

**THE MATTER OF AN
ARBITRATION UNDER THE
UNCITRAL ARBITRATION RULES 1976**

INVESMART, B.V.

CLAIMANT

v

CZECH REPUBLIC

RESPONDENT

AWARD

TRIBUNAL

Dr Michael Pryles

Mr Christopher Thomas Q.C.

Professor Piero Bernardini

Secretary of the Tribunal

Ms Leah Ratcliff

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Award of the Tribunal

The Parties, Representation and Tribunal

1. The Claimant is INVESMART B.V. ("**Invesmart**"), a limited liability company registered with the Amsterdam Chamber of Commerce Company in the Netherlands under the Registration Number 34127007. It was incorporated in August 1999 under the name Robilant International Holding B.V. and was renamed in 2000. Its registered office is situated at:

Via Manzoni 46, 20122
Milan, Italy

("Claimant")

2. The Respondent is THE CZECH REPUBLIC, represented by Miroslav Kalousek, the Director of the Czech Ministry of Finance ("**MOF**"). Its registered office is situated at:

Leetenská 15
118 10 Prague 1
Czech Republic

("Respondent")

3. In this arbitration the Claimant is represented by:

King and Spalding LLP

Mr Reginald R Smith
1100 Louisiana
Suite 4000
Houston, Texas 77002

Mr Kenneth R Fleuriet
25 Cannon Street
London EC4M 5SE
United Kingdom

Mr Craig S. Miles
1100 Louisiana
Suite 4000
Houston, Texas 77002

4. In this arbitration the Respondent was originally represented by:

Linklaters
Ludek Vrana
Partner
Palac Myslbek
Na Prikope 19
117 19 Prague 1

5. By facsimile dated 20 November 2007, Linklaters informed the Tribunal that they no longer represented the Respondent and advised the Tribunal that new counsel had been appointed by the Respondent in this arbitration:

Weil, Gotshal & Manges

Ms Karolina Horakova
Partner
Krizovnicke nam. 1
11000 Prague 1

6. The Claimant, by letter dated 12 April 2007, appointed Professor Piero Bernardini as an arbitrator. The Respondent, by letter dated 14 February 2007, appointed Mr Christopher Thomas Q.C. as an arbitrator. Pursuant to Article 7(1) of the UNCITRAL Arbitration Rules, the two party-appointed arbitrators appointed Dr Michael Pryles as the third and presiding member of the Tribunal on 11 May 2007. All members of the Tribunal signed an Arbitrators Engagement Agreement.
7. On 17 July 2008, the members of the Tribunal, at the consent of the parties, appointed Ms Leah Ratcliff as the Tribunal Secretary.

Procedural Background

8. This arbitration arises from alleged violations of the Agreement on Encouragement and Reciprocal Protections of Investments between The Kingdom of the Netherlands ("Netherlands") and the Czech and Slovak Federal Republic dated 29 April 1991 (the "**BIT**" or the "**Treaty**"). On 8 December 1994, the Czech Republic confirmed to the Netherlands that the Treaty remains in force for the Czech Republic as a successor state to the Czech and Slovak Republic. Article 8 of the BIT provides for the settlement of disputes as follows:

Article 8

1) All disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter shall if possible, be settled amicably.

2) Each Contracting Party hereby consents to submit a dispute referred to in paragraph (1) of this Article, to an arbitral tribunal, if the dispute has not been settled amicably within a period of six months from the date either party to the dispute requested amicable settlement.

3) The arbitral tribunal referred to in paragraph (2) of this Article will be constituted for each individual case in the following way: each party to the dispute appoints one member of the tribunal and the two members thus appointed shall select a national of a third State as Chairman of the tribunal. Each party to the dispute shall appoint its member of the tribunal within two months, and the Chairman shall be appointed within three months from the date on which the investor has notified the other Contracting Party of his decision to submit the dispute to the arbitral tribunal.

4) If the appointments have not been made in the above mentioned periods, either party to the dispute may invite the President of the Arbitration Institute of the Chamber of Commerce of Stockholm to make the necessary appointments. If the President is a national of either Contracting Party or if he is otherwise prevented from discharging the said function, the Vice-President shall be invited to make the necessary appointments. If the Vice-President is a national of either Contracting Party or if he too is prevented from discharging the said function, the most senior member of the Arbitration Institute who is not a national of either Contracting Party shall be invited to make the necessary appointments.

5) The arbitration tribunal shall determine its own procedure applying the arbitration rules of the United Nations Commission for International Trade Law (UNCITRAL).

6) The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively:

- the law in force of the Contracting Party concerned;
- the provisions of this Agreement, and other relevant Agreements between the Contracting Parties;
- the provisions of special agreements relating to the investment;
- the general principles of international law.

7) The tribunal takes its decision by majority of votes; such decision shall be final and binding upon the parties to the dispute.

9. Disputes having arisen between the parties, the Claimant filed a Notice of Arbitration dated 14 February 2007.
10. In its Notice of Arbitration the Claimant stated that attempts to settle the dispute amicably began on 29 July 2003, including a meeting held with the representatives of the Czech Republic in Prague on 24 October 2003, and that there appeared to be little prospect for an amicable settlement of the dispute.
11. Following constitution of the Tribunal a preliminary hearing was convened on 24 August 2007. At the hearing the claimant was represented by Mr Kenneth Fleuriet and Mr Craig Miles of King and Spalding LLP. The Respondents were represented by Ludek Vrana and Dr Rupert Bellinghausen of Linklaters.
12. Following the preliminary hearing the Tribunal made *Procedural Order No 1* dated 30 August 2007 which provided, *inter alia*, that the language of the arbitration is English and, whilst the place of the arbitration is Paris, France, the hearing will be held in London, England.
13. Procedural Order No 1 also set out the following procedural timetable:

STEP IN PROCEEDING	DATE
Claimant's statement of claim together with all documents upon which it relies and witness statements (fact and expert)	10 December 2007
Respondent's statement of defence together with all documents upon which it relies and witness statements (fact and expert) by 10 December 2007	25 March 2008
Parties to request the production of individual or defined categories of documents, in each instance explaining the relevance and materiality of the request	4 April 2008
Parties to produce the requested documents or provide reasons for non-production	By 18 April 2008
Parties may seek an order for production of a document or documents not produced by the other parties	On or before 23 April 2008
Tribunal to endeavour to decide applications for the production of documents	2 May 2008
Claimant to provide a Statement of Reply together with additional documents relied upon and responsive witness statements	15 July 2008
Respondent to provide a Statement of Rejoinder together with any additional documents relied upon and responsive witness statements	3 October 2008
Case Management Conference	9 October 2008
Hearing	10–19 November 2008

14. The parties, having each been granted brief extensions of time, provided the following submissions:

Statement of Claim dated 12 December 2007

Statement of Defence dated 27 March 2008

Reply Memorial dated 18 July 2008

Statement of Rejoinder dated 6 October 2008

15. The Claimant provided statements from the following lay witnesses:

Mr Paul de Sury

Mr Radovan Vávra

16. The Statement of Claim was also accompanied by the following expert reports:

Professor Hyun Song Shin

Associate Professor Raj Desai

PricewaterhouseCoopers

17. The Claimant's Reply Memorial was accompanied by Second Witness Statements from each of the Claimant's fact witnesses and supplementary expert reports from each expert.

18. The Respondent provided witness statements from the following:

Mr Pavel Racoča

Mr Pavel Řežábek

Mr Bohuslav Sobotka

Mr Zdeněk Tůma

19. The Respondent provided expert reports from the following:

Dr Milan Hulmák

Dr Petr Kotáb

Professor Claus-Dieter Ehlermann

Professor Anthony Saunders

Mr Pavel Závitkovský (KPMG)

Mr Jean Luc Guitera (KPMG)

20. The Respondent's Reply Memorial was accompanied by Second Witness Statements from each of the Respondent's witnesses of fact and Second Expert Reports from Professor Saunders, Professor Ehlermann and KPMG (prepared by Mr Pavel Závitkovský).

Discovery/document production

21. On 4 April 2008, both parties requested that the other produce certain categories of documents pursuant to section 6(a) of Procedural Order No 1 dated 30 August 2007.

22. Both parties responded to these requests on 18 April 2008, largely without objection. The Claimant, whilst stating that the "categories of documents requested by the Czech Republic appear overly broad, and the relevance of a number of the categories is neither apparent nor adequately explained", confirmed by letter dated 23 April 2004 that it had produced all of the documents in its possession that were covered by the categories identified by the Respondent. Similarly, by letter dated 18 April 2004 the Respondent produced all documents in its possession that were responsive to the categories, except for documents held by the Czech Office of the Protection of Competition or UOHS to use the Czech acronym ("OPC"), which were subject to formal administrative procedures to facilitate their release. These documents were provided to the Claimant on 16 June 2008.

Security for Costs

23. On 27 March 2008, the Respondent submitted an Application to the Tribunal seeking orders that the Claimant provide security for the Respondent's costs likely to be incurred in this arbitration.
24. On 21 May 2008, the Claimant submitted a Response to this Tribunal objecting to this application.
25. On 3 July 2008, the Tribunal made an Order that it did not have authority to make the order sought in the Respondent's application of 27 March 2008.

Procedural steps as requested by the Chairman to the Tribunal

26. On 3 July 2008, the Chairman of the Tribunal wrote to the Respondent requesting that they provide a table of abbreviations covering all abbreviations used in the Statement of Defence. The Chairman also asked the parties to provide the Tribunal with a list of persons referred to in their respective submissions.
27. On 4 July 2008, the Chairman of the Tribunal requested that the parties provide to the Tribunal, prior to the hearing:
 - (a) an agreed statement of facts;
 - (b) an agreed chronology; and
 - (c) a list of issues to be determined by the Tribunal.
28. On 10 July 2008, the Respondent provided to the Tribunal a list of persons referred to in the Statement of Defence. The Respondent also suggested that the Parties be required to provide the other documents requested by the Tribunal at a date following the second round of Parties' Submissions. The Claimant concurred.
29. By email dated 10 July 2008, the Chairman of the Tribunal deferred consideration of this issue.
30. On 19 September 2008, the Chairman of the Tribunal wrote to the parties requesting that the agreed statement of facts be provided to the Tribunal by 10 October 2008.
31. The Parties were not able to agree upon a statement of facts prior to the Case Management Conference. The provision of this document to the Tribunal was deferred until after the Case Management Conference.

Case Management Conference

32. By the agreement of the parties, the Tribunal postponed the Case Management Conference until 20 October 2008.
33. At this conference, the Tribunal considered a series of procedural matters as listed in the provisional agenda circulated by the Secretary prior to the Conference.
34. Specifically, the matters considered at the conference were the procedure to be followed at the hearing including, *inter alia*, opening statements, order of witnesses, examination of witnesses, sitting times, equal allocation of hearing time between the parties, restrictions on new evidence, interpreters, transcription, document bundles and restrictions on witness attendance.
35. In respect of the agreed statement of facts the Tribunal decided, by agreement of the parties, that negotiations on an agreed statement of facts would resume and that, where the parties' opinions diverged, their separate assessments of a particular fact were to be set out in the Statement.
36. On 24 October 2008, the parties provided to the Tribunal an agreed statement of facts and detailed hearing schedule.

Claimant's extraordinary submission dated 4 November 2008

37. On 4 November 2008, the Claimant made an extraordinary submission to the Tribunal in relation to allegations made by the Respondent in its Statement of Rejoinder that
Principal of Invesmart B.V. submitted to the Czech National Bank ("CNB") "false minutes" of a meeting of Invesmart's shareholders on 16 October 2002.
38. On 5 November 2008, the Respondent submitted a short statement to the Tribunal in reaction to the Claimant's submission.
39. Consideration of the matters raised by the Claimant were deferred until the hearing.

The hearing

40. A hearing took place at the International Dispute Resolution Centre in Fleet Street, London. It commenced on 10 November 2008 and concluded on 18 November 2008. Verbatim transcripts were produced and made available concurrently with the aid of LiveNote computer software.
41. At the hearing the following persons appeared as legal counsel for the Claimant:

Mr Reginald Smith (King & Spalding)

Mr Ken Fleuriet (King & Spalding)

Mr Tom Childs (King & Spalding)

Mr Craig Miles (King & Spalding)

42. , Principal of Invesmart B.V. also attended the hearing as a representative of the Claimant.

43. The following persons appeared as legal counsel for the Respondent:

Ms Karolina Horakova (Weil, Gotshal & Manges)

Ms Barbora Balaptikova (Weil, Gotshal & Manges)

Professor James Crawford

Mr Zachary Douglas

44. Mr Radek Snabl, Ms Marketa Skypalova and Mr Vaclav Rombald attended the hearing as representatives of the Czech Ministry of Finance.

45. Both sides made an oral presentation at the opening of the hearing. At the close of the hearing, the Tribunal decided, by the agreement of the parties, that neither side would make post hearing submissions, except for those relating exclusively to costs.

46. At the hearing all of the above listed witnesses gave evidence and were cross-examined by opposing counsel, with the exception of Mr Milan Hulmák and Dr Kotáb. The Claimant waived its right to cross-examine these witnesses and as a consequence they did not appear at the hearing.

Factual Background

47. In 1990, as a primary step in Czechoslovakia's transition from a communist to a market economy, the Czechoslovakian banking system was reformed. The "monobank" system, in which the central bank was responsible for both monetary policy and commercial banking, was disestablished and privately owned commercial banks commenced operation in Czechoslovakia. Union Banka, which commenced operations in 1991, was one of a number of small banks that were established at this time.

48. The Czech banking system was plagued by instability and severe liquidity issues throughout the 1990s and a number of banks collapsed. In an attempt to address these crises the Czech government initiated three state aid programs, including two Consolidation Programs between 1991 and 1994, and between 1994 and 1995 and a Stabilisation Program between 1995 and 1998.

49. Under the First Consolidation Program the Czech government (and its successors, the Czech Republic and the Slovak Republic) strengthened the balance sheets of the four largest banks (Komerčno banka, Česká sporitelna, Investicni a Postovno banka (IPB), and Ceskolovenska obchodni banka).
50. On 1 January 1993, Czechoslovakia peacefully dissolved into its constituent states: the Czech Republic and the Slovak Republic. The Second Consolidation Program was thus implemented by the newly formed government of the Czech Republic. It was similarly structured to the First Consolidation Program and directed state aid to mid tier and small Czech Banks. A number of insolvent small banks were acquired by other banks with the assistance of the CNB as part of the program.
51. Under the Stabilisation Program state aid was provided to failing banks through Česká Finanční, s.r.o ("CF"), a wholly owned Czech Government entity. Under the stabilisation program the CF purchased participant banks' poor quality (non-performing) assets at nominal value, – a maximum of 110 per cent of the bank's registered capital. In return the bank would, after seven years, repurchase at nominal value any assets that remained uncollected. This arrangement had the effect of offering participant banks a seven year interest free loan. Further, the banks had an obligation to accept and subsequently observe the terms and conditions of a stabilisation plan.
52. The banks were obliged to allocate the funds received from the CF preferentially to well-performing assets having higher liquidity and bearing fewer risks. The implementation of a cautious investment policy should have improved the banks' liquidity and enabled them, in the course of a seven year period, to create sufficient resources to re-transfer the non-performing assets from the CF. A total of six small Czech banks participated in the Stabilisation Programme.

The expansion of Union Banka

53. Against this back-drop, Union Banka expanded its operations within the Czech Republic. In 1995 it underwent internal restructure through the establishment, by Union Banka's shareholders, of Union Group. This became the holding company of Union Banka.
54. Between 1996 and 1998, Union Banka acquired four distressed banks, Ekoagrobanka, Evrobanka, BDS and Foresbank. The acquisitions of Ekoagrobanka, Evrobanka and BDS took place under the aegis of the Second Consolidation Program. These acquisitions were made pursuant to agreements with the CNB whereby the CNB agreed to compensate Union Banka for the difference between the assets recorded on the banks' accounts and the value of those assets as determined by independent audits. The purpose of this agreement was to mitigate the

losses Union Banka would have otherwise borne as a consequence of absorbing the non-performing loan books of other banks.

55. In 1998, a dispute arose between Union Banka and the CNB about the terms of their agreement in relation to Union Banka's acquisition of BDS. This matter was settled in December 1999 pursuant to the "**BDS Settlement Agreement**". The CNB had agreed to compensate Union Banka for 85 percent of the difference between the book value of BDS' balance sheet liabilities and the value of its assets and goodwill, to be established by an independent audit. Compensation was paid but Union Banka subsequently claimed a further amount. When the CNB refused, the bank commenced and succeeded in an arbitral claim. The CNB complied with the arbitral award but in doing so required Union Banka to sign a settlement agreement recording their agreement that the settlement was final and binding.¹
56. In September 2002, while the principal events at issue in this arbitration were occurring, Union Banka initiated further arbitral proceedings against the CNB in relation to the terms of the BDS Settlement Agreement. Union Banka valued this claim at CZK 1.762 billion. This was recorded in its books on 23 September 2002 (the "**CNB Receivable**") as is discussed further below at paragraph 110. The CNB won that arbitration in April 2003.
57. Meanwhile, in late 1997, Union Banka entered into an agreement with CF, the state consolidation agency, to acquire Foresbank as part of the broader Stabilisation Program. However, in 1998 Foresbank was taken out of the Stabilisation Program and an alternative set of agreements were concluded between Union Banka and CF.
58. Pursuant to these agreements, Foresbank repurchased its assets from the CF at the nominal value of the uncollected assets, discounted from the original 2004 payment at 11.5 percent per annum (a rate derived from the then prevailing market interest rate). The discounting of the purchase price allowed Union Banka to retain the economic value of the interest free loan. In addition it was agreed that (1) CF would deposit the proceeds from the sale of the loans back to Union Banka, (2) the deposit (known as the "**Fores Deposit**") would mature on the original 2004 payment date and bear the same 11.5 percent per annum interest rate, and (3) the deposit would be fully secured by Government Bonds. Under the terms of these agreements the Fores Deposit, plus interest, would be worth CZL 1.591 billion to CF at maturity in December 2004.
59. By 2002, market interest rates had fallen to below 4 percent in the Czech Republic and Union Banka was incurring significant losses on the Fores Deposit.

¹ Exhibit R-4, Cooperation Agreement regarding takeover of Bankovní dům SKALA a.s., dated 19 March 1996; Exhibit R-5, arbitration award of the Arbitration Court attached to the Economical Chamber of the Czech Republic and the Agrarian Chamber of the Czech Republic, Ref. No. 55/98, dated 1 April 1999; Exhibit R-6, Settlement Agreement entered into by the CNB and Union Banka on 27 December 1999 ("**BDS Settlement Agreement**").

Union Banka's accumulation of related party loans

60. Throughout this same period Union Banka entered into a number of related party loans ("RPLs") with its shareholders or related parties for the purpose of purchasing shares in Union Banka. The majority of these loans were under-secured and non-performing.
61. In its 1998 Audit Report, Union Banka valued the RPLs at approximately CZK 4.5 billion.² The CNB took remedial action against Union Banka. However, Union Banka's practice of granting RPLs continued. By June 2000, the CNB quantified the RPLs at CZK 5.461 billion.³
62. In January 2001, the CNB took further remedial action against Union Banka and requested that it confine its investment of the proceeds received from repayment of the RPLs or from the sale of Union Group's shareholdings in other companies to assets with zero-risk weighting.⁴ On 31 May 2001, Union Banka was fined CZK 2.5 million by the CNB for providing new RPLs to finance the purchase of Union Group shares.⁵
63. As a result of problems inherited from the acquired problem banks compounded with the RPLs, Union Banka became a problem bank itself. It sought to address these issues through state aid.

State aid discussions between Union Banka and CF in 2001

64. During 2001, Union Banka put forward three separate proposals for state aid. Each involved the assistance of CF in cleansing Union Banka's balance sheets.
65. First, in February 2001, Union Banka proposed that CF buy 100 percent of the shares of Foresbank for its liquidation value thereby terminating the Foresbank Deposit early.⁶
66. Secondly, in October 2001, Union Banka proposed that Foresbank would purchase certain of the assets of Union Banka, including a number that Union Banka acquired through the takeovers of Ekoagrobanka, Evrobanka and Foresbank. CF would then acquire the Foresbank for a purchase price of CZK 1.2 billion.⁷

² Exhibit R-19, 1998 Audit Report of Union Banka prepared by Deloitte & Touche, dated 19 May 1999.

³ Exhibit R-20, Report from bank inspection performed from 11 September to 13 October 2000 by CNB in framework or exercise of bank supervision, dated 22 December 2000, p. 15.

⁴ Exhibit R-21, measure of the CNB against Union Banka, a.s., dated 3 January 2001.

⁵ Exhibit R-25, decision of the CNB, dated 31 May 2001.

⁶ Exhibit R-33, letter dated 2 February 2001 from Union Banka to CF.

⁷ Exhibit C-35, Union Group Proposal for solving relations between Fores, Union Banka and Česká Finanční, dated 24 October 2003.

67. Thirdly, in December 2001, Union Banka proposed the transaction which is referred to as the **CF Transaction** whereby CF would relinquish its deposit arising from Union Banka's acquisition of Foresbank in exchange for a portfolio of under-performing loans.⁸ This was effectively a debt for cash swap which was premised on the Government having greater leverage to recover under these loans than Union Banka. The Government could also seek to acquire equity in the debtor companies (which were mostly state owned entities) in service of the loans.

68. In these proceedings the CF Transaction was also referred to as the Foresbank Settlement.

Invesmart retained by Union Banka

69. In late 2001, Union Banka opted for a strategy whereby it would implement a restructuring plan. The primary aim of the plan was to clean up Union Banka's balance sheet, bring its internal governance in line with western banking standards and improve its profitability. In particular, the management of Union Banka aimed to redevelop both its corporate and retail banking enterprises by attracting additional customers and offering a broader range of services including insurance and leasing services.⁹

70. In order to achieve this, Union Banka, with the support of the Czech Government, sought to find an investor that would acquire Union Banka and assist with its restructuring.

71. Invesmart was hired as a consultant to Union Banka on 8 November 2001 to assist with this process. Under the terms of the consultancy agreement between Union Banka and Invesmart, Invesmart was to:

- (i) assist Union Banka in restructuring its debts;
- (ii) conduct due diligence of the bank and its loan portfolio; and
- (iii) prepare the bank for sale to a strategic investor.

72. Invesmart simultaneously entered into a share sale and purchase agreement ("**SPA**") with certain shareholders of Union Group, effectively acquiring an option to buy their 70 percent shareholding.¹⁰ The Claimant made submissions that the purpose of this agreement was to ensure that initiatives proposed by Invesmart could not be frustrated by shareholders of Union Group or Union Banka.

⁸ See Exhibit R-34, minutes of a meeting between the CNB, Union Banka and Union Group held on 5 December 2001, dated 11 December 2001.

⁹ First Witness Statement of Radovan Vávra, paragraph 10.

¹⁰ Exhibit C-38, Share Sale and Purchase Agreement between Certain Shareholders of Union Group a.s. and Invesmart B.V. as purchaser, dated 6 November 2001.

73. Shortly after being appointed as Invesmart's CEO, [redacted] met with Union Bank's President, Ms Marie Parmová. At that meeting Ms Parmová informed [redacted] that the Government and Union Banka were:

in the final stages of negotiating a deal with Česká finanční (the Foresbank Settlement) that would address the problem of the underperforming loans that Union Banka has unherited under the Czech Government's Consolidation and Stabilization Programs and which would also rectify the issue of the excess interest that Union Banka was having to pay on the Česká finanční deposit.¹¹

74. In December 2001, Invesmart commenced due diligence to determine the value of the bank. Invesmart hired Ernst & Young to undertake due diligence of Union Banka's loan portfolio. Deloitte & Touche, Union Banka's external auditor, was retained to conduct additional reviews of the bank's accounts, including an audit of Union Banka's books ("**2001 Audit**").

75. By February 2002, Invesmart was aware as a result of this due diligence that Union Banka had neither properly characterised its RPLs as unsecured nor made adequate provision for the unsecured credit it had extended. Ernst & Young also established that a number of commercial loans made by Union Banka required higher provision than Union Banka had recorded in its accounts.¹²

Invesmart's decision to acquire Union Banka

76. Notwithstanding these disclosures, in March 2002 Invesmart decided to acquire Union Banka in its own right. It planned to restructure the bank itself and then sell it to a strategic investor in the short to medium term.¹³

77. It was from this time onwards that the events that form the basis of Invesmart's complaints in this arbitration transpired. These events include a complex array of communications between Invesmart, Union Banka and various organs of the Czech Government regarding the provision of state aid to Union Banka, as well as regulatory and private contractual steps that were taken by Invesmart to acquire a controlling interest in Union Banka. In order to assess Invesmart's claim it is necessary to consider the various "strands" of events that ultimately led to the revocation of Union Banka's license.

78. These are:

- (a) Invesmart's contractual arrangements with Union Banka and Union Group to acquire a controlling interest in both entities;

¹¹ First Witness Statement of [redacted], para 17.

¹² Exhibit C-40, Ernst & Young Phase II Report on the Proposed Acquisition of Union Group Holding, a.s., dated 12 February 2002.

- (b) Invesmart's applications to the CNB for regulatory approval to acquire a controlling interest in Union Banka;
- (c) Union Banka's growing financial problems throughout 2002; and
- (d) MOF's consideration of Invesmart's request to provide state aid to Union Banka.

The material facts are considered in turn below.

Invesmart's contractual arrangements to acquire Union Banka

79. Invesmart contracted to acquire an indirect interest in the bank through two SPAs ("SPA A" and "SPA B").¹⁴ These were concluded with different groups of shareholders of Union Group on 9 and 10 May 2002. The transactions contemplated by both SPA A and SPA B were structured with the specific purpose of cleansing the balance sheet of Union Banka and addressing the RPL problem.
80. What was known as "SPA A" was an agreement with the selling shareholders to, in the future, purchase 36.24 percent of the shares in Union Group.¹⁵ Invesmart was to pay two of the shareholders CZK 600 million for their shares. Both of these shareholders were debtors of Union Banka and Invesmart was to pay this part of the purchase price to Union Banka and the remainder (approximately CZK 1 billion) to a third selling shareholder. This agreement was unconditional. Invesmart was to place the purchase price in escrow by 17 June 2002 and to unconditionally close the transaction on 24 June 2002, subject to the payment by Invesmart of a contractual penalty of CZK 60,000,000 in case of failure to close by such date.
81. Under "SPA B" Invesmart agreed with the selling shareholders to, in the future, acquire 33.82 percent of the shares of Union Group.¹⁶ Four of the shareholders selling shares under SPA B were also debtors of Union Banka. Their share of the purchase price (approximately CZK 660 million) was to be used to repay the RPLs owed to Union Banka. The remainder (i.e., approximately CZK 500 million) was to be released to the selling shareholders. Under the terms of SPA B, Invesmart was to post a letter of credit under which it would pay the selling shareholders by 17 June 2002. The payment itself was to take place by 9 December 2002.

¹³ Statement of Claim, para 72.

¹⁴ Exhibit C-47, Share Sale and Purchase Agreement "A" between Certain Shareholders of Union Group, a.s. as Sellers and Invesmart B.V. as Purchaser, dated 10 May 2002; Exhibit C-46, Share Sale & Purchase Agreement "B" between Certain Shareholders of Union Group, a.s. as Sellers and Invesmart B.V. as Purchaser, dated 9 May 2002.

¹⁵ Exhibit C-47, Share Sale and Purchase Agreement "A" between Certain Shareholders of Union Group, a.s. as Sellers and Invesmart B.V. as Purchaser.

¹⁶ Exhibit C-46, Share Sale and Purchase Agreement "B" between Certain Shareholders of Union Group, a.s. as Sellers and Invesmart B.V. as Purchaser.

Simultaneously with the posting of the letter of credit, the selling shareholders would move the shares into escrow.

82. Completion of the transaction was conditional on the provision of state aid by 2 December 2002.¹⁷ Relevantly, the agreement contained the following provision:

If by December 2, 2002, Purchaser fails to receive:

a) the approval statement of Government of the Czech Republic to the proposal of the Ministry of Finances of the Czech republic of settlement of the relationship between Česká Finanční, s.r.o and Union Banka, a.s. concerning the programme of stability reinforcement and consolidation of Foresbank, a.s. (now Fores a.s.) then this Contract shall expire on the date of December 3, 2002.

b) the approval statement of the Czech National Bank to indirect acquisition of Union Banka, a.s. ...then this Contract shall expire on the date of December 3, 2002.

83. Together SPA A and SPA B constituted an agreement to acquire 70 percent of Union Group for CZK 2.833 billion.

84. In the following months SPA A and SPA B were amended.

85. In particular, on 27 May 2002 the SPAs were amended such that a cash payment, instead of the letter of credit, was to be deposited in escrow under SPA B on 17 June 2002 and the closing date under SPA A was postponed to 30 September 2002.

86. On 14 August 2002, Invesmart and Union Group's selling shareholders entered into Addendum No 4 to the SPAs. Instead of making payment to the shareholders in exchange for their shares, Invesmart would assume the shareholders' debts under the RPLs "as soon as the CNB gives the approval with the taking over of debts by [Invesmart]". The Addendum was to become effective upon approval by the shareholders of Invesmart. Thus, SPA A had also become conditional.¹⁸

87. On 14 October 2002, Invesmart and the selling shareholders entered into Addendum No 5 to the SPAs. Invesmart was to assume the debts of the selling shareholders to Union Banka without undue delay. Addendum No 5 was to become effective upon (1) the CNB's approval of Invesmart's acquisition of control over Union Banka and assumption for selling shareholders' debts and (2) approval of Invesmart's shareholders.¹⁹

¹⁷ *Id.*, Clause 3.3.

¹⁸ Exhibit R-50, Addendum No 4 to the Share Sale and Purchase Agreements "A" and "B" dated 14 August 2002.

¹⁹ Exhibit R-75, Addendum No. 5 to the Share Sale and Purchase Agreements "A" and "B", dated 14 October 2002.

Invesmart's applications to the CNB for regulatory approval to acquire Union Banka

88. On 4 April 2002, Invesmart submitted to the CNB the first of three formal applications to acquire a controlling interest in Union Banka.
89. Much is made in the Claimant's submissions about the CNB's ultimate decision to approve Invesmart's acquisition of Union Banka on 24 October 2002. For this reason, it is worthwhile setting out the surrounding facts to enable the CNB's decision to be viewed in context.
90. Pursuant to Czech Law No 215/89 Col. on Banks, Invesmart was required to obtain the CNB's approval before it could acquire a controlling interest in Union Banka.
91. In 2002, Invesmart made three separate applications to the CNB to acquire Union Banka.
92. The first two applications, dated 4 April 2002 and 4 June 2002 respectively, were both rejected by the CNB on the grounds that Invesmart had failed to furnish essential information relating to the source of the funds with which it proposed to acquire Union Banka. This was a significant omission because under Section 9(3)(c) of Decree of CNB No. 166/2002 Coll., dated 8 April 2002, an applicant seeking to acquire an interest in a Czech Bank was required to submit:
- documents on the origin of the applicant's funds from which the purchase of shares of the bank or purchase of a share in an entity through which is acquired indirect share in the bank...is to be covered.²⁰
93. The CNB's decisions to reject Invesmart's first two applications were both subject to 15 day appeal periods. These expired on 3 July 2002 and 22 October 2002 respectively. Despite frequent requests by the CNB, Invesmart was unable to provide evidence of the provenance of its funds. Instead, it sought to secure further government support and alternative forms of finance to strengthen Union Banka's ailing balance sheets and complete the acquisition.
94. The following exchange of correspondence in relation to Invesmart's second application is illustrative of this conduct:
- (a) On 2 September 2002, CNB wrote to Invesmart requesting further information regarding the source of Invesmart's funding for the acquisition of Union Banka.²¹
- (b) On 12 September 2002, Invesmart met with the CNB. At this meeting the CNB warned that if Invesmart could not adduce evidence regarding the provenance of

²⁰ Exhibit R-307, Decree of CNB No. 166/2002 Coll., dated 8 April 2002.

²¹ Exhibit R-56, letter dated 2 September 2002 from CNB to Dr Gert Rienmüller

its funds its application would be rejected.²² The minutes of this meeting show that Invesmart informed the CNB that its investors would not commit funds for the transaction until a final decision regarding state aid was taken.

- (c) On this same day Union Banka wrote to CNB proposing that it would fund Invesmart's acquisition of itself by replacing its existing RPLs with a new RPL to Invesmart.²³ This structure was rejected by CNB.²⁴
- (d) On 16 September 2002, Invesmart wrote to the CNB requesting additional forms of support from the Czech Government. Specifically, Invesmart requested that the Czech Government "define" the financial commitment it would make to support Union Group's Polish banking subsidiary, Bank Przemyslowy.²⁵ It also requested a guarantee from the CNB not to withdraw Union Banka's banking licence unless there is a deterioration "of the Bank's financials" related to the activity of the new management. By this letter Invesmart also informed the CNB that:

The Union Group acquisition will therefore be entirely covered by Invesmart with its own asset [sic]. A Board Meeting and a Shareholder Meeting have been called to increase the capital of the company of additional 90 million euro.

- (e) In response to Invesmart's 16 September 2002 letter the CNB informed Invesmart that:

...any [state assistance] is primarily a matter for the Ministry of Finance, requires approval of the Czech Government and must have the support of the Office for Protection of Economic Competition.

95. On 4 October 2002, the CNB denied Invesmart's second application to acquire a controlling interest in Union Banka on the basis that it had not received sufficient information about the source of the funds that Invesmart would use to finance the acquisition. On the advice of Governor Tůma, Invesmart did not appeal this decision. Rather, it waited until the expiration on 21 October 2004 of the 15 day appeal period for appeal of the decision dated 4 October 2002 to submit a new application.²⁶

²² Exhibit R-61, minutes of meeting held on 12 September 2002.

²³ Exhibit R-64, letter dated 12 September 2002 from Union Banka to the CNB.

²⁴ Exhibit R-65, letter dated 20 September 2002 from CNB to the Directors of Union Banka.

²⁵ Exhibit R-66, letter dated 16 September 2002 from Invesmart to the CNB.

²⁶ Statement of Claim, para 94.

96. On 22 October 2002, Invesmart submitted its third application for approval by CNB for it to acquire a controlling interest in Union Banka.²⁷ The application included Minutes of an Extraordinary General Meeting of Shareholders that was convened by Invesmart on 16 October 2002.²⁸ The application stipulated that the meeting was duly held and a resolution was validly approved for a capital increase of "EUR 90 million by way of share premium upon sole request of the Board of Managing Directors of the Company". . . . further signed and contemporaneously submitted to the CNB a declaration by Invesmart that:

The acquisition of 70% of Union Group, a.s. of the value of approximately EUR 90 million will be entirely funded by Invesmart B.V. with its own capital which has been increased by the Shareholders Meeting of the Company on October 16, 2002 and it will be entirely subscribed by shareholders.²⁹

97. This was the only information submitted by Invesmart to the CNB as evidence of the provenance of the funds that it would use to acquire a controlling interest in Union Banka.
98. The expiration of the appeal period and the consequential failure of Invesmart's second application received significant public attention in the Czech Republic on 22 October 2002.
99. On that day *Mlada fronta Dnes*, one of the Czech national daily newspapers, reported that Invesmart had confirmed that it did not appeal against the negative decision of the CNB.³⁰ . . . was quoted as saying: "It is very complicated. It cannot be definitively said that we do not continue in our negotiations. We are in contact with the CNB".
100. The CNB also publicly commented on the situation at Union Banka. In the afternoon on 22 October 2002 a spokesperson for the CNB, Ms Alice Frišaufová, made the following comment to the Czech media:

In this administrative proceeding the CNB did not grant its approval to Invesmart for the acquisition of qualified interest in Union Banka because the investor failed to provide the source of funding for the acquisition. As far as this proceeding is concerned, the decision is final. This does not, however, preclude Invesmart from filing a new application and commencing new administrative proceedings on granting the approval with the transfer of the shares.³¹

101. The parties agree that depositors of Union Banka commenced a run on Union Banka on 23 October which caused Union Banka to lose approximately CZK 1.7 billion in deposits.

²⁷ Exhibit C-41. Application by Invesmart for Approval for Acquisition of a Qualifying Holding in a Bank, submitted to CNB 22 October 2002.

²⁸ See Exhibit R-434, Resolution of Meeting of Shareholders of Invesmart, dated 16 October 2002; Exhibit R-435, minutes of a meeting of shareholders of Invesmart B.V., dated 16 October 2002. Both documents were attached to Invesmart's Third Application to the CNB for approval of its acquisition of Union Banka.

²⁹ Exhibit R-436, Declaration of Invesmart B.V., signed by . . . , dated 16 October 2002.

³⁰ Exhibit R-78, article published by *Mlada fronta Dnes* on 22 October 2002.

³¹ Transcript, Day 4, p. 191, lines 6-14.

Invesmart attributes this event to the comments made by Ms Frišaufová. The Czech Republic argues that the run was caused by public uncertainty generated as a result of the expiration of the appeal period of Invesmart's second application.

102. It was in these circumstances that on 24 October 2002 the CNB approved Invesmart's application to acquire a controlling interest in Invesmart.³²

Union Banka's growing financial problems throughout 2002

103. The October 2002 run occurred at the end of a period of declining financial fortunes for Union Banka. In June 2002 it became apparent, as a result of Invesmart's due diligence, that its financial situation remained impaired by RPLs to the value of CZK 2.5 billion.³³
104. On 6 June 2002, CNB delivered a report to Union Banka indicating that Union Banka had extended new RPLs to certain of its shareholders and that, as a consequence, significant additional funds (between CZK 160 billion and 1.878 billion) needed to be created by the bank.
105. Invesmart responded by requesting replacement of Union Banka's board of directors. The CNB was informed of this request³⁴ and by letter dated 4 July 2002 informed Union Banka that it too required that it replace all of the members of its Board of Directors.³⁵
106. Union Banka's financial situation continued to deteriorate as Deloitte & Touche sought to finalise its Union Banka's 2001 auditor's report. In the end an acceptable auditor's report for the bank was only secured as a result of two transactions that Invesmart entered to support the balance sheet of Union Banka.
107. First, on 13 August 2002, Invesmart entered into the Receivables Assignment Agreement with Union Banka (the "**Receivables Assignment Agreement**") under which Invesmart unconditionally agreed to purchase the portfolio of loans earmarked for assignment to CF for a cash payment of CZK 1.2 billion, if by 1 December 2002 CF did not take assignment of these loans. As security for its promise to pay, Invesmart agreed to post a CZK 300 million bank guarantee on the date of signing the Receivables Assignment Agreement. Invesmart's commitment under the Receivables Assignment Agreement, combined with the bank guarantee, thus 'replaced' provisions on the loan portfolio earmarked for transfer to CF for the

³² Exhibit R-38, CNB Decision, dated 24 October 2002.

³³ Exhibit R-28, Section 4 of the Formal Application for purchasing a controlling interest in Union Banka, a.s. filed by Invesmart on 17 June 2002 (Second Application to the CNB).

³⁴ Exhibit R-424, letter dated 17 June 2002 from Union Banka to the CNB.

³⁵ Exhibit R-421, letter dated 4 July 2002 from the CNB to Union Banka.

purposes of the audit. In effect, the Receivables Assignment Agreement removed the CF loans from Union Banka's balance sheet.

108. Secondly, on 14 August 2002, and as is discussed at paragraph 86 above, Invesmart and Union Group's selling shareholders entered into Addendum No 4 of the SPAs. Instead of making payment to the shareholders in exchange for their shares, Invesmart would assume the shareholders' debts under the RPLs "as soon as the Czech National Bank gives the approval with the taking over of debts by [Invesmart]". The effect of this agreement, having been entered into simultaneously with the Receivables Assignment Agreement, was to remove the CF Transaction as a condition precedent to the acquisition of Union Group share by Invesmart.
109. The 2001 audit of Union Banka, dated 16 August 2002, was issued in explicit reliance on the Receivables Assignment Agreement and Addendum No 4.³⁶ Specifically, the report was qualified by a statement that in Deloitte & Touche's opinion Union Banka might not be able to continue as a going concern absent Invesmart's capital entry into the bank.³⁷ However, Invesmart did not issue the bank guarantee required under the RAA on 13 August 2002 or at any time thereafter.³⁸ Moreover, when the 1 December 2002 deadline for the contemplated assignment of the loan portfolio to CF passed and Invesmart became liable under the Receivables Assignment Agreement to pay the CZK 1.2 billion it had agreed to pay, it failed to do so.
110. Union Banka's balance sheets were further supported by the entry of the "CNB Receivable" on its books on 23 September 2002. This "receivable" was based on an amount sought by Union Banka from the CNB which, having been rejected by the latter, resulted in an arbitration claim quantified by Union Banka at CZK 1.762 billion against it.³⁹ (Union Banka ultimately lost the arbitration in April 2003.) On 22 October 2002, the same day that Invesmart submitted its third application to the CNB and the day before the run on Union Banka took place, the CNB requested that Union Banka de-recognise the CNB receivable in its accounts by 25 October 2002.⁴⁰ Union Banka never took this action, even though the recording of a contingent asset such as the CNB receivable was contrary to IFRS Standards.⁴¹

³⁶ Exhibit C-31, Audit Report of Union Banka for 2001 issued by Deloitte & Touche on 16 August 2002, p. 1.

³⁷ *Id.*

³⁸ The Audit Report noted that Union Banka might not be able to continue as a going concern absent Invesmart's capital entry into the bank: *Id.*

³⁹ See Exhibit R-70, letter dated 22 October 2002 from the CNB to Union Banka.

⁴⁰ *Id.*

⁴¹ See First KPMG Expert Report, pp. 10-11.

111. Union Banka also failed to respond to the CNB's 4 July 2002 request to replace its Board of Directors. Consequently on 27 September 2002 the CNB requested that Union Banka replace all members of the Supervisory Board.
112. Mr de Sury and Mr Piga were subsequently appointed to Union Banka's board on 27 September 2002. On 8 October 2002 Mr Vávra was appointed CEO of Union Banka and commenced further due diligence of the bank's loan portfolio.⁴²

Negotiations for state aid between Invesmart and Czech Government agencies

113. The documentary record clearly shows that throughout 2002 the MOF was favourably disposed to consider making a grant of state aid to Union Banka. In particular, on 12 April 2002, based on assessments of Union Banka's 2001 proposals, the MOF prepared a draft proposal to Cabinet for the solution of the relationship between Union Banka and CF. This proposal was based on the proposed CF Transaction.⁴³ The MOF decided not to submit this proposal to Cabinet. Union Banka was informed of this decision in May 2002.⁴⁴
114. Parliamentary elections took place in the Czech Republic on 14 and 15 June 2002.
115. Notwithstanding the parliamentary elections, [redacted] wrote to Minister of Finance Rusnok on 28 June 2008. In this letter [redacted] reiterated Invesmart's intention to proceed with its investment in Union Banka and asked Minister Rusnok to reconsider if the relationship between Union Banka and CF relating to the Fores Deposit could be resolved.⁴⁵
116. Following the elections, with effect from 15 July 2002 a new Minister of Finance, Mr Bohuslav Sobotka, took office. After the change in leadership in July 2002, the MOF was favourably disposed to considering a grant of state aid to Union Banka. On 25 July 2008 First Deputy Minister of Finance, Eduard Janota, wrote to Invesmart stating that:

[The Government]...appreciates [Invesmart's] activity and I may confirm we are ready to discuss your proposal in detail. Please do not hesitate and sent [sic] to the Ministry of Finance and authorised a detailed project prepared in collaboration with Union Banka. Ministry is going to submit it to the Czech government and expects it will make final decision.⁴⁶

⁴² Exhibit R-245, letter dated 17 October 2002 from the CNB to Union Banka.

⁴³ Exhibit R-40, Proposal for the settlement of the relationship between Česká Finanční, s.r.o. and Union Banka a.s. prepared by MOF, dated 12 April 2002.

⁴⁴ Exhibit R-41, letter dated 20 May 2002 from Invesmart to the CNB.

⁴⁵ Exhibit R-32, letter dated 28 June 2003 from Invesmart to MOF.

⁴⁶ Exhibit R-48, letter dated 25 July 2002 from Deputy Minister of Finance Janota to Invesmart.

117. In August 2001, Invesmart initiated more regular contact with Czech Government agencies and negotiations with the newly elected Czech Government for the provision of state aid to Union Banka commenced in earnest.
118. Invesmart submitted a three part proposal to the Czech Government on 20 August 2002 (the "20 August Proposal"). The key parts of this proposal were as follows:
- (i) settle Union Bank's obligations under the Fores Deposit immediately by payment of CZK 1,134 million (as opposed to the CZK 1,591 million which Union Banka was obligated to pay on 31 December 2004 under the existing contract);
 - (ii) sell problem loans taken over from the 4 small banks in aggregate nominal value of CZK 1.6 billion (purchase price was not specified); and
 - (iii) invest the amount freed by the early termination of the Fores Deposit (i.e., CZK 1,134 million) into subordinated debt of Union Banka of unspecified maturity and bearing an 8 percent rate of interest, to be modified on an annual basis.⁴⁷
119. This proposal was rejected by the MOF on 24 September 2002 at a meeting between the MOF, CKA and CNB. At that meeting Minister Sobotka informed the officials of the CKA and CNB that the MOF would not accept the 20 August Proposal, but that it would be willing to submit an alternatively structured state aid proposal to the Czech Cabinet. Specifically:
- ...the lowering of prospective interest to market rate was proposed for discussion. The MOF was also willing to discuss a reduction in the principal amount of the Fores Deposit by some CZK 400 million through a transfer of problem assets of that amount.⁴⁸
120. Minister Sobotka also indicated that any grant of state aid would be subject to OPC approval.⁴⁹
121. Invesmart was informed of the outcome of the 24 September meeting by letter from the CNB dated 25 September 2002.⁵⁰

⁴⁷ Exhibit R-53, letter dated 20 August 2002 from Invesmart to MOF, Deputy Minister Sobotka (the "20 August Proposal").

⁴⁸ Statement of Defence, para 88.

⁴⁹ Exhibit R-60, minutes of meeting held on 24 September 2002 between representatives of the MOF, CKA, CNB, and Government Office.

⁵⁰ Exhibit R-72, letter dated 7 October 2002 from MOF to the CNB.

122. On 25 October 2002, the day after CNB issued its regulatory approval, discussions resumed between the MOF and Invesmart about the provision of state aid to Union Banka. A meeting took place between Euro-Trend, the consulting group hired by Union Banka on 16 October 2002 to conduct the state aid negotiations,⁵¹ and First Deputy Minister of Finance Dr Doruška.⁵² At this meeting Dr Doruška suggested possible forms of state aid. Specifically, a combination of:
- (a) lowering the interest rate on the Fores deposit; and
 - (b) the acquisition by CKA of a portfolio of non-performing loans at a value to be determined by an independent expert plus a mark-up of CZK 650 million, less cost of administration of the portfolio.⁵³
123. On 1 November 2002, Union Banka submitted a state aid proposal to the MOF which totalled CZK 1.2 billion (the "**First Euro-Trend Proposal**").⁵⁴ The proposal envisaged:
- (a) lowering the interest rate on the Fores Deposit of 11.5 percent to a rate between PRIBOR and a standard commercial rate;
 - (b) acquisition by CKA of a portfolio of non-performing assets at a price determined by independent experts plus an additional amount of state aid; and
 - (c) withdrawal of the arbitration claim which Union Banka filed against the CNB on 25 October 2002 in connection with Union Banka's takeover of the BDS (the "**BDS Arbitration Claim**") discussed above at paragraph 110.⁵⁵
124. On 5 November 2002, a meeting took place between Union Banka, the MOF and the CKA which was attended by Messrs Vávra (CEO of Union Banka), Nekovar (Euro-Trend), Oklestek (Eurotrend), Janota (First Deputy Minister of Finance, Doruška (MOF), Majer (MOF), Řežábek (CKA) and Svoboda (CKA). At this meeting the parties mooted the possibility of a commercial settlement of the BDS Arbitration Claim as an alternative to the First Euro-Trend Proposal.⁵⁶ The parties also discussed the regulatory requirement that any grant of state aid

⁵¹ Exhibit R-515, Agreement on advisory activities between Union Banka and Euro-Trend, dated 16 October 2002.

⁵² Statement of Claim, paras 90 and 104; Statement of Defence, para 120.

⁵³ Exhibit C-60, minutes of a meeting held on 25 October 2002.

⁵⁴ Exhibit R-13, First Plan submitted by Euro-Trend.

⁵⁵ Exhibit R-80, Claim by Union Banka against the CNB.

⁵⁶ Statement of Claim, para 107.

would have to be approved by the OPC. Invesmart claims that this was the first time at which this requirement was specified by the Czech Government.⁵⁷

125. On 8 November 2002, the CNB, which had already informed Union Banka that it refused to pay the "BDS Receivable" and had requested the bank to de-recognise it in its accounts by 22 October 2002, again advised Union Banka that it would not recognise nor settle the BDS Arbitration Claim.⁵⁸ Due to the CNB's objections, the BDS claim was subsequently removed from consideration as a means of providing state aid. (It was later resurrected by Union Banka in its Restructuring Plans.)
126. On 13 November 2002, the CEO of Union Banka, Mr Vávra, again met with staff of the CNB. At this meeting, Mr Vávra informed officials of the CNB that the new Euro-Trend proposal that was about to be circulated would not include the settlement of the BDS Arbitration claim and that Union Banka would limit its request for state aid to CZK 650 million. According to the statement of Mr Vávra, Union Banka was prepared to limit its request for state aid to CZK 650 million in order to avoid any further delay to the completion of the Foresbank settlement.
127. On 14 November 2002 Euro-Trend submitted to the MOF an amended proposal (the "**Second Euro-Trend proposal**") for the provision of state aid. This proposal was for the Czech Republic to provide aid in an amount not exceeding CZK 650 million on the following terms:
- (a) the lowering of the interest rate applied to the Fores Deposit to a floating market rate;
 - (b) early termination of the Fores Deposit and its transformation into a five year subordinated debt;
 - (c) the acquisition by the Czech Consolidation Agency ("**CKA**") of a portfolio of non-performing assets at a price determined by independent experts plus an additional amount of state aid; and
 - (d) a state guarantee of a portfolio of loans.⁵⁹

Invesmart's takeover of Union Banka and Union Group

128. On 17 November 2002, Invesmart signed 18 agreements to unconditionally assume certain of the RPLs of Union Group and Union Banka in the aggregate principal amount of CZK 2.67 billion.⁶⁰

⁵⁷ *Id.*, para 110.

⁵⁸ First witness statement of Governor Tůma, para 39; first witness statement of Mr. Vávra, para 63.

⁵⁹ Exhibit R-14, Second Euro-Trend Proposal.

⁶⁰ Exhibits R-83–R-100, 18 agreements on debt assumption entered into on 17 November 2002; Exhibits R-101–R-104, individual debt assumption and share purchase agreements.

129. On 18 November 2002, Invesmart officially acquired approximately 60 percent of the shares of Union Group, which owned approximately 75 percent of Union Banka at that time. Invesmart also directly acquired approximately 22 percent of the shares in Union Banka. At the CNB's request, the purchase price paid by Invesmart for the shares in Union Banka was to be used exclusively to pay back Union Banka's RPLs.⁶¹
130. Invesmart never paid for the shares it acquired in Union Banka.

Continued negotiations regarding State Aid

131. On 28 November 2002, Mr Vávra met with officials of the CNB. At that meeting the CNB informed Mr Vávra that the OPC would provide its opinion on the feasibility of state aid. The CNB informed Mr Vávra that there were three obstacles to the provisions of state aid:
- (a) the "one time, last time" rule, meaning that prior recipients would be denied future grants of state aid;
 - (b) the prohibition against state aid where losses were the result of intra-group transfers; and
 - (c) the aid provided must be sufficient for the bank to continue as a going concern.⁶²
132. On 29 November 2002, another meeting took place between representatives of the Ministry for Finance, the OPC, the CNB, the CKA, Union Banka and Euro-Trend. At that meeting the OPC informed Union Banka that it would assess the Second Euro-Trend Proposal against the *EC Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty*. The OPC also offered rescue aid to Union Banka. Union Banka did not accept this offer but asked for three months to prepare a restructuring plan that would be verified by its auditor.⁶³
133. Following the meeting of 29 November 2002, Union Banka began drafting a new restructuring plan that was directly based on the various EU guidelines relating to state aid.⁶⁴
134. Between 7 January 2003 and 12 February 2003, Invesmart submitted three alternative restructuring plans to the MOF and CNB.
135. The first of these was submitted on 8 January 2003 ("**The First Draft Restructuring Plan**") along with a third proposal for the provision of state aid (the "**Third Euro-Trend Proposal**").

⁶¹ Witness Statement of Radovan Vávra, paras 47–48.

⁶² Exhibit R-275, minutes of a meeting held on 29 November 2002 between Invesmart and the CNB.

⁶³ Exhibit R-115, minutes of a meeting held on 29 November 2002 between the Ministry of Finance, OPC, the CNB, the CKA, Union Banka, Euro-Trend and Invesmart.

⁶⁴ Statement of Claim, para 123; Witness Statement of Radovan Vávra, para 70.

The Third Euro-Trend Proposal envisaged that the Czech Government would implement one or more of the following measures:

- (a) a significant decrease of the fixed interest rate on the Fores Deposit or its reduction to zero;
- (b) the early termination of the Fores Deposit and its transformation into five year subordinated debt;
- (c) the acquisition by CKA of a portfolio of non-performing assets at a price determined by independent experts; and
- (d) the purchase of the BDS Arbitration Claim by CF.⁶⁵

136. The First Draft Restructuring Plan identified the settlement of the BDS Arbitration Claim as the proposed mechanism through which the Czech Government would provide state aid to Union Banka.⁶⁶

137. On 23 January 2003, Union Banka delivered a "**Second Draft Restructuring Plan**" which envisaged the provision of state aid to the value of CZK 1.691 billion which was to be provided via:

- (a) settlement of the BDS Arbitration Claim; or
- (b) a guarantee from the Czech Republic covering a portfolio of non-performing loans.⁶⁷

138. The MOF provided comments on both the First and Second Restructuring Plans at a meeting held on 28 January 2003.⁶⁸

139. On 12 February 2003, Union Banka submitted its third and final restructuring plan to the MOF ("**Third Restructuring Plan**") in which Union Banka proposed settlement of the BDS Arbitration Claim or, in the alternative, a state guarantee. The settlement of the BDS arbitration was proposed notwithstanding the CNB's clear statement of 8 November 2002 that

⁶⁵ Exhibit R-15, Third Euro-Trend proposal, page 13, para (e).

⁶⁶ Exhibit R-126, Request for grant of Exemption from State Aid Prohibition, dated 7-8 January 2003, Section 6.2, p. 18.

⁶⁷ Exhibit R-139, Request for grant of Exemption from State Aid Prohibition, dated 23 January 2003, Section 6.2.2 A).

⁶⁸ Exhibit C-68, comments on the restructuring plan expressed by the MOF in a meeting held on 28 January 2003.

it would not recognise or settle the BDS Arbitration Claim on a commercial basis.⁶⁹ The amount of state aid requested totalled CZK 1.762 billion.⁷⁰

140. The Third Restructuring Plan demonstrated that Union Banka's new management led by new CEO Mr Vávra had carried out an in depth inspection of the bank and had decided to create extra adjustments to cover bad loans worth CZK 1.8 billion.⁷¹ It specifically noted that:

The proposed figures for adjustments and provisions to be created considerably exceeds the previously anticipated figures, primarily as a result of the more realistic approach towards the quality of the assets and risk of the Bank's portfolio adopted by the new management team for restructuring.⁷²

The plan acknowledged that new management were of the opinion that Union Banka's situation was more dire than originally expected.

Union Banka's liquidity crisis and the denial of state aid

141. By 19 February 2003, it was clear that there was a growing liquidity crisis at Union Banka. On that day the assistant to Union Banka's CEO, Mr Vávra, sent a letter on his behalf to the Minister's secretary, requesting a meeting with Minister Sobotka within the next 48 hours "in a very urgent and pressing matter 'Crisis in Union banka'".⁷³
142. On the same day that his assistant requested the meeting with the Finance Minister, Mr Vávra met with CNB officials. The meeting's minutes reveal the bank's deteriorating situation:

Mr. Vávra referred to the current development in the area of liquidity as to catastrophic (sic). During the last two weeks (i.e., since the beginning of February), the Bank registers a continuous drain of liquidity. The liquidity cushion of the Bank is currently represented only by ca. CZK 550 mln and if the situation doesn't change fundamentally, it will run down completely next week, according to the judgment of Mr. Vávra. (Note: in mid January, the liquidity cushion of the Bank was around ca. CZK 1.1 mln).

According to the statement of Mr. Vávra, corporate clients are leaving the Bank, whereas deposits in the retail area grow; however, the total amount of deposits drain represents ca. CZK 40 mln per day.

Mr. Vávra resumed the measures taken by the Bank to date:

- holdback of credit transactions since October 2002
- active effort to increase deposits by means of advertisement and interest rates increase. (Note: the current deposits interest rates at the Union Bank are in rank 2x higher than those by other banks with the highest rates on the market!)

⁶⁹ First witness statement of Governor Tůma, para 40; First Witness Statement of Mr Vávra, para 63.

⁷⁰ Exhibit R-18, Third Restructuring Plan.

⁷¹ *Id.*, p. 5.

⁷² *Id.*, p. 31.

⁷³ Exhibit R-156, facsimile dated 19 February 2003 from Darina Koišová of Union Banka to Jana Horová, Ministry of Finance.

However, the Bank is not currently able to prevent the deposits drain by the means of the standard market mechanism...⁷⁴ [Underlining added; italics and bolding in original]

143. Thus, on the bank's own view, its liquidity situation was "catastrophical". It was plainly facing peril, and if no action was taken to stem the outflow of deposits, it faced the imminent prospect of having to close down.

144. The minutes continue, recording Mr Vávra as advising that:

If reversion in the liquidity situation did not occur and no hope for public support existed, there would be no other choice left than to "return the licence".

In this respect, he [Mr. Vávra] was warned by the CNB that optional termination of banking activities was possible only under the condition of settlement of all obligations. Thus in the current situation would come into question only administrative hearing about the licence withdrawal, because for example legal causes for the introduction of sequestration were not met (the stability of the banking system was not endangered) (sic).⁷⁵ [Emphasis added.]

145. Mr Vávra's 19 February 2003 request for liquidity support from the CNB was denied.

146. At 3 pm on the following day, 20 February 2003, Union Banka's Supervisory Board, comprising [redacted] and Mr de Sury, met with Governor Tůma and three colleagues from the CNB.⁷⁶ At that meeting, Governor Tůma read them his copy of the Minister's letter denying the aid which he had himself just received. The minutes record that the members of the bank's Supervisory Board were not able to express their opinion regarding the impact of this development on Invesmart's affiliation with Union Banka, "nor the possibility of the bank's shareholders securing its liquidity".⁷⁷ They indicated that they would keep the CNB informed of their actions in the next few days.⁷⁸

147. This meeting was followed by a meeting between the CNB and Mr. Vávra at 4 p.m. He too was informed of the Minister's rejection of the restructuring plan. According to the minutes, Mr Vávra informed the CNB of:

...the critical situation of the bank with respect to its liquidity, when deposit withdrawals by particularly corporate clients increased and in average, the value of deposit values is daily decreased by approx. CZK 40 million. By October 2002, the bank had already used all commercial measures, particularly limitation of loan

⁷⁴ Exhibit R-150, minutes of a meeting held on 19 February 2003 between Mr. Vávra for Union Banka, and Mr. Krejča, Mr. Jíříček, Ms. Goldscheiderová, and Mr. Majer of the CNB.

⁷⁵ *Id.*, p. 2.

⁷⁶ Exhibit R-154, minutes of a meeting held on 20 February 2003 between [redacted] and de Sury and Governor Tůma, Mr. Štěpánek, Mr. Krejča and Mr. Jíříček of the CNB.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁸ *Id.*

transactions in an active attempt to increase deposits through promotions and increase of interest rates and the sale of quickly liquid assets, but it unable to prevent further outflow of deposits. Other measures, particularly in the area of sale of receivables or repo operations with respect to receivables, are not feasible within the near future and do not resolve the situation of the bank.

...With regard to the above-mentioned situation, the bank is unable to fulfil its legal obligation to maintain solvency and further operation of the bank would only harm the position of its depositors.

The above statement is to be treated as notice under Section 26b of the Act No. 21/1992 Coll., as amended.

3. Mr. Vávra promised to discuss further steps by the bank at a meeting of the board of directors immediately following this meeting and to inform shareholders and the CNB.

4. The CNB acknowledged the above-mentioned facts and considers the eventual decision of the bank to close its branches to be rational. If the bank decides to close its branches, the CNB will immediately notify the Deposit Insurance Fund in order to start the pay-outs of compensation to depositors as soon as possible to minimize the impact on the depositors. Maximum information provided to the public is considered important by the CNB and the CNB is ready to cooperate with the bank in this area.

The CNB is interested in the most orderly exit of the bank from the sector with minimum impact on the bank's depositors and the banking sector ...⁷⁹ [Emphasis added.]

148. In the evening of 20 February 2003, Union Banka's management met and decided not to open branches the next day. They informed the CNB about this decision by letter prepared later that same evening, with the time of 7 p.m., in which Mr Vávra and two senior bank officers stated:⁸⁰

...In a situation where the liquidity of the bank is continuously declining and this trend has continued culminating for the last two weeks, we were informed today of the decision of the State not to grant the bank the requested state aid. The decision was publicized during the afternoon and makes a real possibility, according to our recent experience, that a run on the bank will start on 21 February 2003. In accordance with Section 26b of the Banking Act, we have, therefore, come to the conclusion that the bank shall, as a result of the above-mentioned circumstances, in all likelihood become insolvent tomorrow and we give you this information pursuant to the above-mentioned Section 26b.

At the same time, in view of the last consultations with the Czech National Bank, we are taking immediate measures pursuant to Section 26 of the Banking Act and shall limit certain permanent activities, especially, with immediate effect, i.e., with effect from the next following business day – 21 February 2003 – we shall close all branches of Union banka, the clearing centre, etc.⁸¹ [Emphasis added.]

⁷⁹ Exhibit R-155, minutes of a meeting held on 20 February 2003 between Mr. Vávra and Governor Tůma, Mr. Krejča and Mr. Jířiček of the CNB.

⁸⁰ Exhibit R-158, letter dated 20 February 2003 from Union Banka to the CNB.

⁸¹ *Id.*

149. The following day, Union Banka closed all of its branches and the CNB initiated administrative proceedings to revoke the bank's licence.⁸² The Deposit Insurance Fund was notified that it might be required to compensate the bank's depositors and the CNB commenced administrative proceedings to revoke the bank's licence.⁸³
150. It is evident that this notification did not find favour with Invesmart. Three days later, two of the three signatories to the letter, Messrs Vávra and Roman Truhlář, were dismissed and replaced by Mr Michal Gaube and Mr Roman Mentlík. It appears that the reason for their dismissal lay in what [redacted] considered to be "the fact that [the] members of the board of directors whose dismissal was proposed, may take irreversible steps, measures or legal acts that would contradict the interests of Union banka, a.s., its shareholders and clients of Union banka, a.s."⁸⁴
151. There is further evidence of a disagreement between Mr Vávra and [redacted] as to the proper way to proceed. An article in the Czech publication, *Týden*, dated 10 March 2003, later quoted Mr Vávra as saying that the depositors in Union Banka:
- ...should hope for a quick revocation of Union banka's licence and quick payout from the deposit insurance funds. ... This was precisely my logic, why I closed the bank's branches, because the head of Invesmart [redacted] and the CNB did not do it. The branches were closed by me in order for as much money as possible to be saved. ... [redacted] wanted to continue to keep the bank open. He did everything to make that happen, gave me various orders from his post as the head of the Supervisory Board. I firmly stood behind my view that under no circumstance would I do that.⁸⁵ [Emphasis added.]
152. On 24 February 2003, the first two applications for declaration of bankruptcy of Union Banka were filed by creditors with the Regional Court in Ostrava.⁸⁶

Union Banka's attempts to renew its operation

153. On 27 February 2003, Union Banka presented a salvage plan to the CNB for the renewal of its operations.⁸⁷ This plan was supplemented on three occasions during March 2003.

⁸² Exhibit C-81, letter dated 21 February 2003 from Union Banka to the CNB; Exhibit C-79, CNB notification to Union Banka of the commencement of administrative proceedings to withdraw a banking licence.

⁸³ Exhibits C-79 and C-81, letters dated 21 February 2003 respectively from the CNB to Union Banka.

⁸⁴ Exhibit R-160, minutes of the extraordinary meeting held on 24 February 2003 of the Supervisory Board of Union Banka.

⁸⁵ Exhibit R-445, *Týden*, dated 10 March 2003.

⁸⁶ Exhibit R-161, Petition for declaration of bankruptcy of Union Banka filed by City Realitni Spravni S.R.O. v Likvidaci and Inert Investment Corp in the Regional Court in Ostrava on 24 February 2003.

⁸⁷ Exhibit R-162, Report for the meeting of the Board of Directors of Union Banka on the 27 February 2003 proposal for renewal of business operation ("First Proposal").

154. First, on 3 March 2003, Union Banka filed the plan with the CNB and commented on the CNB's notice of the commencement of administrative proceedings to revoke Union Banka's licence.⁸⁸ This plan was based on unverified data. It included a statement that the plan was subject to change pending an external audit to verify the correctness of assumptions and information presented therein.
155. Secondly, on 10 March 2003, Union Banka submitted a supplement to its plan to the CNB.⁸⁹ This proposal envisaged Union Banka continuing to operate on a limited licence whereby it would be prohibited from taking further deposits. It would pay out 100 percent of claims by depositors itself and would finance payment of claims by depositors in excess of CZK 5 million per client under a five year loan agreement with the Bank Deposit Insurance Fund ("FPV"). The Czech Government was not satisfied that Union Banka had funds to implement this plan. Further, the proposal was inconsistent with provisions of the Czech *Banking Act* and the law establishing the FPV.⁹⁰
156. Thirdly, on 18 March 2003, [redacted] informed the CNB that Invesmart had entered into a memorandum of understanding with MTGLQ investors, L.P., a wholly owned subsidiary of Goldman Sachs, to cooperate on a new plan.⁹¹ The CNB was informed of this plan once it had already made its decision to proceed with the revocation of Union Banka's banking license, which occurred on that same day.
157. On 27 March 2003, the FMV applied for Union Banka's bankruptcy before the Regional Court in Ostrava. On 31 March 2003, Union Banka created provisions for debts assumed by Invesmart as requested by CNB, resulting in negative capital of CZK 1.29 billion.⁹²

The fraudulent bankruptcy proceedings of Union Banka

158. The orderly bankruptcy of Union Banka was interrupted by proceedings commenced on 31 March 2003 before the Commercial Court in Ústí nad Labem. On that same day Judge Berka, the presiding Judge, declared Union Banka bankrupt and appointed Daniel Thonat as the bank's bankruptcy trustee. On 1 April 2003, Mr Thonat and a group of armed men forcibly entered Union Banka's main office in Prague.

⁸⁸ Exhibit R-163, Proposal dated 3 March 2003 to resolve the situation of Union Banka; Exhibit R-164, Union Banka statement dated 3 March 2003 to the commencement of administrative proceedings to revoke Union Banka's licence.

⁸⁹ Exhibit R-168, Supplement dated 10 March 2003 to the proposal for resolution of the situation of Union Banka.

⁹⁰ See Exhibit R-304, Section 1(1) of the Banking Act; Exhibit-304 and expert opinion of Dr. Kotáb, para 33. See also Exhibit R-169, opinion of the Management of FPV on the proposal of Union Banka, dated 11 March 2003.

⁹¹ Exhibit C-88, letter dated 18 March 2003 from [redacted] to the CNB.

⁹² Exhibit C-89, Report by the Czech Chamber of Deputy Standing Committee on Banking regarding the situation of Union Banka, a.s. in June 2003, Section 8.

159. It is common ground that these proceedings were fraudulent and were only sustained on the basis of forged documents. For this reason, Judge Berka annulled his bankruptcy decision on 4 April 2004. Further, on 8 April 2003, the President of the Czech Republic and Prime Minister approved the removal of Judge Berka's immunity.⁹³ Judge Berka was subsequently prosecuted for abuse of power by a public official.
160. On 14 April 2003, Union Banka filed an application for a voluntary composition with its creditors with the Bankruptcy Court in Ostrava and a voluntary bankruptcy petition. The members of Union Banka's Board of Directors who filed the voluntary bankruptcy petition were recalled the same day and the petition for voluntary bankruptcy was withdrawn the same day.⁹⁴
161. On 24 April 2003, Union Banka lost the BDS Arbitration Claim.⁹⁵
162. On 28 April 2003, the Czech Securities Commission ("CSC") requested Invesmart to honour its obligations to purchase shares in Union Banka tendered to it by the minority shareholders who accepted Invesmart's mandatory tender offer.⁹⁶

The revocation of Union Banka's banking licence and the liquidation of Union Banka

163. On 30 April 2003, the CNB Board rejected Union Banka's appeal of the CNB's decision of 18 March 2003 to revoke its banking licence. The revocation of Union Banka's licence became effective on 2 May 2003.⁹⁷
164. On 9 May 2003, the CNB filed a petition with the Regional Court in Ostrava to dissolve Union Banka and appoint a liquidator.⁹⁸ On the same day, the Regional Court in Ostrava declared Union Banka to have entered liquidation and appointed Value Added S.R.O. as liquidator.⁹⁹ The decision came into effect on 19 May 2003. Union Banka did not appeal the decision.
165. On 17 May 2003, the FTV began making payments to Union Banka's depositors.¹⁰⁰

⁹³ Statement of Claim, para 188.

⁹⁴ Exhibit R-205, Union Banka's application for declaration of bankruptcy filed on 14 April 2003; Exhibit C-135, Union Banka's application for composition filed on 14 April 2003; Exhibit R-208, Revocation of Union Banka's bankruptcy application, dated 14 April 2003.

⁹⁵ Exhibit C-137, Arbitration award of the Court of Arbitration at the Chamber of Commerce of the Czech Republic and the Agrarian Chamber of the Czech Republic.

⁹⁶ Exhibit R-293, letter dated 28 April 2003 from the Securities Commission to Invesmart.

⁹⁷ Exhibit R-215, CNB decision Ref. No. 203/2512/110, dated 30 April 2003. See also the protocol and delivery of the decision, dated 2 May 2003; Exhibit R-214.

⁹⁸ Exhibit R-216, CNB application for liquidation of Union Banka, dated 6 May 2003.

⁹⁹ Exhibit R-217, letter dated 26 May 2003 from the CNB with decision on liquidation of Union Banka attached.

¹⁰⁰ Exhibit C-142, decision of the Regional Court in Ostrava Ref. No. 33K 10/2003, dated 29 May 2003.

166. On 27 May 2003, the Regional Court in Ostrava dismissed Union Banka's application for composition.¹⁰¹
167. On 29 May 2003, the Regional Court in Ostrava declared Union Banka bankrupt and appointed Ms Michaela Huserová as bankruptcy trustee.¹⁰² Ms Huserová immediately commenced liquidation of the banks assets, a process which continued until Ms Huserová was removed as Union Banka's trustee following a decision of the High Court in Olomouc that she had been involved in unlawfully selling the assets of Union Banka.¹⁰³
168. On 13 June 2003, Union Banka appealed the declaration of bankruptcy and the decision rejecting its application for composition.¹⁰⁴ Both appeals were rejected.

Invesmart's refusal to pay for shares it acquired in Union Banka

169. Invesmart's refusal to pay for the shares it acquired in Union Banka has been the subject of litigation both in the Netherlands and in the Czech Republic.
170. On 9 June 2004, a bankruptcy application lodged by Union Banka's then bankruptcy trustee Ms Huserová was rejected based on debts owing to Union Banka which Invesmart had assumed as consideration for the shares in Union Group.¹⁰⁵
171. On 9 August 2004, Invesmart applied to the Municipal Court in Prague to annul its assumption of debts pertaining to Union Banka, claiming the assumption void on account of breach of the Banking Act by Union Banka. This claim is still pending. Invesmart in the same submission sued the CNB for EUR188 million in damages allegedly caused to Invesmart by wrongful official procedure applied by the CNB.¹⁰⁶
172. On 23 April 2004, Ms Huserová on Union Banka's behalf filed three claims against Invesmart in court for a total of CZK670 million in connection with Invesmart's debt assumption.¹⁰⁷

¹⁰¹ Exhibit R-218, decision of the Regional Court in Ostrava Ref. No. 13KV 1/2003, dated 27 May 2003.

¹⁰² Exhibit C-142, decision of the Regional Court in Ostrava Ref. No. 33K 10/2003, dated 29 May 2003.

¹⁰³ Statement of Claim, para 207.

¹⁰⁴ Exhibit R-223, Union Banka's appeal against the decision of the Regional Court in Ostrava, dated 12 June 2003; Exhibit R-219, Union Banka's appeal against the decision on liquidation of Union Banka, dated 12 June 2003.

¹⁰⁵ Exhibit R-239, petition for involuntary liquidation of Invesmart filed on 9 July 2004 in the District Court of Amsterdam.

¹⁰⁶ Exhibit R-243, petition for determination of invalidity of the relationship of obligation between Invesmart and the trustee in bankruptcy of Union Banka and claim for damages filed on 9 August 2004 in the Municipal Court in Prague.

¹⁰⁷ Exhibits R-240–R-242, decisions ref. nos. 26 Cm119/2004-28, 26Cm117/2004- 30 and 26Cm118/2004-28, dated 23 February 2005.

173. On 23 February 2005, the Regional Court in Ostrava ordered Invesmart to pay CZK670 million in connection with Invesmart's debt assumption following Ms Huserová's claim filed on 23 April 2004. Invesmart did not pay.
174. On 31 May 2005, Ms Huserová filed a further 15 claims against Invesmart totalling CZK 2.67 billion based on debts assumed by Invesmart as consideration for the shares in Union Group. These claims are still pending.

Jurisdiction

Introduction

175. The Respondent has asserted that the Tribunal does not have jurisdiction to decide the case. In its Statement of Defence, Statement of Rejoinder and at the hearing the Respondent put forward several contentions for its assertion of lack of jurisdiction. In essence, three discrete arguments have been raised:

- (i) the Claimant is not a Dutch investor;
- (ii) the Claimant did not make an investment in the Czech Republic; and
- (iii) the Claimant, through its actions in the Czech courts, is precluded from arguing that it validly acquired the shares in Union Banka and its holding company.

176. The Tribunal will deal with each of these arguments in turn.

Nationality

177. Article 1(b) of the BIT defines "investors" as follows:

- (b) the term 'investors' shall comprise:
 - i. natural persons having the nationality of one of the Contracting Parties in accordance with its law;
 - ii. legal persons constituted under the law of one of the Contracting Parties.

178. It is not doubted that Invesmart is a legal person constituted under the law of The Netherlands. However, the Respondent argues that the Claimant does not have any real connection to the Netherlands and for that reason does not satisfy the notion of an "investor" pursuant to the BIT. The Respondent argues that the Claimant has no real presence and no management in the Netherlands, it being physically located in Italy and controlled by Italian nationals.

179. For its part, the Claimant relies on the wording of Article 1(b) of the BIT and on the fact that it is constituted under the law of the Netherlands. The Claimant argues that there is no "origin of capital" requirement in the BIT and no such requirement may be implied. It notes that the Czech Republic's "origin of capital" argument was rejected by another tribunal's Decision on Jurisdiction of 29 April 2004 in *Tokios Tokelés v Ukraine*.¹⁰⁸
180. This Tribunal considers that the words of Article 1(b) of the BIT are clear and that, in the case of legal persons, the only requirement is that the legal person is constituted under the law of one of the Contracting Parties. There is no basis for implying any further requirement. Accordingly the Tribunal decides that the Claimant is an investor within the meaning of Article 1(b) of the BIT.

Investment

181. In its Statement of Defence the Respondent contended that the Claimant never acquired beneficial ownership of the shares in Union Banka and Union Group and made no substantive investment in the sense of committing capital. The Respondent contended that:

[a]s the Respondent has already shown in this Statement of Defence, Invesmart (i) paid no purchase price for the shares, (ii) having agreed (at a shareholder meeting held on 16 October 2002) to a EUR 90 million capital increase in order to allow the Union Banka transaction to proceed, did not increase its capital, (iii) entered into debt assumption agreements in return for the transfer of shares but never met its obligations to Union Banka and Union Group under those debts, (iv) defaulted on its obligation to pay for shares of minority shareholders in Union Banka, which Czech law required it to offer to acquire and (v) is still a party to the Czech Repudiation Claim proceedings in which it argues that the debt assumptions were void *ab initio* as a matter of Czech law.

As a result, even if it could be established that Invesmart had legal title to the shares in Union banka and Union Group (which is denied for the reasons detailed above), the Claimant never became the beneficial owner of the shares in question because it never performed the obligations which were the *quid pro quo* of its acquisition of those shares. Accordingly, Invesmart cannot be said to have invested any assets in the Czech Republic as required under Article 1(a) of the BIT. Therefore, Invesmart made no investment protected by the BIT.¹⁰⁹

182. In its subsequent Statement of Rejoinder, and at the hearing, the Respondent appeared to retreat from its first contention, that the Claimant did not become the owner of the shares, and emphasised the second aspect of its argument, namely that there had been no investment of capital. As far as ownership of the shares in concerned, the decisions of the Czech courts, which are referred to below, would appear to establish, or at least are consistent with, the

¹⁰⁸ ICSID Case No. ARB/02/18.

¹⁰⁹ Statement of Defence, paras 276 and 277.

proposition that the Claimant did in fact become the legal owner of the shares in Union Banka and Union Group.

183. The second aspect of the Respondent's argument focuses on the substance of the investment. The Respondent refers to the preamble to the BIT which states that the Treaty's object is to "stimulate the flow of capital and technology and the economic development of the Contracting Parties". The Respondent maintains that merely acquiring legal title over any kind of asset is not sufficient to bring that asset under the protection of the BIT. The Respondent contends that there must be a commitment of money to earn a financial return. The Respondent states that the Claimant has not paid for the shares and that throughout the lifetime of its activities in the Czech Republic, the Claimant has outlayed no expenditure for the benefit of Union Banka. Indeed the Claimant has instead been reimbursed for its due diligence work and for the living expenses of its representatives operating in the Czech Republic.

184. In support of its argument the Respondent refers to a number of cases including *Salini Costruttori S.p.A and Italstrade S.p.A v Kingdom of Morocco*,¹¹⁰ *Joy Mining Machinery Limited v Arab Republic of Egypt*,¹¹¹ amongst others.

185. The Claimant contends that the cases cited by the Respondent are ICSID cases that examine the meaning of the term "investment" in Article 25 of the ICSID Convention, which was purposely left undefined by the drafters. However, the Claimant argues that the definition of investment for the purposes of the BIT is defined and is exclusive.

186. Article 1(a) of the BIT defines "investments" as follows:

- (a) 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.

¹¹⁰ ICSID Case No. ARB/00/4, Decision on Jurisdiction of 23 July 2001; ILM, vol. 42 (2003), p. 609, para 52.

¹¹¹ ICSID Case No. ARB/03/11, Award on Jurisdiction of 6 August 2004, para 53.

187. It will be seen that Article 1(a)ii expressly includes "shares" in the definition of "investments". The Respondent's contention would require the Tribunal to read in a qualification that there be payment or other consideration for the acquisition of the shares. Moreover it would seem to follow that any consideration however small may not suffice. Would a nominal consideration of say one cent or a peppercorn be any different, in substance, from no consideration? The Respondent referred to the aim of the BIT, as set out in its preamble, which is to stimulate the flow of capital and economic development. If the shares were acquired for a nominal value this could hardly be regarded as sufficient to stimulate the flow of capital and economic development.
188. It would seem, then, that the Respondent's submission, if accepted, would require the Tribunal to embark on an inquiry as to whether the consideration paid for the shares was adequate or perhaps substantial. Such an enquiry would necessitate the Tribunal undertaking an assessment of the value of the investment and the consideration paid with no criteria to guide it. Moreover even if the consideration paid was adjudged to be 'adequate', would there have to be a further assessment as to whether the total amount invested was sufficiently substantial having regard to the aim of the BIT to stimulate the flow of capital and economic development?
189. The Respondent's submission would require the Tribunal to qualify the express words of Article 1 by implying an additional requirement of a qualitatively adequate investment. The Tribunal sees no compelling reason for doing so. The Tribunal considers that Article 1 should be given its plain and literal meaning and that the express inclusion of "shares" as an investment means that the acquisition of shares constitutes an investment without further inquiry.

Preclusion

190. The consideration which the Claimant agreed to provide for its acquisition of the shares was an unconditional promise to pay EUR 90 million to discharge Union Banka's related party loans. The Claimant never made the payment, contending that the whole arrangement was conditional on the Czech Government providing aid to the bank. Subsequently Union Banka were placed in liquidation and the bankruptcy trustees commenced some 18 proceedings against the Claimant seeking payment of the EUR 90 million. The Claimant contended that the share acquisition agreements, and in particular its obligation to pay the EUR 90 million, were void or otherwise unenforceable. Three of these cases have been decided. In each, the Czech courts decided that the share purchase agreements were valid and that Invesmart consequently had an obligation to pay the EUR 90 million consideration.

191. The Respondent argues that the Claimant has adopted fundamentally inconsistent positions in the Czech court proceedings and in this arbitration. In this arbitration the Claimant states that it has made an investment in the Czech Republic and seeks relief against the Czech Government with respect to its alleged breaches of obligations under the BIT concerning that investment. However in the Czech court proceedings the Claimant contends that the debt assumptions, and in turn the share acquisitions, were void with the logical consequence that there could never have been an investment.
192. The share acquisition agreements were entered into between the Claimant and third persons who are not parties to this arbitration. Neither party to this arbitration has asked this Tribunal to determine whether the share acquisition agreements are valid and the Tribunal has not heard argument as to whether it has jurisdiction to do so.
193. In the circumstances, the Tribunal assumes the validity of the share purchase agreements unless and until it is established that another court or tribunal with authority has determined that the share purchase agreements are void as a matter of Czech law. Moreover, the evidence before this Tribunal is that in three decided cases, the Czech courts have held that the share purchase agreements as well as the obligation of the Claimant to pay the consideration of EUR 90 million are valid and enforceable. Therefore, this Tribunal has no basis for considering the agreements to be void. The Claimant is not precluded from contending that it made a valid investment in the Czech Republic.

Applicable Law

194. Article 8(6) of the BIT provides:

The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively:

- the law in force of the Contracting Party concerned;
- the provisions of this Agreement, and other relevant Agreements between the Contracting Parties;
- the provisions of special agreements relating to the investment;
- the general principles of international law.

195. The application of this provision was clarified by representatives of the Netherlands and the Czech Republic who held consultations pursuant to Article 9 of the BIT. As a result of these consultations, Agreed Minutes dated 1 July 2002 provided:

- (i) On the issue of investment disputes and interpretation of Article 8.6 of the Agreement [i.e., the Treaty]:

The arbitral tribunal shall decide on the basis of the law. When making its decision, the arbitral tribunal shall take into account, [in particular] though not exclusively, each of the four sources of law set out in Article 8.6. The arbitral tribunal must therefore take into account as far as they are relevant to the

dispute the law in force of the contracting party concerned and the other sources of law set out in Article 8.6. To the extent that there is a conflict between national law and international law, the arbitral tribunal shall apply international law.¹¹²

196. The Claimant submits that in practice this means that the Tribunal must apply the substantive legal provision set forth in the Treaty, the applicable international law instrument to the merits of this dispute, along with any relevant general rules of international law.¹¹³ According to the Claimant Czech law plays two roles. First, the Treaty itself provides that Czech law is relevant to the extent that it is more favourable to the investor than the Treaty. Secondly, it is a well-established principle of international law that, before an international tribunal, the host state's domestic law is relevant with respect to factual issues.¹¹⁴
197. The Respondent proposes that Czech law enforced during the events described in the Statement of Claim must be applied to the extent relevant to this dispute and to the extent not contrary to international law. According to the Respondent Article 3(5) certainly does not mean that the law of the host state should be disregarded and limited only to cases where it affords better treatment to the investor. There are good reasons why national law needs to be examined before turning to international law. The Respondent further claims that whether the existence of a "commitment" to provide state aid to the Claimant could have arisen in the circumstances must be based upon or consistent with Czech law as in effect.¹¹⁵
198. The Tribunal observes that the difference in the position of the Claimant and the Respondent is more apparent than real. The Claimant concedes that a host state's domestic law is relevant with respect to factum and refers to Oppenheim's International Law (9th Edition 1996 by Sir Robert Jennings and Sir Arthur Watts). In the Tribunal's opinion, Czech law is relevant insofar as it prescribes the requirements for making an investment and obtaining state aid. The difference in result if Czech Law is applied as factum or as a governing law is immaterial and to some extent academic. However, the Tribunal notes that Czech law is a governing law under the treaty, although its application as a governing law is always subject to the qualification that in the event of conflict between national law and international law, international law prevails.

¹¹² These minutes are quoted in the *CME Czech Republic B.V. v The Czech Republic*, Final Award, dated 14 March 2003, para 91.

¹¹³ Reply Memorial, para 278.

¹¹⁴ Statement of Claim, paras 227, 231 and 233.

¹¹⁵ Statement of Rejoinder, paras 40–48

Fair and equitable treatment

General standard

199. Chief amongst Invesmart's claims is its submission that the Czech Republic violated the fair and equitable treatment standard which is set out at Article 3(1) of the BIT. This article provides that "each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party".
200. The Tribunal notes that there has been a growing jurisprudence and case law dealing with the notion of fair and equitable treatment in recent years. The content of this obligation has been variously and not consistently described as including the different strands of protection of an investor's legitimate expectations, protection against manifestly arbitrary or grossly unfair treatment, requiring consistency of governmental decision-making, transparency, due process and adequate notice, protection against discrimination that does not amount to a breach of the national treatment standard and protection against acts of bad faith.
201. The tribunal in *Waste Management v Mexico* sought to bring together various NAFTA awards and to state the law in summary terms:
- [F]air and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves lack of due process leading to an outcome which offends judicial propriety... in applying the 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.¹¹⁶
202. In its Statement of Defence the Respondent correctly noted that the two most fundamental features of the fair and equitable treatment standard are:
- (i) the fact that the violation of that standard occurs only when a certain minimum level of inappropriateness of the host state's conduct is exceeded; and
 - (ii) that the dominant feature of that standard is the protection of the investor's expectations which must, however, be legitimate and reasonable and follow from the state of the domestic law at the time of the investment and the totality of the business environment at the time.
203. In support of these observations the Respondent drew the Tribunal's attention to the *Saluka* Partial Award where that tribunal endorsed and commended ("as a useful guide") *Waste Management's* threshold for infringement of the fair and equitable treatment standard when interpreting the instant Treaty. *Saluka* went on to quote the comments of tribunals in the

¹¹⁶ Exhibit C-193, *Waste Management, Inc. v The United Mexican States (No.2)*, ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, para 98.

Tecmed, CME, Waste Management and the *Occidental Petroleum* cases as to the relationship between the notion of “legitimate expectations” and the fair and equitable treatment standard, and stated its view that:

304. This Tribunal would observe, however, that while it subscribes to the general thrust of these and similar statements, it may be that, if the terms were 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 unequitable 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 “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.¹¹⁷

Legitimate Expectations

The Claimant

204. The central plank of Invesmart's fair and equitable treatment claim was its contention that it formed a legitimate expectation that the Respondent committed to provide state aid having a certain financial effect upon Union Banka. This expectation was said to have crystallised on 24 October 2002 when, after extensive written and oral communications with various Czech agencies, Invesmart’s third application to acquire control of the bank was approved by the CNB.
205. Invesmart submitted that throughout its discussions with the Czech Government it stated that its investment in the bank was contingent upon a grant of state aid and that its investment was based on an express, or in the alternative an implied, commitment of state aid. The Czech financial authorities were fully aware of its position as Invesmart had communicated this to them. The express promise came from governmental officials and the implicit promise lay in the CNB’s approval which, in the Claimant’s view, would not have been granted had the Ministry of Finance not committed to provide state aid. Therefore, when the CNB approved the acquisition of a controlling shareholding in the bank on 24 October 2002, a promise of state aid enforceable at international law was said to have crystallised.

¹¹⁷ See Exhibit C-194, *Saluka* Partial Award of 17 March 2006, paras 288, 304-305, italics in original.

206. Accordingly, Invesmart argued that the Tribunal should find in its favour if it finds that the Czech Republic made an express representation that state aid would be granted, or, alternatively, if the Czech Republic induced Invesmart to acquire the bank and assume the related party loans under circumstances where Invesmart held a legitimate expectation of state aid.¹¹⁸
207. The Claimant adduced several categories of evidence in support of its characterisation of the CNB's approval of its acquisition, including:
- (a) written communications between Invesmart, the CNB and the MOF which Invesmart offered as proof that it had stated that its acquisition of Union Banka was subject to state aid being granted;
 - (b) internal government documents which Invesmart offered as proof of the CNB's understanding that Invesmart would not invest in Union Banka absent state aid; and
 - (c) communications surrounding internal government meetings held on 24 September 2002 and 24 October 2002, which Invesmart claimed were pivotal points in its negotiations concerning Union Banka.
208. In developing its submissions it went on to characterise the state aid negotiations following the CNB's approval as changing the rules of engagement once the acquisition had been made.
209. The specific items of evidence adduced by Invesmart in support of its submissions are described in more detail in the paragraphs directly below.

Correspondence between Invesmart and the CNB and MOF

210. The Claimant referred to five examples of written communications with the CNB and the Ministry of Finance where it stated that it would acquire control of Union Banka only if state aid were granted. For example, the minutes of a meeting held on 5 December 2001 between the CNB and Union Banka, just after Invesmart became involved with the bank, noted the contemplated sale of shares in Union Group to Invesmart and recorded that the sale was subject to conditions such as CNB approval and "resolving the Fores (Česká finanční project)" ("**CF Transaction**").¹¹⁹

¹¹⁸ Transcript, Day 7, Smith, p. 5, lines 20–25, p. 6, lines 1–9.

¹¹⁹ Exhibit R-34, minutes of a meeting held at the premises of the CNB on 5 December 2001 between the CNB, Union banka, and Union Group.

211. Likewise, by letter dated 26 March 2002 to Pavel Racoča and Vladimír Krejča of the CNB, copied to Marie Parmová (then President of Union Banka), Invesmart's Giuseppe Roselli stated the company's intention to purchase 70 percent of Union Group's shares. Mr Roselli's letter recorded Invesmart's position on the need for the CF Transaction:

In [sic] the same time we are preparing, in cooperation with our advisors, the reconstructing plans for both Union Group and Union banka. We want to finalise the whole transaction in the shortest time, as soon as your approval will be granted, therefore we would appreciate any support for the conclusion of the "Fores-Česká Finanční" deal, which constitutes condition precedent for the contract's completion [sic].¹²⁰

212. Three letters to similar effect followed during the course of the spring and summer of 2002.¹²¹

213. The Claimant noted that the CNB itself believed that given Union Banka's poor condition, if state aid were not granted, Invesmart would not invest in it. For example, a report prepared by the CNB's Banking Supervision Division, dated 5 September 2002, noted:

Even though Invesmart B.V. has in no written material ever stated entirely unambiguously that if aid is not provided to Union Banka, a.s. it will have no interest at all in acquiring it, it is highly likely, given the bank's situation, that state aid is absolutely essential for the profitability of the whole operation from the point of view of the applicant, and thus also for its decision whether to enter Union Banka, a.s.¹²²

214. The Claimant also highlighted a draft unsigned letter that was annexed to the record of the CNB's 5 September 2002 meeting from Governor Tůma to Finance Minister Sobotka. Invesmart argued that the Government "induced" it to acquire the bank through the promise of state aid, citing the draft letter in support of its contention. The draft letter stated:

... it appears that before making a definitive decision on the issue of financing its purchase of a stake in Union Banka, Invesmart B.V. is waiting to find out the Finance Ministry's opinion on the proposal for dealing with the 'Fores problem' that the bank has put forward. The Finance Ministry's decision on this issue is thus likely to have significant consequences for the situation in Union Banka, a.s. The Czech National Bank believes it is unacceptable for the uncertainty concerning the bank's future to be further prolonged for an unlimited time, and so it would welcome if steps could be taken that would induce the applicant to make a decisive statement.¹²³ [Emphasis added.]

¹²⁰ Exhibit R-36, letter dated 26 March 2002 from Giuseppe Roselli to Pavel Racoča and Vladimír Krejča of the CNB, copied to Marie Parmová.

¹²¹ Exhibit R-31, letter dated 25 June 2002 from _____ to Vladimír Franc, Acting Secretary of Česká Finanční; Exhibit R-32, letter dated 28 June 2002 from _____ to then-Finance Minister Jiří Rusnok; Exhibit R-53, letter dated 20 August 2002 from Invesmart's Gert H. Rienmüller to First Deputy Finance Minister Eduard Janota.

¹²² Exhibit C-291, Report prepared by the CNB's Banking Supervision Division, dated 5 September 2002.

¹²³ Exhibit C-291, draft letter from the Governor of the CNB to the Minister of Finance annexed to the Report prepared by the CNB's Banking Supervision Division, dated 5 September 2002.

Meeting of 24 September 2002

215. Invesmart also relied upon two meetings held in the autumn of 2002. The first, held on 24 September 2002, involved the CNB, CKA and Finance Ministry officials, including the newly appointed Finance Minister Bohuslav Sobotka. The troubled state of Union Banka and Invesmart's possible equity participation in the bank was discussed at this meeting.
216. Under the heading "Conclusions", the minutes recorded that the loss from the credit agreement between CF and Union Banka should be covered by the National Property Fund in conformity with the 1996 government stabilisation fund, and in case of a change to the agreement, the Office for the Protection of Economic Competition (OPC) "will need to be consulted and government approval will be required". There was also a discussion of the form of state aid, namely, a reduction of the interest rate for the CF deposit in Union Banka from 11.5 percent to approximately 3.5 percent and the purchase of bad quality loans "according to selection by CKA against a decrease of the Česká Finanční deposits".¹²⁴
217. The Claimant placed particular emphasis on the recording in the minutes that "the minister of finance is ready to submit a document for the state aid defined in this way for the government session".¹²⁵ The Claimant submits that this demonstrated that the amount and structure of state aid had been agreed; that, as matters stood, the consent of the OPC was *not* needed for its granting; and that the Minister undertook as of 24 September 2002 to submit the initiative to the government for its approval.¹²⁶
218. The minutes proceeded to set out the next steps to be taken. These were that the Ministry of Finance and the CKA "will discuss the state aid with Invesmart by 25 October 2002 at the latest", the CNB "will notify Invesmart on necessity of submitting the documents" to obtain CNB approval, and the Ministry of Finance and the CKA "will discuss the form of the state aid with OPC as settlement of the stabilization programme following return of OPC representatives from Brussels by 1 October 2002 at the latest".¹²⁷
219. Although Invesmart was not represented at the 24 September 2002 inter-agency meeting, it adduced evidence that the contents of the discussion and the decisions taken were

¹²⁴ Exhibit R-60, minutes of a meeting at the Ministry of Finance on 24 September 2002 regarding Union Banka.

¹²⁵ *Id.*

¹²⁶ Transcript, Day 1, Smith, p. 25, lines 13–25, p. 26; Transcript, Day 1, p. 159, lines 3–18.

¹²⁷ Exhibit R-60, minutes of a meeting held at the Ministry of Finance on 24 September 2002 regarding Union Banka.

communicated to it the next day.¹²⁸ This was acknowledged by the CKA's Mr. Pavel Řežábek in his second witness statement.¹²⁹

220. Following the 24 September 2002 meeting, there were a number of communications on the Invesmart proposal between senior Czech officials. These documents were disclosed to the Claimant in response to its request for production of documents. For example, by letter dated 7 October 2002, Minister Sobotka wrote to the CNB Governor advertizing to Invesmart's earlier proposal and noting that the conditions of the entry of the investor to the bank had since been "mutually defined". He referred to the CF matter and noted that on 25 September 2002, a meeting was held at the office of the First Deputy Minister of Finance's office at which representatives of Invesmart gave a binding promise to provide the documents that had been missing in Invesmart's first application for acquisition of control of Union Banka.¹³⁰

221. A reply to Minister Sobotka's letter, dated 11 October 2002, was sent by Oldřich Dědek of the CNB. Referring to the CNB's rejection on 4 October 2002 of Invesmart's second application to acquire the bank due to the missing documents, Mr Dědek noted that while Invesmart had stated that it would supply the requested documents and it had also confirmed that its entry into the bank was "still subject to the state aid in resolving the problem of the receivable of Česká Finanční, s.r.o. due from this bank". Mr. Dědek continued: "Given the above, we may state that, if the state aid is refused, Invesmart B.V. will most probably cease its effort to enter into Union banka, a.s." He thus requested the Ministry of Finance to communicate "its clear standpoint to the representatives of Invesmart B.V."¹³¹ The Claimant construed these letters as confirming its view that the CNB would not have later approved its share acquisition without the Ministry of Finance's having first agreed to provide state aid.

Meeting of 24 October 2002

222. The second meeting upon which Invesmart relied took place on 24 October 2002, the same day as the CNB approved Invesmart's acquisition of indirect control of Union Banka. This was a meeting of the CNB's Bank Board which the Minister of Finance also attended. An excerpt of the record of the meeting, produced by the Respondent in response to the Claimant's request for production of documents, recorded that Union Banka was discussed. The minutes, which were in summary form, noted:

The Bank Board noted the oral details provided by Mr. Sobotka about the Czech Finance Ministry's point of view with regard to negotiations with the foreign

¹²⁸ Transcript, Day 1, p. 159, lines 3–14.

¹²⁹ Second witness statement of Pavel Řežábek; Transcript, Day 1, Smith, p. 40, lines 18–25, p. 41, lines 1–2.

¹³⁰ Exhibit R-72, letter dated 7 October 2002 from Minister Sobotka to Governor Tůma.

¹³¹ Exhibit R-74, letter dated 11 October 2002 from Oldřich Dědek to Minister Sobotka.

investor and the Banking Supervision Department's approach to dealing with Invesmart's latest application for approval to its purchasing of a stake in Union Group, a.s. and Union Banka, a.s.¹³²

223. The Claimant acknowledged that the minutes did not record what the Minister actually said at the meeting, but contended that it could be inferred from the surrounding circumstances that he must have stated his intention to obtain the required state aid package at that meeting.
224. Those circumstances included: (i) Invesmart's application had been expressly conditioned throughout on that requirement; (ii) Invesmart's third application for the CNB's approval had been submitted only two days previously; (iii) the CNB had been pressing the Ministry of Finance for its "clear standpoint" on state aid; (iv) the bank's situation was serious due to a run on the bank after a CNB spokeswoman had commented on the rejection of Invesmart's second application on 22 October 2002; and (v) the fact that CNB's approval of the third application occurred after the Finance Minister made his comments to the Bank Board.¹³³ The totality of the circumstances, Invesmart argued, allow the Tribunal to infer that the Minister must have stated his support for the requested state aid and Invesmart reasonably formed the expectation that that was the case when its third application was approved only two days after it was submitted to the CNB.¹³⁴
225. Invesmart observed further that the day after the CNB approved its acquisition, a meeting was held between a Finance official, Josef Doruška, and two Euro-Trend representatives and the only form of state aid discussed there was the CF Transaction. The minutes record Mr Doruška asserting that "the only hope, in view of time pressure as well, is to proceed" with an amendment to the loan contract with CF.¹³⁵ This indicated, in Invesmart's view, that the form of state aid had been agreed.¹³⁶
226. From the submissions made at the hearing, it appears that for the Claimant the significance of the CNB's approval was twofold. First, it was said to constitute a commitment by the

¹³² Exhibit C-292, record of the 42nd meeting of the CNB Bank Board held on 24 October 2002.

¹³³ Transcript, Day 4, Sobotka, p. 31, lines 815.

¹³⁴ During the hearing, counsel for Invesmart also cross examined both Governor Tůma and Mr. Sobotka on precisely what the latter said at the 24 October 2002 meeting: Transcript, Day 4, Smith-Sobotka, p. 28, lines 14–25, p. 30, lines 1–8, p. 32, lines 17–25, p. 33, lines 1–21; Transcript, Day 4, Smith-Tůma p. 156, lines 7–16, p. 157, lines 15–25, p. 158, lines 1–16. The Claimant also referred to Exhibit C-302, letter dated 17 February 2003 from Governor Tůma to Minister Sobotka, which referred back to the 24 October 2002 meeting and in recapitulating the meeting stated that "[a]t this stage, the Ministry of Finance said that it was prepared to submit the proposal for State aid to the Czech Government for discussion, with a view to resolving the situation at Union Banka, subject to approval from the Czech Office for the Protection of Economic Competition." The Claimant considered that the Minister had been more emphatic at the 24 September 2002 meeting than he acknowledged at the hearing: Transcript, Day 7, Smith, p. 12, lines 6–25, p. 17, lines 3–25, p. 18. Counsel also pointed out that Mr. Sobotka's two witness statements failed to address his attendance at the meeting.

¹³⁵ Exhibit C-60, record of a meeting held at the offices of Euro-Trend on 25 October 2002 with Josef Doruška, Ministry of Finance.

¹³⁶ Transcript, Day 1, Smith, p. 33, lines 6–22.

Respondent that state aid would be granted. Secondly, it was asserted that the CNB approved the acquisition knowing that Invesmart would be taking on a €90 million obligation in connection with the assumption of certain related-party loans.¹³⁷ Invesmart pointed out that appended to its 22 October 2002 application to the CNB were its Share Purchase Agreements with the selling shareholders, together with various addenda thereto.¹³⁸

Claimant's characterisation of negotiations following CNB approval

227. During the hearing, the Claimant developed the point that after the CNB's approval was granted, the Czech authorities changed the rules of engagement and began to impose new conditions on the granting of state aid. This culminated in the denial of state aid to Invesmart, contrary to its expectation. The Claimant argued that it was only after the CNB acted and Invesmart had bound itself to acquire the shares in Union Banka and Union Group that these conditions were brought to its attention. Invesmart argued that at this point the structure of what was acceptable to the government changed and hurdles began to be raised that were inconsistent with its expectation that the CNB's prior approval of 24 October had resolved the issue of state aid in its favour.
228. This argument relates both to the legitimate expectations claim and to the separate alleged violation of Article 3, namely, the claimed inconsistent treatment of Invesmart's investment by the Czech authorities. Insofar as the legitimate expectation argument is concerned, the Claimant referred principally to two events.
229. First, it noted that unbeknownst to Invesmart, the Deputy Prime Minister of the Czech Republic had represented to the European Union that the Republic would not grant any new state aid to the banking sector.¹³⁹
230. Secondly, Invesmart adverted to the meeting between the Ministry of Finance, CKA and Invesmart representatives on 5 November 2002 at which the bank's First Plan was reviewed and Invesmart was informed of the internal discussions that had been held with the OPC. It was advised that any aid had to be "targeted, limited and pre-approved by the OPC" and had to be approved by the government. In addition, it was told that if the solution proposed in the material presented was chosen, the material required further work.¹⁴⁰ Invesmart asserted that this marked the beginning of a series of demands for more detail and shifting mechanisms of delivering state aid, the effect of which was inconsistent with what it had been led to believe

¹³⁷ *Id.*, p. 12, lines 18–21.

¹³⁸ Transcript, Day 7, Smith, p. 43, lines 14–25, p. 44, p. 45, lines 1–8.

¹³⁹ *Id.*, p. 49, lines 3–25.

¹⁴⁰ Exhibit C-61, minutes of a meeting held on 5 November 2002 between the Ministry of Finance, CKA, Invesmart and Euro-Trend.

would occur after the CNB approved its acquisition of indirect control of Union Banka and its shareholders authorised the capital increase. The Claimant emphasised that the 5 November 2002 meeting occurred the day after Invesmart's shareholders had ratified their 16 October 2002 decision to increase the company's share capital by €90 million, i.e., *after* one of the conditions precedent for the completion of the SPAs with the selling shareholders was removed.¹⁴¹

231. By way of example, Invesmart pointed to the discussion at the 5 November 2002 meeting where the CKA's Mr Řežábek raised the possibility of whether the CNB (not represented at the meeting) could recognise the BDS Arbitration Claim as a mechanism for providing state aid. Mr Řežábek suggested that this possibility offered a "purely commercial solution" that would bail out the bank but not require the competition authorities' approval.¹⁴² This proposal was rejected by the CNB on 8 November 2002. The Claimant saw this as a troubling sign of inconsistent treatment (a point to which the Tribunal will return below).
232. With the BDS Receivable suggestion off the table, the discussions reverted to variations on the CF transaction and another possibility, which was to issue a state guarantee for the repayment of a selected group of debts. These were examined at another meeting between the Ministry of Finance, the OPC, the CNB, the CKA, Union Banka, Euro-Trend and Invesmart held on 29 November 2002. The meeting "aimed to achieve consensus" on how the Finance Ministry and Invesmart should proceed in relation to the OPC. The minutes noted that a decision from the OPC was a necessary condition for the government's final decision on the granting of state aid.¹⁴³
233. The competition authorities also advised at this meeting that the request and its accompanying material, particularly the restructuring plan, would have to fully respect the EC's *Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty*. It would also have to be shown why the bank could not survive in the market without state aid and the reasons why its existence should be preserved, "in other words, that state aid was essential (including why the shareholders or other parties could not rescue the bank themselves)".¹⁴⁴ The Claimant also asserted that the record showed that the Minister of Finance's requests for state aid regularly succeeded in being approved by Cabinet.¹⁴⁵ This confirmed, in Invesmart's view, the reasonableness of its expectation that once the 24 September 2002 meeting's results had been

¹⁴¹ Transcript, Day 7, Smith, p. 58, lines 9–22.

¹⁴² Exhibit C-61, minutes of a meeting held on 5 November 2002 between the Ministry of Finance, CKA, Invesmart and Euro-Trend.

¹⁴³ Exhibit C-63, minutes of a meeting held on 29 November 2002 between the Ministry of Finance, the UOHS, the CNB, the CKA, Union Banka, Euro Trend and Invesmart.

¹⁴⁴ *Id.*

¹⁴⁵ Transcript, Day 7, Smith p. 52, lines 16–22.

communicated to it, with the CNB then having approved its acquisition of indirect control of Union Banka, state aid had been promised.

Amount of state aid

234. The disputing parties disagreed as to whether the amount of state aid discussed between August and September 2002 was CZK 650 million in total, or a (larger) grant of state aid that conferred a net benefit of CZK 650 million on the bank. In this regard, Invesmart observed that although the CZK 650 million figure was discussed, from the outset, the Czech authorities understood that the cost to the State would be greater than that sum and that any risk associated with the quality of the CF loan portfolio was clearly to be borne by the government.¹⁴⁶ It pointed to a memorandum dated 10 September 2002 prepared by the Czech Consolidation Agency for Finance Minister Sobotka, which set out the CKA's position on the proposed settlement of relations between CF and Union Banka presented by Invesmart in August 2002. The memorandum noted that the reduction in the interest rate on the Fores deposit would create a retroactive loss to CF of approximately CZK 207 million and a future interest loss of approximately CZK 251. As for the assumption of problem receivables, this would result in a loss of approximately CZK 330–771 million.¹⁴⁷ At the upper end of the estimate, the state aid would cost the government more than CZK 1 billion. Invesmart pointed to this as proof that the parties had previously distinguished between the net impact of the grant of state aid on Union Banka and the cost to the government of providing such aid.
235. The Claimant stressed its view that notwithstanding the Respondent's position in this arbitration, in September-October 2002 the parties were in agreement as to the effect of the state support in connection with Invesmart's acquisition, namely, support in the form of the CF Transaction which would result in an uplift to the net asset value of Union Banka of CZK 650 million.¹⁴⁸
236. As noted in the Facts, on 20 February 2003, the Minister of Finance decided against recommending state aid for Union Banka. The bank closed its doors the next day and an administrative proceeding for the revocation of its licence was immediately initiated by the CNB. The Tribunal will address these events in its discussion of the expropriation claim. For present purposes, it is not necessary to enter into a discussion of the reasons for the denial of state aid because the consideration of the legitimate expectations claim simply requires the

¹⁴⁶ Transcript, Day 1, Smith, p. 28, lines 14–25, p. 29, lines 1–3, p. 30, lines 11–16.

¹⁴⁷ Exhibit R-54, letter dated 10 September 2002 with enclosed memorandum from Pavel Řežábek, Chairman of the Board of CKA, to Minister Sobotka.

¹⁴⁸ Transcript, Day 1, Smith, p. 23, lines 21–25, p. 24, lines 1–7, letter from Pavel Řežábek, Chairman of the Board of CKA, to Minister Sobotka., .

Tribunal to proceed on the basis that the expectation said to have crystallised on 24 October 2002 was not met.

The Respondent

237. The Respondent argued that neither the factual record nor the governing law supported the legitimate expectations claim.
238. It began by asserting that as a matter of Czech law and European Union (EU) law, there was no right to state aid; indeed, state aid is forbidden unless its granting is permitted by the relevant competition authorities. Noting that Article 8(6) of the BIT specifies that the Tribunal must decide “on the basis of the law, taking into account in particular though not exclusively”, *inter alia*, “the law in force of the Contracting Party concerned” and “the provisions of ... other relevant Agreements between the Contracting Parties”, the Respondent asserted that under both its own domestic law and under the various agreements to which The Netherlands and the Czech Republic were party at the time, including the treaty of accession governing the Czech Republic’s admission to the EU, there were prohibitions on the granting of state aid in 2002. Therefore, there could be no legally enforceable right to the grant of state aid.¹⁴⁹
239. Given that the law of the host state did not confer a general right to state aid, but rather prohibited aid unless an exemption was granted, the Respondent argued that there could be no legitimate expectation which is contrary to the law of the host state:
- No investor, can hold, at least not legitimately and not in the absence of the clearest possible commitment made by the state concerned, an expectation which the law of the host state contradicts.¹⁵⁰
240. On a related point, the Respondent challenged the Claimant’s general approach to the governing law in this proceeding which, in the Respondent’s view, had avoided dealing in particular with the Czech law aspects of the case. In the Respondent’s view, the Czech law was extremely important in terms of the governing law.¹⁵¹
241. The Respondent also took issue with the Claimant’s characterisation of the acts of various Czech entities as constituting a promise or commitment of state aid. In its submission, there must be a concrete, specific promise in writing and there was no such document on the record.¹⁵² With no explicit promise in writing unequivocally promising state aid to Union Banka, the Respondent argued that there could also be no expectation of state aid based upon

¹⁴⁹ Transcript, Day 1, Crawford, p. 120, lines 12–22.

¹⁵⁰ *Id.*, p. 120, lines 12–15.

¹⁵¹ Transcript, Day 7, Crawford, p. 159, lines 5–25, p. 160, lines 1–25, p. 161, lines 1–21.

¹⁵² Transcript, Day 1, Crawford, p. 126, lines 15–18.

an implied or constructive promise.¹⁵³ In its view, the Claimant was calling upon the Tribunal to construct a promise out of the materials before it. This was not possible because the granting of aid was a voluntary matter and could only be enforced as a legitimate expectation if the State made an actual promise to deliver the aid.¹⁵⁴ One would fully expect in a matter as important as this that the representation sought to be enforced would be in writing and be unequivocal.

242. Insofar as the Claimant sought to tie the CNB's approval of Invesmart's application for approval of its acquisition of control of Union Banka to a commitment of state aid by the Ministry of Finance, the Respondent argued that the CNB's approval was simply an approval of a shareholding interest, a "prior approval" in a multi-stage acquisition process and nothing more.¹⁵⁵ One of the Respondent's Czech law experts, Dr Petr Kotáb, had opined that under Czech law, the CNB's approval is designed to prevent the entry into the banking sector of persons whose activities may be detrimental to the system's stability.¹⁵⁶ This supported the Respondent's view that what the CNB did on 24 October 2002 was no more than a prior approval. The Respondent is, and was at the time, a party to the *Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime* which requires it to ensure that funds invested in its financial institutions were *bona fide*.¹⁵⁷ The CNB had to satisfy itself that Invesmart's funds met this requirement. Beyond that, the CNB's approval was a necessary step in Invesmart's acquisition of indirect control of the bank, but the approval did not oblige Invesmart to complete that acquisition. Therefore, when the CNB issued its approval on 24 October 2002, that act could not reasonably be viewed to be a commitment to grant state aid by another state entity vested with that power, i.e., the Ministry of Finance.¹⁵⁸
243. The Respondent argued further that there was a fundamental distinction to be drawn between a binding promise and a legitimate expectation. In its closing submission, the Respondent argued that a binding promise occurred when it could be clearly established that the state made a commitment of a particular kind, which was sufficiently specific that the investor could rely on it. A legitimate expectation was, on the other hand, "a modality of fair and equitable

¹⁵³ *Id.*, p. 125, lines 21–25.

¹⁵⁴ *Id.*, p. 125, lines 9–13.

¹⁵⁵ Transcript, Day 7, Crawford, p. 195, lines 7 and 21, p. 196, lines 11–18.

¹⁵⁶ *Id.*, p. 160, lines 10–15.

¹⁵⁷ Exhibit R-127, *Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime* of 8 November 1990, to which the Respondent acceded on 1 March 1997. The Respondent pointed out that under Section 20(a) of the Banking Act, it was expressly prohibited from granting approval for the acquisition of a participation in a Czech bank unless compliance with the Convention was assured. Thus, Section 9(3)(c) of Decree of the CNB No. 166/2002 Coll., dated 8 April 2002 (Exhibit R-307), required an applicant to submit "evidence regarding the origin of funds of the applicant, which will be used in the purchase of the shares in a bank or with the use of which a participation in a person through which an indirect participation in a bank was acquired."

¹⁵⁸ Transcript, Day 7, Crawford, p. 195, lines 13–25, p. 196, lines 1–6.

treatment", not to be equated with anything analogous to a contract. Even assuming *arguendo* that, on the facts of this case, the Respondent had given the Claimant an expectation of aid in the amount sought in the Third Restructuring Plan, CZK 1.762 billion, the state could give an investor an expectation of a certain treatment but in the end, that still did not mean that in failing to accord such treatment, the state had breached the fair and equitable treatment standard. Situations can change and an expectation is not a guarantee; nor is it an estoppel by a government that it could not act in light of changed circumstances.¹⁵⁹

244. As for the terms of the alleged promise the Claimant sought to enforce, the Respondent argued that there cannot be a commitment without the content being sufficiently agreed. Even if there could have been a legitimate expectation of aid, it had to be a precise expectation and in the Respondent's view, the content and conditions of the alleged commitment changed materially after the date on which the expectation was said to have crystallised.¹⁶⁰ The Respondent took issue with the Claimant's argument that the amount of state aid was agreed as of that date. It also challenged the suggestion made at the hearing that the objective of the exercise had been to return Union Banka to a capital adequacy ratio ("CAR") of 14 percent. In the Respondent's view, there was nothing in the record evidence that made any reference to achieving that capital adequacy ratio.¹⁶¹ The Respondent suggested that the reason why the Claimant had advanced the 14 percent CAR result was that nothing else would have sufficed. The evidence showed that as the new management of Union Banka familiarised themselves with the bank's finances, they discovered that the problems were greater than they had thought.¹⁶²
245. The Respondent also took issue with the Claimant's contention that the amount and form of state aid had been agreed by 24 October 2002. In its view, the evidence showed that the amount and conditions for the granting of the state aid at issue changed over time and materially so after the CNB's grant of approval which had allegedly crystallised the commitment. Pointing to the Third Restructuring Plan, submitted to the Ministry of Finance on 12 February 2003, the Respondent noted that the amount of aid then being sought was considerably higher than what had been sought by Invesmart in its initial 20 August 2002 letter to the Ministry of Finance.¹⁶³
246. The Respondent also disputed a number of the factual elements of the Claimant's case. It pointed to contemporaneous documents which showed that Invesmart was aware of the need

¹⁵⁹ *Id.*, p. 163, lines 3–18, p. 164, line 25, p. 165, lines 1–8.

¹⁶⁰ Transcript, Day 1, Crawford, p. 126, lines 24–25, p. 127, lines 1–8.

¹⁶¹ *Id.*, p. 128, lines 10–24.

¹⁶² *Id.*, p. 129, lines 5–24.

¹⁶³ Transcript, Day 7, Crawford, p. 166, lines 8–12, pp. 179–181.

for the OPC's approval months before it filed its third application with the CNB.¹⁶⁴ It asserted that, contrary to its pleading in this proceeding, Invesmart did not make its investment contingent upon the CNB's approval and the implicit approval of state aid now claimed to be bound up in that approval. In this regard, the Respondent reviewed the documents amending the Share Purchase Agreements and argued that Invesmart had become an obligor with liabilities under the amended Share Purchase Agreements in mid-August 2002 (six weeks before Invesmart's second application was rejected by the CNB and over two months before its third application was approved) and hence, contrary to Invesmart's plea in this proceeding, it did not condition its acquisition of liabilities in connection with its assuming indirect control of Union Banka upon the granting of state aid.¹⁶⁵

247. The Respondent also noted that the legitimate expectation claim had to be evaluated having regard to the state's "margin of appreciation" recognised by international law. This margin is particularly wide, it was argued, when it comes to state aid and there was no case where a breach of fair and equitable treatment had been found as a result of a regular exercise of inherently discretionary governmental powers such as a refusal of state aid.¹⁶⁶

248. Finally, insofar as the Basel Committee's Guidelines had been relied upon in support of the legitimate expectations claim, the Respondent did not see such standards as being relevant to determining a breach of the fair and equitable treatment standard. The Guidelines addressed "best practices" and were by their own terms non-binding. They could not be equated with an international legal obligation, breach of which gave rise to a breach of Article 3 of the Treaty.

¹⁶⁷

The Tribunal's analysis - General Approach

249. In the Tribunal's view, six propositions are relevant to its consideration of this claim.

250. First, although an investor's expectation is subjective, i.e., what the investor believed to be the import of its dealings with government officials on which it claims to have relied, for the Tribunal, the test of whether such an expectation can give rise to a successful claim at international law is an objective one. It is not enough that a claimant have sincerely held an expectation; the expectation must be reasonable and the Tribunal must make the determination of reasonableness in all of the circumstances. If the expectation was unreasonable (for

¹⁶⁴ *Id.*, p. 196, lines 23–25, p. 197, lines 1–25.

¹⁶⁵ Transcript, Day 7, Horáková p. 145, lines 9–16, Douglas, p. 216, lines 5–12, p. 197, lines 3–25, p. 198, lines 7–25.

¹⁶⁶ Transcript, Day 7, Crawford, p. 168, lines 14–21.

¹⁶⁷ *Id.*, p. 192, lines 22–25, p. 193, lines 1–16.

example, ill-informed or overly optimistic), it matters not that the investor held it and it will not form the basis for a successful claim.

251. Secondly, a source of contemporaneous evidence of the investor's expectation can be the contractual documents by which it acquired its investment or otherwise dealt with the seller of the investment where it purchased an existing investment.
252. Thirdly, there is a temporal dimension to evaluating a claimed expectation. To the extent that the expectation is based upon the investor's reliance upon the acts and/or statements of the responsible government officials, it must be based on how the officials actually dealt with the investor at the time.
253. For example, in the Tribunal's view, it is not appropriate to base a claimed expectation upon the content of internal governmental discussions to which the investor was not privy at the time. If the contents of a particular governmental discussion or deliberative process to which the investor was not a party were nevertheless disclosed to it, they can contribute to the investor's expectation. However, if it was not privy to a discussion nor informed of its results, the investor cannot use documents disclosed in a subsequent arbitration as proof of its expectation at the time. Such documents can confirm a claimed expectation, but they cannot be used to establish a particular factual element of a claimed expectation if such element was unknown to the investor at the time.¹⁶⁸
254. Fourthly, the due diligence performed when the investor made its investment plays an important role in evaluating its expectation. A putative investor, especially one making an investment in a highly regulated sector such as financial services, as in the instant case, has the burden of performing its own due diligence in vetting the investment within the context of the operative legal regime.
255. Fifthly, and related to the fourth point, an investor's expectations must be based on the legal regulatory regime in place in the host state. Although there has been a suggestion in some cases that the investor's subjective expectations are to be given substantial weight, they are not to be the definitive source of the host state's obligations. In this regard, the Tribunal agrees with the point made in *Saluka* that:

The scope of the treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by the foreign investor's subjective motivations and expectations. Their expectations in order to be protected

¹⁶⁸ For example, prior to this proceeding, Invesmart had no knowledge of Minister Sobotka's attendance at a meeting held on 24 October 2002 of the Bank Board of the CNB (Transcript, Day 7, Bernardini-Smith, p. 15, lines 4-16). This evidence could only be used to confirm an expectation then held by Invesmart.

must rise to the level of legitimacy and reasonableness in light of the circumstances.¹⁶⁹

256. As noted in the decision of the *ad hoc* Annulment Committee in *MTD v Republic of Chile*:

... The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have. A tribunal which sought to generate from those expectations a set of rights different from those contained in or enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly.¹⁷⁰

257. The Tribunal agrees with that statement and observes that when ascertaining the Respondent's obligations under the Treaty, the Tribunal must have regard to the governing law which, in the instant case, includes the law of the host state and other relevant international agreements to which the Contracting States are party. It is the Treaty which guides the Tribunal in determining whether an investor's subjective expectation is legitimate.

258. Sixthly, it is important to distinguish between the various entities of the state. While the acts of governmental entities are attributable to the state for the purposes of international responsibility, the fact of attribution cannot be used to obscure the allocation of different competencies between different entities of the state when the issue of breach is determined. The investor deals with the state in its various emanations. Barring some kind of agency relationship, one entity of the state not vested with actual decision-making authority cannot be taken to bind the entity which by law possesses the actual authority. In the instant case, to the investor's knowledge, there was a division of jurisdiction, powers and responsibilities between the Ministry of Finance, the CKA, the OPC and the Czech National Bank, a point to which the Tribunal will revert below.

Detailed analysis

259. As noted above, Invesmart's case is that it received an express, or in the alternative, an implicit commitment of state aid from the Respondent. With respect to the latter, Invesmart claims that it held a legitimate expectation that given its repeated prior statements that state aid was an essential condition of its investment and its understanding of what the internal thinking of the Czech financial authorities was (or must have been), the CNB could only have given its approval on 24 October 2002 on the basis of a prior commitment by the Ministry of Finance to provide the requisite state aid. Invesmart claims that it was reasonable on its part to have then ratified its earlier approval of the capital increase and to assume the related party loans.

¹⁶⁹ Saluka Partial Award of 17 March 2006, para 304.

¹⁷⁰ *MTD Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, para 67, cited with approval by *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, para 600.

260. Before proceeding with its detailed analysis of the claim, the Tribunal finds it helpful to summarise certain points elicited from [redacted] because his testimony had the effect, in the Tribunal's view, of narrowing the legitimate expectations claim from the way in which it was advanced in the written pleadings. The Tribunal was struck by three points elicited from [redacted] on: (i) whether an express promise of aid was made to Invesmart; (ii) what the CNB's role in the events at issue was; and (iii) the Claimant's awareness of the potential role of the OPC.

261. [redacted] admitted that Invesmart received no written promise of state aid from the Respondent.¹⁷¹ In terms of an oral promise, [redacted] was, in the Tribunal's view, vague about who made such a promise. He testified that "several people within the Czech Government" made such a promise.¹⁷² But when asked to name someone who did so, he responded "there was – the information we were given by the Minister of Finance"¹⁷³ and when asked whether he was referring to Minister Sobotka, he responded:

Yes. Not directly; from his office. We also consider – and I didn't have the chance to finish what I was saying, but we also consider that the approval from the Czech National Bank to our acquisition of Union banka was implicitly a binding promise or commitment of state aid.¹⁷⁴

262. He testified further that:

Someone promised me, or we understood a commitment was to help Union banka to increase its value of 650 million.¹⁷⁵

263. This testimony is not sufficiently cogent and precise to support the claimed express promise of state aid. The witness could reasonably be expected to have a precise recollection of specifically who in the government promised state aid because that is such a material fact for this limb of the Claimant's case. The witness should have been able to specify names and the circumstances in which such an important commitment was claimed to have been given. Yet the testimony on this point was vague and tentative. This, combined with [redacted]'s retreating to the CNB's approval as an implicit promise of aid, leads the Tribunal to view the legitimate expectations claim as being more properly founded upon an alleged implicit promise of state aid.

264. That implicit promise was said to be bound up in the CNB's approval on 24 October 2002. Reflecting Investmart's awareness at the material time of the allocation of different

¹⁷¹ Transcript, Day 1, [redacted], p. 166, lines 10–19.

¹⁷² *Id.*, p. 165, line 10.

¹⁷³ *Id.*, p. 165, lines 12–13.

¹⁷⁴ *Id.*, p. 165, lines 15–20.

¹⁷⁵ *Id.*, p. 167, lines 10–12.

jurisdictions, powers and responsibilities between the various state entities, conceded that the CNB could not promise state aid because it was a banking regulator.¹⁷⁶ When asked whether Governor Tůma had ever stated that “we understand that by giving permission we accept a commitment to pay state aid”, [redacted] responded, “No, no, he never said that”.¹⁷⁷ Insofar as the period prior to 24 October 2002 was concerned, when asked whether there was any document from the CNB promising state aid if Invesmart obtained CNB approval, [redacted] testified, “No, I don’t remember specifically”.¹⁷⁸

265. This means, in the Tribunal’s view, that the CNB’s approval in itself cannot be taken to have amounted to an implicit commitment because Invesmart understood that it had no role in the decision whether to grant state aid. This in turn narrows the inquiry to the Claimant’s contention that the CNB would only have approved its application if it had had a concrete statement from the Minister of Finance that state aid was going to be granted. The Tribunal will revert to this below.
266. As for the role of the OPC [redacted] acknowledged that when Invesmart was debriefed about the 24 September 2002 inter-agency meeting, he was told that the advice of the OPC was being sought “in order to get their advice on the viability as far as the EU issues were concerned”.¹⁷⁹ He agreed that the OPC was the entity of the Czech Republic that was to decide whether the reduction of the interest rate on the Fores deposit would constitute state aid.¹⁸⁰ He also acknowledged that he was told by Union Banka’s consultants, Euro-Trend, on 25 October 2002 (one day after the CNB had approved Invesmart’s acquisition of indirect control of the bank) of the commitment made in writing to the EU by Deputy Prime Minister Rychetský that the Respondent did not anticipate providing any further state aid to the Czech banking sector.¹⁸¹
267. [redacted]’s testimony that he was made aware of the OPC’s role as a result of the 24 September 2002 meeting, that it would determine whether lowering the Fores interest rate constituted state aid, and that Euro-Trend was informed of the Rychetský letter to the EU on 25 October 2002 – eleven days before Invesmart’s shareholders ratified their earlier approval of the €90 million capital increase – is also relevant to the Tribunal’s consideration of the legitimate expectation claim.

¹⁷⁶ *Id.*, p. 165, line 25, p. 166, line 1.

¹⁷⁷ *Id.*, p. 169, lines 23–25, p. 170, line 1.

¹⁷⁸ *Id.*, p. 170, lines 4–7 and 22–25, p. 171, lines 1–4.

¹⁷⁹ *Id.*, p. 174, lines 23–25, p. 175, line 1.

¹⁸⁰ *Id.*, p. 176, lines 4–8.

¹⁸¹ *Id.*, p. 176, lines 14–25, p. 177, lines 1–8.

268. With these points in mind, the Tribunal now turns to what it considers to be the key issues bearing on the claim.

The law on state aid

269. There is no legal entitlement to state aid at international law. As an exercise of its sovereignty, leaving aside any treaty obligations it may have, a State has the discretion to decide whether or not to grant aid. On the facts of this case, there was nothing in Czech law which affirmatively stated that state aid would be granted upon request and a properly advised investor would understand that to be the case.

270. In fact, rather than obliging signatory states to grant aid, the member States of the EU have to the contrary undertaken *not* to grant it within the common market. That is, they have agreed to constrain their previously unfettered right to grant aid in order to achieve the goal of free competition. As an aspiring member of the EU, the Czech Republic was one such state at the material time in this case.

271. Under Article 8(6) of the BIT, the Tribunal must have regard both to Czech law and the provisions of "other relevant Agreements between the Contracting Parties". The relevant EU instruments and the Czech law implementing them fall within these categories. Under those regimes (the national and the supranational, which were consistent with each other in 2002 as the Czech Republic moved towards full accession to the Treaty of Rome), there could be no *prima facie* legal right to the granting of state aid. To the contrary, Section 2 of the Law on state aid affirms that aid is forbidden if the OPC does not authorise an exemption from the prohibition.¹⁸²

Due diligence

272. One element relevant to judging a legitimate expectation claim is whether the investor could have made itself aware of the regulatory issues that faced its investment. Some tribunals have characterised this as an issue of transparency. International agreements that have contained express transparency obligations have cast them in terms of a duty imposed on the state to publish its laws and regulations so as to allow a private party to familiarise itself with them and be able to conduct its business affairs accordingly.¹⁸³

273. Czech law and the relevant international agreements between the two Contracting States to the Treaty were both readily discoverable by the Claimant in 2001-2002. The regulatory practice

¹⁸² Exhibit R-183, Act on State Aid of 24 February 2000; First and Second Expert Reports of Dr. Claus-Dieter Ehlermann.

¹⁸³ See, for example, Article X of the *General Agreement on Tariffs and Trade 1994*.

of the Czech Republic in the area of state aid was becoming more stringent in view of its impending accession to the Treaty of Rome. In the Tribunal's view, this too was discoverable to the Claimant. The expert evidence of Professor Claus-Dieter Ehlermann adduced by the Respondent shows that the relevant law and guidelines were available to be consulted had Invesmart decided to retain counsel on this matter.¹⁸⁴ Those materials posited relatively stringent requirements for granting an exemption to the prohibition on state aid. Counsel would have been able to examine publicly available information on the materials needed to request state aid and the types of considerations applied by national and supranational agencies when evaluating state aid proposals.

274. During the hearing, _____ acknowledged that Invesmart did not retain legal counsel to advise it on the competition law issues governing the grant of state aid.¹⁸⁵ The Tribunal found this surprising because the evidence shows that Invesmart knew fairly early on that competition law and the enforcement agency, the OPC, both had a role to play in the resolution of the bank's hoped-for state support.

275. In a letter dated 28 June 2002, addressed to the then-Minister of Finance, Jirí Rusnok, requesting him to "reconsider the possibility to realize the project of 'Finalisation of the Foresbank stabilisation program'", _____ recognised that the state aid being sought by Invesmart could be refused on the objection of the competition authorities. He noted in this regard that:

... We are also working on submission of another expert's opinion for selected assets' portfolio and the Economic Competition Office standpoint so that the Office will not prevent us from the realisation of our project.¹⁸⁶ [Emphasis added.]

276. Beyond _____, noting the fact that Invesmart was seeking an expert's opinion, there is no record evidence of what that advice amounted to. In the Tribunal's view, _____ letter shows an awareness as of 28 June 2002 that the OPC could block the aid.

277. In the Tribunal's view, Invesmart should have sought legal advice on the EU and Czech law so that it understood precisely what the requirements were for making out the case for the granting of an exemption to the restrictions on granting state aid. Had it done so, it could have determined for itself that the law imposed strict guidelines on what information would be required to be submitted to the relevant authorities in order to maximise its chances of obtaining the requested aid to be granted.

¹⁸⁴ First Expert Report of Claus-Dieter Ehlermann, paras 28–41.

¹⁸⁵ Transcript, Day 1, _____ p. 154, lines 21–22, p. 156, lines 1–3, p. 158, lines 20–24.

¹⁸⁶ Exhibit R-32, letter dated 28 June 2002 from _____ to Minister Rusnok.

278. [redacted] conceded that “looking back, we should have” obtained legal advice on the state aid issue.¹⁸⁷ His explanation was that Invesmart did not do so because it found an existing transaction on the table and it took it from there and that “my understanding, my shareholders’ understanding throughout the whole process, has been that it was in the primary interest of the Czech Government and the Czech Republic to rescue and save Union Banka”.¹⁸⁸ This does not assist the Claimant because, while the Claimant did indeed receive positive signals from the Respondent, the record shows that they were not all in that direction. There had been attempts by the bank’s existing management to resolve the problem, but those had been unsuccessful.

279. Indeed, when [redacted] approached the newly-appointed Minister of Finance in July 2002 after the parliamentary elections there was no “existing transaction” on the table because Minister Sobotka’s predecessor had *rejected* Invesmart’s approach in May 2002. This is what had led [redacted] to send his letter of 28 June 2002 to Minister Rusnok asking him to reconsider. His reference in that letter to Invesmart’s seeking an expert opinion so that the OPC would not block the project shows an understanding that state aid was not automatic even if the Minister of Finance were inclined to recommend its granting. Likewise, after the Ministry of Finance indicated that it was willing to look at the issue of state aid, as

[redacted] 16 September 2002 letter shows, Invesmart’s 12 September 2002 meeting with the CNB was not entirely positive from the investor’s perspective. [redacted] recorded the CNB’s Mr Jířiček as stating that “he sees no or very little chances for the transaction to be completed”.¹⁸⁹ The CNB’s reply to [redacted] while not prejudging the outcome of the state aid issue, emphasised the MOF’s and OPC’s roles in approving the aid and pointed out that determining whether to grant aid was not the CNB’s responsibility.¹⁹⁰ The information conveyed to Invesmart after the 24 September 2002 intra-governmental meeting highlighted the OPC’s role. In short, even the positive statements made by government officials during the material period did not in any way purport to vary the legal regime applicable to state aid.

280. [redacted] position, though not entirely unreasonable, did not show the prudence that could be expected of an investor whose investment was being conditioned upon the government’s financial support.

281. The Tribunal considers that Czech counsel would have been aware of the tightening of the Czech rules on state aid and the increasing oversight of the EC. Not surprisingly, as the state aid regime became more stringent for the Czech Republic, the onus upon a party seeking such

¹⁸⁷ Transcript, Day 1, [redacted], p. 156, line 3.

¹⁸⁸ *Id.*, p. 156, lines 3–10.

¹⁸⁹ Exhibit R-64, letter dated 16 September 2002 from [redacted] to the CNB.

¹⁹⁰ Exhibit R-66, letter dated 19 September 2002 from the CNB to Invesmart.

aid and indeed upon a state inclined to grant it became heavier. What might have passed muster in the mid-1990s would not necessarily pass muster in 2002.

282. The failure to seek legal advice reflected an underlying feature of the case: that the entire venture seemed to be driven by frequent requests for state aid bound up in undoubted enthusiasm and drive to secure ownership of a cleaned up bank which he could then sell to an established Western European bank. While the Tribunal considers that and de Sury brought financial acumen to the project, there appears to have been relatively little substantive legal due diligence performed by Invesmart. This is also reflected in Invesmart's contractual dealings with the bank and the selling shareholders, a matter to which the Tribunal now turns.

Invesmart's contractual relations with Union Banka and the selling shareholders

283. An important theme of the Claimant's case was that at all material times, it informed various government entities that it would not proceed with the investment unless the state provided aid resulting in an uplift to the net asset value of the bank of some CZK 650 million.¹⁹¹ There is ample correspondence and records of meetings that demonstrates that this position was communicated by Invesmart throughout the period leading up to 24 October 2002.
284. In the Tribunal's view, however, there is something of a disjuncture between those statements and the legal documents relating to Invesmart's relationship with Union Banka and Union Group, some of which show that Invesmart did not act consistently with its position as articulated to the Czech Republic.
285. First, the Receivables Assignment Agreement was executed on 13 August 2002. At this point in time, according to the Agreed Statement of Facts, Invesmart had been communicating its interest in acquiring control of the bank for over eight months. Invesmart's Gert H Rienmüller informed the CNB by letter dated 12 August 2002 that it had decided to "support" the bank "without closing the purchase of the bank".¹⁹²
286. The text of the letter warrants reproducing because it shows that prior to even submitting its first summary proposal for the resolution of the bank's issues with Česká Finanční, Invesmart assumed obligations in relation to the Česká Finanční loan portfolio. Mr Rienmüller stated:

... with reference to your letter dated 25 July 2002 ... I would like to inform you that in the above mentioned matter intense talks between the current shareholders and the investor, Invesmart, B.V. regarding the financial statements for the year

¹⁹¹ Transcript, Day 1, Smith, p. 23, lines 21–25, p. 24, lines 1–22; Transcript, Day 7, Miles p. 134, lines 5–8, p. 136, lines 3–10.

¹⁹² Exhibit R-52, letter dated 12 August 2002 from Gert H. Rienmüller to Vladimír Krejča of the CNB.

2001 have taken place. The result of the talks is that without closing the purchase of the bank Invesmart has decided to support Union banka by a grant of a guarantee in the amount of CZK 300 million in order to secure an acceptable auditor's report on the bank for 2001.

Meantime, Invesmart was also acquainting itself with the Česká Finanční case. After unsuccessful attempts of the existing shareholders of the bank Invesmart is attempting to solve this problem itself through direct negotiations with the CNB, Česká finanční and the MOF. The results of these contacts cannot be predicted at this time. However, taking into account that Invesmart increased its purchase price by CZK 300 million, it cannot be expected that it would assume additional obligations against Česká finanční, which were represented by the seller in negotiations as solved.¹⁹³ [Emphasis added.]

287. Although Mr Rienmüller's letter referred to a CZK 300 million guarantee being issued by Invesmart, that was only one aspect of the transaction. In the Receivables Assignment Agreement, Invesmart and Union Banka recognised that the bank was attempting to sell the loan portfolio to CF.¹⁹⁴ Invesmart agreed to an irrevocable assumption and purchase of that portfolio if it was not transferred to CF, subject to the proviso that Union Banka would only be able to require such assumption if and after it had failed to, for any reason whatsoever, assign the receivables to CF by 1 December 2002.¹⁹⁵ In that event, Invesmart agreed to pay CZK 1.2 billion for the portfolio and the CZK 300 million guarantee to which Mr Rienmüller referred was to secure that obligation. In the event that it failed to take over the loan portfolio, the guarantee, valid until 15 December 2002, was enforceable by the bank after its having given notice to Invesmart.¹⁹⁶
288. The Receivables Assignment Agreement appears to have had at least two effects.
289. First, as Mr Rienmüller anticipated in his 12 August 2002 letter to the CNB, it permitted the bank to secure the issuance of the auditor's report for the year ending 31 December 2001.¹⁹⁷ On 16 August 2002, Deloitte & Touche issued its audit report on the bank's 2001 financial statements. Without such an audit report, the evidence showed, the bank's situation would have been extremely tenuous.

¹⁹³ *Id.*

¹⁹⁴ Exhibit R-49, Receivables Assignment Agreement dated 13 August 2002 entered into between Union Banka and Invesmart, Recital.

¹⁹⁵ *Id.*, Clause II.1.

¹⁹⁶ *Id.*, Clause II.5.

¹⁹⁷ In Exhibit C-31, Audit Report of Union Banka for 2001 issued by Deloitte & Touche on 16 August 2002, p. 2, Deloitte & Touche noted that the bank might not be able to continue as a going concern absent Invesmart's capital entry into the bank.

290. Secondly, the Receivables Assignment Agreement evidently led to an amendment of the SPAs because on 14 August 2002, the day after its execution, Invesmart entered into Addendum No 4 to the two SPAs. In the Tribunal's view, the importance of these contractual developments is this: Invesmart assumed the obligation to pay for the CF loan portfolio – a key element of the state aid that it was seeking – 7 days *before* submitting its proposal on the settlement of the bank's relationship with CF to the MOF. That is, Invesmart's first proposal to the MOF was made on 20 August 2002, seven days *after* it executed the Receivables Assignment Agreement.¹⁹⁸

291. In the Tribunal's view the Receivable Assignment Agreement and Addendum No 4 tend to undermine the Claimant's contention that it made its participation in Union Banka conditional upon the grant of state aid. In mid-August 2002, it bound itself to having to deliver the substantial part of what it later proposed the state should grant. Moreover, although Addendum No 4 still reserved the power to approve the share purchase to Invesmart's shareholders, its conditions for completing the transaction did not reflect the position that Invesmart was consistently articulating to different government agencies. When asked by the Chairman as to whether Invesmart sought legal advice on the amendments to the SPAs, I answered:

I believe it was not very much a legal issue at the time, it was very much contained in a business decision at the time.¹⁹⁹

292. The Tribunal recognises that it is not privy to the negotiating history of the entire transaction and it is loath to impose legal perfection on an evolving situation after the fact. However, it considers that the Claimant exposed itself in a sense in the way in which it structured the conditions for the acquisition of the shares and the assumption of the related-party loans and when it assumed the CF loan portfolio.

293. If the grant of state aid was the *sine qua non* of Invesmart's acquisition of control of Union Banka, it might have been expected that it would have either: (i) completed its acquisition of control of the bank only upon receipt of a written undertaking from the Minister of Finance that the requested state aid would be provided; or (ii) to be even more certain, have completed the acquisition simultaneously with the aid being granted. Invesmart did not follow either course of action.

¹⁹⁸ As noted in the Agreed Statement of Facts, at p. 8, on that date, "Invesmart submitted its state aid proposal to the Ministry of Finance ... Invesmart proposed the following measures: (i) the early termination of the Fores Deposit; (ii) the investment of the proceeds from the Fores Deposit in subordinated debt of Union banka; and (iii) CF's purchase of a CZK 1.6 billion portfolio of non-performing loans."

¹⁹⁹ Transcript, Day 2, Pryles-*t*, p. 104, lines 2–4.

294. [redacted] frankly admitted that they had erred in not obtaining a written promise of state aid, testifying that “stupidly enough, looking back, we didn’t ask for it”.²⁰⁰ Invesmart’s failure to relate its requirements for completing the transaction, as communicated to various Czech agencies, to its contractual documents with the selling shareholders and the bank created exposure in the event that state aid was not granted. Such exposure is precisely what has forced the Claimant to argue that if there was no express promise of state aid, the CNB’s approval constituted an implicit promise to grant it. It would have been more prudent for Invesmart to have formally conditioned its obligation to assume the related-party loans upon the grant of state aid rather than rely upon what it now contends was an implicit promise of aid bound up in the CNB’s approval.
295. The Tribunal will discuss the last amendment to the SPAs, Addendum No 5, in the course of its discussion of the events of October 2002 below.

The Claimant’s general awareness of the domestic competition law regime prior to 24 October 2002

296. Consistent with its view as to the related roles of due diligence and the host State’s law and relevant international agreements between the investment Treaty’s Contracting Parties, the Tribunal now turns to consider the role of competition law and the competition authorities in the events at issue. This is an important issue when considering the legitimate expectations claim, because the regulatory approval structure for state aid provides the legal context in which the various government entities and indeed Union Banka and Invesmart itself operated at the time.
297. The Claimant’s legitimate expectations claim emphasised that it was only after Invesmart’s application was approved by the CNB that the role of the OPC in approving any aid and what it saw as increasingly onerous conditions for the aid’s granting became clear.²⁰¹
298. The Tribunal has already noted at paragraphs 274-276 that Invesmart was aware by June 2002 that the OPC would have a role in approving state aid. By letter dated 25 June 2002 to the Acting Secretary of CF, [redacted] noted that Invesmart was trying “to get a standpoint of the Economic Competition Office”.²⁰² A letter dated three days later addressed to the then-Minister of Finance explicitly recognised that the aid being sought could be prevented by the competition authorities and for that reason Invesmart was “working on submission of another

²⁰⁰ Transcript, Day 1, [redacted] p. 166, lines 13–16.

²⁰¹ Transcript, Day 7, [redacted] p. 156, lines 19–25, pp. 156–157.

²⁰² Exhibit R-31, letter dated 25 June 2002 from [redacted] to the Acting Secretary of Česká Finanční.

expert's opinion for selected assets' portfolio and the Economic Competition Office standpoint "so that the Office will not prevent us from the realisation of our project"²⁰³.

299. The minutes of the 24 September 2002 meeting at the Ministry of Finance, on which the Claimant placed significant reliance, also show that the state aid issue and the need to consult the competition authorities was part of the government's internal discussions. The testimony is that the substance of this meeting was accurately and fully communicated to Invesmart the next day and [redacted] acknowledged that he was told that the advice of the OPC was being sought "in order to get their advice on the viability as far as the European Union issues were concerned".²⁰⁴

The issue of "old" versus "new" aid

300. One issue that arose during the hearing concerned whether the OPC had to consent to a resolution of the bank's issues with CF. The Claimant contended that that was not seen as state aid that required the OPC's approval because it was settling a previous arrangement that dated back to the mid-1990s.²⁰⁵ There was no new state aid being discussed, in its view, and the statements of government officials seemed to show that they likewise held that view, at least until after Invesmart decided to acquire the shares of Union Group.
301. In the Tribunal's view, looked at on their own, the 24 September meeting's minutes are not clear on precisely what the Ministry of Finance believed the competition authorities' role to be in relation to the CF Transaction then being discussed.
302. Strictly speaking, the Ministry of Finance could not speak for the OPC. But on the basis that Invesmart thought that significant progress was being made towards a grant of state aid, the Tribunal will examine what was conveyed to Invesmart on the issue of state aid prior to its increasing its share capital and approving the SPAs.
303. On the one hand, the 24 September 2002 meeting's minutes record that "in case ... [there is a] change to the agreement" the "Office for the Protection of Competition will need to be consulted and government approval will be required". This, as the Claimant argued, suggests that the then-contemplated form of state aid (i.e., reduction of the Fores deposit interest rate and the purchase of bad loans at book value or something closely related to book value) did *not* have to be approved by the OPC.

²⁰³ Exhibit R-32, letter dated 28 June 2002 from [redacted] to Minister Rusnok.

²⁰⁴ Transcript, Day 1, [redacted] p. 174, lines 23–25, p. 175, line 1.

²⁰⁵ *Id.*, p. 157, lines 6–12.

304. On the other hand, as the Respondent pointed out, the "next steps" identified by officials in the same minutes record that the "Ministry of Finance and CKA will discuss the form of the state aid with OPC as settlement of the stabilisation programme following return of OPC representatives from Brussels by 1 October 2002 at the latest". This suggests that the competition authorities had to be consulted on any deal that might constitute state aid and that they might determine that the Finanční interest rate and receivables deal *did* fall within their mandate.
305. The minutes are ambiguous on the issue of whether the competition authorities had to approve the CF deal sought by Union Banka and Invesmart. Since the substance of the discussions was disclosed to Invesmart, it would have been told that the OPC had some role to play in the approval of state aid (a point which was already known to it. However, the Tribunal cannot infer one way or the other whether the description of the meeting accorded with the part of the minutes that the Claimant emphasised or the part that the Respondent emphasised (or both).
306. Were this to be the only contemporaneous document that discussed the state aid issue, the Tribunal would be unable to judge what was conveyed to Invesmart. Further light can be shed on this issue, however, by two other contemporaneous documents showing that the competition authorities would play a role in a decision to grant state aid of any kind.
307. The first document was generated after the 12 September 2002 meeting between Invesmart representatives and the CNB. The meeting had evidently not gone well from Invesmart's perspective because of the CNB officials' statements about Invesmart's second application for approval and what its rejection might mean for Union Banka's licence. (As shall be seen (at paragraphs 543-546), a representative of certain shareholders in Invesmart attended the meeting and evidently formed a less than positive view of the bank's prospects.) In a letter dated 16 September 2002 sent after the meeting to the Governor of the CNB and four of his colleagues, [redacted] stated that the CNB's Mr Jirí Jířček had informed them that if enough information on the financial aspects of the acquisition was not received by 16 September 2002, he would start the process to deny authorisation of the acquisition by Invesmart. [redacted] also recorded Jířček's stating that in such a case he will also start the proceeding to withdraw the banking licence to Union Banka".²⁰⁶
308. [redacted] letter spurred a reply from the CNB dealing with among other issues the process by which the requested state aid would be addressed. At point 3 of its letter, the CNB recorded the fact that its representatives had informed Invesmart that:

²⁰⁶ Exhibit R-66, letter dated 16 September 2002 from [redacted] to Zdeněk Tůma, Pavel Racoča, Vladimír Krejča, Petr Jířček, and Renate Vernerova, p. 2.

[redacted] to Zdeněk Tůma, Pavel Racoča, Vladimír

3. As regards the CNB's standpoint concerning the successful completion of the transaction to acquire a qualifying holding and the possibility of the Bank's receiving state assistance, the CNB stated that any such assistance is primarily a matter for the Ministry of Finance, requires the approval of the Czech Government and must have the support of the Office for the Protection of Economic Competition, which is also assessing this matter in the context of the preparations for the Czech Republic's accession to the European Union. The CNB's opinion on the completion of the overall transaction was not expressed at the meeting.²⁰⁷ [Emphasis added.]

309. This passage is instructive because it expressly brought to [redacted] attention the division of competencies between the CNB, Ministry of Finance and the OPC, the need for Czech government approval above and beyond the Minister's approval, the need for the support of the competition authorities, and the fact that the proposal was "also" being assessed within the context of the accession to the EU, the plain implication being that EU issues would be taken into consideration. At the hearing, [redacted] acknowledged that by this letter Invesmart was told by the CNB, before it approved the share acquisition, what the requirements for the granting of state aid were.²⁰⁸

310. The second document, a letter from Minister Sobotka to Governor Tůma, dated 7 October 2002, referred back to the meeting with Invesmart on 25 September 2002 at which the government's deliberations were disclosed to it. The Minister noted that:

On 25 September 2002 a meeting was held in the office of the First Deputy Minister of Finance with the representatives of Invesmart B.V. (Mr. Roselli, Mr. Rienmüller, Mr. Braun) in the presence of CEO of the Czech Consolidation Agency. In the context of the meeting, the representatives of Invesmart B.V. were informed of the requirements of the Bank Supervision Department for completion of the documents needed for grant of approval with entry of the investor to the bank with the deadline of 4 October 2002. Mr. Roselli gave a binding promise to provide the missing documents to the Bank Supervision Department in due course. At the same time the representatives of Invesmart B.V. were informed of the planned meeting with the Office for the Protection of Economic Competition in Brno with the aim to assess the procedure and options for resolution of the investor's requirement for settlement of the problems of Union Banka a.s. with regard to public support.²⁰⁹ [Emphasis added.]

311. Any ambiguity in the 24 September 2002 minutes as to the state of thinking within the Government and as to what was communicated to Invesmart is thus resolved by a clear statement in writing sent to Invesmart just before the 25 September meeting and corroborated by the letter sent by the Finance Minister to the CNB Governor recapitulating what occurred in the meeting held the preceding day.

²⁰⁷ Exhibit C-52, letter dated 18/19 September 2002 from the CNB to Invesmart.

²⁰⁸ Transcript, Day 2, [redacted] p. 206, lines 21–25.

²⁰⁹ Exhibit R-72, letter dated 7 October 2002 from Minister Sobotka to Governor Tůma.

312. In the Tribunal's view, the role of the competition authorities in vetting *any* proposed state aid, including a settlement of the bank's relations with CF, was brought to the Claimant's attention before it submitted its third application on 22 October 2002.

The Czech Republic's commitment to the European Union

313. The Claimant argued further that the Respondent did not advise it prior to its shareholders approving the capital increase on 16 October 2002 that a statement had been made to the EC that the Czech Republic did not expect any further provision of state aid to the banking sector.²¹⁰ It also complained that it was not until a meeting held on 29 November 2002 that Invesmart was advised that Union Banka needed to submit a Restructuring Plan in accordance with the EU's *Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty*.²¹¹
314. In this regard, the Claimant pointed to a document which showed that at a meeting held on 16 May 2002 between the Ministry of Finance, the CNB, CF, and the Czech Consolidation Commission, Invesmart's potential acquisition of control of Union Banka was discussed by officials and in light of the undertaking given to the EU and the participants' view that there was little reason to provide state aid to the bank, it was resolved that CNB would proceed with the approval procedures but the "Ministry of Finance will inform the investor about the infeasibility of provision of state aid".²¹² [Emphasis added.] The Claimant argued that it was not informed of this complicating factor until after it approved the capital increase.
315. The consideration of this complaint requires the Tribunal to first take note of the amendment to the SPAs that was effected just before Invesmart's shareholders approved the €90 million capital increase at a meeting held on 16 October 2002. Addendum No 5, which cancelled its predecessor, No 4, was concluded on 14 October 2002. The purchaser and the sellers agreed in this addendum that Invesmart would assume the debts of the selling shareholders without undue delay. The assumption of debts obligation was made conditional upon (i) the CNB's approval of Invesmart's application to acquire control of the bank and its assumption of the selling shareholders' debts; and (ii) the approval of Invesmart's shareholders.²¹³
316. Two features of this addendum are salient. First, consistent with its predecessor's removal of Clause 3.3 from SPA B (the condition precedent relating to state aid), nothing in this addendum expressly made the completion of the Share Purchase Agreements conditional upon

²¹⁰ Exhibit R-432, minutes of a meeting held on 16 May 2002 between the Ministry of Finance, the CNB, Česká Finanční, and the Czech Consolidation Commission.

²¹¹ Transcript, Day 7, Smith, p. 48, lines 12-25, p. 49, lines 1-7.

²¹² Exhibit R-432, minutes of a meeting held on 16 May 2002 between the Ministry of Finance, the CNB, Česká Finanční, and the Czech Consolidation Commission, p. 2.

²¹³ Exhibit R-75, Addendum No. 5 to the Share Sale and Purchase Agreements "A" and "B", dated 14 October 2002.

the granting of state aid. Secondly, Invesmart nevertheless still had a right *not* to complete the deal because its shareholders had to approve the transaction before it could bind the company.

317. The second point is relevant to the legitimate expectations argument because there is a temporal issue relating to the Claimant's decision to approve the SPAs. The Claimant argued that it did not know about the Respondent's commitment to the EC until after its shareholders approved the capital increase.²¹⁴ This may be so, but it is not the end of the matter.
318. Due to Invesmart's failure to properly convene the 16 October 2002 meeting at which its shareholders approved the capital increase, that decision had to be put to another vote on 4 November 2002 whereupon the shareholders ratified their earlier decision.²¹⁵ It was at this same meeting that the SPAs were approved.²¹⁶ Thus, the relevant time for determining whether Invesmart irrevocably committed to its investment in the bank without knowledge of the Czech Government's undertaking to the EC is not 16 October, but 4 November 2002.
319. It is clear from the record that Invesmart was advised in the CNB's letter of 19 September 2002 that the aid issue was being considered in "the context of the preparations for the Czech Republic's accession to the European Union".²¹⁷ To the extent that this failed to fully disclose the Minister's undertaking, the Tribunal notes that at a meeting held on 25 October 2002, ten days before Invesmart's shareholders approved the SPAs, the company's advisors, Euro-Trend, were informed of the Rychecký letter to the EC that there would be no more public subsidisation of the banks.²¹⁸
320. Thus, although the Claimant correctly points out that this discussion occurred one day after the CNB approved the acquisition, this information was conveyed to Invesmart's representatives well before Invesmart held its second shareholders meeting on 4 November 2002 at which the shareholders approved the Share Purchase Agreements.
321. The Tribunal also notes that with respect to the need to draw up a Restructuring Plan, it appears from the record that that was explicitly discussed for the first time at a meeting held on 29 November 2002. The Claimant has sought to attribute responsibility for this to the Respondent in the sense that this was "sprung" on Invesmart after it completed its acquisition of its shareholding interests. The Tribunal notes however that at the 25 November meeting,

²¹⁴ Transcript, Day 7, Smith, p. 49, lines 8–14, p. 51, lines 7–14.

²¹⁵ Exhibit R-469, minutes of the extraordinary meeting of shareholders of Invesmart B.V. held at Rotterdam on 4 November 2002, proposal 1.

²¹⁶ *Id.*, proposal 5.

²¹⁷ Exhibit C-52, letter dated 19 September 2002 from the CNB to Invesmart.

²¹⁸ Exhibit C-60, minutes of a meeting held on 25 October 2002 between Josef Doruška of the Ministry of Finance and Euro-Trend representatives.

Union Banka's new Director, Mr Radovan Vávra, provided a different explanation. The minutes record him informing the meeting that:

... The UB's director then explained why the former management has not made any efforts for granting of state aid earlier and had not prepared a restructuring plan – the reason was that they had assumed that the bank would win the arbitration against the CNB regarding the compensation of damages of CZK 1.9 billion.²¹⁹ [Emphasis added.]

322. Mr Vávra's remark must have been directed to the management personnel who held senior positions prior to his joining Union Banka in the autumn of 2002.

323. There is also record evidence that suggests that Invesmart had reason to appreciate that competition law considerations pertaining to EU accession could thwart its request for state aid for some months. As noted earlier, the inter-agency meeting which discussed the EU commitment was held on 16 May 2002. Invesmart met with the then-Minister of Finance shortly thereafter. The precise message conveyed to Invesmart when the Ministry of Finance then refused to consider granting state aid is not on the record, although the fact of that rejection is. [redacted] wrote to the CNB's Pavel Racoča by letter dated 20 May 2002 (four days after the inter-agency meeting was held), noting that:

... As you probably already know our meeting with the Minister of Finance was not particularly positive.

The Minister stressed that at this time they do not consider to conclude the acquisition of Fores by Česká Finanční.

As I mentioned to you last Friday we consider that transaction a main condition for completing our acquisition of 70 per cent of Union Group.

Nevertheless, considering the upcoming elections and the fact that Union Banka application at Česká Finanční has not been formally rejected, we have decided to follow up with our application with the Central Bank and to confirm our commitment to the project...²²⁰

324. The Tribunal has already adverted to [redacted] 28 June 2002 letter which recognised that the OPC could block the transaction.

325. Thus, although there is no direct evidence of precisely what was communicated to Invesmart by the Respondent after the inter-agency meeting of 16 May 2002, it can be inferred from [redacted] contemporaneous letters that Invesmart was informed of issues relating to competition law as it affected the granting of state aid to Union Banka. There would have been

²¹⁹ Exhibit R-115, minutes of a meeting held on 29 November 2002 between Ministry of Finance, OPC, CNB, CKA, Union Banka, Euro-Trend and Invesmart representatives.

²²⁰ Exhibit R-41, letter dated 20 May 2002 from [redacted] Pavel Racoča of the CNB.

no reason for to advert to the OPC's role had that not been brought to Invesmart's attention.

326. Finally, assuming *arguendo* that the Czech authorities did not inform Invesmart of the undertaking to the EU in May 2002 and instead referred only to competition law issues generally, the question is whether that undertaking was materially different from what Invesmart knew or should have known was the situation under Czech and EU law.
327. Here the Tribunal is of the view that: (i) the Czech Republic's accession to the Treaty of Rome was well known; (ii) Invesmart knew from June 2002 that the OPC could, to use Mr Catalfamo's words, "prevent us from the realisation of our project"; (iii) Invesmart was advised in mid-September 2002 that the state aid was being assessed "in the context of the preparations for the Czech Republic's accession to the European Union"; (iv) Invesmart's advisors were informed on 25 October 2002 of the Rychetský letter; (v) reasonable due diligence into the governing Czech and EU law would have confirmed that state aid is prohibited unless an exemption is granted; and (vi) the Czech Republic's undertaking was communicated to Invesmart at the latest by 25 October 2002, prior to 4 November 2002 when its shareholders approved the Share Purchase Agreements. The Claimant was in a position to understand that state aid had to be justified because it would be scrutinised by both Czech and EU competition authorities.

What did the Ministry of Finance commit to do?

328. The Tribunal turns to the seminal issue, namely; what did the Minister of Finance agree to do at the 24 September 2002 meeting? The parties disagree over the meaning and import of the 24 September 2002 meeting minutes' statement that "the minister of finance is ready to submit a document for the state aid defined in this way for the government session". The question is whether a document which by its own words indicates a willingness to follow a process of seeking approval of aid constituted a promise, to deliver that aid, enforceable under the Treaty.
329. The disagreement centres on whether the Minister undertook an obligation of result such that, beginning with the debriefing on 25 September 2002 and crystallising on 24 October 2002, the Claimant formed a legitimate expectation that state aid was approved (the Claimant's view), or whether the Minister undertook an obligation of process, i.e., that he would evaluate the bank's planned restructuring and if he formed the view that it had a reasonable prospect of success, he would submit it to the Cabinet and the OPC for approval (the Respondent's view).
330. In the Tribunal's view, the weakness for the Claimant's case is that the evidence shows that as of 24 October 2002, the form of state aid and the modalities of getting approvals from the Ministry of Finance, the Cabinet and the OPC were not fully defined. Put simply, on 24 October 2002, the bail-out plan was a proposal from Invesmart dating back to 20 August 2002

which lacked the kind of detail and definition that would be required to obtain regulatory approval.

331. The Tribunal finds support for this finding in the following facts derived mainly from contemporaneous documents prepared prior to and after 24 October 2002.
332. First, although the Claimant relied upon the inter-agency meeting of 24 September 2002 as proof of the Minister's commitment to deliver state aid in a particular form,²²¹ the evidence strongly suggests that the CNB did not consider that the Finance Minister had made such a commitment at that meeting. Otherwise, there would have been no reason for the CNB's Mr Dědek to write to Minister Sobotka on 11 October 2002 to outline the CNB's subsequent discussions with Invesmart, noting that the investor had stated its intention to deliver all of the missing documents (pertaining to the source of its funds for the acquisition of its shareholding in the bank) very soon, and to "ask you, dear Minister, that the Ministry of Finance of the Czech Republic ... [communicate] its clear standpoint to the representatives of Invesmart B.V."²²² Had the Ministry already promised to deliver state aid, a letter from the CNB requesting him to communicate his clear standpoint on the aid issue would have been unnecessary.
333. Secondly, the testimony of both Governor Tůma and former Minister Sobotka was consistent that up to 24 October 2002, including at the meeting of the CNB's Bank Board that day, the Ministry of Finance had indicated its willingness to proceed with the process of considering state aid, but that no commitment to deliver state aid had been undertaken by the Ministry up to and including that date.²²³
334. The minutes recording the Bank Board's 24 October 2002 meeting are cryptic in that they record the fact of that the Minister spoke but not what he said. Due to the seminal importance of this issue, the Tribunal has examined the contemporaneous documents with care in order to determine whether there is any document that corroborates the witnesses' testimony on this point. It notes that after the CNB approved Invesmart's entry into Union Banka, the minutes of the meeting of 5 November 2002 record the Ministry of Finance's view that the CNB's approval of 24 October 2002 had been the MOF's *pre-condition* for the resumption of negotiations between the Ministry and Invesmart. The minutes record him as stating that:

²²¹ Transcript, Day 7, Smith, p. 9, line 25, p. 10 lines 14-25, p. 11, lines 1-5.

²²² Exhibit R-74, letter dated 11 October 2002 from Oldřich Dědek to Minister Sobotka.

²²³ Transcript, Day 4, Sobotka, p. 35, lines 1-14; Day 4, Tůma, pp. 208-209.

The MOF's condition for negotiations to be reopened was an unambiguous position of CNB on the approval of the investor Invesmart B.V. entry into Union banka, a.s. This condition was fulfilled.²²⁴ [Emphasis added.]

335. This record, from a document prepared two weeks after the Bank Board meeting but prepared well before the instant dispute arose, is in the Tribunal's view, corroboration of the two Respondent witnesses' testimony on this point. It is consistent with Governor Tůma's testimony that prior to 24 October, a certain deadlock had arisen between the CNB and the Finance Ministry: "On the one hand, the Finance Ministry wanted to know whether Invesmart was acceptable for us, and once again we are back to the question that Invesmart was not a substantial company and so on". He continued, "... on the other hand, we certainly would prefer to know from the State whether they would have been willing to provide the state aid or not". Somebody had to break the deadlock, he testified, "... so we said, 'Okay, this investor is acceptable for the Czech National Bank', and then it was up to the Finance Ministry to decide".²²⁵ The Tribunal also notes that there is no record of anyone representing Union Banka or Invesmart taking issue with the Ministry of Finance's characterisation of its "condition for negotiations to be reopened".
336. Thirdly, roughly one week *before* the CNB issued its approval, on 16 October 2002, Union Banka retained Euro-Trend to advise it on the state aid issue.²²⁶ The letter of authorisation specifically contemplated Euro-Trend's conducting negotiations "aimed at the restructuring" with "the Ministry of Finance of the Czech Republic, the Czech Consolidation Agency, Česká finanční s.r.o. and other state institutions".²²⁷ Reference to the terms of the contract shows that Union Banka's objective was to negotiate "the restructuring of its balance sheet with the participation of the Czech State", and Euro-Trend was to "perform ... all necessary negotiations with all involved parties, in particular with the Czech Ministry of Finance, Česká konsolidační agentura, and Česká finanční s.r.o. in order to successfully implement the objective" just described.²²⁸ [Emphasis added.] The Agreement further provided that Euro-

²²⁴ Exhibit R-461, minutes of the meeting held at the offices of the First Deputy Minister of Finance on 5 November 2002 between Finance officials and representatives of Euro-Trend, Union Banka and Invesmart. During the hearing, former Minister Sobotka adhered to the position that throughout the September–October 2002 period, although Invesmart had a proposal on the table in the form of its 20 August 2002 letter, the negotiations were not advanced and since Invesmart's application had twice been rejected by the CNB, the Ministry was interested in whether the CNB would approve its entry into Union Banka.

²²⁵ Transcript, Day 4, Tůma, p. 207, lines 3–16. He also emphasised this point at another stage of his testimony: Transcript, Day 4, Tůma, pp. 165–168.

²²⁶ Exhibit R-59, letter of authorisation dated 16 October 2002 issued by Union Banka, a.s. in favour of Euro-Trend, s.r.o. "to carry out all negotiations aimed at the restructuring of the Union Banka balance with state participation on behalf of Union Banka."

²²⁷ *Id.*

²²⁸ Exhibit R-470, Agreement between Union banka a.s. and Euro-Trend, s.r.o., dated 16 October 2002.

Trend would be paid a fixed monthly amount of CZK 100,000 and a contingency fee of CZK 5 million in "the event the Customer's objective is successful".²²⁹

337. The timing and content of this agreement indicates that having received a debriefing of the 24 September 2002 inter-agency meeting and having appointed Mr Vávra as its new CEO, Union Banka then retained professional advisors to negotiate on its behalf.²³⁰ The retention of advisors to assist in negotiations is indicative that a state aid package had not been agreed, even in Union Banka's view. Moreover, with the contract's heavy weighting of compensation towards a success fee, both parties explicitly recognised that the substantial part of Euro-Trend's fee would be paid only upon the attainment of the objective, i.e., the grant of the aid being sought.

338. This contract, executed on the same day as the shareholders of Invesmart initially voted on the capital increase, supports the finding that all parties, including Union Banka and Invesmart, considered that they were about to engage in a process of negotiation, the outcome of which was plainly hoped-for by the bank and the Claimant, but which could not be guaranteed.

339. Although it does not place great weight upon it, the Tribunal notes that an interview given by [redacted] on 24 February 2003, after the aid was refused, was consistent with its finding. The interview quoted [redacted] as stating that:

After obtaining a majority stake in Union banka, our first steps quite logically led to the Ministry of Finance, where we wanted to begin discussion on what would happen with the bank from now on. We received a letter signed by Mr. Janota stating that the Ministry of Finance was ready and willing to look for a solution and to assist in the restructuring of Union banka. In November, we therefore started negotiations...²³¹ [Emphasis added.]

340. This was put to [redacted] during cross examination. He testified that he could not remember what was said on 24 February 2003 because the situation was very hectic and he participated in many press interviews. He asserted that the quote attributed to him, that there had been no negotiations before November 2002, was not accurate. He did accept, however, that there were "many differences, absolutely" between the story published by *Euro* magazine on 24 February 2003 and the case pleaded before the Tribunal.²³²

²²⁹ *Id.*

²³⁰ The Tribunal notes that the parties to this Agreement understood the potential need for legal advice in supporting the negotiations. Article 1.3 permitted Euro-Trend, with Union Banka's consent, to seek advice on legal matters "provided by subcontractors-specialized firms or by individuals conducting business pursuant to special regulations (tax advisors, commercial lawyers, auditors etc.)."

²³¹ Exhibit R-431, "We Invested Three Billion," *Euro Magazine*, 24 February 2003.

²³² Transcript, Day 2, [redacted] pp. 65-66.

341. Fourthly, the Tribunal notes that Euro-Trend's First Proposal for Union Banka, dated 4 November 2002, was submitted to the Ministry of Finance 11 days after the Claimant says that its expectation crystallised. The Plan set out the proposed CF Transaction (lowering of the interest rate and the sale of the loan portfolio to CF) but also noted that there was a potential connection between this aid (which Euro-Trend argued could not be characterised as a grant of new state aid as suggested by what it called a "potential opinion" of the OPC²³³) and the resolution of Union Banka's arbitration claim against the CNB:

The proposed grant of state aid may be further connected to the resolution of the existing dispute between Union banka, a.s. and CNB, concerning the additional reimbursement of losses from transactions of overtaken banks amounting to approx. CZK 1.9 billion, such that no further requirement on fiscal funds would arise.²³⁴

342. This indicates that the form of the aid was still up for consideration even from Union Banka's perspective. Indeed, the BDS "receivable" can be seen as an attempt by the bank to find an alternative to the CF Transaction, because Euro-Trend had been told on 25 October that that transaction raised competition law issues.

343. Fifthly, the view of government officials who reviewed the First Proposal was that it required more work. The minutes of the 5 November 2002 meeting recorded the view that "any aid must be targeted, limited and pre-negotiated with the UOHS [OPC]" and that the "submitted document, if the solution proposed therein is chosen, must be further supplemented by the description of evaluation method, averaging of gained values, if appropriate, and by the clarification of procedure used in 'final calculation of the aid up to CZK 1.2 billion'".²³⁵

344. Sixthly, the Tribunal notes that in the meetings held on 25 October, 5 November and 29 November 2002, there is no record of Union Banka, Euro-Trend or Invesmart ever complaining that the issues then being discussed by the participants were inconsistent with their earlier expectation that a concrete state aid package had been promised when the CNB approved the share acquisition on 24 October 2002. The bank's representatives did express concern at the length of time that it would take to obtain the OPC's approval, but there is no suggestion in the minutes that the government was being accused of renegeing on a prior promise to deliver an agreed amount of state aid.

345. In brief, the documentary evidence surrounding 24 October 2002 indicates that the form of state aid was not agreed and that negotiations were expected by all sides of the proposed transaction. If there is any doubt on this point, it is put to rest by the next meeting of the parties at which Euro-Trend's Second Plan was discussed. This proposed changing the form of state

²³³ Exhibit R-13, First State Aid Plan elaborated by Euro-Trend, dated 4 November 2002, p. 8.

²³⁴ *Id.*, Part I, p. 2.

²³⁵ *Id.*

aid, envisaging that the state would implement one or more of the following measures: (i) the lowering of the fixed interest rate on the Fores Deposit of 11.5 percent to a floating market rate; (ii) the early termination of the Fores Deposit and its transformation into five-year subordinated debt; (iii) the acquisition by CKA of a portfolio of non-performing assets at a price determined by independent experts plus an additional amount of state aid; and (iv) a state guarantee of a portfolio of loans.²³⁶ The possibility of a state guarantee was raised by Euro-Trend. There is no indication from the record that it had been discussed previously.

346. Having regard to all the evidence, the Tribunal considers that although Invesmart could reasonably have held the view after 24 September 2002 that the Minister supported a potential bail out of Union Banka, it could not have a legitimate expectation either as of that date or as of 24 October 2002, when the CNB approved its acquisition of control of the bank, that the Czech government had promised to grant state aid. Had it retained counsel to advise on the competition law aspects of the state aid issue, it would have understood that the aid proposed through the settlement of the bank's relations with CF almost certainly did constitute state aid under EU and Czech law and that the process of preparing a detailed justification for its granting was necessary and without such a document the Minister and the Cabinet, let alone the OPC, could not approve it.

Conclusion on legitimate expectations

347. Before concluding on the legitimate expectations claim, the Tribunal wishes to address one other limb of the Claimant's case.
348. It appeared to the Tribunal that the Claimant argued that to the extent that the evidence showed that the Respondent had undertaken a commitment to a process as opposed to a result (the latter being the Claimant's primary position), the Respondent could not take advantage of its own failure to comply with its domestic laws in failing to obtain the requisite approvals of the Czech Cabinet and the OPC.²³⁷ In its closing submissions, Invesmart argued that its case was not that state aid would be supported in violation of Czech or EU law, but rather that the Respondent "would take such steps needed to lawfully supply the promised state support."²³⁸ At another point, it asserted that its legitimate expectation was "a clean bank with a combination of the Česká Financní transaction and a contribution of the assumption of the related-party loans with a net asset value of CZK 1.162 million".²³⁹

²³⁶ Exhibit R-14, Second Euro-Trend Proposal.

²³⁷ Transcript, Day 7, Smith, p. 7, lines 20-25.

²³⁸ *Id.*, p. 7, lines 11-15.

²³⁹ Transcript, Day 1, Smith, p. 32, lines 21-25, p. 33, line 1.

349. No matter how the proposition is put, in the Tribunal's view, the Claimant's legitimate expectation argument presupposed the approval of the Cabinet and the OPC. That is, on the basis of what was communicated to Invesmart prior to 24 October 2002, state aid would have been granted if the Minister had only submitted the request.
350. In the Tribunal's view, this was not the case. Having regard to the legal framework that governed the granting of state aid, the Minister could not simply rubberstamp the bank's application without evaluating its merits in terms of its potential to meet the requirements of Czech and EU law.²⁴⁰ For an application to be submitted to the Cabinet, let alone be approved by the OPC, the Minister had to be satisfied that it had a reasonable prospect of achieving the goal of stabilising the bank. This required the applicant to submit a restructuring plan that met the requirements of the law, and the Minister, the Cabinet and the OPC had to agree that the plan met those requirements.
351. The Tribunal does not see how the Claimant's legitimate expectation that the Ministry of Finance would follow a process meant that such expectation would deliver the desired result. At the time that the expectation was said to have crystallised, the Respondent was not, in the Tribunal's view, in a position to promise that state aid would be granted. It could, and did, undertake a commitment of process, but not of result and the Claimant should have understood that to be the case. As the evidence shows, ultimately, the Minister concluded that the Restructuring Plan did not have a reasonable prospect of success.

Inconsistency and ambiguity

The Claimant

352. The Claimant relied on a recent line of case law to argue that the Czech Republic breached the fair and equitable treatment standard by failing to treat its investments "consistently" and "without ambiguity".²⁴¹
353. Specifically, the Claimant submitted that the Respondent had acted inconsistently by:

²⁴⁰ By the end of the hearing, it was common ground between the parties that the CNB is not vested with the authority or power to decide whether state aid should be granted. That falls within the remit of the Minister of Finance. Even then, the evidence is that the Minister does not possess final decision-making power; rather, having evaluated a proposal, he decides whether to put it to Cabinet for its approval and by virtue of Czech law implementing EU law, the Cabinet decision is not effective without the approval of the OPC. This is fundamental to, and expressed in, the operation of the host state's law on state aid and the Tribunal must have due regard to it.

²⁴¹ *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, (ICSID Case No. ARB(AF)/00/2) (Award of 29 May 2003); *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case No. ARB/01/7) (Award of 25 May 2004); *Saluka v Czech Republic* (Partial Award of 17 March 1996).

- (a) Approving Invesmart's acquisition of Union Banka and then simultaneously causing a run on Union Banka by making irresponsible comments to the Czech media on 22 October 2002;²⁴²
- (b) Adopting inconsistent positions towards Invesmart and Union Banka after Invesmart's assumption of Union Banka's RPLs. Invesmart submitted that it had invested in Union Banka and Union Group in the belief that the Government would provide state aid under the CF Transaction. Following the Invesmart's acquisition of Union Banka and Union Group the CNB continued to support the CF Transaction whilst the Ministry of Finance and the CKA did not;²⁴³
- (c) Further, Invesmart submitted that it was caught between the inconsistent proposals of different organs of the Czech Government in relation to the form of state aid.²⁴⁴ Specifically, at the 5 November 2002 meeting, discussed at paragraph 124 above, the CKA supported the settlement of the BDS Arbitration Claim as a "purely commercial solution that should not meet with a negative response from the UOHS".²⁴⁵ However, the CNB was not prepared to settle the BDS Arbitration Claim;²⁴⁶
- (d) Resiling from its position held prior to Invesmart's acquisition of Union Banka that the OPC need only be "consulted" with respect to state aid. Following the investment, the Czech Republic "changed the rules of engagement" by requiring that the OPC "pre-approve" any grant of state aid;²⁴⁷
- (e) After Invesmart prepared the restructuring plan, the MOF failed to submit it for review and approval by the OPC as promised;²⁴⁸
- (f) Failing to publicly declare its support for Invesmart and Union Banka through the making of a Resolution as it had promised to do on 29 November 2002, which would have aided the bank.²⁴⁹

354. Invesmart's claim of "ambiguity" in the context of, or in addition to, "inconsistency" related to the Respondent's failure to disclose, before approving Invesmart's acquisition of Union Banka

²⁴² Statement of Claim, para 303.

²⁴³ *Id.*

²⁴⁴ Statement of Claim, para 303.

²⁴⁵ Exhibit R-81, Minutes of Meeting held on 5 November 2002.

²⁴⁶ first witness statement of Governor Tůma, para 39; first witness statement of Mr. Vávra, para 63.

²⁴⁷ *Id.*

²⁴⁸ Claimant's Opening Statement, p. 36.

and Union Group, that the Deputy Prime Minister of the Czech Republic had made a commitment to the EC that the Czech Republic would not provide any new aid to banks.²⁵⁰

The Respondent

355. The factual basis for each of these allegations was rejected by the Respondent. Its defence of these claims can be summarised thus:

- (a) The run on Union Banka was not caused by inaccurate statements made by the CNB to the media but arose instead from the public's loss of confidence in Union Banka's capacity to resolve its long-standing difficulties when the deadline for Invesmart to appeal the rejection of its Second Application for state aid expired. This was of common public knowledge;²⁵¹
- (b) It did not adopt conflicting positions toward Invesmart and Union Banka for it was Invesmart and Union Banka, and not the Government, who introduced the CNB Receivable as a potential mechanism to secure delivery of state aid in January 2003 even though the CNB Receivable had been discussed and rejected by the Government a full two months earlier;²⁵²
- (c) The requirement that state aid be "pre-approved" by the OPC was not arbitrary; rather it flowed from the then applicable Czech and EU law with which it was not erroneous of the Government to insist compliance on the part of Invesmart. Failure to comply warranted the denial of state aid;²⁵³
- (d) The Czech Republic was under no obligation to publicly declare its support of Union Banka before a decision on the grant of state aid was given just as it was similarly under no obligation to grant state aid.²⁵⁴

356. With respect to the Claimant's allegation that the Czech Republic failed to provide adequate notice of its decision not to grant state aid, the Respondent points out that Invesmart was given notice of the decision not to grant aid orally on the day the decision was taken.²⁵⁵ Further a letter informing Invesmart of the decision in writing was sent to Union Banka's official

²⁴⁹ *Id.*, para 304.

²⁵⁰ Statement of Reply, para 365.

²⁵¹ Statement of Defence, paras 393–394.

²⁵² *Id.*, paras 396–399.

²⁵³ *Id.*, paras 403–404.

²⁵⁴ *Id.*, para 405.

registered address where the Bank publicly professed to have its place of effective management.²⁵⁶

Tribunal's analysis

Inconsistency - OPC approval

357. At the core of Invesmart's claim that is the allegation that the Government changed the rules of engagement and following its assumption of the RPL's introduced a new requirement: that state aid be subject to OPC approval.
358. This issue was also raised in the context of legitimate expectations. The Tribunal concludes at paragraph 327 that the role of the competition authorities in vetting any proposed state aid, including in respect of the CF transaction, was brought to the Claimant's attention before it submitted its third application to acquire Union Banka on 22 October 2002. It follows from this conclusion that when the Government informed Invesmart on 5 November 2002 that the CF Transaction constituted "new" state aid and would be subject to OPC approval that there was no change in position as the Claimant alleges.²⁵⁷

The run on Union Banka

359. At the hearing the parties agreed as to the specific wording of the comment Ms Frišaufová made to the Czech media on 22 October 2002. Specifically, Ms Frišaufová made the following statement:

In this administrative proceeding the CNB did not grant its approval to Invesmart for the acquisition of qualified interest in Union Banka because the investor failed to provide the source of funding for the acquisition. As far as this proceeding is concerned, the decision is final. This does not, however, preclude Invesmart from filing a new application and commencing new administrative proceedings on granting the approval with the transfer of the shares.²⁵⁸

360. The Tribunal's considers that these comments were ill-considered, given Union Banka's already weak financial position. In late October 2002 the uncertainty surrounding Union Banka was, in part, a consequence of the CNB Governor's advice to Invesmart submit a new application to acquire a controlling interest in Union Banka rather than appeal the CNB's

²⁵⁵ See Exhibit R-154, minutes of a meeting held on 20 February 2003 between the CNB and members of the Supervisory Board of Union Banka, a.s. and Exhibit R-155, minutes of a meeting held on 20 February 2003 between the CNB and Union Banka, a.s.

²⁵⁶ Statement of Rejoinder, para 232. See also Exhibit R-121, minutes of the general meeting of Union Banka held on 20 December 2002; Exhibit R-446, press article, "Union banka's headquarters to remain in Ostrava", *Mladá Fronta Dnes* dated 8 November 2002.

²⁵⁷ Exhibit C-61, minutes of a meeting held on 5 November 2002 between the Ministry of Finance, CKA, Invesmart and Euro-Trend.

rejection of Invesmart's second application during the appeal period 4 - 22 October 2002. The CNB was aware that Invesmart had submitted a revised submission on 22 October 2002 and this was recognised by the CNB spokeswoman. In consequence, the CNB's approval of the new application and the OPC's approval of state aid were, at that time, open issues.

361. The destabilising impact of the CNB's comments is illustrated by the way the issue was reported by the Czech media. In particular, a report published by Česká Tisková Kancelár included the following sentence "Frišaufová said she did not want to anticipate future developments, but did not rule out that taking away the bank's license was one possibility".²⁵⁹
362. That the run on Union Banka might have been avoided is shown by the fact that it was ended when on 24 October 2002, the CNB approved Claimant's application to acquire a share in Union Banka and Union Group.
363. The statements in question, having been made publicly by the CNB spokeswoman, are imputable to the CNB; the conduct of a state entity such as the CNB being attributable to the Czech Republic. The Respondent cannot escape criticism in view of the recognised sensitivity of public announcements in the banking sector.
364. That being said, the Tribunal holds that this conduct cannot amount, *per se*, in isolation, to a violation of fair and equitable treatment. The Tribunal notes that at the time this statement was made it was, strictly speaking, factually accurate. The purpose of making the statement was explained by Governor Tůma in cross-examination:
- Everybody knew at that time that Union banka was in [a] difficult position, and the pressure for the bank didn't occur after the statement by Mrs Frišaufová. The pressure was long -- longer, for a longer period. We decided, and everybody knew, or the general public knew that -- and by the way, it was used as the argument that the investor is applying and there is a chance that the investor would take over, and this is -- so it was used also by the Union banka as the argument for the general public that the situation would calm down.²⁶⁰
365. These comments by Governor Tůma are persuasive. In particular, that the problems at Union Banka existed many months prior to October 2002 and that the comments made by Ms Frišaufová are capable of being characterised as an attempt to reassure the public. Whilst these comments may be criticised in retrospect, given the run that occurred on 23 October 2002, the Tribunal is not satisfied that the conduct constitutes a breach of fair and equitable treatment.
366. The Respondent also asserted that the information contained in Ms Frišaufová's statement was already in the public domain. This contention is strongly supported by public statements made

²⁵⁸ Transcript, Cross-examination of Governor Tůma, Day 4, p. 191, lines 6–14.

²⁵⁹ Exhibit C-54, newspaper article published 22 October 2002 by Česká Tisková Kancelár.

²⁶⁰ Transcript, Day 4, Cross-examination of Governor Tůma, p. 191, lines 4–13.

by _____ prior to the comments made by Ms Frišaufová. The Respondent tendered evidence that on 22 October 2002 *Mlada fronta Dnes*, one of the principal Czech National dailies, reported that Invesmart had confirmed that it did not appeal against the decision of the CNB to deny its second application to acquire Union Banka. This paper quoted as saying "It is very complicated. It cannot be definitively said that we do not continue in our negotiations. We are in contact with the CNB".²⁶¹

367. Ultimately, the run on Union Banka occurred as a result of public perception that the prospects of Union Banka being acquired by a foreign investor had declined. It may be equally fair to speculate that this perception existed as a result of _____ comments, or both _____ and the CNB's comments taken together.

The CKA's proposal to settle the BDS arbitration claim

368. At the 5 November meeting CKA proposed settlement of the BDS Arbitration Claim for CZK 1.8 billion as a means of conferring a benefit on Union Banka "that would not meet with a negative response from the UOHS".²⁶² The minutes of the meeting record that the proposal would be put to the CNB expeditiously,²⁶³ the latter having not attended the meeting. However, few days later, at a meeting held on 29 November 2002, the CNB rejected the proposal since it "did not admit the Union Banka's claim".²⁶⁴ Mr Vávra for Union Banka, present at the meeting together with a representative of Invesmart, took note of the CNB's position, no remarks or objection on his part being reflected by the minutes of the meeting.
369. Thus, Union Banka and Invesmart were made aware, about three weeks after the CKA's proposal, that the same could not be implemented due to the CNB's opposition. The Tribunal considers that a governmental entity against which an arbitral claim had been made, and which was not represented at the meeting at which the settlement of the claim against it was discussed, was entitled to state its objection when it became apprised of the discussion.
370. This conduct by the various entities of the Czech Republic does not amount to a violation of Article 3.

²⁶¹ Exhibit R-78, article published by *Mlada fronta Dnes* on 22 October 2002.

²⁶² Exhibit C-61, minutes of a meeting held on 5 November 2002 between the Ministry of Finance, CKA, Invesmart and Euro-Trend.

²⁶³ *Id.*, conclusion.

²⁶⁴ Exhibit C-63, minutes of a meeting held on 29 November 2002 between the Ministry of Finance, the OPC, the CNB, the CKA, Union Banka, Euro-Trend and Invesmart, p.2, line 1.

The MOF's failure to submit the Third Restructuring Plan to the OPC

371. The reasons for the MOF's rejection of the Third Restructuring Plan were given by Minister Sobotka in his letter to Union Banka dated 20 February 2003.²⁶⁵ The application for state aid having been rejected, there was no reason for the MOF to submit Union Banka's application to the OPC for an exemption from state aid prohibition, as mentioned by Minister Sobotka in the same letter. The MOF's prior approval was in fact a necessary pre-condition of the OPC's review of state aid proposals. Further, the MOF, after the many months spent in an attempt to find a solution to the state aid issue, had no obligation to meet again with Union Banka to explore alternative solutions. Union Banka's financial situation at that point in time, as confirmed by its CEO, Mr Vávra, on 19 February 2003, was so critical ("catastrophical", regarding the liquidity situation) as to suggest that no time was left for further discussions.²⁶⁶

The MOF's "undertaking" to issue a resolution in support of Union Banka

372. The minutes of the 29 November 2002 meeting do not appear to reflect the Claimant's assertion that the Government undertook "to issue a public commitment in the form of a resolution allowing an exemption on the ban on State aid" with the view of reassuring the public and Union Banka's customers that the bank had the full support of the Government.²⁶⁷ The record shows that Mr Vávra proposed that:

Given the time needed to draw up a restructuring plan and the time it would take the UOHS to issue a decision, the UB CEO asked if it would be possible to make use of this period by submitting all the necessary material to the government, which would then issue a resolution stating that the government had considered the issue and would only assess the possibility of providing state aid to the bank on condition that the UOHS allowed such aid to be provided under Law 59/2000 on State aid - in other words, issue a decision allowing an exemption from the ban on state aid.²⁶⁸

373. The somewhat confused record of this part of the minutes prompted a clarification by the First Deputy Finance Minister (present at the meeting), who suggested that the exemption by the MOF was not meant to refer to the ban on state aid but rather "to the comments procedure".²⁶⁹
374. Following that meeting, based on its understanding that the Government had accepted to issue a resolution allowing an exemption on the ban on state aid, Union Banka circulated a draft of

²⁶⁵ Exhibit R-151, letter dated 20 February 2003 from then-Minister of Finance Sobotka to Union Banka.

²⁶⁶ See Exhibit R-150, minutes of a meeting held on 19 February 2003 between Mr. Vávra for Union Banka, and Mr. Krejča, Mr. Jiríček, Ms. Goldscheiderová, and Mr. Majer of the CNB.

²⁶⁷ Exhibit C-63, minutes of a meeting held on 29 November 2002 between the Ministry of Finance, the UOHS, the CNB, the CKA, Union Banka, Euro-Trend and Invesmart and Statement of Claim, para 122.

²⁶⁸ *Id.*

²⁶⁹ *Id.*

the Government's resolution to that effect.²⁷⁰ The draft resolution was unacceptable to the Government since it amounted to the approval of state aid to Union Banka on condition of a positive decision of the OPC,²⁷¹ providing further that the amount and form of state aid resulting from UB's restructuring plan "shall be accepted by the Office for the Protection of Competition".²⁷² [Emphasis added.]

The Czech Republic's renewed commitment to the EC

375. As already mentioned, the Czech Republic cannot be reproached for its alleged failure to alert Invesmart about the need of the OPC's approval of the state aid. The Claimant contends that the Respondent should have informed Invesmart in a timely manner that obtaining such approval had become more difficult following the Deputy Prime Minister's commitment to the EC that the Czech Republic would not provide any new aid to banks. Due to the terms of the commitment so made (as reflected in the minutes of 29 November 2002 meeting),²⁷³ the prospects of obtaining the EC's approval of new state aid by the Czech Republic were reduced.
376. The minutes mention that "possible further aid to UB would mean a violation of the commitment made by Deputy Prime Minister Pavel Rychetsky that the Czech Republic would not provide any new aid to banks".²⁷⁴ In the Claimant's view, this wording underlines the fact that a serious additional obstacle existed to the granting of state aid to Union Banka, although the OPC's representatives indicated at the meeting that "they would not rule out the provision of aid to the bank on principle".²⁷⁵
377. According to the Claimant, the significance of the Czech Republic's failure to inform Union Banka and Invesmart in a timely manner is made manifest by the fact that by 29 November 2002 Invesmart had already completed its acquisition of Union Banka and Union Group. The Debt Assumption Agreements signed by Invesmart on 17 November 2002 had in fact become effective upon the transfer of shares in Union Banka and Union Group to Invesmart on 18 November 2002.²⁷⁶
378. The Claimant's complaint is misplaced in more than one respect. As already indicated at paragraph 319 above, the Deputy Prime Minister's commitment to the EC that there would be

²⁷⁰ Exhibit R-15, Third Euro-Trend Proposal, dated 7-8 January 2003.

²⁷¹ *Id.*, Point II, front page.

²⁷² *Id.*, Point III, front page.

²⁷³ See Exhibit C-63, Exhibit C-63, minutes of a meeting held on 29 November 2002 between the Ministry of Finance, the UOHS, the CNB, the CKA, Union Banka, Euro Trend and Invesmart.

²⁷⁴ *Id.*,

²⁷⁶ Exhibits R-83 and R-102 and Statement of Defence, para 132.

no more public subsidisation to the banks had been disclosed to Union Banka's advisors, Euro-Trend, at a meeting held on 25 October 2002.²⁷⁷

379. Further, as also already discussed at paragraph 318 above, the relevant time for determining whether Invesmart irrevocably committed to its investment in the bank without knowledge of the Respondent's commitment to the EC is not 16 October, but 4 November 2002.
380. The facts at hand may therefore be distinguished from the cases to which Invesmart referred in making its claim. In the present case, no decisions or permits had been issued by the State on which Claimant could reasonably rely to assume its commitments. This was the case in *Tecmed* and *MTD*. No such reliance was justified by the CNB's approval of Invesmart's acquisition of shares in Union Banka and Union Group since state aid had still to be cleared by the OPC. Contrary to the *Saluka* case, where the tribunal found that the Czech Republic had "acted inconsistently in its overall communications with IPB and Saluka/Nomura",²⁷⁸ no such inconsistency may be imputed in the present case to the Czech Republic.
381. In the light of the foregoing, the Tribunal holds that Claimant's claim of breach by the Czech Republic of fair and equitable treatment for inconsistency and ambiguity of conduct fails.

Discrimination

The Claimant

382. With regard to its fair and equitable treatment claim, Invesmart also submitted that the Czech Republic's denial of state aid to Invesmart was discriminatory. The basis of this claim was Invesmart's contention that between 1990 and 2004 the Czech Republic routinely provided state aid to Czech banks whose circumstances were comparable to those of Union Banka whether viewed in terms of size, the amount of aid to be provided, the form of aid or the purpose of aid.²⁷⁹
383. Invesmart also argued that several of these banks had received emergency liquidity loans from the Czech Republic and that the Czech Republic's refusal to provide similar support to Union Banka was discriminatory.
384. In developing its submissions Invesmart referred the Tribunal to the *Saluka* arbitration in which the Czech Republic was found to have discriminated against a large Czech bank (IBP) without justification when it denied IBP's requests for state aid while granting state aid to three

²⁷⁷ Exhibit C-60, minutes of a meeting held on 25 October 2002 between Josef Douruška of the Ministry of Finance and Euro-Trend representatives.

²⁷⁸ *Saluka*, Partial Award, dated 17 March 2006, para 419.

²⁷⁹ Statement of Claim, para 346.

of the four other major Czech banks. In *Saluka* the tribunal accepted that this discrimination violated the fair and equitable treatment standard and the impairment clause. The Claimant argued that Union Banka's circumstances were analogous to those of IBP and that it was similarly discriminated against.

385. Invesmart went on to refer the Tribunal to its own analysis of state aid provided by the Czech Republic, and its predecessor state, to banks between 1990 and 2004.²⁸⁰ This analysis was largely derived from information provided to the EC by the Czech Republic.²⁸¹ The Claimant's submissions on discrimination were also supplemented by Appendix A of the Statement of Claim which summarised the main forms of state aid that the Czech Republic provided to banks between 1990 and 2004. This evidence was summarised in the following way by the Claimant in opening submissions:

- (a) 12 mid-sized and small Czech banks received state aid from 1996 to 2001, including Prago Banka (1997), Agrobanka (1998) and PMB (2000, 2001);
- (b) Four Czech banks received state aid from 2001 to 2005 including PMB, Ceska Sportielna, Komerčni Banka and CSOB;
- (c) The Czech Republic provided vast amounts of state aid to promote restructuring and onward sales to strategic investors including IPB, Komerčni Banka, Ceska Sportielna, CSOB and Agrobanka.²⁸²

386. Invesmart also tendered expert evidence in support of its discrimination claim in the form of two reports by Associate Professor Raj M Desai dated 6 December 2007 and 11 July 2008. Professor Desai's first report was on the "relevant policies, methods and interests used in the provision of state support and assistance to the banking sector in the Czech Republic between the mid 1990s and mid 2000s".²⁸³ Professor Desai's second report was in the form of a reply opinion which sought to evaluate the submission made in the Statement of Defence that Union Banka "could not be reasonably compared with other banks that received direct or implicit state budgetary or off-budgetary assistance".²⁸⁴

387. Professor Desai's first report described the state aid provided to Czech banks under the first and second Consolidation Programs and the Stabilisation Program in the 1990s. He opined that from 1998 onwards it was the policy of the Czech Republic to find a strong private "strategic

²⁸⁰ Statement of Claim paras 29–50; Transcript, Day 1, Fleuriet, p. 64, lines 9–15.

²⁸¹ Transcript, Day 1, Fleuriet, p. 63, lines 13–14.

²⁸² Claimant's opening statement, pp. 43–44.

²⁸³ Report of Associate Professor Raj Desai, dated 6 December 2007, p. 3.

²⁸⁴ Report of Associate Professor Raj Desai, dated 11 July 2008, para 1.

investor" to assist with the privatisation and restructure of banks.²⁸⁵ A number of Czech banks were privatised during this period and acquired by foreign investors, including IBP, Komerční Banka, Ceska Sporitelna, COB and Agro Banka. Each was provided with state aid in various forms.²⁸⁶ Finally, Professor Desai described a number of small and medium sized banks that were granted state aid in the 1990s.²⁸⁷

388. In Professor Desai's second report much was made of the similarities between Nomura's acquisition of IBP, that was the subject of the *Saluka* arbitration, and Invesmart's acquisition of Union Banka. This was based on the contention that the problems afflicting both banks were typical of those experienced by Czech Banks throughout the 1990s. The report stated:

Insufficient capital adequacy, related lending, non-transparency in ownership, and consequent asset stripping and non-performing loans, were common across all types of Czech Banks in the 1990s -big and small, formerly state-owned or *de novo*.²⁸⁸

389. Professor Desai also opined that state aid was provided to numerous Czech banks from 2000 onwards. In paragraph 13 he states:

State aid was provided to numerous Czech banks after 2000. In particular, state support to Česká Spořitelna, a.s., took the form of bad-asset transfers (in March 2000) and contingent guarantees (June 2000 and June 2001). In the case of Komerční Banka, a.s. (KB), state aid was provided through rescue and restructuring support (March 2000) and guarantees as part of a sale of stock (October 2001). Československé Obchodní Banka, a.s., (CSOB) received state aid in conjunction with its acquisition of IPB (in June 2000), as well as through state-supported rescue and restructuring operations (throughout 2000, 2001, and 2002).²⁸⁹

The Respondent

390. The Respondent submitted that the factual record did not support Invesmart's discrimination claim.
391. The Respondent referred the Tribunal to the test for discrimination enunciated by the *Saluka* tribunal, namely as being whether (i) similar cases are (ii) treated differently (iii) without reasonable justification.²⁹⁰
392. The Respondent submitted that the Tribunal should distinguish Union Banka's circumstances from the facts in *Saluka* on the basis that in *Saluka* there was differential treatment between four clearly analogous banks. The Respondent pointed to a number of similarities between IBP

²⁸⁵ Report of Associate Professor Raj Desai, dated 6 December 2007, p. 20.

²⁸⁶ *Id.*, pp. 20-29.

²⁸⁷ *Id.*, pp. 30-34.

²⁸⁸ Report of Associate Professor Raj Desai, dated 11 July 2008, para 8.

²⁸⁹ *Id.*, para 13.

²⁹⁰ Statement of Defence, para 417 referring to *Saluka* Partial Award, para 313 (Exhibit C-194).

and the three other major Czech banks: the four banks were all of a similar size; all had portfolios of non-performing loans; all were undergoing a process of privatisation; the failure of any of the banks would have had systemic consequences for the Czech banking sector.²⁹¹

393. The Respondent went on to argue that no Czech banks operated under conditions similar to those of Union Banka. It submitted that:

(a) Union Banka was one of a more diverse group of small privately owned banks, some of which had been allowed to fail without the provision of state aid or following the provision of state aid,²⁹²

(b) Union Banka's balance sheet problems were the unique consequence of its acquisition of the four smaller banks in the 1990s;²⁹³ and

(c) No similarly situated Czech bank was granted state aid in 2002 or 2003.²⁹⁴

394. The Respondent's submissions were supported by two expert opinions prepared by Professor Dr Dr h.c. Claus-Dieter Ehlermann dated 25 March 2008 and 2 October 2008, respectively.

395. In particular, Professor Elhermann's analysis introduced a temporal aspect to the discrimination case. Professor Ehlermann opined that "the situation in February 2003 was different from and not comparable to the situation in which earlier privatisations and takeover operations had taken place".

396. Professor Elhermann advanced two main arguments in support of this position.

397. First, the Czech Act on state aid, which was enacted on 1 April 2000 and entered into force on 1 January 2001, restricted the Czech Republic's legal right to grant state aid unless the OPC approved the grant.²⁹⁵ The implementation of the new law had a significant impact on the preparedness of the Czech Government to make grants of state aid. Professor Elhermann acknowledged that the Czech Republic made grants of state aid after the implementation of the Act between January and June 2001. However, he suggested that these grants of state aid related to 'older' negotiations that pre-dated the Act.²⁹⁶

398. Secondly, state aid controls were imposed on the Czech Republic as part of its accession to the EU. Large sections of Professor Elhermann's first report were dedicated to describing how the

²⁹¹ *Id.*, para 418.

²⁹² *Id.*, para 419

²⁹³ *Id.*,

²⁹⁴ *Id.*, para 420.

²⁹⁵ First Report of Professor Elhermann, para 285.

EC required that state aid control be implemented by the Czech Republic. These requirements were not strictly observed by the Czech Republic between 1998 and 2001. However, Professor Elhermann opined that the observance of these controls crystallised during the pre-accession period which coincided with Invesmart's and Union Banka 's negotiations with Czech government officials concerning state aid.²⁹⁷

399. At the core of Professor Elhermann's analysis was the distinction between the granting and payment of aid. As Professor Elhermann stated in his second report:

... there is a fundamental difference between the act of entering into a legally binding commitment, i.e. the grant, on the one hand, and the acts of implementation, i.e. the payments etc., on the other. These two different acts do not have the same character and should therefore not be characterised to be "alike" for a meaningful comparison under the principle of non-discrimination.²⁹⁸

400. The Respondent conceded that since 2000 there have been many examples of state aid being paid pursuant to arrangements made prior to 2001. However, the Respondent submitted that from 2001 onwards only two grants of state aid were made to banks by the Czech Republic.²⁹⁹

401. In closing submissions these grants were described by Professor Crawford in the following terms:

Since 2001 State aid was given to two banks and this aid was subsequently notified to the European Commission in the document exhibits C17 and C18. Each of those transactions has special features.

First in relation to PNB, this was a small bank in which the City of Prague had an interest, and under an indemnity of 27 December 2001 an amount of [CZK] 3.43 million was paid by way of aid. That amounts to €114,000 by my calculation.

Secondly, Komerční Banka was granted a tax relief in relation to State aid previously granted in an earlier year, which gave it an extraordinary profit. So in effect the government accepted the argument that the earlier aid shouldn't, as it were, be taken away in the form of taxation.³⁰⁰

402. In closing submissions the Respondent also tendered, without objection from the Claimant, a table listing 21 examples where OPC denied requests for state aid between 2001 and 2004.³⁰¹ Similarly, in the Statement of Defence the Respondent listed four small and medium sized banks that had been allowed to fail without the provision of state assistance.³⁰²

²⁹⁶ First Report of Professor Elhermann, para 286.

²⁹⁷ *Id.*, paras 288–289.

²⁹⁸ Second Report of Professor Elhermann, para 11.

²⁹⁹ Transcript, Day 7, Professor Crawford, p. 237, lines 11–21.

³⁰⁰ Transcript, Day 7, Professor Crawford, p. 237, lines 6–7.

³⁰¹ Transcript, Day 7, Professor Crawford, p. 235, line 25, p. 236, 1–25, p. 237. 1–5.

³⁰² Statement of Defence, para 418: the banks are listed in fns 608 and 609.

The Tribunal's analysis

403. On the basis that the parties adverted to *Saluka*, when making submissions on the discrimination issue and without engaging in an analysis of the correctness of that tribunal's treatment of discrimination as a part of the fair and equitable treatment standard, the Tribunal will consider whether the evidence other Czech banks were (i) similarly situated to Union Banka, yet (ii) treated differently (iii) without reasonable justification.

Were the other recipients of state aid similarly situated to Union Banka?

404. The Tribunal is not satisfied that Union Banka was similarly situated to other Czech Banks who received state aid at the time Union Banka sought it.
405. In its submissions the Claimant referred the Tribunal to numerous banks that received state aid following the State's transition from a communism, many as part of the Consolidation and Stabilisation Programs during the 1990s. The Tribunal notes that the parties agreed that throughout the 1990s the Czech banking system was in crisis and that as a result the Czech Republic, and its predecessor state, implemented three state aid programs to restructure and stabilise the banking system.³⁰³ The parties also agreed that following the end of the Stabilisation Program in 1998 aid was provided to Czech banks in order to avert the failure of banks and to facilitate the sale of banks to foreign "strategic" investors.³⁰⁴
406. The Claimant placed significant emphasis on the state aid provided to Czech Banks during the Second Consolidation Program in 1995-1996 and the Stabilisation Program between 1996 and 1998. For example, in its opening submissions Invesmart referred the Tribunal to 12 mid-sized and small Czech banks that received state aid from 1996 to 2001. However, based on the evidence contained in the first report of Professor Desai it is apparent that the arrangements for the provision of this state aid were made between 1996 and 1998.
407. The Claimant said that Union Banka's problems were similar to those experienced by these other Banks because they were typical of systemic problems that plagued the Czech banking system throughout the 1990s. To wit, the key element of the Claimant's discrimination case was that the Czech Republic, in denying state aid, including emergency liquidity loans, had treated Union Banka differently to other banks that had similar problems.
408. In the Tribunal's opinion there are four key factors that arise from the Respondent's rebuttal of the discrimination claim which contradict this analysis.

³⁰³ Agreed Statement of Facts, paras 2, 4 and 5.

³⁰⁴ Agreed Statement of Facts, para 6.

409. First, the Respondent's claim that the policy of the Czech Republic towards the granting of state aid changed as a consequence of its accession to the EU significantly. The entry into force of the Czech Act on State Aid on January 2001 was a critical step in this process and it was clear that after this time there was a marked reluctance by the Czech Republic to grant state aid. This is supported by the fact that only two grants of state aid were made to banks between 2001 and 2003. It is also supported by the numerous denials of requests for state aid made by the OPC between 2001 and 2004. Further, it seems logical that the onus would be on the Czech Republic to strictly observe its commitments to the EU in the pre-accession period, particularly in respect of state aid control. No evidence was advanced by the Claimant that contradicted this claim.

410. Secondly, the Respondent was correct to draw a distinction between the granting and the paying of state aid. It is necessary for the Tribunal to compare the Government's decision to deny state aid with other instances where the state aid was granted. The point at which the decision was made and the Czech Republic assumed an obligation to pay state aid is the relevant factor in the Tribunal's inquiry in respect of discrimination.

411. The Tribunal notes that questions regarding the relevance of the distinction between granting and paying aid were put to Professor Desai in cross-examination. However, it is apparent from the following exchange that Professor Desai did not incorporate this distinction or specifically compare Union Banka's circumstances with those of banks who were granted state aid in 2002 and 2003.

Professor Crawford: You say in paragraph 13 of your opinion: "State aid was provided to numerous Czech Banks after 2000". If, by that, you mean State aid was disbursed to a number of Czech Banks after 2000, then I can agree with you. I think that is certainly true. But do you give any example of - and, of course, the words "after 2000" need clarification as well. By "after 2000" I mean any event after 1st January 2001.

Professor Desai: I understand.

Professor Crawford: So after the end of the calendar year 2000. Do you give any example in your opinion of a decision to grant State aid made after the end of the calendar year 2000?

Professor Desai: In this section I wasn't trying to make a distinction between grants and payments, which I do appreciate is a distinction that is important, as you've presented it. However, there are examples. From my understanding of the record, there are examples of grants, new grants, made. I believe in - certainly in 2000, you say --

Professor Crawford: I said after the end of 2000

Professor Desai: One, my understanding, for the record, is that there were some cases of grants made in 2001 I did not draw a

distinction between them in this paragraph because I was not trying to make the distinction for the legal basis.³⁰⁵

412. Thirdly, the circumstances of the two banks that received state aid in 2002-2003 can be readily distinguished from the circumstances of Union Banka. In this regard, the distinction drawn by the Respondent in closing submissions seems sound. The Claimant did not seek to contradict this analysis, despite having been given the opportunity to do so.

413. Fourthly, it is highly relevant that there were other banks that were denied state aid and allowed to fail between 2000 and 2004. There can be no finding of discrimination if banks similarly situated to Union Banka are found to have been treated similarly to Union Banka. The fact that other banks were denied aid suggests this may be the case. Neither party made detailed submissions on the similarities between the small and medium banks that were denied aid, other than by reference to their size and the widespread problems affecting numerous Czech banks. The Claimant did not seek to distinguish Union Banka's circumstances from the banks that failed.

414. Finally, it is necessary for the Tribunal to refer to the analogy drawn by the Claimant between the facts in *Saluka* and the facts at hand. The Tribunal is of the opinion that the discrimination against IBP in *Saluka* was fundamentally different to that to the Czech Republic's treatment of Union Banka. This is because of the close comparison that the *Saluka* tribunal was able to draw between IBP and the three other major Czech banks. In its award, the *Saluka* tribunal noted that:

... irrespective of whether the bad debt problem with which the Big Four banks were face 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 increase provisions and consequently 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.³⁰⁶

415. The Tribunal is not satisfied that Union Banka was in a situation comparable to that of any other Czech bank, let alone to all the other members of an identified class of Czech banks. The question of whether Union Banka was similarly situated to other banks requires more than an identification of single points of similarity, such as size, origin or private ownership. There must be a broad coincidence of similarities covering a range of factors. The comparators must

³⁰⁵ Transcript, Day 5, Cross examination of Associate Professor Desai, p. 66, lines 20-25 and p. 67, lines 1-19.

³⁰⁶ *Saluka* Prtial Award, 17 March 2006, para 322.

be similarly placed in the market and the circumstances of the request for state aid must be similar. Therefore, the Tribunal concludes that Invesmart has not demonstrated that Union Banka was subject to discrimination by the Czech Republic.

Bad faith

The Claimant

416. The final strand of Invesmart's claim for breach of fair and equitable treatment is its claim that the Czech Republic acted in bad faith. In its Statement of Claim Invesmart advanced several examples of conduct undertaken by the Czech Republic which it claimed were examples of bad faith, including:

- (a) The Respondent induced Invesmart to acquire Union Banka by committing to undertake the CF Transaction in exchange for Invesmart's assumption of the RPLs. It then refused to complete the CF Transaction;
- (b) The Respondent's decision (or effective decision) to deny state aid had the result of saddling Czech taxpayers with a loss of CZK 18.5 billion, rather than providing some CZK 650 million in aid to Union Banka;
- (c) The Respondent mishandled the bankruptcy proceedings against Union Banka in Ústí nad Labem and in Ostrava. These proceedings, combined with criminal prosecutions of senior officials involved with the Ostrava proceedings, constituted a "deliberate conspiracy" by the Czech Republic against Union Banka.³⁰⁷

417. In its opening submissions Invesmart also claimed that the Czech Republic had acted in bad faith by engaging in a course of conduct that comprised the following actions:

- (a) failing to provide Invesmart with any notice of its decision to deny state aid;
- (b) leaking the decision to deny state aid to the media the same day that Invesmart was informed of the decision;
- (c) commencing administrative proceedings to revoke Union Banka's banking licence the day after state aid was denied;
- (d) making inflammatory press statements over the course of 21 February 2003; and

³⁰⁷ Statement of Claim, paras 335-336.

- (e) refusing to seriously consider four different plans put together by Invesmart and Union Banka to salvage Union Banka.³⁰⁸

The Respondent

418. The Respondent rejected the Claimant's allegation of bad faith. It submitted that the allegation was primarily based on the existence of a commitment of state aid that, in fact, never existed. In all other respects, the Respondent said, the Claimant's allegations of bad faith were unsubstantiated and it was entitled to a presumption of good faith.³⁰⁹

The Tribunal's analysis

419. In making its allegation of bad faith the Claimant correctly pointed out that while acts of bad faith violate the fair and equitable treatment standard, bad faith is not required to make out a violation of the standard.
420. This was noted by the tribunal in *Mondev International Ltd. v United States of America* when it stated that:

To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably with out necessarily acting in bad faith.³¹⁰

421. Similar sentiments were expressed by the tribunal in the *Loewen* case:

Neither state practice, the decisions of international tribunals nor the opinion of commentators support the view that bad faith or malicious intention is an essential element of unfair and inequitable treatment.³¹¹

422. In the Tribunal's opinion these statements notably draw an appropriate distinction between other forms of unfair and inequitable conduct, such as manifest unreasonableness, inconsistency and arbitrariness, and bad faith conduct, which has malicious or egregious intent, such as deliberate conspiracy, as an essential ingredient.
423. The Tribunal was unable to identify this essential ingredient in the Respondent's conduct on the evidence presented to it.

³⁰⁸ Claimant's Opening Statement, pp. 47-51.

³⁰⁹ Statement of Defence. paras 429-431.

³¹⁰ *Mondev International Ltd. v United States of America*, ICSID Case No ARB(AF)/99/1, Award dated 11 October 2002, para 16.

³¹¹ *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (ICSID Case No. ARB(AF)/98/3), Award dated 26 June 2003, para 185.

424. The factual aspects of many of the Claimant's bad faith allegations have been considered by the Tribunal in assessing other aspects of the Claimant's fair and equitable claim and its claims under Article 5.1 of the BIT.
425. Rather than restate this analysis the Tribunal only raises those aspects of the evidence that are specifically pertinent to the Claimant's allegation of bad faith.

Inducement to assume the RPLs

426. For the reasons set out in paragraphs above the Tribunal is not persuaded by the Claimant's submission that the Czech Government induced Invesmart to assume the RPLs by undertaking to complete the CF transaction. At paragraphs 347-351 the Tribunal has already concluded that Invesmart could not have had a legitimate expectation that the Czech Republic would provide any form of state aid.. Further, at paragraphs 290-291 the Tribunal observes that Addendum No 4, which removed the provision of state aid as a pre-condition to SPA B, was dated 14 August 2002, seven days before it made its first proposal to the MOF on 20 August 2002. It follows from these findings that there was no inducement by the Czech Republic and therefore no bad faith.
427. Arguably, Invesmart entered these arrangements on the hope that state aid would be provided. However, this was a commercial judgment, the risk for which must be borne by Invesmart.

Failure to choose the least cost option

428. The Tribunal next turns its attention to Invesmart's contention that in revoking Union Banka's banking license the Czech Republic opted for a more costly alternative than providing the requested state aid to Union Banka.
429. Invesmart raised this same argument in relation to its expropriation claim. Specifically, Invesmart argued that the Czech Republic's expropriatory actions breached the BIT because the revocation of the banking licence was not in the public interest; the Czech Republic opted for the more costly course of action rather than grant state aid.
430. This argument mischaracterises the concept of bad faith. A government cannot be accused of acting in bad faith merely because it chooses one of several policy alternatives. Even where the course of action adopted is capable of criticism there is no showing of bad faith absent egregious intent.
431. The allegation is especially misguided given the evidence that it was not clear that the provision of state aid was the least-cost alternative given the dire financial circumstances of Union Banka in February 2003. It was reasonable, given the fragile liquidity situation of Union Banka, for the Minister of Finance to consider that even if aid were provided the future

solvency of Union Banka would still be highly uncertain. It was, by February 2003, a case of putting good money after bad.

The proceedings in Ústí nad Labem and the allegation of deliberate conspiracy

432. In its opening submissions the Claimant described these proceedings thus:

That was a criminal proceeding to steal the bank's assets. The Czech Government itself has prosecuted the judge, the bankruptcy trustee and several other Government official that were involved in the Ústí nad Labem debacle ... As a result of this sham proceeding the bank was actually seized by a band of armed men ... who described himself as the bankruptcy trustee. and others were forced out of the bank. The situation was resolved to the Czech Republic's credit, in four or five days, but it may say something about motive in this case.³¹²

433. The Tribunal assumes that the reference to motive in the Claimant's opening submissions is a reference to the allegation that the Ústí nad Labem proceedings represented a deliberate conspiracy against Union Banka pertaining to high levels of the Czech Government.

434. The Tribunal finds that there is no evidence that such a conspiracy existed. Whilst the conduct of the judge in the proceedings is attributable under Article 4 of the BIT to the Czech Republic, the Tribunal notes that the Czech Republic took swift action to ameliorate the situation, that the assets of Union Banka were not in fact looted as a result of the decision, that the judge actually reversed the decision himself and that the Czech Republic has taken criminal action against him. Given the efficiency with which the Czech Republic acted in relation to the Ústí nad Labem proceedings it is impossible to conclude that a conspiracy was afoot.

Impairment clause

Applicable legal standard

435. Article 3(1) provides that with 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.

436. Before considering the parties' submissions in respect of alleged breaches of the impairment clause it is necessary to consider whether this standard operates as separate and freestanding protection that offers protection to investors independently of the first limb of Article 3(1) of the BIT, the fair and equitable treatment standard.

³¹² Transcript, Day 1, p. 70, lines 9-21.

437. The Tribunal notes that the parties disagree on this question.

438. In its Statement of Defence the Respondent contended that the impairment standard in Article 3(1) of the BIT "is not, in fact, a separate, free-standing standard that can add anything" to Invesmart's claims under the fair and equitable treatment and expropriation standards.³¹³

439. The Respondent based this analysis on comments made in *Saluka* that

[in] so far 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 requirements merely identifies more specific effects of any such violations.³¹⁴

440. By contrast the Claimant described the relationship between the standards of protection described in Article 3(1) in the following terms:

The Czech Republic is required to treat the investments of Dutch investors fairly and equitably, and it is additionally prohibited from impairing such investments by unreasonable or discriminatory measures ... Furthermore, since the phrase "unreasonable or discriminatory measures" in Article 3(1) uses the disjunctive "or" instead of the conjunctive "and", it is clear that either "unreasonable" or "discriminatory" measures will violate the impairment clause.³¹⁵

441. In the Tribunal's opinion the Claimant's characterisation of Article 3(1) as comprising two separate standards is correct. It is not for the Tribunal to speculate about the circumstances in which a factual allegation may be held to constitute a breach of the impairment clause but not fair and equitable treatment. However, the Claimant is entitled to invoke the protections afforded by both clauses.

442. The *Saluka* tribunal acknowledged that the standards of "reasonableness" and "discrimination" contained in the impairment clause have no different meaning than in fair and equitable treatment. However, it also recognised that it offered a separate standard of protection. This is borne out by the tribunal's separate analysis of *Saluka*'s claims under the impairment clause.

443. In the Tribunal's opinion the Claimant was thus correct when it stated:

The plain wording of Article 3(1) demonstrates that it contains two distinct legal standards. Additionally, under cardinal principles of treaty interpretation, the impairment clause must be interpreted in a manner that gives it substance and meaning, rather than as mere surplusage that adds nothing to the fair and equitable treatment clause.³¹⁶

³¹³ Statement of Defence, p. 434.

³¹⁴ *Saluka* Partial Award, paras 460–461.

³¹⁵ Reply Memorial, para 374.

³¹⁶ Reply Memorial, para 377.

444. The Tribunal further agrees with the *Saluka* tribunal's analysis about the meaning of the standard enshrined in the impairment clause when it states:

"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.

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 ...

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.

445. The Tribunal need not replicate its analysis of the Claimant's discrimination claim here. It will limit its analysis to those aspects of the unreasonableness claim that have not been dealt with above.

Unreasonableness

The Claimant

446. In its Statement of Claim Invesmart listed more than a dozen actions or courses of conduct taken by the Czech Republic which it claimed were unreasonable and, in consequence, in breach of the impairment clause.

447. These actions included:

- (a) approving an investment predicated on the CF Transaction without confirming its ability and willingness to carry out that commitment;
- (b) approving an investment predicated on state aid and then failing to provide any form of state assistance;
- (c) causing a run on the bank by suggesting that it was struggling to find an acceptable investor at the very moment it was approving Invesmart's application;
- (d) insisting upon state aid alternatives and pre-approval from the UOHS, working with Invesmart to put together a new restructuring plan that satisfied those conditions, and then rejecting the plan;
- (e) promising to make a public declaration supporting the bank and then failing to do so;

- (f) refusing to give Invesmart or Union Banka any notice or warning about its decision to reject the restructuring plan and to deny state aid, thereby preventing them from locating alternative sources of capital, and thus ensuring the bank would fail;
- (g) leaking that decision to the press, thereby commencing another run on the bank and further ensuring the bank would fail;
- (h) refusing a liquidity loan on the basis that the bank could not provide "liquid collateral", when the applicable regulations contained no such requirement;
- (i) refusing to seriously consider the salvage plans put together by Invesmart and Union Banka to avoid liquidation, thereby ensuring the complete loss of Invesmart's investments;
- (j) saddling Czech taxpayers with a financial burden, through the liquidation of Union Banka, that was at least 28 times greater than the CZK 650 million in state aid that the Government refused to provide;
- (k) subjecting Union Banka to the fraudulent bankruptcy proceeding in Ústí nad Labem;
- (l) subjecting Union Banka to the corrupt bankruptcy proceedings in Ostrava; and
- (m) failing to notify Invesmart of the bankruptcy proceeding for Union Group.³¹⁷

448. In its Reply Memorial Invesmart reformulated this claim and submitted that four aspects of this conduct were particularly egregious. Specifically:

- (a) The Czech Republic acted unreasonably when the CNB approved Invesmart's acquisition of Union Banka with the understanding that the acquisition was the first step in a three-step restructuring plan, only then to renege on step two, namely, the Government's completion of the Foresbank settlement;
- (b) The various organs of the Czech Republic failed to take a coordinated and consistent position regarding the provision of state aid after approving Invesmart's acquisition of Union Banka;
- (c) The Government's decision to deny state aid was made on grounds that were unreasonable. Invesmart's primary complaint against the Czech Republic was that Mr Sobotka's decision to deny state aid was made on the basis of the Government's

³¹⁷ Statement of Claim, para 342.

strategy in the *Saluka* arbitration. Invesmart also claimed that the decision to deny state aid was unreasonable because:

- (i) Minister Sobotka disregarded the opinion of Governor Tůma, which was given at the request of Minister Sobotka, that "a sufficient media presentation of public support which would lead to a suspension of deposit outflow"; and
 - (ii) Minister Sobotka concluded that the settlement was legally unviable without seeking legal advice.
- (d) The Government failed to give Invesmart adequate notice of its decision to deny state aid.³¹⁸

449. The Claimant has itself acknowledged that these allegations replicate many of those made in respect of fair and equitable treatment and expropriation claims. For this reason the Tribunal will consider only aspects of Invesmart's unreasonableness claim that require elaboration in relation to the application of the reasonableness standard. Specifically, the question of whether it was unreasonable for the CNB to approve Invesmart's acquisition of Union Banka and then for the MOF to deny Invesmart's request for state aid.

The Respondent

450. In answer to the allegation that it had acted unreasonably by renegeing on its obligations under a three-step restructuring plan, the Czech Government denied that such a restructuring plan existed.³¹⁹ The Respondent argued that this allegation was unfounded given that Invesmart had no specific expectation of state aid and that such a commitment could not reasonably be gleaned from the CNB's approval of Invesmart's application to acquire Union Banka.

451. The Respondent further argued that Invesmart had failed to demonstrate that this conduct had no rational policy basis when viewed in light of Czech law or international standards of banking regulation. The Respondent submitted:

There could be no doubt at the time the CNB prior approval was issued that all that approval did was a clear and necessary regulatory hurdle for Invesmart to invest in the Czech banking sector. This followed transparently both from a legal provisions establishing a need for such approval (section 20A of the Banking Act at Exhibit R-304) and from the clearly delineated distinction between the role of the CNB as the authority of the State responsible for monetary policy and banking system

³¹⁸ Reply Memorial, paras 384–388.

³¹⁹ Statement of Rejoinder, paras 94-97.

supervision and that of the MOF as the fiscal authority, delineated not only in Czech Law, but also as a matter of general international practice.³²⁰

The Tribunal's analysis

The reasonableness of the CNB's approval

452. The question of what the parties understood to be the significance of the CNB's approval is considered in the Tribunal's discussion of legitimate expectations at paragraphs 264-265 above. The Tribunal has concluded that the evidence does not demonstrate that any of the parties, including Invesmart, understood that approval by the CNB constituted a commitment that the Foresbank settlement or any other form of state aid would be provided.

453. The remaining question is therefore whether it was unreasonable for the CNB to approve Invesmart's application to acquire Union Banka and for the MOF to deny its request for state aid.

454. The standard to apply in assessing this question is whether the conduct of the Czech Republic bore a reasonable relationship to some rational policy. This question is to be distinguished from any consideration of the merits of the policy adopted by the Czech Republic.

455. The Tribunal notes that Professor Shin, in his first expert report, suggested that on any view the conduct of the CNB and the MOF fell short of international regulatory best practice.

456. For example, in his first expert report Professor Shin stated:

The CNB as the bank supervisor approved the acquisition of Union Banka by Invesmart on October 24 2002. I see three mutually exclusive possibilities concerning consultations between the CNB and the Ministry of Finance:

a. **Either** the CNB did not consult the Ministry of Finance before giving approval of the acquisition;

b. **Or** the CNB consulted the Ministry of Finance, but the CNB approved the acquisition without receiving formal approval from the public funding support by the MOF.

c. **Or** the CNB consulted the MOF and the CNB received formal approval of public funding support from the MOF before granting approval of the acquisition.

I find (a) inconceivable for a responsible banking supervisor. If the CNB did not consult the MOF at all this would be highly irresponsible, this would be a highly irresponsible act by a banking supervisor. The Basel Committee report makes it clear that such a course of action would run counter to international best practice

³²⁰ Statement of Defence, para 411.

Leaving (a) to one side, I am left with (b) and (c). Here I am faced with a great deal of uncertainty concerning the facts of the case. However, neither (b) nor (c) put the Czech authorities (collectively) in good light.

a. If (b) is true, so that the CNB gave approval of the acquisition without obtaining formal approval of funding from the Ministry of Finance, then the CNB did not follow international best practice. It sanctioned a course of action that entailed the use of public funds without authorisation from the Ministry of Finance. Thus, if (b) is true, the CNB acted against international best practice.

b. If (c) is true, then the Ministry of Finance gave the formal go-ahead to the CNB to approve the acquisition of Union Banka by undertaking to fund the cost of public support. If this is the case, then I am puzzled by why the MOF did not provide public funding support for the acquisition as contemplated. Thus, if (c) is true, the actions of the Ministry of Finance are at fault.³²¹

457. This opinion was rejected by the Respondent, who tendered the expert opinion of Professor Saunders. Professor Saunders stated that:

It is well-established best practice to separate the central banking function from the political and fiscal governmental authorities..

These entities [the MOF and Central Bank] have different policy objectives and potentially different views as to what is least cost policy.³²²

458. Professor Saunders went on to make the following conclusion:

The behaviour of the Czech National Bank was entirely reasonable. In contrast, it would not have been reasonable for the CNB to deny the regulatory approval under the information that was available to it at the time, since it would have eliminated any possibility that Invesmart and the Ministry of Finance could come to an agreement.³²³

459. The Tribunal does not consider that it is required to form an opinion about the merits of the policies that underpinned the decisions made by the MOF and CNB. A state should not be held to an obligation to act in accordance with international best practice. To read such an obligation into a BIT is untenable.

460. The Czech Republic can be held to have acted reasonably so long as, in the Tribunal's view, it did so out of some reasonable policy consideration, as opposed to conduct that was motivated by the intention to deprive an investor of the value of its investment.

461. At paragraph 264 above the Tribunal explained why in its opinion the CNB acted in accordance with its supervisory functions when it approved the acquisition by Invesmart of Union Banka. This involved a number of elements, including that the CNB be satisfied of the providence of Invesmart's funds. Once the CNB was satisfied of Invesmart's bona fides it

³²¹ First report of Shin, paras 76–77. [Emphasis added.]

³²² Report of Saunders, paras 11–13.

³²³ *Id.*, para 20.

approved the acquisition because, in the absence of any other investor, Invesmart's involvement was the best chance available of securing the bank's stability. This view point is consistent with evidence given by Governor Tůma at the hearing:

THE CHAIRMAN: Why did you approve its [Invesmart's] acquisition?

GOVERNOR TŮMA: Because in the end we believed they would be able to deliver that money. They committed themselves. It means -- generally speaking, it's not an easy decision to close the bank. So that you look for chances how to avoid that. You look for potential mergers and so on. So there was an investor, and I believed at that time, I trust, that [redacted] was fair and honest person. Unfortunately it was my biggest mistake, probably, and -- but in the end we believed that that commitment by the shareholders meeting was fair and that Invesmart would be able to deliver the money. So -- but we are speaking about that wasn't a substantial company, so explaining that at the time this was -- I am just saying this was a crucial issue, but in the end we decided to try it. So it was a chance and we didn't want to kill it.³²⁴

462. Whilst the merits of this decision may be questioned, this is not a matter for this Tribunal. It is clear that the Czech Republic acted in the interests of legitimate policy concerns, being the ongoing survival of Union Banka, and cannot, therefore be said to have acted unreasonably.
463. Similarly, the evidence clearly suggests that the MOF acted in accordance with rational policy consideration. There is no need to restate the Tribunal's analysis about the justification for the MOF's decision to deny state aid. These actions were clearly reasonable in the circumstances. Any fault that may be found in the Czech Republic's actions falls far short of establishing a breach of the impairment clause.

Expropriation

464. The Claimant alleged that the Respondent expropriated its investment in Union Banka through a combination of measures ranging from the denial of state aid to the revocation of Union Banka's licence, and to various measures taken in the course of the bank's liquidation.
465. Article 5 of the Treaty provides:

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...

³²⁴ Transcript, Day 4, pp. 186–187, lines 1–4 and 13–25.

466. Although this claim was advanced in the Claimant's written pleadings, it did not figure prominently at the oral hearing.³²⁵ The Claimant did not abandon the claim however and the Tribunal will consider its merits.

The Claimant

467. The Claimant's expropriation claim primarily focused on the Respondent's revocation of Union Banka's licence and placing the bank into bankruptcy and liquidation, which according to the Claimant, amounted to a direct expropriation or, in the alternative, an indirect expropriation.³²⁶ The revocation and ensuing measures "overtly purported to interfere with Invesmart's rights" and as a result it was "legally and practically deprived of its rights in Union Banka".³²⁷ The Claimant also submitted that in taking these measures the Respondent did not comply with the three requirements of Article 5 which, if cumulatively satisfied, make an act of expropriation lawful under the Treaty.

468. In respect of Article 5(a), Invesmart claimed that the measure were not in the public interest because by closing and liquidating Union Banka the Government saddled Czech taxpayers with a financial burden that was many times greater than granting state aid (estimated by the Claimant to be some 28 times as much as the aid sought).³²⁸ Invesmart's expert on banking regulation, Professor Hyun Song Shin, noted that this could not be in the public interest under the "least cost principle", observed in international best practices for the resolution of weak banks.³²⁹ In this case, the Respondent deliberately chose the most expensive solution, thereby acting against the public interest.³³⁰

469. In Invesmart's view the Respondent also violated Article 5(b) because notwithstanding its majority ownership of Union Group, it received no notice of the bankruptcy petition. Moreover, the bank's assets were then liquidated as part of a fraudulent bankruptcy proceeding in Ostrava.³³¹

470. Invesmart further argued that contrary to Article 5(b) the closure and liquidation of the bank and Union Group was discriminatory. The treatment accorded to Union Banka was said to be

³²⁵ Statement of Claim, paras 236–272; Reply Memorial, paras 298–302. In its closing submissions, the Claimant focused on its two primary claims in relation to the fair and equitable treatment standard but in doing so indicated that it was not abandoning its other claims, such as its expropriation claim: Transcript, Day 7, Fleuriet, p. 78, lines 4–8.

³²⁶ Statement of Claim, paras 241 and 249.

³²⁷ *Id.*, para 241.

³²⁸ *Id.*, para 257.

³²⁹ *Id.*, paras 258–265.

³³⁰ *Id.*, para 259.

³³¹ *Id.*, para 267.

“markedly less favorable than that received by a number of other similarly situated Czech banks”.³³² (This aspect of the expropriation claim was developed in more detail in the Claimant’s separate discrimination complaint under Article 3).

471. The Claimant also asserted that Article 5(c) was violated since the Czech Government never paid compensation to Invesmart for the expropriation of its investments in the bank and Union Group.³³³

472. In developing its submissions the Claimant endorsed the proposition that foreign investors are not presumptively immune from a host state’s police or regulatory powers:

... a well-founded, non-discriminatory exercise of a state’s police or regulatory power, conducted for the purpose of protecting the public interest and with respect for due process, does not entail an “expropriation” under international law. However, neither of these propositions is responsive to Invesmart’s position in this case, which is that the Czech Republic’s taking of Invesmart’s investments was not a proper exercise of governmental power.³³⁴ [Emphasis in original.]

473. In developing this point, the Claimant referred back to the merits of the Minister’s decision to deny state aid and his failure to provide any notice of that decision, as well as the CNB’s refusal to provide a liquidity loan. The resulting bankruptcy and liquidation process imposed the large financial burden already noted and the measures at issue in this case were said to be very far removed from a proper, legitimate exercise of regulatory power.

474. The Claimant distinguished Union Banka’s situation from the situation that existed in *Saluka*. Here there was an “abject failure of notice or due process” in relation to the decision to deny state aid, the leaking of that decision to the public which inevitably resulted in the bank’s failure, the revocation of its licence and its liquidation. Moreover, unlike the present case, *Saluka* did not raise any public interest questions.³³⁵

475. The Claimant also submitted that the Minister acted on improper grounds, namely its ‘litigation strategy’, in the *Saluka* arbitration when denying state aid to Union Banka.³³⁶ In support of this assertion, the Claimant relied upon a letter of legal advice dated 3 December 2002, which was produced by the Respondent, advising the MOF that:

From the point of view of the possible impact on the on the [sic] arbitration proceedings in progress between Saluka and the Czech Republic, we feel it would be best if the State aid was not provided. We must stress, though, that this is a very narrowly defined perspective. If, in view of the wider context and economic reasons

³³² *Id.*, para 268.

³³³ *Id.*, para 269.

³³⁴ Reply Memorial, para 288.

³³⁵ *Id.*, para 292.

³³⁶ Transcript, Day 7, Smith, p. 72, lines 1–25.

in particular, the decision is taken to provide aid, we are ready to defend this decision in arbitration proceedings, subject to the condition that the State aid is duly authorized by the Czech Office for the Protection of Economic Competition. In view of the sensitive nature of this matter, we would prefer to let you know the arguments on which our standpoint is based face-to-face.³³⁷

476. Invesmart listed further procedural complaints, including that:

- (a) the Government failed to communicate with Invesmart and Union Banka for several critical weeks in February 2003;
- (b) the Ministry failed to inform Invesmart of the denial of state aid until after the decision was leaked to the press;
- (c) CNB denied a liquidity loan to Union Banka on spurious grounds in order to ensure that the bank would be forced to close and then commenced revocation proceedings; and
- (d) the proceedings to bankrupt and liquidate Union Banka were marred by procedural irregularities, including the dismissal of the principal trustee for fraud.³³⁸

The Respondent

477. The Respondent's submissions on the Minister's decision for denying state aid have already been recorded in the Tribunal's discussion of the legitimate expectations claim. They need not be repeated here.

478. Insofar as the licence revocation and the ensuing measures are concerned, the Respondent denied that anything approaching a direct expropriation had occurred. It observed that the revocation of the licence and the bank's subsequent liquidation left intact Invesmart's shareholding in Union Group and Union Banka and did not affect its shareholding as such. This meant that the Claimant was left to argue that the State's actions constituted an indirect expropriation insofar as they deprived it of any value that it might have had.³³⁹

479. The Respondent also took issue with the Claimant's characterisation of the measures as expropriatory. The Respondent submitted that the CNB's administrative proceeding was a lawful regulatory measure within the state's police powers, for which no compensation was

³³⁷ Exhibit C-305, letter dated 3 December 2002 from Squire, Sanders & Dempsey to the Ministry of Finance.

³³⁸ *Id.*, paras 294–297.

³³⁹ Statement of Defence, para 301.

required. The powers pursuant to which the CNB took action were based in published Czech law and pre-dated the Claimant's involvement with Union Banka.³⁴⁰

480. Referring to the *Saluka* case for the proposition that when exercising banking regulatory powers the CNB enjoyed "a margin of discretion" which had to be considered by a tribunal applying Article 5 of the Treaty, the Respondent noted that that tribunal concluded that the deprivation of that claimant's investment constituted a non-compensable deprivation because it was based on an exercise of regulatory powers in the public interest.³⁴¹
481. The Respondent went on to argue that in any event, even if the CNB's measures could be characterised as expropriatory, the steps taken met the various requirements of Article 5 for a lawful expropriation in that they were (i) in the public interest and under due process of law; (ii) not discriminatory; and (iii) since the value of Invesmart's investment (if it actually had made one) was at the time negative, there was no failure to compensate the Claimant for the value of its investment.³⁴²
482. Finally, in the Respondent's view, the Claimant's reliance on the "least cost principle" was inapposite. Even if it constituted a generally accepted bank regulatory practice and it was violated in the instant case (which was denied), it would not rise to the level of a breach of an international obligation and would not support a claim for breach of the Treaty.³⁴³

The Tribunal's Analysis

The Minister's decision to deny state aid

483. The expropriation claim has been linked to the fair and equitable treatment claim in that the Minister's reasons for denying state aid and the means by which that information was conveyed to Invesmart (and allegedly to the public) have figured in both claims. The Tribunal has already explained that it does not consider that the denial of state aid amounted to a breach of Article 3.
484. Turning to the expropriation claim, the Tribunal begins with a consideration of the law. It agrees with the Respondent's argument that in relation to ministerial decisions on expenditures of state revenues, a "margin of appreciation" that recognises the discretionary features of such decisions must be accorded to them.³⁴⁴ Ministers must make often difficult, multi-variable

³⁴⁰ *Id.*, paras 302–303.

³⁴¹ *Id.*, para 306.

³⁴² *Id.*, paras 310–324.

³⁴³ *Id.*, paras 313–316.

³⁴⁴ Transcript, Day 7, Crawford, p. 168, lines 4–13, p. 171, lines 15–19.

decisions that do not necessarily admit of clear right or wrong answers. For example, a minister who chooses to deny state aid, as in this case, faces questions about the possibly greater expense attached to such a denial. As the Claimant argued forcefully, why deny the aid when the cost of doing so is so much higher than granting it?³⁴⁵ The answer lies in other policy and legal considerations which a minister must have regard to.

485. The Tribunal also agrees with an observation made by the *Saluka* tribunal in the context of its fair and equitable treatment discussion:

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.³⁴⁶

486. An international tribunal must approach a minister's decision not to spend taxpayers' money with circumspection.
487. This is not to say that the Tribunal considers that the Minister's decision in this case is beyond review, for it is not. Were it convinced that the Minister acted for wholly improper reasons, for example, in denying aid that he and his advisors considered should have been granted to Union Banka solely because granting the aid might complicate the defence of the *Saluka* claim, the Tribunal would not hesitate to find that the Minister's act attracted international responsibility (though more likely under Article 3 than Article 5).
488. However, the Tribunal is of the view that the *Saluka* litigation strategy concern was not the primary or even a significant reason for the denial of state aid. In the Tribunal's view, it was likely a factor but not a dominant factor because the legal advice itself was qualified. Furthermore, there are other compelling reasons that explain the Minister's actions.
489. The record shows that by January 2003, before the Third Restructuring Plan was submitted to the Ministry of Finance, grave problems had been identified by the bank's new management.
490. First, the new management had carried out an in-depth inspection of the bank and had decided to create extra adjustments to cover bad loans totalling CZK 1.8 billion.³⁴⁷ Secondly, in principle this was covered by the "BDS Receivable", but if that claim was "taken off the balance-sheet at Union Banka, a.s., the Bank would not be able to satisfy the basic ratios set for managing a bank and would have to cease operating as a bank".³⁴⁸ Thirdly, although the

³⁴⁵ Statement of Claim, paras 258–262.

³⁴⁶ *Saluka* Partial Award, para 411.

³⁴⁷ Exhibit R-18, Third Restructuring Plan, p. 5. At p. 31, the Plan noted that: "The proposed figures for adjustments and provisions to be created considerably exceeds the previously anticipated figures, primarily as a result of the more realistic approach towards the quality of the assets and risk of the Bank's portfolio adopted by the new management team for restructuring."

³⁴⁸ *Id.*, p. 5.

amount now being sought from the Respondent was higher than in previous plans, the result of the plan if state aid was granted was modest: after cleaning up its balance sheet, the bank “will be capable of generating an [annual] net profit of between CZK 30 million and CZK 50 million”. The Plan acknowledged that this “figure is wholly insufficient in terms of the bank’s balance-sheet, number of branches, workforce and capital and would not allow the bank to continue to operate in the long-term”.³⁴⁹ Finally, there was a gap between what Invesmart had committed to in terms of a capital injection, and what was needed to rescue the bank:

The investor has repeatedly stressed that they cannot make any further investments to complete restructuring of the bank’s balance-sheet. Instead they are relying on the repeated assurance that the State would contribute to rectifying the effects of the Consolidation Programme and Stabilisation Programme to a not insignificant extent.

It is unrealistic to assume that another investor could be found who would be willing to intervene as a very minor shareholder and yet contribute to a significant improvement in the bank’s balance-sheet. Invesmart on the other hand is refusing to increase the registered capital because they do not have the funds to invest in increasing the registered capital and they do not agree to their stake being watered down, because this does not form part of their investment strategy and the price of their stake would then cease to make economic sense.³⁵⁰

491. In short, the additional work completed on the restructuring plan showed that the bank’s situation was even more grave than had previously been understood and Invesmart was not prepared to contribute more capital than it had stated it was already committed to provide.
492. In making its finding that the denial of state aid does not amount to an expropriation, the Tribunal has not relied principally on the testimony of then-Finance Minister Sobotka (who denied that the *Saluka* case was the reason that he denied the aid), but rather has examined the contemporaneous documents.³⁵¹
493. The Tribunal considers that the record, viewed in its entirety, shows that:
- (a) the bank’s financial condition was very poor, and indeed if not technically insolvent in January–February 2003, it was perilously close to being so;
 - (b) the Restructuring Plan’s projections, *even if the state aid and Invesmart’s €90 million were injected into the bank*, showed a minimal improvement in the bank’s fortunes;
 - (c) the bank did not submit an auditor’s opinion with the Plan such that the reliability of the Plan was suspect (particularly in light of the bank’s history of lack of

³⁴⁹ *Id.*, p. 35.

³⁵⁰ *Id.*, p. 27.

³⁵¹ Transcript, Day 3, Sobotka, pp. 79–83.

transparency – a problem which, as just noted, was being dealt with by the bank's new management); and

- (d) the plan could well fail, in which case the Ministry would be throwing away taxpayers' money on a rescue that was destined to fail.

494. These factors had to be evaluated within the regulatory framework for state aid and the increased scrutiny by the European Union of Czech governmental measures in this area. In short, a review of the Third Restructuring Plan in light of all the surrounding circumstances shows that the Minister not unreasonably found that the Plan did not present a sufficient degree of certainty for the Finance Ministry to support its submission to the Cabinet and the OPC for their respective approvals.
495. Accordingly, that part of the expropriation claim which relies upon the denial of state aid is rejected.

The revocation of Union Banka's licence

496. Turning to the revocation of the bank's licence, before addressing the facts and considering this aspect of the claim at the level of principle, the Tribunal observes that it is confronted with a measure taken under a banking statute of general application, which statute predated the Claimant's investment. Section 26(b) of the Czech Banking Act, the statutory power pursuant to which the CNB acted, provides as follows:

(1) If the Czech National Bank ascertains shortcomings in the operations of a bank or a branch of a foreign bank, depending upon the nature of the ascertained shortcoming(s), it is authorized:

b) to change the banking licence by excluding or restricting certain activities stipulated in the licence;³⁵²

497. There is no doubt that Section 26(b) is a *bona fide* non-discriminatory regulation aimed at the general welfare. All states with modern banking regulatory regimes vest a licensing power in their regulators. Inherent in such regimes is the power not only to grant but to revoke the licence.
498. International investment treaties were never intended to do away with their signatories' right to regulate. As found in *Saluka*, where the instant Treaty was being applied, notwithstanding the breadth of its prohibition against expropriation and the absence of an express regulatory power exception, 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

³⁵² Exhibit R-304, Act No. 21/1992 Sb., Banking Act, in wording effective from 1 May 2002 until 30 April 2004.

maintenance of public order.³⁵³ This is common sense. Otherwise, once having granted a licence to operate a bank, the regulator could be constrained from revoking a licence if such action were automatically to be labelled an expropriation at international law.

499. The Tribunal thus agrees with the *Saluka* tribunal's finding that:

It is now well 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.³⁵⁴

500. Although there is no question as to the regulatory *bona fide* of Section 26(b), the Tribunal must also determine as a matter of international law whether the licence revocation on the facts of this case was improper, which plainly could constitute an expropriation. Reverting to *Saluka*:

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.³⁵⁵ [Italics in original.]

501. A decision to revoke a bank's licence, which takes place within a detailed national legal framework that includes administrative and judicial remedies, is not reviewed at the international law level for its "correctness", but rather for whether it offends the more basic requirements of international law. Numerous tribunals have held that when testing regulatory decisions against international law standards, the regulators' right and duty to regulate must not be subjected to undue second-guessing by international tribunals. Tribunals need not be satisfied that they would have made precisely the same decision as the regulator in order for them to uphold such decisions. The proposition first enunciated in the *Myers* case (in the context of the fair and equitable treatment standard) that international law extends a "high level of deference to the right of domestic authorities to regulate matters within their own borders" has been adopted in subsequent cases.³⁵⁶ Indeed, in *Saluka*, that tribunal observed:

... 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

³⁵³ *Saluka*, para 254.

³⁵⁴ *Id.*, para 255.

³⁵⁵ *Id.*, para 264.

³⁵⁶ The comment made by the tribunal in *S.D. Myers, Inc. v. Canada*, Partial Award, at para 261, although made in the course of discussing the fair and equitable treatment standard, is apposite to the circumstances facing the CNB at the time. The *Myers dictum* has been quoted with approval in a number of subsequent awards, including *Saluka v. Czech Republic*, para 284, *Waste Management, Inc. v. United Mexican States*, Final Award, para 94, and *GAMI Investments, Inc. v. United Mexican States*, Final Award, para 93.

in the present case, its judgment on the choice of solutions for the Czech Republic's
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...

502. This comment, made in the context of that tribunal's interpretation of Article 3 is also applicable to Article 5. The *Saluka* tribunal noted, after it reviewed the CNB's forced administration of the bank, that:

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.³⁵⁸ [Emphasis added.]

503. The Tribunal agrees.

504. In the Tribunal's view, the decision to revoke the licence cannot be viewed as an expropriation. This was not a case where the regulator arbitrarily decided to deprive a licensee of its licence. To the contrary, the most senior officer of the bank, Mr Vávra, expressly stated his view on 19 February 2003 that due to its illiquidity, the bank could no longer operate and that notice was being given pursuant to the statutory provision under which the CNB subsequently acted. The Tribunal cannot characterize the CNB's acting in response to such notice as a breach of Article 5 of the Treaty.

505. It is true that Union Banka's Supervisory Board dismissed Messrs Vávra and Truhlář shortly after they signed the 20 February 2003 letter and it might be suggested that they did not act in the best interests of the bank. The Tribunal would reject such a contention because the very difficult circumstances in which the bank was operating, combined with the certainty of a catastrophic run had it opened its doors on 21 February 2003 after news of the denial of state aid was publicised, point both to the reasonableness of the opinion expressed by the bank's three senior officers and the CNB's response thereto.

506. The administrative proceeding to revoke the licence was completed on 18 March 2003. As noted in the review of the Claimant's allegations, there were other aspects of the bankruptcy and liquidation process that were said to breach the Treaty. The Tribunal does not consider that these allegations, even if made out, would change its determination under Article 5.

507. Quite apart from the bank's CEO and senior officers giving formal notice of the bank's inability to carry on, the evidence shows that at the point that the revocation proceeding was initiated, having regard to all the circumstances, there is no question that it had been propped up and in imminent risk of collapse for some months.

³⁵⁷ *Saluka* Partial Award, para 284.

³⁵⁸ *Saluka*, Partial Award, para 272.

508. During the hearing the Claimant directed the Tribunal's attention to a letter dated 19 February 2003 to the Minister of Finance (who had solicited Governor Tůma's opinion on the bank's standing) in which the Governor advised that although "there is a danger that the bank may become insolvent as soon as next week", the "capital adequacy of the bank is currently over 8%" and hence it did not fall below the capital adequacy minimum.³⁵⁹

509. This letter was put to Governor Tůma during the course of the hearing with counsel pointing out that the bank was not technically insolvent as of 19 February 2003:

Q. So the bank was not insolvent at this point in time; it had a liquidity problem, correct? If the bank had been insolvent, I assume you would have told the Ministry.

A. Technically it wasn't insolvent, that is right, but you must take into account that a part of that, let's say, capital was the receivable against the Czech National Bank.

Q. I understand, Governor Tůma, and I understand that was disputed, but in response to the Minister of Finance's enquiry, you made a note in your letter back to him, which you did not have to put in your letter if you chose not to or didn't agree with, that the capital adequacy ratio of the bank was in excess of 8 per cent; correct?

A. That is what I say here.

Q. So the bank was not insolvent.

A. The bank was not technically insolvent.

Q. It had a liquidity problem, at this point in time.

A. Well, I would disagree with this point. The fact that -- once again, it technically wasn't insolvent; it doesn't mean that the situation is, from the point of view of solvency, sustainable in the medium term. By the way, it was mentioned also by the auditor, in the annual report, that without a strategic investor the situation would not be viable.³⁶⁰

510. It appears from the Governor's testimony that whether the bank was technically insolvent or not as of 19 February 2003 depended upon whether one gave any credence to the BDS Receivable which had been recorded in Union Banka's balance sheet in September 2002. This is an important issue to which the Tribunal now turns.

511. In a letter to the First Deputy Minister of Finance dated 22 January 2003, Mr Vávra alluded to the fact that the CNB Receivable had kept the bank from being insolvent throughout the months leading up to the denial of state aid.³⁶¹ Mr Vávra sought "a new round of negotiations ... which would result in a formulation of a revised proposal of a material for discussion within your Ministry and later even for the discussion by the Government of the Czech

³⁵⁹ Exhibit R-1149, letter dated 19 February 2003 from Governor Tůma to Minister Sobotka.

³⁶⁰ Transcript, Day 4, Smith-Tůma, p. 128, lines 23-25 and p. 129, lines 1-22.

³⁶¹ Transcript, Day 7, Crawford, p. 172, lines 13-19. Exhibit R-18, Third Restructuring Plan, p. 5.

Republic". He indicated that since Invesmart had taken over the bank which "enabled the first complete complex and sufficiently deep assessment of the bank's economic situation," the results showed the "necessity of significant increase of provisions which cannot be solved only by a foreign investor's entry".

Missing funds in the balance, which are for the time being covered by the receivable against the CNB, which are subject to arbitration proceedings, reached the amount of 1.7 billion Czech crowns.³⁶² [Emphasis added.]

512. Mr Vávra conceded at the hearing that had the bank de-recognised the receivable at the time that the CNB had so requested (22 October 2002, coincidentally the same day that Invesmart filed its third application to acquire indirect control of Union Banka), it would have fallen below the capital adequacy minimum and its banking licence would have had to be withdrawn.

513. In cross examination, the following questions were put to Mr Vávra:

Q. So, Mr. Vávra, the former management, as we have discussed, realised because of the CNB's inspection that there was a provisioning gap of some 1.8 billion [CZK]. Essentially, it sued the CNB for that amount and then recorded that claim as an asset on its books, correct?

A. Correct.

Q. If it hadn't recorded that asset on its books, it would have been below the capital adequacy minimum and the bank's licence would have to be withdrawn. Is that correct?

A. Sorry. Yes, the answer is yes.³⁶³

514. Mr Vávra's testimony was confirmed by the Third Restructuring Plan submitted by Euro-Trend on 12 February 2003, one week before Mr Vávra gave notice to the CNB under Section 26(b) of the Banking Act. The Plan noted that:

If this claim was taken off the balance-sheet at Union banka, a.s., the Bank would not be able to satisfy the basic ratios set for managing a bank and would have to cease operating as a bank.³⁶⁴

515. Likewise, the minutes of a meeting held on 28 January 2003 between [redacted] and Mr Racocho of the CNB contain a revealing contemporaneous exchange as to the role of the "receivable" and what the bank's true financial condition was. Mr Racocho's record notes as follows:

³⁶² Exhibit R-140, letter dated 22 January 2003 from Mr. Vávra to First Deputy Minister Janota.

³⁶³ Transcript, Day 2, Vávra, p. 167, lines 16-25, p. 169, line 6.

³⁶⁴ Exhibit R-18, Third Restructuring Plan, p. 5.

1. informed that the biggest risk for the bank was its fragile liquidity situation. The situation resulted, among other things, from resignation of the old management and connected departures of some of the clients.

7. According to , booking of the CNB receivable enabled the bank to create necessary provisions to the loan portfolio and provided the bank with some time for solution of the situation. Discussions have been held with the auditor (John Locke – DT) about correctness of the booking of the claim. I called attention to IAS 37, pursuant to which contingent assets should not be included in the balance sheet. I confirmed our interest in meeting with the auditor. I also confirmed determination of the CNB to defend itself against the (in our opinion) unjustified claim.

10. I informed him of my opinion that the bank was technically bankrupt and that any other intended steps were generally useless without a solution of the bank's problems with its solvency. Therefore they should focus their attention in that direction in particular. As a supervisory body we shall proceed correctly exactly in accordance with the law.³⁶⁵ [Emphasis added.]

516. The BDS Receivable was thus critical to propping up Union Banka. In the event, on 24 April 2003, an arbitral tribunal rejected the bank's claim.³⁶⁶

517. The Respondent adduced the expert evidence of Dr Milan Hulmák who opined that the BDS Receivable claim was without merit in light of the previous settlement agreement between the parties.³⁶⁷ The Tribunal examined the settlement agreement concluded by the parties and considers that the CNB took a defensible position in rejecting the bank's claim. Reference to the agreement shows that in Clause 3.5 it is stated:

This Settlement Agreement replaces and supersedes any and all previous agreements and understandings, written or oral, made between CNB and Union banka in connection with the takeover of Bankovní dům SKALA a.s. by Union banka, in particular, the Agreement and Amendment no. 1 thereto. The Parties expressly declare that (i) the settlement hereunder shall regulate ... any and all of their mutual rights and obligations arising out of the takeover by Union banka of Bankovní dům SKALA a.s. ... , and that (ii) upon the execution hereof, none of the Parties shall have against the other Party any other rights and obligations relating to the takeover of Bankovní dům SKALA a.s. by Union banka of any kind and description whatsoever other than the rights and obligations expressly specified herein, not [sic] will they mutually assert against one another any of such rights or obligations.³⁶⁸

³⁶⁵ Exhibit R-138, minutes of a meeting held on 28 January 2003 between and Mr. Racoča.

³⁶⁶ Exhibit C-137, arbitration award of the Court of Arbitration at the Chamber of Commerce of the Czech Republic issued on 24 April 2003.

³⁶⁷ Expert report of Dr. Milan Hulmák, paras 57–63; Transcript, Day 7, Crawford, p. 160, lines 5–9.

³⁶⁸ Exhibit R-6, Settlement Agreement between the CNB and Union Banka, dated 27 December 1999, cl 3.5.

518. In the Tribunal's view, the CNB was within its rights to demand that a contingency of such doubtful validity not be recorded in full as an asset on the bank's balance sheet nor as profit in its profit and loss account.³⁶⁹
519. Had that "asset" been removed when first requested, the bank's real condition would have been exposed even before the CNB's approval was given on 24 October 2002 and well before the deterioration of liquidity that prompted Mr Vávra to seek meetings with the CNB and the Minister of Finance on 19 February 2003.
520. In short, the evidence shows overwhelmingly that the bank was in the most serious of financial straits and the CNB's decision to accept and act upon Mr Vávra's oral and subsequent written notice of Union Banka's inability to meet its obligations *vis-à-vis* its depositors was a *bona fide* regulatory measure that does not fall within the scope of Article 5. The measure falls clearly on the *bona fide* regulation side of the regulation/expropriation divide.

Umbrella clause

521. Article 3(4) of the BIT provides "Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party". This provision, which is commonly described as an "umbrella clause" brings obligations of a host state which arise outside the BIT under the protective "umbrella" of the Treaty.
522. The Claimant refers to a number of cases including *Eureko v Poland*³⁷⁰ where the Tribunal observed that "'any' obligations is capacious; it means not only obligations of a certain type, but 'any' - that is to say, all-obligations entered into with regard to investments of investors".
523. The Claimant relies on this passage for the proposition that an umbrella clause is not confined to contractual obligations but extends to obligations of any sort.
524. The Respondent asserts that the *Eureko* case concerned the assumption of contractual obligations and that "umbrella clauses" have never been held to mean anything else than that (at least some) contractual claims might be raised to the level of international investment claims.
525. The Respondent further says that the Claimant does not and cannot have a claim under Article 3(4) of the BIT because it does not even plead the existence of an obligation on the part of the Czech state to grant to it aid. Its case is based on a "legitimate expectation" to receive a grant of aid, not an obligation.

³⁶⁹ Exhibit R-70, letter dated 22 October 2002 from the CNB to Union Banka.

³⁷⁰ *Eureko, B.V v Republic of Poland*, Partial Award, 19 August 2005.

526. The Tribunal is of the opinion that the claim founded on Article 3(4) of the BIT cannot succeed. Even if the existence of an "umbrella clause" elevates breaches of a contract to breaches of the BIT, a point on which tribunals before and after *Eureko* have reached opposite conclusions, or extends beyond contractual breaches, the Claimant has not established that there was any firm, unconditional undertaking, whether contractual or not, to provide state aid. An "obligation" to provide aid would require the establishment of a clear, unconditional commitment which would specify its essential terms including the amount of aid, the date to be provided and so on. No such obligation has been proven by the Claimant. An encouragement by the state to an investor to apply for aid or an expectation by an investor that aid will be provided is not sufficient by itself to constitute an "obligation" to provide aid.

Concluding comments

Invesmart's financial capacity

527. A factor of some significance, in the Tribunal's estimation, is the Claimant's capacity to effect the transaction which it claims to have been denied the opportunity to consummate. This was not a case where the investor was fully funded and ready to complete the transaction (even according to the "three step plan" that Invesmart contended governed the acquisition³⁷¹).

Invesmart did not pay off the RPLs it assumed

528. It is common ground that although on 17 November 2002, Invesmart assumed the debts of certain Union Banka and Union Group shareholders in the aggregate amount of CZK 2.67 billion and payment obligations towards Union Group in the aggregate amount of CZK 330 million as consideration for 22.6 percent of shares in Union Banka and 60 percent of shares of Union Group, it never paid for the shares.³⁷²

529. The Claimant argued in this proceeding that it would have paid for them had the Respondent complied with its commitment to grant state aid. It argued further that with the Respondent failing to provide the necessary funds, it made no sense for it to pay for the shares.³⁷³

³⁷¹ Reply Memorial, para 21: "The Government always understood that the restructuring of Union Banka would occur in three steps, that the first step would be Invesmart's assumption of the debts under the DAAs [Debt Assumption Agreements] and its acquisition of the shares under the SPAs [Share Purchase Agreements], that the second step would be the Government's completion of the Foresbank Settlement, and that the third step would be Invesmart's repayment of the debts."

³⁷² Exhibits R-83-R-100, 18 agreements on debt assumption entered into on 17 November 2002.

³⁷³ Reply Memorial, paras 21 and 34: "With respect to the capital contribution of €90 million for the RPLs, it is true that once the Czech Republic decided not to honor its commitment to provide state aid, Invesmart decided not to perform the futile act of injecting €90 million into a bank that the Government had just destroyed. But there is no rule of international law – jurisdictional or otherwise – that requires an investor to maximize its damages in order to seek the protection of a BIT."

530. During the hearing, Mr Vávra was cross-examined as to why Union Banka did not call upon Invesmart to pay for its shares after the execution of the debt assumption agreements. It was pointed out that the bank was suffering liquidity problems and the repayment of the RPLs would have been a welcomed source of new capital.³⁷⁴ A document prepared by the CNB, dated 13 January 2003, which was put to Mr Vávra, noted that the bank rolled over ten related party loans in December 2002, contrary to a CNB regulation.³⁷⁵ Mr Vávra explained his decision to roll over the loans as follows:

Q. ... The contractual documentation gave Union banka the right to immediate payment. But for your prolongation, they would have had to pay. That is correct, isn't it?

A. Correct.

Q. Can I just ask you: your fiduciary duty was to Union banka and not to Invesmart?

A. Absolutely.

Q. So how could you responsibly have prolonged Invesmart's obligation to pay liquidity into the bank when the bank desperately needed liquidity?

A. Because I knew if we didn't roll those loans over, Invesmart would not have repaid those loans, it would have defaulted on those loans.

Q. Because you were aware Invesmart had no money behind it.

A. No, I was aware that Invesmart's conditions for making this money available was not being met.

Q. Except those conditions aren't reflected in the contractual documents.

A. Correct. But if I may for a minute -- if I may for a minute just say that asking Invesmart to repay those loans at that very point in time would just mean end to an effort of saving Union banka, and we just didn't feel it was in the interest of any investor.³⁷⁶

531. Mr Vávra thus decided not to call upon the Claimant to make payment when it was due. Although he did not attribute this to Invesmart's lack of the necessary funds, the Claimant

³⁷⁴ Transcript, Day 2, Douglas, p. 192, lines 10–12.

³⁷⁵ Exhibit R-128, minutes of a meeting held on 13 January 2003 between Union Banka and the CNB, para 5: "The Banka was informed of § 14 of the CNB measures no. 9/2002 Coll., which – starting from the 20th of November 2002 – does not enable an extension of maturities with regard to loans provided for financing of certain types of assets."

³⁷⁶ Transcript, Day 2, Vávra, p. 192, lines 2–25.

itself has conceded that the shareholders never made the €90 million capital contribution that they authorised and then ratified on 16 October and 4 November 2002 respectively.³⁷⁷

The shifting sources of the funds

532. As has already been seen, Invesmart was obliged to include in its application to acquire control of Union Banka information as to the provenance of the funds it would use to effect the acquisition. Invesmart did not have such funds at its disposal during the period leading up to the CNB's approval on 24 October 2002. There is some evidence that it initially intended to borrow the money.³⁷⁸ It then informed the CNB that it would raise the funds by means of a shareholders' capital contribution.³⁷⁹
533. Invesmart's first formal application for the approval of its indirect acquisition of a controlling interest in Union Banka, filed on 4 April 2002, did not include the required information and the application was discontinued on 3 July 2002.³⁸⁰ Evidently as a means of providing some assurance on the matter, by letter dated 25 June 2002, Mr Gert H Rienmüller of Invesmart wrote to Vladimír Krejča, manager of the CNB's Bank Supervision Section, referring to previous correspondence and discussing the supplementation of the Invesmart's application concerning the origin of funds. Mr Rienmüller informed the CNB that Fortis, a large Benelux international financial group, "has issued a guarantee for the payment of the price in accordance with a contract which matures in September and December 2002".³⁸¹
534. This appears to be the first and last reference in the record of this proceeding to any role that Fortis might play in financing the transaction, including its having issued a guarantee. The representation evidently did not satisfy the CNB which, on 3 July 2002, discontinued the administrative approval proceeding after the expiry of the statutory three month deadline for its decision on the application.³⁸²
535. Invesmart re-applied for CNB approval on 4 July 2002. Throughout the time that its second application was under consideration, the CNB requested further information on the source of the funds to be used to purchase the shareholding interest.³⁸³ The second application was also

³⁷⁷ Reply Memorial, para 35: "Invesmart did not make the capital contribution of €90 million for the RPLs – the third step in the agreed restructuring plan – because the Czech Republic did not honor its commitment to provide state aid – the second step in the restructuring plan."

³⁷⁸ Exhibit R-66, letter dated 16 September 2002 from Invesmart to the CNB.

³⁷⁹ *Id.*

³⁸⁰ Exhibit C-43, letter dated 3 July 2002 from the CNB to Invesmart.

³⁸¹ Exhibit R-62, letter dated 25 June 2002 from Gert H. Rienmüller to Vladimír Krejča.

³⁸² Exhibit C-43, letter dated 3 July 2002 from the CNB to Invesmart.

³⁸³ Exhibit C-52, minutes of a meeting held on 12 September 2002 between the CNB and Invesmart representatives; Exhibit R-66, letter dated 16 September 2002 from Invesmart to the CNB; Exhibit C-52, letter dated 19 September

rejected for lack of information on the source of the funds.³⁸⁴ The Tribunal will revert to this below.

Invesmart did not comply with the Receivables Assignment Agreement

536. It will be recalled from the Tribunal's discussion of the legitimate expectations claim that in mid-August 2002, Union Banka's auditors were balking at issuing their report for the bank's financial statements for the year ending 31 December 2001. To resolve the auditors' need for adequate provisioning of loans in light of concerns expressed by the CNB, Invesmart concluded the Receivables Assignment Agreement pursuant to which it assumed the troubled loan portfolio that Union Banka (and Invesmart) hoped to transfer to CF as part of the Fores transaction.³⁸⁵ This relieved Union Banka from having to record a provision of CZK 300 million against the loans which it hoped to transfer to CF.

537. Under Clause 11.5 of the Agreement, Invesmart agreed, as of the Agreement's execution, to deliver to Union Banka an irrevocable first demand Bank Guarantee issued by a reputable bank for the amount of CZK 300 million valid through 15 December 2002. This was to secure payment of a penalty in the event that Invesmart did not take over the CF loan portfolio after being so requested by the bank.

538. Invesmart did not issue the bank guarantee on 13 August 2002 or at any time thereafter. Mr Catalfamo conceded that although the Agreement required Invesmart to issue the guarantee, it did not so do:

A. Yes, this is very much connected to the Česká Finanční transactions, and actually the value of 1.2 billion was exactly the same value that had been negotiated at the time with CF. And we decided to take this major step because we wanted to show the commitment of Invesmart to the auditors that we really believed that the Česká Finanční will be concluded and the bank will continue as a going concern.

Q. Paragraph 5, you were supposed to deliver as of this day an irrevocable first demand bank guarantee issued by reputable bank for the amount of 300 million Czech crowns, valid through 15th December. That is right, isn't it?

A. Yes.

Q. You didn't do that, did you?

A. No, we didn't.³⁸⁶

2002 from the CNB to Invesmart; Exhibit R-72, letter dated 7 October 2002 from Minister Sobotka to the CNB; Exhibit R-74, letter dated 11 October 2002 from the CNB to Minister Sobotka.

³⁸⁴ Exhibit R-71, CNB decision, dated 4 October 2002.

³⁸⁵ Exhibit R-52, letter dated 12 August 2002 from Invesmart to the CNB; Exhibit R-49, Receivables Assignment Agreement entered into between Union Banka and Invesmart, dated 13 August 2002.

³⁸⁶ Transcript, Day 2, , p. 40, lines 8-22.

539. Thus, although the Receivables Assignment Agreement cleaned up the bank's finances enough to secure the issuance of the auditor's report, a key obligation undertaken by Invesmart in mid-August 2002 was not performed.³⁸⁷

540. Moreover, when the 1 December 2002 deadline for the contemplated assignment of the loan portfolio to CF passed and Invesmart became liable under the Receivables Assignment Agreement to pay the CZK 1.2 billion it had agreed to pay, it did not do so.

541. _____ was also cross examined on this point:

Q. Why didn't you pay in December?

A. As I said, because we believed that a conclusion of what was the Česká Finanční transaction then – the government changing into another restructuring plan, was very, very close, and there was no need.

Q. This was a private law obligation to Union banka, which was in serious trouble in December. Why didn't you pay?

A. Because we felt it wasn't needed, because without the State support there would be --

Q. No UB?

A. There would be no UB, as we said.³⁸⁸

A number of wealthy shareholders withdrew from Invesmart

542. From the outset, Invesmart was held out as an investment company whose shareholders comprised a number of wealthy and prominent Italian individuals and families. Invesmart repeatedly adverted to the shareholders' substantial financial capacity in its dealings with the Czech authorities.³⁸⁹

543. One of the representatives of those families, a Mr Ajello (an Invesmart shareholder through C.G.I., S.r.l and also a representative of the interests of the Barilla and Ricci families³⁹⁰) joined _____ and Mr Rienmüller in meeting with CNB representatives on 12 September 2002. At this meeting, CNB officials continued to press for further details on the documentation for proof of the source of the funds that was to be submitted with the second application. They noted that the end of the three month approval period was nearing and if the

³⁸⁷ Exhibit C-31, audit report for Union banka issued by Deloitte & Touche on 16 August 2002 which noted, at p.2, that Union Banka might not be able to continue as a going concern absent Invesmart's capital entry into the bank.

³⁸⁸ Transcript, Day 2, Catalfamo, p. 41, lines 19–25, p. 42, lines 1–4.

³⁸⁹ Exhibit R-66, letter dated 16 September 2002 from _____ to the CNB; Exhibit R-18, Third Restructuring Plan submitted by Union Banka to the Ministry of Finance on 12 February 2003, p. 4. Mr. Vávra agreed that when _____ was negotiating the CNB's approval he represented that there were serious companies supporting Invesmart as shareholders: Transcript, Day 2, Vávra, p. 210, lines 24–25, p. 211, lines 1–3.

documents were not provided, the administrative proceeding would likely be terminated with a negative decision. The minutes record the CNB observing that:

... proving financial capacity of Invesmart B.V. to realize the transaction and to remove problems of Union banka (particularly paying loans granted to shareholders and persons related to Union Group) is a key feature for CNB to assess the application.³⁹¹

544. The minutes further record Invesmart's position that it did not expect that "the investors would deposit funds with a foreign bank and prove thereby the origin of funds and their actual amount until the final decision is made with respect to the transaction realization". Invesmart's priority was to decide whether to continue with the transaction, but it would "assess another possible method to prove the financial capacity".³⁹²

545. testified that:

[t]he reason why Mr. Ajello was there and participated in the meeting was for them to understand better what was the status of the Union banka transactions ... [and] we met some of the representatives of the supervisory departments. The reception was not very good, and Mr. Ajello was a little bit surprised that -- not to find the same kind of attitude that I had represented, which was that we were working entirely with the governments.³⁹³

546. The meeting's significance lies in the fact that the shareholders represented by Mr Ajello decided not to participate further in Invesmart. Indeed, at the very meeting at which Invesmart's shareholders approved the capital increase, some of its shareholders (such as the Barilla family) either abstained from voting on the increase or were unrepresented at the meeting and moreover had decided to sell their shares to _____ and thus withdraw from the company.³⁹⁴

547. The 12 September 2002 meeting led to an exchange of letters between _____ and the CNB. By letter dated 16 September 2002, _____ informed the CNB that Invesmart had

³⁹⁰ Transcript, Day 2, _____, p. 16, lines 22-24.

³⁹¹ Exhibit R-61, minutes of a meeting held on 12 September 2002 between the CNB and Invesmart.

³⁹² *Id.*, pp. 1-2.

³⁹³ Transcript, Day 2, _____, p. 17, lines 4-14.

³⁹⁴ Exhibit R-469, minutes of a meeting held on 4 November 2002 of shareholders of Invesmart B.V.. At this meeting, in addition to ratifying the capital contribution approved at the 16 October 2002 shareholders meeting (which decision had been taken at a meeting that had not been convened in accordance with the company's bylaws and therefore had to be ratified at a duly convened meeting), the shareholders approved the sale of shares from Sabina International S.A. to _____ and authorised the sale of shares from Fin.Ba, S.p.A., C.G.I., S.r.l, Selfid S.p.A. and Cititrust S.p.A. to _____

decided to complete the acquisition of up to 95 percent of Union Group subject to the resolution of certain matters such as the conclusion of a satisfactory transaction with CF.³⁹⁵

548. He noted further that the complexity and “inreliability” (sic) of the project made it impossible for Invesmart to obtain third party financing and that therefore the Union Group acquisition “will be therefore entirely covered by Invesmart with its own asset.” Board and shareholders’ meetings had been called (he attached the notices convening the two meetings on Invesmart letterhead) for 24 September 2002 and 16 October 2002, respectively, “to increase the capital of the company of additional €90 million”.³⁹⁶
549. The letter went on to describe some of Invesmart’s shareholders, which described as having “a strong and solid financial weight and reputation”. They included the previously mentioned Barilla and Ricci families and others.³⁹⁷
550. Invesmart’s 16 September 2002 letter evidently did not provide sufficient comfort to the CNB as to the source of the funds and consequently on 4 October 2002, for the second time, the CNB denied Invesmart’s application to acquire control of Union Banka.³⁹⁸ This set the stage for Invesmart’s third application, filed on 22 October 2002 and leading up to that, the holding of the shareholders meeting on 16 October 2002 at which the €90 million capital increase was approved.
551. At the 16 October 2002 shareholders’ meeting administered by Meespierson in Rotterdam, the only shareholders voting in favour of the resolution to increase the share capital of the company by €90 million by way of share premium were [redacted] and de Sury (the holder of a very small interest). Apparently unbeknownst to the CNB (which had been advised in a previous communication that he owned 21 percent of Invesmart’s shares³⁹⁹) [redacted] now owned 56 percent of Invesmart’s shares after some shareholders, such as the Barilla family, had decided to exit the company. At Invesmart’s 4 November 2002 extraordinary general meeting convened to ratify the 16 October 2002 resolution and to take certain other decisions, resolutions were passed to either approve the sale or permit the sale of their shares to [redacted].⁴⁰⁰

³⁹⁵ Exhibit R-66, letter dated 16 September 2002 from [redacted] to Zdeněk Tůma, Pavel Racoča, Vladimír Krejča, Petr Jiříček, and Renate Vernerová, p. 2.

³⁹⁶ *Id.*

³⁹⁷ *Id.*

³⁹⁸ Exhibit R-71, CNB Decision, dated 4 October 2002.

³⁹⁹ Exhibit R-469, minutes of a meeting held on 4 November 2002 of shareholders of Invesmart B.V., proposals 3 and 4.

⁴⁰⁰ Exhibit R-469, minutes of the meeting held on 4 November 2002 of shareholders of Invesmart B.V.

**capacity to raise the majority of the €90 million capital increase was
doubtful**

552. The exit of wealthy investors who decided not to participate in Invesmart suggests that experienced investors did not see the upside potential of the Union Banka deal being pursued by . The timing of their decision also warrants note: global financial markets declined after the events of 11 September 2001 and Invesmart's other investment funds were destined to be wound up. In fact, the decision to do so was also taken at the 4 November 2002 shareholders' meeting.⁴⁰¹

553. There is no documentary evidence to show how the remaining investors, in particular , could have paid for their shares of the €90 million capital increase. testified that he had his own means to make a contribution, but that he was also counting on his family to come up with the necessary funds.⁴⁰² Other than testimony there is no record evidence that shows that his family was prepared to contribute the significant funds owed to Union Banka pursuant to the debt assumption and share purchase agreements.

554. While there is no doubt as to enthusiasm for the acquisition and profitable onward sale of Union Banka, having regard to all of the circumstances (particularly Invesmart's failure to issue the CZK 300 million bank guarantee on 13 August 2002 which had led the bank's auditors to issue the audited financial statements for the year ending 31 December 2001), the Tribunal does not consider his hope of familial financial support to be sufficient proof of his ability to finance his majority share of the €90 million needed to complete the deal. There is no indication that at any time after 4 November 2002 any shareholder made its respective contributions so as to enable the company to pay off the RPLs.

555. It also warrants noting that no claim for costs thrown away in the pursuit of the Union Banka acquisition was advanced in this proceeding. Indeed, such evidence as has been adduced shows that Invesmart used its control of the bank to authorise payment to it of the costs of its due diligence in acquiring control of the bank and that at least CZK 35 million of the CZK 65 million authorised by Union Banka's shareholders after Invesmart acquired control was paid out to it.⁴⁰³ No evidence was adduced of the costs incurred in pursuing the investment,

⁴⁰¹ *Id.*, proposals 7 and 8. The shareholders resolved *inter alia* to liquidate the Pleiades I-fund, Zodiac Hedge Fund Ltd. and Investar S.A.

⁴⁰² Transcript, Day 2, , p. 90, lines 10–25, p. 91, lines 1–13.

⁴⁰³ Exhibit R-125, letter dated 2 June 2003 submitted by Union banka "in liquidation" to Silvie Goldscheirová and Jiří Majer of the CNB. At a meeting between : and the CNB held on 22 January 2003 the latter advised that the CZK 65 million payment could be a "possible contradiction" of the Banking Act (Exhibit R-137, minutes of a meeting held on 22 January 2003 between and Messrs Racoča, Štěpánek, and Krejča). A legal opinion rendered on 30 April 2003 stated that the payment was unlawful and the liquidator sought its repayment from Invesmart. No repayment was made.

although in closing submissions, counsel for the Claimant noted that Invesmart had spent close to two years trying to effect the transaction.⁴⁰⁴

556. The Tribunal views from Invesmart's: (i) lax due diligence; (ii) uncertain financial means; (iii) reliance upon the means of wealthy Italian shareholders who were about to sell their shares to⁴⁰⁵; (iv) failure to ensure that the various legal agreements it signed accorded with the conditions that it says governed its acquisition of control of the bank; and (v) failure to either issue the bank guarantee on 13 August 2002 or to pay the consideration for the Receivables Assignment Agreement when it came due in December 2002, collectively to be indicative of the Claimant's approach to the investment opportunity. This was, in the Tribunal's view, to take a "flyer" at gaining ownership of the bank with the assistance of state aid and then sell it at a quick profit.

557. It likewise appears to the Tribunal that recognising that Union Banka was in serious peril, the CNB erred in agreeing to treat with Invesmart. The CNB knew that Invesmart was a new company with no experience in running a bank. In response to the Chairman's question as to why the CNB approved the acquisition in such circumstances, Governor Tůma testified that:

... in the end we believed they would be able to deliver that money. They committed themselves. It means -- generally speaking, it's not an easy decision to close the bank. So that you look for chances how to avoid that. You look for potential mergers and so on.⁴⁰⁶

558. The evidence is that no Western bank would touch Union Banka in its current condition and the testimony was that Invesmart was the bank's only chance. Governor Tůma testified that "in the end we decided to try it. So it was a chance and we didn't want to kill it". He stated further that this was a mistake.⁴⁰⁷ The Tribunal agrees.

559. The CNB's willingness to treat with Invesmart goes however to the issue of an award of costs. It is the Tribunal's view that although the claims have been rejected, the CNB bears some responsibility for the bringing of this international proceeding.

⁴⁰⁴ Transcript, Day 7, Smith, p. 122, lines 24–25, p. 123, lines 1–8.

⁴⁰⁵ Even after the Barilla family sold their interests to (effective December 2002) their involvement in Invesmart was being represented to the Czech Ministry of Finance. The Third Restructuring Plan, submitted on 12 February 2003, continued to emphasise the wealth of various families that were no longer involved in Invesmart. acknowledged this to be a mistake (Transcript, Day 2, , p. 24, line 23). Other investors were still involved but were withdrawing.

⁴⁰⁶ Transcript, Day 4, Tůma, p. 186, lines 14–18.

⁴⁰⁷ *Id.*, p. 186, line 21.

Tribunal's determination on costs

Costs of arbitration

560. Article 38 of the UNCITRAL Arbitration Rules requires the Arbitral Tribunal to fix the costs of the arbitration in the award. The Claimant's costs (which include its share of the Tribunal's fees and disbursements) amount to €5,899,846. The Respondent's costs (including its share of the Tribunal's fees and disbursements) total €4,116,712.

561. Accordingly the costs of the arbitration amount to €10,016,558.

Allocation of costs

562. Article 40(1) of the UNCITRAL Arbitration Rules provides, subject to paragraph 2, that the costs of arbitration shall in principle be borne by the unsuccessful party. However the Arbitral Tribunal may apportion such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.

563. With respect to the costs of legal representation and assistance, Article 40(2) provides that the Arbitral Tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable.

564. Thus the general rule under the UNCITRAL Rules that the unsuccessful party shall bear the costs of arbitration does not apply with respect to that portion of the costs of arbitration which comprise the costs of legal representation and assistance. In both instances, however, the Tribunal possesses a discretion. With respect to the costs of arbitration (excluding costs of legal representation and assistance) the unsuccessful party bears the costs but subject to the Tribunal's discretion to apportion such costs taking into account the circumstances of the case. With respect to the costs of legal representation and assistance the Tribunal decides which party shall bear such costs or whether the costs should be apportioned.

Parties' submissions

565. The Respondent submits that the general rule as to the costs of arbitration (excluding costs of legal representation and assistance) referred to in Article 40(1) should apply. Hence it says that the prevailing party should be reimbursed for all non-legal costs. The Respondent further states that this rule has been widely followed by arbitral tribunals in recent investment arbitrations conducted under the UNCITRAL Arbitration Rules and is consistent with Czech practice.

566. As to the costs of legal representation and assistance, the Respondent says that the success of a party in the dispute is a determining factor as recent decisions in investment treaty arbitrations have confirmed.
567. The Claimant also submits that the successful party should be awarded costs including costs of legal representation and assistance.

Determination

568. The Tribunal has already referred to Article 40(1) and (2) of the UNCITRAL Arbitration Rules. The general rule as to the costs of arbitration (excluding costs of legal representation and assistance) is that they shall be borne by the unsuccessful party. While no general rule is stated with respect to the costs of legal representation and assistance the Tribunal agrees with the parties' submissions that such costs are also often awarded to the successful party and are therefore borne by the unsuccessful party.
569. However it is abundantly clear that under Article 40 the Tribunal possesses a discretion as to the awarding of costs and their allocation. The concluding words of Article 40(1) require the Tribunal to take into account "the circumstances of the case". Thus decisions of other tribunals in previous cases concerning the awarding of costs are not determinative and do not establish a precedent. They are merely illustrative of the application of Article 40 to the case at hand. In this case the successful party is the Respondent. However upon careful reflection, the Tribunal has concluded that there are special circumstances which make it inappropriate to award the Respondent costs.
570. In the first place the Respondent applied for an order for security for costs which was unsuccessful. This is a relevant factor although the Tribunal acknowledges that the costs incurred in connection with the application comprise only a small percentage of the total costs of arbitration.
571. A much more significant factor concerns the facts established by the Tribunal.
572. The Claimant is a company with extremely limited financial resources and little or no experience or expertise in banking. It was a most unlikely and perhaps inappropriate entity to acquire and manage what had been, at one time, a significant bank within the Czech Republic. And yet it received permission from the CNB to acquire the shares in Union Banka. It is true that the Claimant intended to on-sell Union Banka, after restructuring it, but even an acquisition for a limited time or purpose appears inappropriate, having regard to the financial resources and expertise of the Claimant.
573. At the hearing Mr Tůma, who was the Chairman of the CNB at the time the share acquisition was approved, was called to give evidence. Claimant's counsel asked Mr Tůma what he meant

when he said in his witness statement that Invesmart was not a substantial company. Mr Tůma answered:

I think that I already mentioned that today. It means Invesmart was not any Deutsche Bank or Société Générale or other well-known bank, so it was, let's say, no name in the banking sector, having no expertise in running the bank, and no experience in that respect. That is why, as I explained already, the procedure and the procedure for providing licence is -- would differ probably from looking at Deutsche or some other bank. So it is not -- that is one point.

Secondly, it wasn't a wealthy investor. So that I can imagine there are financial investors, so this was some kind of a financial investor, but it wasn't -- we didn't see at that time, at the beginning, enough money behind it. So that is why it was very -- it was one of the crucial issues during that licence procedure.⁴⁰⁸

574. The Chairman of the Tribunal then asked Mr Tůma why he had approved the acquisition to which he responded:

Because in the end we believed they would be able to deliver that money. They committed themselves. It means -- generally speaking, it's not an easy decision to close the bank. So that you look for chances how to avoid that. You look for potential mergers and so on. So there was an investor, and I believed at that time, I trust, that was a fair and honest person. Unfortunately it was my biggest mistake, probably and -- but in the end we believed that that commitment by the shareholders meeting was fair and that Invesmart would be able to deliver the money. So -- but we are speaking about that wasn't a substantial company, so explaining that at the time this was -- I am just saying this was a crucial issue, but in the end we decided to try it. So it was a chance and we didn't want to kill it.⁴⁰⁹

575. Having acquired Union Banka, the Claimant pressed its application for state assistance and argued in this arbitration that the CNB's approval of the share acquisition led it to believe that state aid would be granted.

576. Although this Tribunal has held that there was no breach of the BIT, the actions of the Czech authorities, and in particular the CNB in approving the share acquisition, were perhaps unfortunate or unwise.

577. In these circumstances the Tribunal, although unable to find that there was a breach of the BIT, considers that the Respondent should not recover any of the costs of arbitration which it has incurred and that the costs of arbitration should be allocated between the parties in accordance with the amounts they have paid or the costs incurred.

578. Accordingly the Tribunal makes no order concerning the costs of arbitration.

⁴⁰⁸ Transcript, Day 4, Tůma, p. 185, lines 23-25 and p. 186, lines 1-12.

⁴⁰⁹ Transcript, Day 4, Tůma, p. 186, lines 14-24.

AWARD AND ORDER

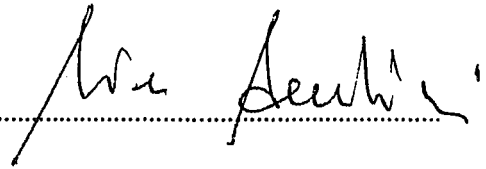
- 1. The Tribunal finds that the Respondent did not breach its obligations to the Claimant under the BIT.

- 2. The Claims of the Claimant are dismissed.

- 3. Each party is to bear its own costs.

This award is made this **26** day of **June** 2009

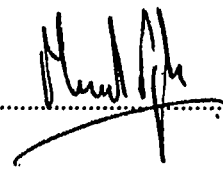
Signed by co-arbitrator
PIERO BERNARDINI

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Signed by co-arbitrator
CHRISTOPHER THOMAS QC

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Signed by chairman
MICHAEL PRYLES

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