of these negotiations that it was unwilling to provide such capital unless at the same time the Czech State provided adequate financial assistance to IPB. The parties were, however, unable to bridge this gap in their approaches.



341. The Tribunal therefore finds that the Czech Government was fully aware of IPB's need for State assistance at a time when it was still feasible to prevent IPB from failing.

342. Finally, the Respondent argues that IPB's financial problems that ultimately led to its failure and forced administration were due to IPB's own irresponsible business strategy, especially its lending policy. The Respondent therefore denies that the Claimant could legitimately expect a government bailout.

343. The Claimant denies that IPB differed in any significant way from the other Big Four banks, especially CS and KB: neither in terms of the size and the impact of its non-performing loan portfolio or in terms of its credit rating, nor in terms of its liquidity or in terms of the management of its loan portfolio could IPB be said to have been uniquely bad.

344. The Tribunal finds that the size of the non-performing loan portfolios and their impact on the balance sheet was in fact comparable for all the Big Four banks, with the exception, to some degree, of CSOB. Accordingly, the credit ratings of all these banks were equally downgraded in 1998 and the relative improvement of IPB's competitors in 2000 was due to the State aid they had received in the meantime.

345. As far as the Big Four banks' liquidity position until 1999 is concerned, the parties disagree on the criteria that are relevant for a comparison between IPB and its competitors. In principle, liquidity is defined as the sum of assets that can be easily turned into assets that may be used for the payment of debts in relation to total assets. In order to prove that IPB's liquidity position was worse than its competitors', the Respondent relies on the "liquid asset ratio" and the "cash asset ratio". The Claimant, in order to prove that IPB's liquidity position was even relatively better than its competitors', relies on the "quick asset ratio". The Tribunal finds, however, that "quick assets" are not much different from "liquid assets". Consequently, the parties' diverging calculations are less due to the criteria, but rather to their statistical foundations. Whatever the correct liquidity ratios of the Big Four banks from 1998 to early 2000 may have been, the Tribunal is not convinced that different liquidity ratios warranted different treatment with regard to the provision of State financial assistance in order to overcome the bad debt problem.

346. As far as the Respondent's contention relating to IPB's allegedly flawed business strategy and imprudent loan portfolio management is concerned, the Tribunal notes that IPB's competitors (especially CS and KB) proved not to be able to overcome the bad loan problem without financial assistance from the Czech State, even though they allegedly followed a less flawed business strategy and had a more prudent loan management.

347. The Tribunal therefore finds that the Respondent has not offered a reasonable justification for IPB's differential treatment. Consequently, the Czech Republic is found to have given a discriminatory response to the bad debt problem in the Czech banking sector, especially by providing state financial assistance to three of the Big Four banks to the exclusion of IPB, and thereby created an environment impossible for the survival of IPB.

b) Failure to Ensure a Predictable and Transparent Framework

348. The Czech Republic has failed to ensure a predictable and transparent framework for Saluka's investment, if it has frustrated Saluka's legitimate expectations regarding the treatment of IPB without reasonable justifications.

349. The Claimant argues that the Czech Republic has frustrated Saluka's expectations

(a) by contradictory and misleading declarations about its policy towards the banking sector in crisis and by justifying IPB's exclusion from the State aid granted to save the other banks on the grounds that it had already been fully privatised;

(b) by the unpredictable increase of the provisioning burden for non-performing loans; and

(c) by leaving the banks with no effective mechanisms to enforce loan security.

350. The Tribunal will assess the legitimacy and reasonableness of these expectations and, if they were legitimate and reasonable, whether they have been frustrated by the Czech Republic without reasonable justification.

i) Nomura's Expectation that IPB would not be Treated Differently

351. Firstly, Nomura's expectation that the Government would not address the bad loan problem by support to the banks was initially said to have been based on an express assurance to that effect given by the then Minister of Finance. The Claimant has also argued that this was consistent with the obligations undertaken by the Czech Government in their pre-accession agreement with the European Commission (the Europe Agreement) to adhere to European Union norms on State aid. The Claimant has admitted, however, that whatever assurance the Minister of Finance may have given, he could not bind future Governments. Especially, he could not give any assurance that the privatisation of the other banks would proceed in the same way as the privatisation of IPB, *i.e.* without any State financial assistance. Nomura therefore had no basis for expecting that there would be no future change in the Government's policy towards the banking sector's bad loan problem or in the Government's willingness to adhere during the pre-accession period to the rules on State aid in the Europe Agreement.

352. The Claimant insists, however, that Nomura was justified in expecting that, should the Czech Government change its policy and provide State financial assistance to the banks in order for them to overcome the "systemic" problem of bad loans, that solution would itself be "systemic" and thus non-discriminatory. The Claimant contends that the Czech Government has frustrated this expectation by excluding IPB from the financial assistance provided to IPB's competitors. This discriminatory treatment is said to have been unpredictable.

353. The Tribunal notes that this claim is in substance identical with the Claimant's previous claim according to which the Czech Republic has violated the "fair and equitable

treatment” standard by the discriminatory response of the Czech Republic to the bad debt problem in the Czech banking sector. It has therefore already been dealt with in the context of the Claimant’s first claim.

ii) The Unpredictable Increase of the Provisioning Burden for Non-Performing Loans

354. Secondly, the Claimant argues that Nomura’s legitimate expectations have been frustrated by the CNB’s introduction of more stringent prudential rules for the banks. The CNB should rather have taken a “gradualist” approach so that the banks had time to adjust.

355. The Respondent argues that Nomura was aware of some of the CNB’s regulatory amendments at the time the shareholding in IPB was acquired, and others were clearly foreseeable.

356. The Tribunal notes that the increased stringency of the CNB’s prudential rules contributed to the distress suffered by the Czech banking system by forcing the banks to increase provisioning. Consequently, it became even more difficult for the banks to meet the regulatory capital requirements than it had been before due to the bad loan problem.

357. However, the CNB’s policy of tightening the regulatory regime must be seen in the context of the Czech Republic’s preparation for accession to the European Union. It was the CNB’s declared intention to bring its regulatory regime into line with the norms in the European Union. In 1999 a “Twinning Programme” for banking supervision had been launched which was deliberately designed to adjust the Czech regulatory methodology and the practical implementation of banking supervision to European Union standards.<sup>44</sup>

358. It can hardly be disputed that these developments could have been anticipated in 1998. Nomura was, therefore, not justified to expect that the CNB would not introduce a more rigid system of prudential regulation and thereby change the framework for Nomura’s investment in IPB shares. However, Nomura was unable to anticipate the discriminatory way in which the Czech Government responded to the distress suffered by the Czech banking sector, *i.e.* the exclusion of IPB from any State assistance that was granted to the other three of the Big Four banks in order for them to overcome their inability to meet the regulatory capital requirements. This aspect of the Czech Government’s attitude towards the banking sector has, however, already been dealt with in the context of the Claimant’s first claim.

iii) Nomura’s Expectation regarding the Legal Framework for the Enforcement of Loan Security

359. It is undisputed between the parties that Czech Law failed to provide effective mechanisms to enforce loan security. The CNB expressly acknowledged that its tightening of the prudential regulations and the increase of the provisioning requirements were in fact a response to the shortcomings in the legislation to protect creditors in recovering receivables and exercising liens as well as to other institutional shortcomings that were preventing banks in practice from realising real estate pledged as collateral.

360. The Tribunal finds that the aforementioned legal shortcomings must have been known to Nomura when it made its investment. An expectation that such shortcomings would quickly be fixed by the Czech legislature would have been unfounded. Consequently, even though the lack of adequate protection of creditors' rights will most certainly have contributed to the aggravation of the bad debt problem, the Tribunal is unable to find that the Czech Republic has frustrated Nomura's legitimate and reasonable expectations and violated the "fair and equitable treatment" standard by its failure to improve the legal framework within a timescale of help to Nomura.

c) Refusal to Negotiate in Good Faith

361. The Claimant contends that, whereas Saluka and Nomura as well as IPB were actively engaged in seeking a solution to IPB's financial problems, the Czech Government refused to negotiate in good faith on the proposals made by IPB and its shareholders. The Czech Ministry of Finance and the CNB are said to have instead conspired and taken sides with CSOB, which was interested in acquiring IPB's business. While purporting to negotiate with IPB and its shareholders, the Czech Government is said to have acted as an accessory to CSOB's plan to take over IPB's business. According to this plan (the Paris Plan), IPB's business would be transferred to CSOB upon the pretence of forced administration. The Claimant argues that this conduct of the Czech Government was unreasonable and discriminatory.

362. The Respondent argues that the Claimant's proposition is unfounded. The Czech Government had neither engaged in a conspiracy nor taken sides with CSOB to the detriment of IPB and its shareholders. The Respondent denies that there was a premeditated plan (the Paris Plan) to oust IPB from control over its enterprise by transferring it to CSOB by way of IPB's forced administration. The CNB is rather said to have been compelled to impose forced administration because IPB was no longer meeting the regulatory requirements for its banking business. Also, IPB's banking business had to be transferred to CSOB since there was no other strategic investor capable of saving IPB's business and prepared to step in immediately. The Respondent therefore argues that the Czech Government's conduct was reasonable under the circumstances and that it did not in any way imply an unjustifiable discrimination against IPB and its shareholders.

363. The Tribunal's assessment starts from the proposition that the Czech Republic's conduct was unfair and inequitable if it unreasonably frustrated IPB's and its shareholders' good faith efforts to resolve the bank's crisis. A host State's government is not under an obligation to accept whatever proposal an investor makes in order to overcome a critical financial situation like that faced by IPB. Neither is a host State under an obligation to give preference to an investor's proposal over similar proposals from other parties. An investor is, however, entitled to expect that the host State takes seriously a proposal that has sufficient potential to solve the problem and deal with it in an objective, transparent, unbiased and even-handed way.

364. The Claimant has identified a number of elements of the factual record which are said to support the Claimant's proposition that the Czech Government used its power to unilaterally support CSOB in implementing its strategy to acquire the business of IPB to the detriment of IPB and Saluka. The factual details and especially the inferences and conclusions that may be derived therefrom are, however, highly disputed between the parties.

365. In light of the evidence before it, the Tribunal considers it helpful to contrast two intertwined but distinguishable developments during the first half of 2000: the unfolding of CSOB's acquisition of IPB, on the one hand, and the unfolding of the negotiations between IPB and Saluka/Nomura and the Czech Government, on the other.

i) The Developments during the First Half of 2000

(a) The Government's Role in CSOB's Acquisition of IPB

366. By January 2000 it became clear to CSOB that it could implement its strategic objective of expanding into the retail banking sector only by acquiring IPB. CSOB's interest in this acquisition was, if not "discussed" as the Claimant contends, then at least expressed at a meeting of the CEO and Chairman of the Board of CSOB, Mr Kavánek, with the Minister of Finance, Mr Mertlík, as early as 10 January 2000. It is not clear whether further meetings took place in January and February 2000.

367. In March 2000 CSOB retained Consilium Rothchilds and Boston Consulting Group to start preparing a deal structure for acquiring IPB.

368. On 26 April 2000 CSOB prepared a presentation to the Czech Government about its acquisition plans for IPB. This presentation entitled "Discussion Materials" provided an analysis of IPB's situation, CNB's objectives and the "main options" available to the Czech Government, including "do nothing", "self-help" of IPB, "broker a deal with a third party" and "full intervention". The two last options clearly referred to the entry of a strategic partner into IPB, on the one hand, and to forced administration (which was, however, characterised as being generally seen as the last resort) on the other. Since "self-help" was no longer considered a viable option in IPB's circumstances, "broker a deal" was seen as the next best option in persuading the CNB, whereas "full intervention" should remain a "credible potential stick" for IPB/Nomura to facilitate the process.

369. On 30 May 2000 the CEO and Chairman of the Board of CSOB, Mr Kavánek, presented several documents at a meeting held in Paris by the Czech Minister of Finance, Mr Mertlík, the Governor of the CNB, Mr Tošovský, and the President of CSOB's parent company KBC, Mr Remi Vermeiren, who on that day were attending a banking conference. The documents presented by Mr Kavánek, together referred to by the Claimant as "the Paris Plan", set out a "Preliminary approach to the Carthago-India business case"<sup>45</sup> (in which CSOB explained the potential synergies to be expected from a combination of CSOB and IPB), CSOB's "Readiness to act" (in terms of CSOB's readiness and capability to manage the integration of IPB into CSOB) and a "Summary Transaction Structure" (explaining the procedural steps to be taken for the integration of IPB into CSOB).

370. In the two appendices to the latter document, CSOB explained in more detail two alternative strategies for a takeover of IPB: firstly, the "transaction structure to be used in negotiated transaction with India"; secondly, the "transaction structure to be used in forced administration of India". The first "transaction structure" was characterised as not being without legal, political and implementation risk; but it was emphasised that it would "present a potential (and perhaps only [*sic*]) structure which, in light of the options available under

current Czech law, addresses the goal of a rapid transfer of the India business to Carthago”. The second “transaction structure” was characterised as being novel and as not being without legal, political and implementation risk either; it was also emphasised, however, that it would “present a potential (and perhaps only [*sic*]) structure which, in light of the options available under current Czech law, addresses the goals of minimal involvement of the Forced Administrator and of a rapid transfer of the India business to Carthago”.

371. In anticipation of the Paris meeting, the Chairman of the Board of CSOB, Mr Kavánek, had written a letter dated 26 May 2000 to the Minister of Finance expressing his expectation that the Paris meeting would “contribute to additional positive progress in the subject matter”. Nevertheless, the precise nature and content of the talks at the Paris meeting are a matter of dispute between the parties and remain unclear.

372. On 13 June 2000, after the second run on IPB had already set in, the Vicegovernor of the CNB, Mr Niedermayer, acting on behalf of an *ad hoc* working group whose mission was to determine a solution for IPB including a transfer of IPB’s business to a strategic investor, requested CSOB to submit by 9:00 a.m. the next day a “co-operative” proposal for a takeover of IPB.

373. On 14 June 2000 the CEO and Chairman of the Board of CSOB, Mr Kavánek, wrote a letter to the Vicegovernor of the CNB, Mr Niedermayer, setting out a detailed proposal for a takeover of IPB to be negotiated with Nomura. It was clearly stated that State participation in the risks and losses linked with the operation had to be anticipated. The letter stated at the same time, however, that Nomura had declared its lack of interest in the proposal. The Claimant has denied that Nomura had in fact been contacted to discuss the proposal.

374. Also on 14 June 2000 the Director of the State Aid Department of the OPC, Mr Rudolecký, was informed by his superior, Dr Buchta, of the State aid envisaged for IPB/CSOB in case of CSOB’s takeover of IPB’s business. It was anticipated that an exemption from the prohibition of State aid would be necessary.

375. On 15 June 2000 the Czech Government met to assess the situation of IPB. The Cabinet’s deliberations were based on “Materials for the Talks of the Czech Republic’s Government” prepared and submitted by the Minister of Finance, Mr Mertlík, and the Governor of the CNB, Mr Tošovský. The “Materials” took two alternative solutions into consideration: a cooperative solution involving IPB’s shareholders and a non-cooperative solution involving forced administration coupled with a quick sale to a strategic investor. In Appendix No. 3 to the “Materials” the strategic investor was clearly identified as being CSOB. Also, the “Materials” expressly stated that any solution “necessitates a support on the side of the state”.

376. The Claimant contends that only the non-cooperative solution was seriously presented to the Cabinet with CSOB being the only candidate taken into consideration as a strategic investor of IPB. The Respondent insists that the Cabinet was fully briefed on both alternative solutions, including the cooperative solution. In any event the Government, by Resolution No. 622 of 15 June 2000, consented to and recommended the imposition of forced administration upon IPB with the objective of a subsequent sale to CSOB as the strategic investor, the provision of a government guarantee for the assets of IPB in favour of CSOB

and the issuing of government guarantees in favour of the CNB in order to cover the losses resulting from the indemnity to be issued by the CNB in favour of CSOB for the debts assumed from IPB and the losses suffered from the takeover of IPB's business.

377. On 16 June 2000 the CNB decided to introduce forced administration of IPB and appointed Mr Staněk as administrator (*i.e.* a sort of trustee in bankruptcy). Mr Staněk was expressly instructed to “perform all required steps that would result in accelerated sale of the company to [CSOB], being its strategic partner”. He was also promised a “special bonus” for the implementation of this instruction.

378. On 19 June 2000 IPB's business was transferred to CSOB. The Ministry of Finance granted the guarantee envisaged in such Resolution No. 622 of the Government and the CNB signed its promise of compensation for any risk and loss that CSOB had requested. Also, on the same day, the OPC (to which the Government's guarantee and indemnity in favour of IPB/CSOB had been formally notified the day before) issued a decision exempting the State's financial assistance from the legal prohibition of State aid provided by the Public Assistance Act.

(b) The Government's Role in IPB's and Saluka's/Nomura's Attempts to Negotiate a Cooperative Solution

379. Nomura began searching for a strategic partner for IPB in October 1999. It was clear from the beginning that the involvement of the Czech Government would be needed, not only in terms of the various approvals required from the Czech regulatory authorities, but especially in terms of State financial assistance without which private investors would find an investment in IPB unattractive given the finding of the CNB that IPB was massively under-provisioned and had insufficient regulatory capital.

380. Discussions began between representatives of the CNB and the Ministry of Finance, on the one hand, and representatives of IPB and Saluka/Nomura on the other.

381. It appears that the CNB and the Ministry of Finance initially expected a Nomura-led solution, because they assumed that Nomura as IPB's largest shareholder (through Saluka) would try to preserve its investment in IPB and lead the effort to solve IPB's problems either by injecting additional capital into IPB or by identifying a strategic investor for IPB. It transpires from the evidence before the Tribunal that some representatives of the Government and the CNB regarded Saluka/Nomura itself as a *de facto* strategic investor whose responsibility it was to assist IPB in overcoming its difficulties.<sup>46</sup> Nomura has, however, always insisted on its role as a portfolio investor and has made its willingness to rescue IPB dependent upon State financial assistance which the Czech Republic was unwilling to provide in the circumstances.

382. It soon turned out that some foreign financial institutions began to show an interest in becoming a strategic partner of IPB, especially a consortium formed by Allianz and Hypo-Vereinsbank which was later replaced by the UniCredito.

383. In December 1999 Nomura proposed a merger of IPB and CS, since Allianz considered an offer for both IPB and CS. This proposal was rejected by the State, because a public tender for the State's shareholding in CS was already underway and negotiations with Erste Bank of Austria (to which CS was eventually sold) were in their final stages.

384. In February and March 2000 IPB and Nomura developed a proposal for a merger of IPB and KB. This proposal was also rejected by the Government, because it would have led to a combination of two banks both of which required consolidation and substantial assistance.

385. Also in February and March 2000 the Deputy Managing Director of Nomura, Mr Jackson, entered into negotiations with the Vicegovernor of the CNB, Mr Niedermayer, on the draft of a "Memorandum of Understanding on the restructuring of IPB by Nomura in cooperation with shareholders of IPB and with the Czech Republic" ("MOU"). The purpose of the cooperation was said "to combine private sector and public sector resources". Nomura expressly declared its willingness to invest in IPB "on commercial terms applicable to comparable investments by private sector investors", including Nomura's participation in an increase of IPB's capital. It was made equally clear, however, that the CNB and the Ministry of Finance were required to assure State measures of support for IPB, including the purchase of subordinated debt and potentially participating in the capital increase. The Memorandum was finally rejected by the Czech side on the ground that it did not specify any concrete steps that Nomura would take to address IPB's problem and that there was no assurance for the State that its financial input would be spent effectively or would not wind up in the hands of IPB's shareholders or management.

386. On 14 March the Prime Minister of the Czech Republic expressed the view that the provision of State aid to IPB was conditional on Nomura injecting new capital into IPB. Nomura for its part reiterated on 3 April 2000 its unwillingness to address IPB's capital adequacy problems without State support.

387. Sometime in mid-March 2000 the Minister of Finance and the CNB are said to have lost trust in Nomura, *i.e.* confidence that Nomura would be able to come up with a viable solution for IPB. The Minister of Finance refused to meet personally with representatives of Nomura any longer. Instead, he and the Governor of the CNB appointed deputies (Deputy Finance Minister, Mr Mládek, and Vicegovernor of the CNB, Mr Niedermayer) to deal with Saluka/IPB. They were merely provided with a "soft mandate" and could only have unofficial meetings off Ministry premises.

388. On 14 April 2000 IPB submitted to the CNB a draft proposal of "Measures for the Stabilisation of IPB". A revised draft of this proposal was submitted to the CNB in May 2000. It explored various possibilities of rescuing IPB from its untenable situation by "bridging measures" as well as by "stabilisation measures" which included again the idea of merging IPB and KB as well as the search for a strategic partner. In any case, all the solutions explored in the proposal required the State's financial assistance. The proposal envisaged, however, that "as for the principal solution related to the entry of a strategic partner, the requested government assistance should focus on that part of [the] loan and asset portfolio which was created before the IPB privatisation and is comparable with portfolios of KB and CS where the government assistance is being provided". The proposal was rejected as



unacceptable, because it did not give the State sufficient control over the restructuring process.

389. In April and May 2000 Nomura's attempt to find a strategic partner for IPB made some progress. The Allianz/UniCredito consortium's interest became more and more concrete. Finance Minister Mertlík met with representatives of the Allianz/UniCredito consortium who made proposals similar to those made by CSOB, *i.e.* they wished to purchase IPB's assets. On 22 May 2000 UniCredito began due diligence enquiries on IPB and on 26 May 2000 UniCredito in fact proposed to purchase IPB's assets at an opening bid for IPB of CZK 25-30 billion (twice its book value, subject to agreement on the book value) with a possibility of paying more. Allianz/UniCredito made it clear, however, that their willingness to acquire IPB's assets was dependent upon a guarantee and promise of indemnity from the Czech State. Also, Allianz/UniCredito wanted several months to conduct due diligence.

390. At the same time representatives of CSOB also had meetings with Nomura's representatives to discuss CSOB's potential entry into IPB as a strategic partner. CSOB made it clear to Nomura that if IPB wanted Government support, it needed CSOB. However, these discussions led nowhere, because CSOB wanted to take over IPB first and negotiate the terms of the acquisition later. This was (perhaps not surprisingly) unacceptable to Nomura.

391. On 2 May 2000 the Governor of the CNB, Mr Tošovský, expressed in a letter to the Minister of Finance, Mr Mertlík, some dissatisfaction with the negotiations between the Czech Government and Saluka/Nomura. He wrote:

As is well-known to you from a number of working meetings, the CNB, apart from the performance of its legal obligation of banking supervision, has also acted on the grounds of care in regard of the stability of the financial system and together with representatives of the Ministry of Finance and the National Property Fund it entered the talks with the main shareholder of the bank [*i.e.* Saluka/Nomura] and is contributing to the work of a working group whose establishment it initiated some time ago.

The aforesaid work brought about a widening of the awareness of the situation, clarified some opinions and priorities, but has not led as yet to a sufficiently expedite and clear course of action. The problem is not only the slow communication with the main shareholder [*i.e.* Saluka/Nomura], his unclear position at the bank and a certain unwillingness to discuss a specific course of action, but also certain "half-officiality" of communication between the state, the shareholder and the bank at a level other than supervisory.

However, Governor Tošovský also stated in the following terms the basic conditions for a satisfactory solution:

I believe the most necessary is to expedite and refine the works and prevent thereby the creation of still greater costs. For this reason allow me to acquaint you with the foundation and conclusions which I made together with my colleagues in regard to the situation:

- a) regardless of the specific results of the audit or supervision of the CNB at IPB it is possible to believe that without the substantial strengthening of the capital of the bank or a clean-up of assets, the bank will not be able to further exist,
- b) from this point of view it appears to be unlikely that the planned sale of the bank to a new strategic investor is realizable as a commercial transaction without the support of the state.

The letter concluded by setting out three options for action: the stabilisation of IPB by a private entity with the support of the State (the option favoured by the Governor, provided the State would retain a certain control over the whole process), the nationalisation of the bank (an option that was said to involve considerable risk), liquidation or bankruptcy (an option that was characterised as totally undesirable).

392. Shortly thereafter the CNB requested Nomura to approach the Minister of Finance and engage in formal dialogue about the future of IPB. However, letters addressed by Nomura to the Minister of Finance on 5, 8 and 9 May 2000, setting out its willingness to meet the CNB's request for an injection of fresh capital in IPB and to arrange for up to CZK 13.2 billion of new capital for a capital increase, remained without any response from the Minister.

393. Nomura continued its efforts to meet government officials in order to find a solution for IPB. Further letters dated 9, 18 and 24 May 2000 were sent to representatives of the Ministry of Finance and the CNB.

394. On 18 May 2000 Nomura was informed by the Deputy Finance Minister, Mr Mládek, that the Ministry of Finance intended to nationalise IPB and proposed that Nomura should sell Saluka's IPB shares at a symbolic price of 1 euro. Moreover, Mr Racoča for the CNB explained that, if neither IPB nor its shareholders resolved IPB's problems, the CNB would impose forced administration on IPB. Both propositions were not the ones that had been favoured by Governor Tošovský in his aforementioned letter of 2 May 2000 to the Minister of Finance.

395. On 24 May 2000 Nomura submitted to the Prime Minister a further proposal ("Securing future for IPB"). It involved a capital injection by Nomura of CZK 20 billion for a capital increase, a sale of 51% of IPB shares to the Allianz/UniCredito consortium and to CSOB/KBC, and a KoB guarantee of IPB's balance sheet. The same presentation was given to the Deputy Finance Minister, Mr Mládek, on 25 May 2000. On 29 May 2000 Mr Mládek rejected the proposal, the major concern being again that it involved direct aid to IPB without the State having any control over the use of the funds. More precisely, Mr Mládek declared the proposal regarding the guarantee of IPB's balance sheet by KoB to a new commercial bank unacceptable. Instead, Mr Mládek reiterated his proposal that Nomura should sell Saluka's IPB shares at a symbolic price of 1 euro.

396. Nomura subsequently wrote to Mr Mládek suggesting that the Ministry of Finance propose an amendment to Nomura's proposal that would make it acceptable to the Ministry. However, by 31 May 2000, the Ministry had refused to communicate officially with Nomura in order to consider any solution relating to IPB.

397. On 1 June 2000 the Government informed Nomura that State assistance would only be forthcoming if Nomura acquired a 51% stake in IPB (*i.e.* an additional 5%, since Saluka already held 46%).

398. On 2 June 2000 the Government repeated its 1 euro proposal. On 4 and 5 June, Nomura attempted to accommodate that proposal by presenting to the Deputy Finance Minister, Mr Mládek, and the Vicegovernor of the CNB, Mr Niedermayer, three alternative solutions to enable the entry of a strategic investor:

(1) Nomura would procure the transfer of 51% of the shares of IPB to the Government in return for acceptable financial assistance. The purchasing price should be 1 euro for 46.16% (*i.e.* the stake that Saluka already held in IPB) and market price for the remaining shares (which Saluka would have to acquire first). The IPB shares would then be sold for their purchase price to a commercial banking investor that was agreed in advance among the Government, CNB and Nomura. The commercial banking shareholder would recapitalise IPB and take management control on terms agreed in advance.

(2) Nomura would procure the recapitalisation of IPB with CZK 20 billion of new capital in return for acceptable financial assistance. The current and new shares of IPB would then be sold to a commercial banking shareholder who would become a controlling shareholder in IPB. The commercial shareholder would then recapitalise IPB and take management control.

(3) Nomura would procure the sale of 51% shareholder ownership of IPB to the CNB or the Government at fair market value defined as CZK 116 per share, representing the average purchase price of the seller.

None of these proposals was considered acceptable to the Government, mainly because they were seen to involve direct financial assistance by the State in favour of Nomura, or the State's assumption of all of IPB's losses and of the costs of IPB's restructuring.

399. Subsequently, by about 6 June 2000, Nomura was focussing on an asset sale as a solution.

400. On 7 June 2000 the Deputy Finance Minister, Mr Mládek, urged Nomura again to accept the 1 euro proposal, otherwise IPB would be "toast".

401. On Friday, 9 June 2000, the Czech news agency CTK reported the Deputy Finance Minister, Mr Zelinka, to have said that

[c]ompulsory administration makes sense, because talks with a potential investor are at an advanced stage and there is a danger that the bank will go bankrupt in the meantime.

Even though by law compulsory administration does not mean freezing the deposits, Zelinka does not see any other way of protecting the bank from being invaded by its customers.

402. During the run on IPB, which started the following Monday, 12 June 2000, Nomura, on behalf of Saluka, continued to search for a solution. On 14 June 2000 Nomura submitted a new proposal to the Ministry of Finance, the CNB and the Prime Minister (the “IPB Proposal”) that also received the approval of IPB’s Board of Directors and of IPB’s Supervisory Board. According to this proposal, IPB would transfer its banking business to KoB for CZK 1 for on-sale to a long-term commercial banking partner acceptable to the Government (*i.e.* Allianz/UniCredito or CSOB/KBC). The proposal also stated IPB’s readiness to execute the transaction before 16 June 2000.

403. Under this proposal KoB would have provided limited State assistance to accomplish the sale to a strategic partner. The sale proceeds would have been distributed to the Government as reimbursement for the costs of any financial assistance, and any excess would have been shared by IPB and the Government.

404. On 15 June 2000 Nomura’s representatives met with representatives of the CNB and of the Ministry of Finance, including the Deputy Finance Minister, Mr Mládek, to discuss the IPB Proposal. From the Czech side the IPB Proposal was seen to involve serious economic, legal and organisational risks. The Czech Republic’s main concern was the uncertain scope of the IPB assets that would not be covered by the proposed transfer to KoB but rather retained by IPB, especially the assets belonging to IPB’s Tritton Fund. Negotiations continued into the evening and, after their closure, continued by e-mail. The final e-mail concluded by saying that the Ministry of Finance team was “now leaving for home and will continue tomorrow morning”. This left Nomura’s representatives with the impression that the IPB Proposal had been substantially agreed and that the negotiations would continue the next day. That impression proved to be mistaken.

405. On the evening of 15 June 2000 the Government (*i.e.* the Cabinet Presidium) convened and considered IPB’s situation. The materials on which the Cabinet Presidium based its deliberations referred to both cooperative solutions and forced administration. However, the two cooperative solutions (the one relating to Saluka’s sale of its shareholding in IPB to the State and the other relating to IPB’s partial sale of its assets to KoB) were only briefly mentioned. The focus was on the CSOB proposal for forced administration followed by a quick sale to itself as a strategic investor. The Government preferred anyway the imposition of forced administration upon IPB with the objective of a subsequent sale of IPB’s business to CSOB on the terms mentioned before.

406. The Claimant argues that the IPB proposal would have been by far the better deal and the Government has therefore failed to choose the solution with the least cost for the State’s budget. The Respondent insists that after the run on IPB had started and IPB’s liquidity had deteriorated dramatically, forced administration was unavoidable and CSOB was the only bank that was prepared and able in terms of management capacity to step in immediately to rescue IPB’s banking business.

ii) The Tribunal’s Finding

407. In light of all the factual elements relating to the Czech Government’s role in CSOB’s successful acquisition of IPB’s business, and IPB’s as well as Saluka’s/Nomura’s unsuccessful attempts to find a cooperative solution, the Tribunal finds, for the reasons set

out below, that the Czech Republic's conduct towards IPB and Saluka/Nomura in respect of Saluka's investment in IPB shares was unfair and inequitable. In particular, the Ministry of Finance and the CNB unreasonably frustrated IPB's and its shareholders' good faith efforts to resolve the bank's crisis. The Czech Government failed to deal with IPB's as well as Saluka's/Nomura's proposals in an unbiased, even-handed, transparent and consistent way and it unreasonably refused to communicate with IPB and Saluka/Nomura in an adequate manner.

(a) The Lack of Even-Handedness

408. The Czech Government failed to deal with IPB and its shareholder Saluka/Nomura, on the one hand, and CSOB, on the other hand, in an unbiased and even-handed way.

409. It transpires from the evidence before the Tribunal that both CSOB as well as IPB and its shareholder Saluka/Nomura clearly needed the cooperation of the Czech Government in order to implement their plans to acquire IPB's business or find a strategic investor for IPB. The involvement of the Czech Government was indispensable in terms of the various approvals needed from the Czech regulatory authorities as well as in terms of State financial assistance without which neither CSOB nor any other private investor, including Saluka/Nomura, would find an injection of new capital, a strategic investment or a takeover of IPB's business attractive given IPB's financial distress. Moreover, the Allianz/UniCredito consortium had made this point sufficiently clear.

410. It is, however, equally clear that only CSOB met with the degree of responsiveness on the part of the Czech Government which was a prerequisite for a successful search for a strategic investment or a takeover of IPB's business. In particular, the Ministry of Finance and the CNB were always open to receive information about CSOB's plan to acquire IPB, to discuss CSOB's strategy and finally to contribute to its implementation both in terms of granting the necessary regulatory approvals and in terms of massive State financial assistance.

411. In principle, there is nothing wrong with a Government deciding in favour of an investor which is determined, ready and capable of maintaining the business of an important bank suffering serious financial problems such as IPB. It is also very doubtful whether a Government can be said to be under an international legal obligation always to choose the least cost alternative and not to waste taxpayers' money. A Government that is bound by the standard of fair and equitable treatment of foreign investors, however, cannot avoid paying due regard to the good faith efforts of a foreign investor holding a considerable block of shares in the bank to solve the bank's problems.

412. In the case before the Tribunal, the Czech Government was determined at a rather early stage to give preference to CSOB. Since mid-March 2000 – three months before IPB had to be put into forced administration – the Minister of Finance refused further meetings with representatives of Saluka/Nomura thereby indicating that he no longer considered proposals from Saluka/Nomura helpful in solving IPB's problems. The seriousness of any negotiations with IPB or Saluka/Nomura on alternative solutions was thereby undermined relatively early on when there was still time for alternative cooperative solutions. The failure to develop a workable cooperative solution in good time led to a situation where the forced

administration of IPB could be regarded as unavoidable and CSOB could appear as the only choice available for an immediate rescue of IPB's banking business whose failure was imminent.

413. An even-handed dealing with the situation would have required that the Government (*i.e.* the Cabinet Presidium) in its meeting on the evening of 15 June 2000 had paid the same attention to the two cooperative solutions proposed by Nomura (the one relating to Saluka's sale of its shareholding in IPB to the State and the other relating to IPB's partial sale of its assets to KoB) as was paid to the non-cooperative solution favoured in the meantime by CSOB. The Tribunal is sufficiently satisfied that in fact the contrary had happened: the cooperative solutions involving Nomura and IPB were not seriously considered because at this point they appeared to the Cabinet Presidium not satisfactory for whatever reasons, whereas it had already been decided that the forced administration and the subsequent transfer of IPB's business to CSOB was the Government's first choice. The Tribunal notes that, the day before the Cabinet meeting (*i.e.* on 14 June 2000), the Director of the State Aid Department of the OPC, Mr Rudolecký, had already been informed by his superior, Dr Buchta, of the financial assistance envisaged for IPB/CSOB in the event of CSOB's takeover of IPB's business, because the Government anticipated that an exemption from the prohibition of State aid would be necessary.

414. Furthermore, the Forced Administrator was not left with his usual discretion to find the most appropriate solution for IPB's future based on an objective and unbiased assessment of all relevant factors. Instead he was instructed by the Government to implement immediately the transfer of IPB's business to CSOB and he was even provided a financial incentive to follow exclusively the Government's instruction.

415. A crucial element in the Czech Republic's preferential treatment of CSOB was once again the Government's willingness to support CSOB's acquisition of IPB's business by granting massive State aid while at the same time refusing to provide similar support for the implementation of the proposals originating from IPB or its shareholder Saluka/Nomura.

416. The justifications offered by the Government for its uneven treatment of IPB and Saluka/Nomura, on the one hand, and CSOB, on the other hand, are unconvincing. The Government's position was largely based on the misconception that Saluka/Nomura was a *de facto* strategic investor in IPB and was therefore itself responsible for solving IPB's problem by injecting new capital. Nomura, however, had always made it clear that this was not so, that Nomura had entered IPB rather as a portfolio investor and that the Government was not justified in imposing upon Nomura a shareholder's responsibility that was unfounded. Furthermore, when CSOB planned its takeover of IPB's business, it did not consider entering IPB as a strategic investor either, but nevertheless successfully relied on the Government's willingness to provide financial assistance to overcome IPB's financial problem.

(b) The Lack of Consistency

417. The Czech Government's conduct was also characterised by inconsistencies which made it difficult or even impossible for IPB and Saluka/Nomura to accommodate their proposals to the Government's position.

418. IPB's and Saluka's/Nomura's requests for State assistance were always part of their various proposals. Yet, the Czech Government took varying, sometimes even contradictory positions. Basically, the Government's position was that it was Saluka's/Nomura's own responsibility to rescue IPB without any State aid. The MOU on which Nomura had negotiated with the Vicegovernor of the CNB, Mr Niedermayer, in February and March 2000 was, however, aborted on the grounds that there was no assurance for the State that its financial input would be spent effectively or would not wind up in the hands of IPB's shareholders or management. This reasoning implicitly acknowledged at least in principle that State aid was needed for the rescue of IPB, an acknowledgement that was later even expressly stated in the letter from the Governor of the CNB, Mr Tošovský, addressed to the Minister of Finance, Mr Mertlík, on 2 May 2000. On 14 March 2000 the Prime Minister expressed the view that the provision of State aid to IPB was conditional on Nomura injecting new capital: not only was this a suggestion that had in principle always been part of Saluka's/Nomura's own proposals, but it demonstrated that the provision of State aid for IPB was by no means excluded in principle. IPB's draft proposal of "Measures for the Stabilisation of IPB" submitted to the CNB on 14 April 2000 made an attempt to accommodate the request for State financial assistance to the Government's concern that the State would bail out IPB for losses caused after its privatisation by its own imprudent loan policy: the proposal limited the request for State aid to that part of the bad loan portfolio which was created before the privatisation. The proposal was nevertheless rejected. On 1 June 2000 the Government took another turn and informed Nomura that State assistance would be forthcoming, if Nomura acquired a 51% stake in IPB (*i.e.* an additional 5%, since Saluka already held 46%).

419. Moreover, the Czech Republic acted rather inconsistently in its overall communications with IPB and Saluka/Nomura. The MOU on which Nomura had negotiated with the Vicegovernor of the CNB in February and March 2000 was designed to lead to a mutually satisfactory solution still to be determined in detail. Before that could be achieved, however, the "Memorandum" was already aborted on the grounds that it did not specify any concrete steps that Nomura would take to address IPB's problem. Furthermore, since mid-March 2000, the Minister of Finance had refused to meet Saluka's/Nomura's representatives because he had lost confidence in Nomura's ability to develop a solution for IPB, but at the same time he kept the channel for communication formally open by appointing deputies to deal with Saluka/Nomura and IPB on the basis of a "soft mandate" off the Ministry's premises.

(c) The Lack of Transparency

420. The Czech Government's exchange of views with Saluka/Nomura and IPB on possible solutions for IPB also lacked sufficient transparency to allow Saluka/Nomura and IPB to understand exactly what the Government's preconditions for an acceptable solution were.

421. Saluka/Nomura and/or IPB made various proposals all of which the Czech Government simply rejected with varying reasons.

422. Some of the reasons, however, were not totally unfounded. Thus, Nomura's December 1999 proposal of a merger of IPB and CS as well as IPB's and Nomura's proposal for a merger of IPB and KB were rejected on acceptable grounds.

423. The MOU, however, which Nomura had negotiated with the Vicegovernor of the CNB in February and March 2000, was said to lack specific steps that Nomura would take to address IPB's problem, even though the specification of such steps was the very objective of the ongoing negotiations. The Government failed to respond in any constructive way. IPB's proposal of 14 April 2000 submitted to the CNB was refused because it allegedly did not give the State sufficient control over the restructuring process. The proposal submitted on 24 May 2000 to the Prime Minister was rejected on the grounds that it involved direct aid to IPB without the State having any control over the use of the funds.

424. Nomura's proposals of 4 and 5 June 2000, which were designed to lead to the entry of a strategic investor, attempted to accommodate the Government's proposal of 1 June 2000 as well as its 1 euro proposal. They were nevertheless rejected on the grounds that they involved direct financial assistance from the State in favour of Nomura or the State's assumption of all of IPB's losses and of the costs of IPB's restructuring, even though the Governor of the CNB, Mr Tošovský, had already stated in his letter of 2 June 2000 to the Minister of Finance, Mr Mertlík, that a sale of IPB to a new strategic investor was not realizable without the support of the State.

425. Nomura's last proposal of 14 June 2000 also sought to accommodate the 1 euro proposal by offering a partial sale of IPB's assets to KoB for 1 CZK (for on-sale to a strategic investor such as Allianz/UniCredito or CSOB/KBC). The next day representatives of the CNB and of the Ministry of Finance began even to negotiate this proposal with Nomura's representatives and led them to believe that negotiations would be continued the next day, the main point for further clarification being the specification of IPB's assets that would not be covered by the transfer to KoB. This proposal was aborted by the supervening imposition of forced administration upon IPB.

(d) The Refusal of Adequate Communication

426. In light of the serious difficulties IPB was in and the urgency of finding a solution that would rescue IPB, the Czech Government's refusal to actively engage in constructive and direct negotiations with IPB and its major shareholder Saluka/Nomura was unreasonable. There could not have been any doubt that any cooperative solution necessarily made Saluka's/Nomura's involvement indispensable.

427. From mid-March onwards – three months before forced administration was imposed upon IPB – the Minister of Finance, Mr Mertlík, simply gave up communicating directly with IPB's major shareholder Saluka/Nomura. He downgraded the Ministry's communication with Saluka/Nomura to the Deputy level while at the same time he continued communicating personally with the CEO and Chairman of the Board of Directors of CSOB, Mr Kavánek.

428. Even on the Deputy level, communication with Saluka's/Nomura's representatives was not allowed on the premises of the Ministry of Finance.

429. Letters addressed by Nomura to the Minister of Finance on 5, 8 and 9 May 2000, setting out Nomura's willingness to meet the CNB's request for an injection of fresh capital and to arrange for up to CZK 13.2 billion of new capital for a capital increase in IPB simply remained without any response from the Minister.



430. Nomura nevertheless continued its efforts to meet Government officials, although with only limited success. Instead of engaging in meaningful negotiations, Nomura was confronted with the possibility of IPB's nationalisation or forced administration and with the 1 euro proposal.

431. On 31 May 2000, one day after the Minister of Finance, Mr Mertlík, had met with the CEO and Chairman of the Board of Directors of CSOB, Mr Kavánek, in Paris, official communication with Saluka/Nomura was discontinued even on the Deputy level. Saluka's representative, Mr Dillard, had to meet informally with Deputy Minister of Finance, Mr Mládek, in a wine bar.

432. Official communication was resumed on 15 June 2000 in order to discuss Nomura's last proposal. The Tribunal is very doubtful whether these discussions between Nomura's representatives and representatives of the CNB and of the Ministry of Finance were seriously meant as a last-minute effort of the Czech Government to find a cooperative solution. The OPC had already been informed the day before of the imminent takeover of IPB's business by CSOB. Already on 9 June 2000 the Deputy Minister of Finance, Mr Zelinka, had indicated to the Czech news agency CTK that forced administration of IPB was unavoidable.

d) Provision of Financial Assistance to IPB after Acquisition by CSOB

433. The Claimant argues that the Czech Republic acted in violation of the "fair and equitable treatment" standard by illegally granting massive financial assistance to IPB's business, once the beneficiary of such assistance had become CSOB following the forced administration.

434. On 19 June 2000 the Ministry of Finance, following the Government's Resolution No. 622 of 15 June 2000, issued an unlimited and unconditional guarantee of all on- and off-balance sheet assets transferred to CSOB, and the CNB entered into an agreement with CSOB under which the CNB promised to indemnify CSOB for certain other potential risks in connection with the acquisition of IPB's business. The transaction implemented by the Forced Administrator therefore conveyed to CSOB a fully guaranteed bank without requiring any substantial payment for its franchise value.

435. The Claimant, relying on the expert evidence of Professor Piet Jan Slot, contends that the Government Guarantee and the CNB indemnity were State aids provided in contravention of the Czech Public Assistance Act and in breach of the Czech Republic's obligations under the Europe Agreement, concluded between the European Communities and the Czech Republic on 4 October 1993.<sup>47</sup> Article 64 of that Agreement provided:

- (1) The following are incompatible with the proper functioning of the Agreement, in so far as they may affect trade between the Community and the Czech Republic:

...

- (iii) any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.

436. The OPC's decision of 19 June 2000 exempted the Government's financial assistance for CSOB/IPB from the legal prohibition of State aid, on the grounds that it was "restructuring aid" and especially aid to remedy a "serious disturbance" in the Czech economy consistent with the Europe Agreement as interpreted by the EC Commission in its Guidelines on Rescue and Restructuring Aid. The validity of that decision is questioned by the Claimant, in particular, on the grounds that the assistance did not properly qualify as "restructuring aid" or aid to remedy a "serious disturbance", and that the OPC lacked independence and had also violated the procedural rules of the Public Assistance Act. Furthermore, the Government is said to have illegally implemented its aid for CSOB/IPB before the OPC's exemption decision came into effect.

437. The Claimant has also emphasised that the exemption decision was in any case conditional upon the Ministry of Finance subsequently submitting to the OPC (i) by 19 September 2000 a restructuring plan for IPB; (ii) by 19 September 2000 preliminary information concerning the amount of assistance provided under the Government Guarantee; and (iii) by 19 December 2000 final information concerning the assistance. The Ministry of Finance is said to have failed to comply with the last of these Conditions and to have thereby committed another breach of the Public Assistance Act which was not adequately penalised by the OPC.

438. The Claimant argues that the Czech Republic, by providing illegal State aid and by failing to implement procedural rules giving effect to violations of the prohibition of State aid, violated its international Treaty obligation under the Europe Agreement thereby establishing a *prima facie* violation of the "fair and equitable treatment" standard in Article 3.1 of the Treaty.

439. The Respondent, relying on the expert testimony of Professor Dr Jürgen Basedow, contested the subject matter jurisdiction of the Tribunal as far as the application of the substantive rules on State aid of the Europe Agreement are concerned. Since the Europe Agreement's substantive provisions are not "directly applicable" (self-executing), it is said to be not for this Tribunal to assess the legality of the Czech Government's financial assistance for CSOB/IPB under the Europe Agreement. The Tribunal is said to be only competent to assess the procedural legality of that assistance.

440. In any case, the OPC is said to have been justified in exempting the Government's financial assistance as "restructuring aid" and as a remedy for a "serious disturbance". Also, the State aid could have been exempted as indirect investment aid or operating aid in accordance with the EC Commission's Guidelines on national regional aid. The Claimant's criticism is therefore said to be unfounded.

441. The Tribunal finds, for the reasons set out below, that the Claimant's claim is without merit. The Czech Government's provision of State financial assistance to CSOB/IPB, *i.e.* upon the acquisition of IPB's business by CSOB subsequent to the imposition of forced administration upon IPB, did not amount to a breach of Article 3.1 of the Treaty.

442. The unlawfulness of a host State's measures under its own legislation or under another international agreement by which the host State may be bound, is neither necessary nor sufficient for a breach of Article 3.1 of the Treaty. The Treaty cannot be interpreted so as to penalise each and every breach by the Government of the rules or regulations to which it is subject and for which the investor may normally seek redress before the courts of the host State.

443. As the tribunal in *ADF Group Inc.* has stated with regard to the "fair and equitable treatment" standard contained in Article 1105(1) NAFTA:

something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements....<sup>48</sup>

Quite similarly, the *Loewen* tribunal stated in the same legal context that

whether the conduct [of the host State] amounted to a breach of municipal law as well as international law is not for us to determine. A NAFTA claim cannot be converted into an appeal against decisions of [the host State].<sup>49</sup>

444. The Czech Government's conduct of which the Claimant is complaining must therefore be assessed in light of the Treaty's own "fair and equitable treatment" standard. Consequently, the Tribunal does not find it necessary to determine the legality of the financial assistance given to CSOB/IPB under Czech national law or under the Europe Agreement. The only relevant question is whether the Czech Government's provision of financial assistance to CSOB/IPB constituted unfair and inequitable treatment of Saluka irrespective of whether it was in compliance with the Czech Public Assistance Act or the Europe Agreement.

445. The "fair and equitable treatment" standard cannot easily be assumed to include a general prohibition of State aid. Financial assistance is a tool used by States to implement their commercial policies. Even though it tends to distort competition and to undermine the level playing field for competitors, States cannot be said to be generally bound by international law to refrain from using this tool. According to States' treaty practice, prohibitions of State aid are explicitly stated and defined in international agreements such as the Europe Agreement. A similar prohibition cannot be read into general principles such as the "fair and equitable treatment" standard. Consequently, an investor cannot claim to be generally protected against the host State providing State aid to its competitors.

446. Having said this, the Tribunal also emphasises that the host State, in providing State aid, is clearly bound not to frustrate an investor's legitimate and reasonable expectation to be treated fairly and equitably. The host State is therefore obliged to provide financial assistance to firms or industries in a way that does not amount to an unfair or inequitable treatment of a foreign investor. In particular, the provision of State aid to specific firms or industries must not be discriminatory or unreasonably harmful for the foreign investor.

447. In the case before the Tribunal, the Czech Government's guarantees and indemnities in favour of CSOB/IPB were part of the overall transaction whereby IPB's banking business

was transferred to CSOB subsequent to the imposition of forced administration upon IPB. At the time the financial assistance was implemented, IPB had already lost its banking business to CSOB. It is therefore not conceivable that, due to the State aid provided for CSOB/IPB, IPB and its shareholders could have suffered harm in addition to the harm that had already been caused by the forced administration and the subsequent loss of the banking business. After the takeover of IPB's banking business by CSOB, IPB was no longer a competitor of CSOB who's competitive position could be undermined by the State aid provided by the Czech Government.

e) Unjust Enrichment of CSOB at the Expense of Saluka

448. The Claimant contends that the Czech Republic failed to prevent the unjust enrichment of CSOB at the expense of the IPB shareholders including Saluka upon the transfer of IPB's business to CSOB and the provision of the aforementioned State aid following the forced administration.

449. The concept of unjust enrichment is recognised as a general principle of international law.<sup>50</sup> It gives one party a right of restitution of anything of value that has been taken or received by the other party without a legal justification. As the Iran-United States Claims Tribunal has stated more specifically:

There must have been an enrichment of one party to the detriment of the other, and both must arise as a consequence of the same act or event. There must be no justification for the enrichment, and no contractual or other remedy available to the injured party whereby he might seek compensation from the party enriched.<sup>51</sup>

450. If it is assumed that the "fair and equitable treatment" standard also includes the general principle of unjust enrichment, an investor would therefore also be protected by this standard against unjust enrichment by the host State.

451. In the case before the Tribunal, the question would be whether the Czech State has, by means of the transfer of IPB's business to CSOB and the provision of the aforementioned State aid following the forced administration, taken or received anything of value at the expense of Saluka. For the reasons set out below, the Tribunal would answer this question in the negative.

452. Firstly, it was not the Respondent which received the banking business from IPB, but CSOB. Even though the Czech State was still a (minority) shareholder of CSOB, CSOB cannot be equated with the Czech State. It is a general principle of company law that a company is a legal entity separate from its shareholders. The corporate assets are owned by the company itself, not by the shareholders. The concept of piercing the company's veil would be totally inapposite in this context. Anything acquired by CSOB from IPB was therefore not acquired by the Respondent.

453. Secondly, it was IPB's and not the Claimant's banking business that was transferred to CSOB. IPB's assets were owned by IPB itself, not by its shareholders. Again, the concept of the separateness of the company from its shareholders prevents the Tribunal from equating IPB and Saluka. Consequently, CSOB did not receive anything at the expense of Saluka.

454. The Claimant has in fact acknowledged that the transfer of IPB's business to CSOB resulted in the enrichment, if any, of one private entity at the expense of another. The Claimant has also argued, however, that in order for the Czech Republic to become liable towards Saluka it is sufficient to establish that the Czech Republic actively participated in a conspiracy to enrich one private party at the expense of another by using regulatory powers to effect an illegal transfer of ownership in IPB's business.

455. The Tribunal finds that the Claimant's argument is legally not well founded. It stretches the principle of unjust enrichment beyond its proper scope. The notion of one party being an accessory to an unjustified transfer between two other parties is not part of the concept of unjust enrichment. Even though, according to the Claimant, it is well established in the general international law of State responsibility for wrongful acts, especially in case of unlawful expropriation, that the ultimate beneficiary of the wrongful act of the State need not be the State itself, the Tribunal has not been convinced that this holds true for the principle of unjust enrichment.

456. Since there was no enrichment of the Respondent to the detriment of the Claimant, the Tribunal does not consider it necessary to assess the legal justification of the transfer of IPB's business to CSOB at any length. Suffice it to say that the transfer was based on the Sale Agreement between the Forced Administrator of IPB, and CSOB. It cannot be for this Tribunal to question the validity of this agreement as long as it has not been invalidated by a competent court or tribunal. Questionable as the circumstances surrounding the Sale Agreement may be, it provides, within the context of the principle of unjust enrichment, a sufficient legal justification for the transfer of IPB's banking business to CSOB.

### C. Non-Impairment

457. The legal basis of the Claimant's claims is not limited to the "fair and equitable treatment" standard contained in Article 3.1 of the Treaty but includes the non-impairment obligation contained in the same provision. Article 3.1 of the Treaty provides that:

[W]ith reference to the investments of investors of the other Contracting Party, each Contracting Party . . . shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.

It is for the Tribunal therefore, to determine whether the Czech Republic has, by certain measures, violated this obligation.

#### 1. Meaning of the Standard

458. "Impairment" means, according to its ordinary meaning (Article 31 of the Vienna Convention on the Law of Treaties), any negative impact or effect caused by "measures" taken by the Czech Republic.

459. The term "measures" covers any action or omission of the Czech Republic. As the ICJ has stated in the *Fisheries Jurisdiction Case (Spain v. Canada)*

[I]n its ordinary sense the word is wide enough to cover any act, step or proceeding, and imposes no particular limit on their material content or on the aim pursued thereby.<sup>52</sup>

460. The standard of “reasonableness” has no different meaning in this context than in the context of the “fair and equitable treatment” standard with which it is associated; and the same is true with regard to the standard of “non-discrimination”. The standard of “reasonableness” therefore requires, in this context as well, a showing that the State’s conduct bears a reasonable relationship to some rational policy, whereas the standard of “non-discrimination” requires a rational justification of any differential treatment of a foreign investor.

461. Insofar as the standard of conduct is concerned, a violation of the non-impairment requirement does not therefore differ substantially from a violation of the “fair and equitable treatment” standard. The non-impairment requirement merely identifies more specific effects of any such violation, namely with regard to the operation, management, maintenance, use, enjoyment or disposal of the investment by the investor.

462. The term “investment” is defined in Article 1 of the Treaty so as to include, *inter alia*, shares, bonds and other kinds of interests in companies [...], as well as rights derived therefrom.

As the Tribunal has already stated earlier, Saluka’s shareholding in IPB clearly is an “investment” in this sense.

463. It will transpire from the application of the non-impairment standard to the facts of this case that among the various objects of a potential impairment listed in Article 3.1 of the Treaty only Saluka’s “enjoyment” of its investment appears to be relevant in the present context. “Enjoyment” means, *inter alia*,

[t]he exercise of a right [...] [which] includes the beneficial use, interest and purpose to which property may be put, and implies right to profits and income therefrom.<sup>53</sup>

## 2. Application of the Standard

464. Three different sets of facts need to be assessed in light of the non-impairment obligation:

(a) first, the facts that have given rise to the Tribunal’s findings of violations of the “fair and equitable treatment” standard contained in Article 3.1 of the Treaty;

(b) second, the facts on which the Claimant has based its deprivation claim under Article 5 of the Treaty;

(c) third, the facts relating to the second run on IPB which subsequently led to the forced administration of IPB.

The Tribunal will assess these three sets of facts separately.

a) The Facts Underlying the Violations of the “Fair and Equitable Treatment” Standard (Article 3.1 of the Treaty)

465. The Tribunal finds that the Czech Republic, by violating the “fair and equitable treatment” standard of Article 3.1 of the Treaty, at the same time violated its non-impairment obligation under the same provision.

466. The Czech Republic, by

(i) giving a discriminatory response to the bad debt problem in the Czech banking sector, especially by providing State financial assistance to three of the Big Four banks to the exclusion of IPB and thereby creating an environment impossible for the survival of IPB, and

(ii) by refusing to negotiate in good faith on the proposals made by IPB and its shareholders,

impaired the “enjoyment” of Saluka’s investment, *i.e.* the shareholding in IPB.

467. There can be no doubt that the Czech Republic’s discriminatory response to the bad debt problem in the Czech banking sector and its unfair and inequitable treatment of IPB regarding the provision of State aid as well as its refusal to negotiate in good faith on the proposals made by IPB and its shareholders for the rescue of IPB had a detrimental impact upon IPB and Saluka’s shareholding in IPB. The unlawful conduct of the Czech Government contributed to the aggravation of IPB’s financial distress and to its subsequent failure and thereby impaired Saluka’s beneficial use of and interest in its shareholding in IPB.

b) The Facts Underlying the Deprivation Claim (Article 5 of the Treaty)

468. The Claimant’s allegation that the Czech Republic has, by certain measures, unlawfully deprived Saluka of its investment in IPB also includes the allegation that the Czech Republic has, by the same measures, impaired the operation, management, maintenance, use, enjoyment or disposal of Saluka’s investment in IPB. A “deprivation” is most certainly at the same time an “impairment”.

469. In order for the Tribunal to find in favour of the Claimant, the “measures” assessed in light of Article 5 of the Treaty must be shown, in the context of Article 3.1 of the Treaty, to have been “unreasonable or discriminatory”.

470. As far as the Claimant’s allegation of an unlawful impairment of Saluka’s investment by the Czech Government’s imposition of forced administration upon IPB is concerned, the reasons which led the Tribunal, in the preceding Chapter of this Award, to find that the “deprivation” of Saluka’s investment caused by the forced administration was lawful and that the Czech Republic did not violate Article 5 of the Treaty also lead the Tribunal to find that the “impairment” of Saluka’s investment by the same measure was lawful as well and that the

Czech Republic did not violate Article 3.1 of the Treaty in this respect either. Since in the context of Article 5, the “deprivation” of Saluka’s investment by the imposition of forced administration upon IPB was justified on reasonable regulatory grounds, the same applies *a majore ad minus* to the “impairment” of Saluka’s investment in the context of Article 3.1. In other words: to the extent that the concepts of “deprivation” and “impairment” overlap, because a “deprivation” is just one variety of possible “impairments”, the regulatory power exception (or “police power exception”) explained in the previous Chapter of this Award applies to both.

c) The Czech Government’s Alleged Triggering of the Second Run on IPB

471. The Claimant contends that the second run on IPB, which began on 12 June 2000 and which led directly to the imposition of forced administration upon IPB, was triggered by the Czech Government’s leaks of information. The Respondent has denied any such leaks. The details are highly controversial.

472. The Tribunal finds, for the reasons set out below, that the Government did in fact unreasonably spread negative information on IPB to the public and that this contributed to the aggravation of IPB’s financial distress and to its subsequent failure.

473. According to the evidence before the Tribunal, the following appears to be undisputed: In May 2000 IPB submitted to the CNB its revised draft proposal of “Measures for the Stabilisation of IPB”. Shortly thereafter, the Czech newspaper *Mladá Fronta DNES* reported that:

According to a highly reliable source, the central bank received a document titled “Measures for stabilisation of IPB” where the managers of the bank, among others things, propose the transfer of bad debts to the State-owned Konsolidacni banka.

The source quoted in the newspaper was the CNB.

474. On 8 June 2000 Dow Jones Newswires reported that

a source in the central bank [has told] [there was] a “fifty-fifty” chance forced administration will occur [at IPB].

475. According to the Claimant, on 9 June 2000 the Czech news agency CTK reported the Deputy Finance Minister, Mr Zelinka, as having said that

[c]ompulsory administration makes sense, because talks with a potential investor are at an advanced stage and there is a danger that the bank will go bankrupt in the meantime.

Even though by law compulsory administration does not mean freezing the deposits, Zelinka does not see any other way of protecting the bank from being invaded by its customers.



476. On 10 June 2000 *Mladá Fronta DNES* wrote:

According to reliable sources at the central bank, IPB does not have adequate reserves to cover losses from bad loans ... in such a case, the current status of IPB may lead to the withdrawal of its banking licence.

An undisclosed source from the ministry [of Finance] ... said that the intent is to cut off the existing shareholders from any influence on the operations of the bank.

...

The State has two possibilities for nationalisation of the bank and continuation of operations. It either acquires the majority share from Nomura, or takes over control of the bank via imposing forced administration.

...

“Both variants are possible”, said a source from the ministry that is a party to the negotiations. After the taking over control of the bank and an expensive cleaning up of its portfolio, it is to be sold to a strategic partner. Among the interested parties are, for example, CSOB or Italian Unicredito.

However, Nomura for the present does not want to accept the proposal to assign the shares to the State at a symbolic price of 1.- CZK, since it doesn't want to participate in the stabilisation of the bank.

477. As will be recalled, on 12 June 2000 the second run on IPB began.

478. None of the aforementioned press reports was in any way misstating the situation. Almost all of them contained a clear indication that forced administration of IPB was imminent. All of the reported information was said to have been received from Government sources.

479. The Respondent, by contending that there had been numerous press articles about the bank, some reporting publicly available information in ways that could easily create public panic or cause depositors to begin to make withdrawals, implicitly admits that there have also been press articles reporting confidential information that was not publicly available. There is even reason to believe that certain information was deliberately leaked to the press by “sources” in the CNB and the Ministry of Finance.

480. The crucial question for the Tribunal to determine relates to causation: was the publication of the information referred to a *conditio sine qua non* for IPB's forced administration? The nature of the information was such that IPB's customers could become seriously concerned about the safety of their savings deposited with IPB and start to withdraw their deposits. On the other hand, it is inconceivable that the public was not already to some degree aware that IPB had problems with its bad loan portfolio. It was one thing, however, for the public to have known of IPB's distress in general terms; it was quite another for the public to have been informed that the failure of IPB was imminent and forced administration

unavoidable, as stated by the Deputy Finance Minister, Mr Zelinka, on 9 June 2000 (*i.e.* on the Friday before the Monday when the second bank run set in).

481. Furthermore, there is some indication that the Government “sources” deliberately engineered the circulation of negative information about IPB in order to precipitate IPB’s failure. Mr Zelinka’s statement of 9 June 2000 may well be interpreted in this sense. Once forced administration was publicly stated to be unavoidable, that statement became a self-fulfilling prophecy, because the bank run was certain to set in the following Monday. This conduct of the Government was unjustifiable and unreasonable and contributed in all probability to the unsustainability of IPB’s situation. The Respondent has provided no convincing evidence to the contrary.

#### D. Full Security and Protection

482. The Claimant has argued that the Czech Republic has also violated its obligation under Article 3.2 of the Treaty which “more particularly” provides that each Contracting Party shall accord to the investments of investors covered by the Treaty “full security and protection”.

##### 1. Meaning of the Standard

483. The “full protection and security” standard applies essentially when the foreign investment has been affected by civil strife and physical violence.<sup>54</sup> In the *AMT* arbitration, it was held that the host State “must show that it has taken all measures of precaution to protect the investments of [the investor] in its territory”.<sup>55</sup>

484. The standard does not imply strict liability of the host State however. The *Tecmed* tribunal held that “the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it”.<sup>56</sup> The host State is, however, obliged to exercise due diligence.<sup>57</sup> As the tribunal in *Wena*, quoting from *American Manufacturing and Trading*,<sup>58</sup> stated,

The obligation incumbent on the [host State] is an obligation of vigilance, in the sense that the [host State] shall take all measures necessary to ensure the full enjoyment of protection and security of its investments and should not be permitted to invoke its own legislation to detract from any such obligation.<sup>59</sup>

Accordingly, the standard obliges the host State to adopt all reasonable measures to protect assets and property from threats or attacks which may target particularly foreigners or certain groups of foreigners.<sup>60</sup> The practice of arbitral tribunals seems to indicate, however, that the “full security and protection” clause is not meant to cover just any kind of impairment of an investor’s investment, but to protect more specifically the physical integrity of an investment against interference by use of force. In light of the following findings, it appears not to be necessary for the Tribunal to precisely define the scope of the “full security and protection” clause in this case.

## 2. Application of the Standard

485. The Claimant contends that the Czech Republic has failed to accord Saluka's investment full protection and security by its oppressive use of public powers, post-forced administration, with a view to depriving Saluka of any residual economic benefit or use of its investment and by harassing its officers and employees. The measures complained of by the Claimant relate more specifically to

- (a) the suspension of trading of IPB shares;
- (b) the prohibition of transfers of Saluka's shares; and
- (c) the police searches of premises occupied by Nomura and its employees.

The Tribunal will assess these three groups of measures separately.

### a) The Suspension of Trading in IPB Shares

486. According to the Claimant, the CSC's preliminary injunction of 15 June 2000 imposing an immediate suspension of trading in IPB shares as well as the subsequent successive extensions thereof were unjustified. The Respondent argues that there was nothing improper with the suspension decisions.

487. Saluka has lodged appeals against the CSC's suspension decisions. The appeals were rejected, however, by the competent Presidium of the CSC.

488. On 1 January 2001, the Czech Securities Act was amended to the effect that shareholders no longer had standing to appeal a CSC's suspension of trading in the shares held by the shareholders. Consequently, after 1 January 2001 Saluka was excluded from challenging suspensions of trading in its IPB shares.

489. The Respondent argues that the amendment to the Czech Securities Act was of general application and was not specifically targeted against Saluka.

490. Even assuming that the suspension of trading of shares may be State conduct within the scope of the "full security and protection" clause, the Tribunal, without deciding that question, finds that this claim of the Claimant is without merit. On this account, the Czech Republic cannot be said to have failed to provide "full protection and security" to Saluka's investment. The reasoning behind the CSC's suspension decisions cannot be said to have been totally devoid of legitimate concerns relating to the securities market. The suspensions of trading in IPB shares were at least justifiable on regulatory grounds. Also, the elimination of shareholders' right of appeal does not *per se* transcend the limits of a legislator's discretion. Shareholder's rights vary greatly in different jurisdictions. The amendment of the Czech Securities Act cannot be said to be totally unreasonable and unjustifiable by some rational legal policy.

b) The Prohibition of Transfers of Saluka's Shares

491. The Claimant also argues that the Police Order issued at the request of CSOB by the Public Investigator's Office on 26 October 2000 as well as subsequent decisions of the police authorities, freezing specifically Saluka's shareholding in IPB, were unjustified.

492. Saluka, however, appealed, with some success, against the freezing orders. Even the Public Prosecutor's Office's order of 23 April 2002 which upheld the freezing order on different grounds was quashed, upon Saluka's appeal, by the Supreme Public Prosecutor's Office. The Claimant still feels aggrieved by a procedural denial of justice due to the fact that the latter office, which was the last instance for appeals, upheld the freezing of Saluka's shares in IPB on still different grounds on which Saluka had not been heard. No further appeal being possible, on 18 July 2002 Saluka lodged a petition with the Constitutional Court seeking an appropriate remedy.

493. Even assuming that the freezing of the IPB shares held by Saluka may be State conduct within the scope of the "full security and protection" clause, the Tribunal, without deciding that question, fails to see a procedural denial of justice that would violate the Czech Republic's Treaty obligations. The absence of further appeals against decisions of the last instance for appeals is not *per se* a denial of justice. The alleged denial of Saluka's right to be heard is the basis for the petition lodged with the Constitutional Court. Nothing therefore emerges from the facts before the Tribunal that would amount to a manifest lack of due process leading to a breach of international justice and to a failure of the Czech Republic to provide "full protection and security" to Saluka's investment.

c) The Police Searches

494. The Claimant furthermore complains of the search of Nomura's (not Saluka's) Prague Representative Office and the seizure of Nomura's documents. According to the Claimant, these police actions were illegal and violated Nomura's fundamental rights to the inviolability of privacy and home, to the protection against unauthorised interference with its privacy and unauthorised gathering of data, and to the protection of ownership rights.

495. Saluka (not Nomura), however, successfully lodged a petition with the Czech Constitutional Court which in a decision of 10 October 2001 held in favour of Saluka.

496. Consequently, having been granted the relief petitioned for, the Claimant can no longer be aggrieved. The Tribunal, without going into the relevance of the distinction between Nomura and Saluka in this context, therefore finds that, on this account also, the Czech Republic cannot be found to have violated its Treaty obligation to accord "full protection and security" to Saluka's investment.

E. Conclusion

497. In summary, the Tribunal finds, based on the totality of the evidence which has been presented to it, that the Respondent's treatment of Saluka's investment was in some respects

unfair and inequitable and violated the “fair and equitable treatment” obligation as well as the “non-impairment” obligation under Article 3.1 of the Treaty.

498. The Respondent has violated the “fair and equitable treatment” obligation by responding to the bad debt problem in the Czech banking sector in a way which accorded IPB differential treatment without a reasonable justification. The Big Four banks were in a comparable position regarding the bad debt problem. Nevertheless, the Czech Republic excluded IPB from the provisioning of financial assistance. Only in the course of CSOB’s acquisition of IPB’s business during IPB’s forced administration was considerable financial assistance from the Czech Government forthcoming. Nomura (and subsequently Saluka) was justified, however, in expecting that the Czech Republic would provide financial assistance in an even-handed and consistent manner so as to include rather than exclude IPB. That expectation was frustrated by the Respondent. The Tribunal finds that the Respondent has not offered a reasonable justification for IPB’s differential treatment.

499. The Czech Republic has furthermore violated its “fair and equitable treatment” obligation by unreasonably frustrating IPB’s and its shareholders’ good faith efforts to resolve the bank’s crisis. Saluka was entitled to expect that the Czech Republic took seriously the various proposals that may have had the potential of solving the bank’s problem and that these proposals were dealt with in an objective, transparent, unbiased and even-handed way. The fundamentally different approach of the Czech Government towards CSOB’s acquisition of IPB, on the one hand, and towards IPB’s and Saluka’s/Nomura’s attempts to negotiate a cooperative solution, on the other, frustrated Saluka’s legitimate expectations. The Czech Government’s conduct lacked even-handedness, consistency and transparency and the Czech Government has refused adequate communication with IPB and its major shareholder, Saluka/Nomura. This made it difficult and even impossible for IPB and Saluka/Nomura to identify the Czech Government’s position and to accommodate it. The Respondent has not offered a reasonable justification for its treatment of Saluka.

500. The Tribunal does not find, however, that the Respondent has violated its “fair and equitable treatment” obligation by a failure to ensure a predictable and transparent framework for Saluka’s investment. Neither was the increase of the provisioning burden for non-performing loans unpredictable for Saluka/Nomura, nor could Saluka/Nomura legitimately expect that the Czech Republic would fix the legal shortcomings regarding the protection of creditor’s rights and the enforcement of loan security within a timescale of help to Nomura.

501. Nor does the Tribunal find that the Respondent has violated its “fair and equitable treatment” obligation by providing financial assistance to CSOB after its acquisition of IPB. At the time the financial assistance was implemented, IPB had already lost its banking business to CSOB. Therefore, IPB and its shareholders could no longer have suffered harm in addition to the harm that had already been caused by the forced administration and the subsequent loss of the banking business. After the takeover of IPB’s banking business by CSOB, IPB was no longer a competitor of CSOB whose competitive position could be undermined by the State aid provided by the Czech Government.

502. The Tribunal also cannot find that the Respondent has violated its “fair and equitable treatment” obligation by a failure to prevent the unjust enrichment of CSOB at the expense of the IPB shareholders, including Saluka, upon the transfer of IPB’s business to CSOB and the provision of State aid following forced administration. For there to be an actionable, unjust

enrichment as between the parties, the Respondent must have received something at the expense of the Claimant. It was not the Respondent which received the banking business from IPB, but rather CSOB, nor was it the Claimant's banking business that was transferred to CSOB, but rather IPB's.

503. The Tribunal does find a violation by the Respondent of its "non-impairment" obligation under Article 3.1 of the Treaty. This violation is based firstly on the same grounds which have led the Tribunal to find a violation of the "fair and equitable treatment" standard. The unjustified differential treatment of IPB regarding the Czech Republic's response to the bad debt problem in the banking sector as well as the Czech Government's refusal to negotiate in good faith on the proposals made by IPB and its shareholders were measures that impaired the enjoyment of Saluka's investment, *i.e.* the shareholding in IPB.

504. The violation of the "non-impairment" obligation is based secondly on the Czech Government's unjustifiable and unreasonable conduct regarding the circulation of negative information about IPB during the week before the second run on IPB that led to its failure. This conduct contributed in all probability to the unsustainability of IPB's situation.

505. The Tribunal fails to find a breach by the Respondent of its "full security and protection" obligation under Article 3.2 of the Treaty. Neither the suspension of trading of IPB shares, which was justifiable by legitimate concerns relating to the securities market, nor the prohibition of transfers of Saluka's IPB shares or the police searches of Nomura's Prague Representative Office and the seizure of Nomura's documents, against which Saluka has lodged appeals or petitions to the competent authorities or courts, amount to a breach of that obligation.

## VII. OTHER MATTERS

506. The Claimant, in its Memorial, considered it appropriate and efficient to postpone precise issues of the loss it had suffered to a separate phase of the proceedings when the Tribunal's decision on liability would be known. The Respondent, in its Counter-Memorial, was of the same view in relation to losses which were the subject to its counterclaims. Accordingly, neither party pursued questions of *quantum* in any detail in their various pleadings on the merits of the dispute submitted to arbitration.

507. Now that the Tribunal's conclusions of the question of liability are known, and include its finding that there has been a breach by the Respondent of its obligations under Article 3 of the Treaty, it is necessary to address the question of the appropriate redress for that breach, including questions of *quantum* which arise in that context.

508. The Tribunal, pursuant to Article 32.1 of the UNCITRAL Rules, accordingly renders its present Award as only a partial Award. The Tribunal retains its jurisdiction in order to decide the outstanding question of redress, including questions of *quantum*, in a second phase of this arbitration.

509. The Tribunal, bearing in mind Article 23 of the UNCITRAL Rules, will communicate with the parties about appropriate periods of time for the filing by the parties of written statements on the question of redress, including questions of *quantum*.

510. The Tribunal, bearing in mind Article 38 of the UNCITRAL Rules, will address questions of costs within the framework of its eventual decision at the conclusion of the second phase of this arbitration.

### VIII. DECISIONS

511. For the foregoing reasons, the Tribunal unanimously renders the following decisions as its Partial Award in the present arbitration:

- a. The Tribunal has jurisdiction to hear and decide the dispute which the Claimant, Saluka Investments BV, has submitted to it;
- b. the Respondent, the Czech Republic, has not acted in breach of Article 5 of the Treaty;
- c. the Respondent has acted in breach of Article 3 of the Treaty;
- d. the question of the appropriate redress for that breach, including questions of *quantum*, will be addressed in a second phase of this arbitration, for which the Tribunal retains jurisdiction;
- e. the Tribunal will separately determine the timetable for the second phase of this arbitration; and
- f. the Tribunal reserves questions of costs until final consideration can be given to the costs of this arbitration as a whole.

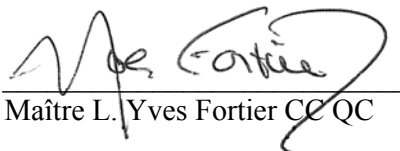
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Place of arbitration: Geneva, Switzerland

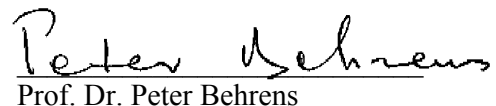
Dated: 17 March 2006



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Sir Arthur Watts KCMG QC  
Chairman



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Maître L. Yves Fortier CCQC



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Prof. Dr. Peter Behrens

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- <sup>1</sup> CNB Report, *The Banking Sector During the Economic Transformation* 7 (1997).
- <sup>2</sup> Decision of the Council and Commission of 19 December concerning the conclusion of a Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Czech Republic, of the other, OJ (L 360/1), 31 December 1994 [hereinafter Europe Agreement].
- <sup>3</sup> Treaty Establishing the European Community, OJ (C 325), 24 December 2002.
- <sup>4</sup> *Sic.* Presumably, “by a foreign person” was intended.
- <sup>5</sup> Claimant’s Reply, para. 30.
- <sup>6</sup> Article 31(3)(c) of the 1969 Vienna Convention on the Law of Treaties, 1155 UNTS 331.
- <sup>7</sup> See Case Concerning Oil Platforms (Islamic Republic of Iran v. USA), Judgment, 6 November 2003, ICJ Reports (2003), paras 23 and 41. See also *AAPL v. Sri Lanka*, 106 ILR 440, para. 41 (1990).
- <sup>8</sup> L.B. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AJIL 515 (1961).
- <sup>9</sup> OECD Draft Convention on the Protection of Foreign Property (12 October 1967), 71 ILM 117.
- <sup>10</sup> Restatement (Third) of Foreign Relations Law § 712 cmt. g (1987).
- <sup>11</sup> The tribunal in *ADF Group Inc. v. United States of America* agreed with the position taken by a tribunal in another case (*Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2) “that any general requirement to accord ‘fair and equitable treatment’ ... must be disciplined by being based upon State practice and judicial or arbitral caselaw or other sources of customary or general international law”. Although the foregoing case deals with “fair and equitable” treatment, the principle quoted applies in the same way to “deprivation”. See *ADF Group Inc. v. USA*, ICSID Case No. ARB(AF)/00/1, Award, 9 January 2003, para. 184.
- <sup>12</sup> *MethanexCorp. v. USA*, Final Award, 3 August 2005, 44 ILM 1343, para. 410 (2005). See also *Too v. Greater Modesto Insurance Associates*, 23 Iran U.S. Cl. Trib. Rep. 378, para. 26 (1989); *S.D. Myers, Inc. v. Canada*, 40 ILM 1408, para. 281 (2001); *Lauder (USA) v. Czech Republic*, Final Award, 3 September 2002, para. 198 (available at [www.investmentclaims.com](http://www.investmentclaims.com)); *Technicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, 29 May 2003, para. 119.
- <sup>13</sup> See *Too v. Greater Modesto*, 23 Iran U.S. Cl. Trib. Rep. 378; *Robert Azinian and others v. United Mexican States*, ICSID Case No. ARB(AF)97/2, Award, 1 November 1999; and *S.D. Myers Inc.*, 40 ILM 1408.
- <sup>14</sup> The Presidium of the Cabinet of the Czech Republic had consented to the imposition of forced administration by Resolution on 15 June 2000.
- <sup>15</sup> In any event, the Respondent will have the opportunity to raise this argument, if it wishes, in the quantum phase of this arbitration.
- <sup>16</sup> See *NAFTA Arbitration Pope & Talbot Inc. v. The Government of Canada*, Award on the Merits of Phase 2, 10 April 2001, para. 155 (available at [www.naftaclaims.com](http://www.naftaclaims.com)).
- <sup>17</sup> *S.D. Myers, Inc.*, 40 ILM 1408, para. 261.
- <sup>18</sup> Guidance may also be derived from some comprehensive surveys that have recently taken stock of States’ treaty practice, arbitral jurisprudence, relevant literature and documents prepared by international organisations. See, e.g., OECD, *Fair and Equitable Treatment Standard in International Investment Law*, Working Papers on International Investment, No. 2004/3 (2004) [hereinafter OECD Working Papers]; R. Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, *The International Lawyer* 87-106 (Spring 2005); C. Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, *Journal of World Investment & Trade* 357-386 (June 2005).
- <sup>19</sup> *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, 11 October 2002, para. 118; see also *Waste Management, Inc. v. United Mexican States*, 30 April 2004 (available at [www.naftaclaims.com](http://www.naftaclaims.com)) and *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, 25 May 2004.
- <sup>20</sup> *Pope & Talbot*, 10 April 2001; other arbitral awards referred to by the Claimant in support of its submission include *Lauder v. Czech Republic*, 3 September 2002, para. 292, and *CME Czech Republic BV (The Netherlands) v. Czech Republic*, Partial Award, 13 September 2001, para. 611 (available at [www.investmentclaims.com](http://www.investmentclaims.com)), both of which were also based on Article 3 of the Treaty.



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<sup>21</sup> North American Free Trade Agreement, 8-17 December 1992, 32 ILM 605 (entered into force 1 January 1994).

<sup>22</sup> *Waste Management*, 30 April 2004, para. 98.

<sup>23</sup> See Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia, ICSID Case No. ARB/99/2, 25 June 2001, para. 367.

<sup>24</sup> USA (L.F. Neer) v. United Mexican States, 21 AJIL 555, at 556 (1927).

<sup>25</sup> Article 1105(1) of NAFTA, *supra* note 21, provides that:

Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

<sup>26</sup> See G. Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection, Recueil des Cours*, Tome 269, at 341 (1997); R. Dolzer & M. Stevens, *Bilateral Investment Treaties* 60 (ICSID 1995); see also United Nations Conference on Trade and Development (UNCTAD), *Fair and Equitable Treatment*, Series on Issues in International Investment Agreements 40 (1999).

<sup>27</sup> *Genin*, ICSID Case No. ARB/99/2.

<sup>28</sup> *Genin*, ICSID Case No. ARB/99/2, para. 289.

<sup>29</sup> *Genin*, ICSID Case No. ARB/99/2, para. 290; see also *Mondev*, ICSID Case No. ARB(AF)/99/2, para. 116.

<sup>30</sup> Vienna Convention on the Law of Treaties, May 23, 1969, 1155 UNTS 331.

<sup>31</sup> The Treaty entered into force on 1 October 1992 for both The Netherlands and the Czech and Slovak Federal Republic.

<sup>32</sup> See *MTD Equity*, ICSID Case No. ARB/01/7, para. 113, where the Tribunal referred to The Concise Oxford Dictionary of Current English (5<sup>th</sup> ed.).

<sup>33</sup> *S.D. Myers, Inc.*, 40 ILM 1408, para. 263.

<sup>34</sup> For a comprehensive account of recent arbitral practice see Schreuer, *supra* note 18, at 374-380; see also Dolzer, *supra* note 18, at p. 103.

<sup>35</sup> *Tecmed*, ICSID Case No. ARB(AF)/00/2, para. 154 (emphasis added).

<sup>36</sup> *CME v. Czech Republic*, 13 September 2001, para. 155 (emphasis added).

<sup>37</sup> *Waste Management*, 30 April 2004, para. 98 (emphasis added).

<sup>38</sup> See the comprehensive account of arbitral practice in OECD Working Papers, *supra* note 18, at 25-39; see also Schreuer, *supra* note 18, at 373-385.

<sup>39</sup> Occidental Exploration and Production Company (OEPC) v. Ecuador, 1 July 2004, para. 183 (emphasis added).

<sup>40</sup> *S.D. Myers, Inc.*, 40 ILM 1408, para. 263.

<sup>41</sup> For a comprehensive account of arbitral practice see Schreuer, *supra* note 18, at 380-383.

<sup>42</sup> IMF, *Lessons from Systemic Bank Restructuring: A Survey of 24 Countries* (Washington 1997).

<sup>43</sup> Resolution of the Czech Government No. 369, 27 May 1998.

<sup>44</sup> See Czech National Bank, *Report on Banking Supervision in the Czech Republic* 24-28 (December 1999).

<sup>45</sup> In the documents, the following code names were used for CSOB and IPB: “Carthago” for CSOB; “India” for IPB.

<sup>46</sup> Witness Statement of Mr Daniel Jackson, at para. 72: “Mr Niedermayer [Vicegovernor of the CNB] warned that there was little appreciation within the Government or the CNB about the limitations of shareholder liability, and this misapprehension underlay the expectation that Nomura must cover any losses at IPB”.

<sup>47</sup> Europe Agreement, *supra* note 2.

<sup>48</sup> *ADF Group*, ICSID Case No. ARB(AF)/00/1, para. 42.

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<sup>49</sup> The Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID Case No. ARB(AF)/98/3, 19 June 2003, para. 134.

<sup>50</sup> See the Award in the Lena Goldfields, Ltd., Arbitration, 3 September 1930, 36 Cornell Law Quarterly 42, paras. 23-24 (1950); A. Nussbaum, *The Arbitration Between the Lena Goldfields, Ltd., and the Soviet Government*, 36 Cornell Law Quarterly 31, at 41 (1950); C. Schreuer, *Unjustified Enrichment in International Law*, 22 American Journal of Comparative Law 281 (1974).

<sup>51</sup> *Benjamin Isaiah v. Bank Mellat*, 2 Iran U.S. Cl. Trib. Rep., 30 March 1983, 232, at 236-237.

<sup>52</sup> Fisheries Jurisdiction Case (Spain v. Canada), Judgment on Jurisdiction of the Court, 4 December 1998, ICJ Reports (1998), at para. 66.

<sup>53</sup> Black's Law Dictionary (6<sup>th</sup> ed. 1990).

<sup>54</sup> See American Manufacturing & Trading, Inc. (AMT) (USA) v. Republic of Zaire, ICSID Case No. ARB/93/1, 21 February 1997 (lack of protection against loss of investment caused by widespread looting); *Tecmed*, ICSID Case No. ARB(AF)/00/2, paras. 175-177 (alleged lack of the host State's protection against interference with the investor's investment by adverse social demonstrations).

<sup>55</sup> *AMT*, ICSID Case No. ARB/93/1, para. 6.05; see also *Wena Hotels Ltd. (UK) v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, 8 December 2000 (lack of protection against loss of investment by forced and illegal seizure of investor's hotels).

<sup>56</sup> *Tecmed*, ICSID Case No. ARB(AF)/00/2, para. 177.

<sup>57</sup> Dolzer & Stevens, *supra* note 26, at 61.

<sup>58</sup> *AMT*, ICSID Case No. ARB/93/1, para. 28.

<sup>59</sup> *Wena*, ICSID Case No. ARB/98/4, para. 84.

<sup>60</sup> See OECD Working Papers, *supra* note 18, at 26-28 ("obligation of vigilance and protection").