PCA Case No. 2009-12

IN THE MATTER OF AN AD HOC ARBITRATION PURSUANT TO THE TREATY BETWEEN THE FEDERAL REPUBLIC OF GERMANY AND THE CZECH AND SLOVAK REPUBLIC CONCERNING THE PROMOTION AND RECIPROCAL PROTECTION OF INVESTMENTS

between:

InterTrade Holding GmbH
(Germany)

Claimant

- and -

The Czech Republic

Respondent

FINAL AWARD

The Arbitral Tribunal:

L. Yves Fortier, C.C., Q.C. (Chairman)
Henri Alvarez, Q.C.
Professor Brigitte Stern

Assistant to the Tribunal:

Alison G. FitzGerald

Representing the Claimant:

PYTHON & PETER

Representing the Respondent:

SQUIRE, SANDERS & DEMPSEY LLP

TABLE OF CONTENTS

I. INTRODUCTION 6

II. PROCEDURAL HISTORY 6

A. The Parties 6

B. The Request for Arbitration 7

C. The Arbitral Tribunal and Commencement of the Proceedings 7

D. The Issue of Bifurcation 8

E. The Written Procedure 9

F. The Oral Procedure 10

G. The Post-Hearing Procedure 11

H. The German-Czech BIT 11

I. The Relief Requested 13

III. FACTUAL BACKGROUND 14

A. The Czech Forestry Industry 14

B. The Company CE Wood 17

C. The 2004/2005 Tender Proceedings 18

D. The Administrative Challenge to the Tender Proceedings 20

E. The EC Challenge to the Tender Proceedings 21

F. The Sale of CE Wood 22

IV. ISSUES TO BE DETERMINED 22

V. ANALYSIS AND DISCUSSION 23

A. Jurisdiction 23

1. The Respondent's Position 23

2. The Claimant's Position 27

3. Discussion 29

4. *Finding* 44

B. Attribution 44

1. *The Claimant's Position* 44

2. *The Respondent's Position* 48

3. *Discussion* 52

4. *Finding* 61

C. Liability 62

1. *Fair and Equitable Treatment* 62

2. *Arbitrary or Discriminatory Measures* 68

3. *National Treatment* 70

4. *Full Protection and Security* 72

5. *Indirect Expropriation* 74

D. Causation 76

1. *The Claimant's Position* 76

2. *The Respondent's Position* 77

E. Damages 79

1. *The Claimant's Position* 79

2. *The Respondent's Position* 80

VI. COSTS 80

VII. OPERATIVE PART 82

DRAMATIS PERSONAE

CORPORATE PERSONS

ALLWOOD, a.s.: A subsidiary of CE Wood trading in finished wood.

AWYN GmbH: Purchased 100% of the shares in CE Wood from InterTrade.

ČAPLH: The Czech Forestry Association.

CE Wood: The Czech forestry company in which the Claimant purchased shares; formerly known as EP Kapital Group, s.a.

EP Kapital Group, s.a.: A Czech forestry company wholly owned by Exportní Průmyslova, a.s. until its purchase by InterTrade on 3 September 2000; a holding company for four different regional investment companies: FORESTINVEST Praha, a.s., FORESTINVEST Brno, a.s., FORESTINVEST Frýdek-Místek, a.s., and FORESTINVEST Velké Karlovice, a.s..

Exportní Průmyslova: The initial owner of the EP capital Group, s.a., declared bankrupt on 25 July 2001.

InterTrade Holding GmbH: The Claimant, a German company.

Lesy Beskydy, a.s: A Czech corporation, formerly Lesy Silherovica, a.s., established on 1 July 2004; won three forestry units (Lysa, Ostravice and Silherovice) in the tender proceedings.

Lesy Ceske Republiky, S.P.: The Czech State enterprise responsible for, *inter alia*, management of State forests.

Lesy Hluboka: A Czech corporation that won five out of nine forestry units in the tender proceedings.

Lesy Silherovica, a.s.: Predecessor corporation to Lesy Beskydy, a.s., established on 26 February 2003.

NKU: The Supreme Audit Office, responsible for auditing the management of State property, among other tasks.

UOHS: Czech Office for the Protection of Competition.

INDIVIDUALS

: Managing director of InterTrade and son of

: Member of the Board of Directors of EP Kapital Group from 2001 to 2004 and Chairman of the Supervisory Board from 2004 to 2006.

: The Chief Executive Officer of CE Wood (and its predecessor companies) since October 1995.

: Minister of Agriculture of the Czech Republic from 2007 to 2009.

Minister of Agriculture of the Czech Republic from 2002 to 2005.

THE ARBITRAL TRIBUNAL

Composed as above,

After deliberation,

Makes the following Award:

I. INTRODUCTION

1. The present arbitration involves a dispute between a German investor and the Czech State over the conduct of procurement proceedings held in 2005, the purpose of which was to transform the Czech forestry sector from a cartel-like structure to a competitive market. The investor complains that the proceedings were manipulated in breach of the Czech Republic's treaty obligations, resulting in loss and damage to the investor. The Czech State denies that the proceedings were manipulated and that there has been any treaty breach. Moreover, the Czech State denies that the Tribunal has jurisdiction to hear the dispute that is the subject of this arbitration or that the acts complained of are attributable to it under international law.

II. PROCEDURAL HISTORY

A. *The Parties*

2. The Claimant, InterTrade Holding GmbH ("**InterTrade**"), is a limited liability company incorporated under the laws of Germany. Its registered office is located at Am Hagen 37, 53783 Eitorf, Germany. The Claimant is represented in these proceedings by Mr. , Ms. and Mr. , Python & Peter, 9 rue Massot, 1206 Geneva, Switzerland.

3. The Respondent is the Czech Republic. The Respondent is represented in these proceedings by Mr. , Nöerr s.r.o., Na Porici 1079/3a, 11000 Prague 1, Czech Republic; Mr. , Squire, Sanders & Dempsey LLP, 2000 Huntington Center, 41 South High Street, Columbus, Ohio 43215, USA; Mr. , Squire, Sanders & Dempsey LLP, 30 Rockefeller Plaza, 23rd floor, New York, NY 10112, USA; Mr. Squire Sanders & Dempsey LLP, 4900 Key Tower, 127 Public Square, Cleveland, Ohio 44114, USA.

B. *The Request for Arbitration*

4. The Claimant commenced these proceedings by way of a Request for Arbitration, dated 23 October 2008 (the "**Request**"). Prior to filing its Request, the Claimant sent a Notification of Dispute to the Respondent, dated 28 August 2007.

5. In its Request, the Claimant invoked several provisions of the Treaty between the Federal Republic of Germany and the Czech and Slovak Federal Republic Concerning the Promotion and Reciprocal Protection of Investments, signed in Prague on 2 October 1990 (the "**German-Czech BIT**"), which it alleged had been violated through the acts and omissions of the Czech Republic.

C. *The Arbitral Tribunal and Commencement of the Proceedings*

6. The Arbitral Tribunal was constituted on 27 May 2009. It is composed of Mr. L. Yves Fortier, C.C., Q.C. (Canadian), appointed by agreement of the Parties as Chairman, and Mr. Henri Alvarez, Q.C. (Canadian) and Professor Brigitte Stern (French), appointed respectively by the Claimant and the Respondent as co-arbitrators (the "**Tribunal**").

7. The Tribunal held a first meeting with the Parties in Geneva, Switzerland, on 26 August 2009. During this meeting, two alternative timetables for the conduct of the proceedings were agreed by the Parties, one providing for a separate jurisdictional phase and one contemplating a single phase. These alternative timetables were annexed to Procedural Order No. 1, dated 14 September 2009 ("**Procedural Order No. 1**").

8. The Parties also reached agreement on several other issues relating to the conduct of the proceedings, which are recorded in the Terms of Appointment, executed on 26 August 2009, and Procedural Order No. 1, as well as in a subsequent exchange of letters between the Parties on 31 August 2009 and 11 November 2009.

9. The Parties agreed that the seat of the arbitration shall be Paris, France.

10. The Parties agreed that these proceedings shall be conducted in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law, 1976 (the "**UNCITRAL Rules**") and that the International Bureau of the Permanent Court of Arbitration (the "**PCA**") shall act as Registry.

11. The Parties also agreed that the Tribunal may appoint an Assistant to the Tribunal. Accordingly, during the first meeting, Ms. was appointed to serve in this capacity, consistent with the provisions of the Terms of Appointment.

D. *The Issue of Bifurcation*

12. In Procedural Order No. 1, the Tribunal ordered the Respondent to submit, by 2 October 2009, a list of the issues on the basis of which it questioned the Tribunal's jurisdiction, together with a short summary of its arguments on each of the points listed.

13. The Respondent submitted its list of questions on 2 October 2009, together with brief arguments concerning the existence of an "investment", the Claimant's status as an "investor", the arbitrability of the matter *ratione materiae*, and the "active legitimation" of the Claimant.

14. By letter of 9 October 2009, the Claimant objected that the submissions provided by the Respondent did not meet the requirements set out by the Tribunal in Procedural Order No. 1, averring that the Respondent raised "doubts" as to the Tribunal's jurisdiction over the dispute but no "legal arguments".

15. Following the filing of the Respondent's Statement of Defence, the Claimant reiterated its concerns, by letter of 23 April 2010, in connection with the jurisdictional objections raised by the Respondent. In particular, the Claimant alleged that the Respondent had raised a new jurisdictional objection in its Statement of Defence, based on attribution, not previously notified in its 2 October 2009 submission.

16. On 26 April 2010, the Tribunal directed the Claimant to provide written submissions in connection with the "new" jurisdictional objection set out in the Respondent's Statement of Defence.

17. By letter of 27 April 2010, the Respondent replied to the Claimant's 23 April 2010 letter, averring that its 2 October 2009 submission was not intended to be exhaustive and that, in any event, no prejudice would be suffered by the Claimant in connection with the "new" objection set out in its Statement of Defence.

18. By letter of 28 April 2010, the Claimant submitted its response to the Respondent's "new" jurisdictional objection.

19. On 30 April 2010, the Tribunal held a telephone conference on the issue of bifurcation during which counsel for both Parties provided extensive oral submissions. Following the telephone conference on bifurcation, the Tribunal issued Procedural Order No. 2, dated 4 May 2010, in which it determined that the proceedings would not be bifurcated, and that the timetable set out in Annex A to Procedural Order No. 1 would govern the remainder of the proceedings ("**Procedural Order No. 2**"). Accordingly, the Tribunal confirmed that a single Hearing on jurisdiction and merits would take place from 8 to 17 December 2010.

20. On 8 September 2010, the Claimant advised the Tribunal by e-mail that the Parties had reached an agreement that a period of four days, beginning on 14 December 2010, with an additional day held in reserve, would be sufficient for the Hearing of this matter. The Respondent confirmed the Parties' agreement by e-mail on 13 September 2010. Accordingly, the Tribunal confirmed that the Hearing would take place from 14 to 17 December 2010, with one reserve day.

E. *The Written Procedure*

21. The Claimant filed its Statement of Claim, together with witness statements, documents and legal authorities, on 18 December 2009.

22. The Respondent filed its Statement of Defence on 16 April 2010. The Claimant brought an application on 20 April 2010, requesting that the Tribunal direct the Respondent to, *inter alia*, provide the Claimant with immediate access to electronic copies of all documents filed with the Statement of Defence, including witness statements, expert reports and exhibits. On 21 April 2010, the Respondent provided the Claimant with the requested access to these documents.

23. The Parties exchanged requests for documents in the form of "Redfern Schedules" on 5 May 2010, responses to these respective requests for documents on 19 May 2010, and replies to those responses on 26 May 2010.

24. Further to these requests for documents, the Tribunal issued Procedural Order No. 3, dated 11 June 2010, ordering the disclosure of certain documents and categories of documents requested by each Party and denying certain other requests ("**Procedural Order No. 3**").

25. On 12 August 2010, the Claimant wrote to the Tribunal advising that it was dissatisfied with the Respondent's production of documents. In particular, the Claimant submitted that the Respondent's production was "highly incomplete". The Respondent replied on 19 August 2010, further to the Tribunal's invitation, noting that no application had been made and confirming that it had complied with its discovery obligations to the extent documents ordered to be produced were within its possession.

26. The Claimant filed its Reply, together with witness statements, documents and legal authorities, on 17 September 2010.

27. The Respondent filed its Rejoinder on 22 November 2010. On 23 November 2010, the Claimant brought an urgent application requesting that the Tribunal order the Respondent to immediately provide to the Claimant electronic copies of all witness statements and expert reports. The Respondent confirmed in writing on the same day that hard copies of the requested material would be available to the Claimant as of 24 November 2010. By Procedural Order No. 4, dated 23 November 2010, the Tribunal ordered the Respondent to provide electronic copies of all witness statements and expert reports accompanying the Respondent's Statement of Rejoinder, noting the close proximity to the Hearing and other procedural steps preparatory to the Hearing ("**Procedural Order No. 4**").

F. ***The Oral Procedure***

28. A Hearing on jurisdiction and merits was held in Paris, France, from 14 to 18 December 2010. The following persons appeared before the Tribunal:

(a) On behalf of the Claimant: Dr. Ms. and Mr.
and

(b) On behalf of the Respondent: Mr. , Mr. Mr.
, and Mr.

29. During the Hearing, the following fact witnesses were called to testify: *for the Claimant* – Mr. , Mr. , Mr. , Mr. , Mr. , Mr. , Mr. , Mr. , and Mr. ; *for the Respondent* – Mr. , Mr. , Mr. .

30. The following expert witnesses were also called to testify: *for the Claimant* – Mr. Philip Haberman and Mr. Richard Ramsauer; *for the Respondent* – Mr. Peter Clokey.

31. The Parties confirmed at the end of the Hearing that they were satisfied with the conduct of the proceedings and were afforded a fair opportunity to present their respective cases (see Tr. Day 5, pp. 123-124).

G. *The Post-Hearing Procedure*

32. The Tribunal directed the Parties to file, simultaneously, post-hearing briefs on 25 March 2011, and reply post-hearing briefs on 6 May 2011. These briefs were duly filed by the Parties in accordance with the Tribunal's instructions as to form and length.

33. On 19 December 2011, the Tribunal directed the Parties to file, simultaneously, their costs submissions. These submissions were also duly filed by both Parties on 9 January 2012.

H. *The German-Czech BIT*

34. Article 10 of the German-Czech BIT contains the Parties' arbitration agreement and provides as follows:

> "*Article 10*
>
> (1) Disputes between either Contracting Party and an investor of the other Contracting Party regarding investments shall, as far as possible, be settled amicably between the parties to the dispute.
>
> (2) If the dispute cannot be settled within six months from the date on which it was officially raised by either party to the dispute, it shall at the request of the investors of the other Contracting Party, be submitted for arbitration. In the absence of any other arrangements between the parties to the dispute, the provisions of article 9, paragraphs 3 and 5 shall apply *mutatis mutandis* subject to the proviso that the members of the arbitral tribunal shall be appointed by the parties to the dispute in accordance with the provisions of article 9, paragraph 3, and that, if the time-limits provided for in article 9, paragraph 3, are not observed, either

party to the dispute may, in the absence of any other arrangements, request the Chairman of the Arbitration Institute of the Stockholm Chamber of Commerce to make the necessary appointments. The award shall be recognized and enforced under the Convention of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

(3) The Contracting Party which is a party to the dispute shall not in [sic: the] course of arbitration proceedings or the execution of the arbitral award raise an objection on the grounds that the investor who is the other party to the dispute has already received compensation for all or part of his losses under an insurance policy."

35. The Claimant invokes several substantive provisions in the German-Czech BIT, the relevant portions of which are reproduced below:

"*Article 2*

(1) Each Contracting Party shall in its territory promote as far as possible investments by investors of the other Contracting Party, permitting such investments in accordance with its laws. It shall in all cases afford investments just and equitable treatment.

(2) No Contracting Party shall in any way impede the management, maintenance, use or enjoyment of investments in its territory by investors of the other Contracting Party by means of arbitrary or discriminatory measures.

[...]

Article 3

[...]

(2) Each Contracting Party shall accord in its territory, to investors of the other Contracting Party, in respect of their activities in connection with such investments, treatment no less favourable than that accorded to its own investors or to investors of third States.

[...]

Article 4

(1) Investments by investors of either Contracting Party shall enjoy full protection and full security in the territory of the other Contracting Party.

(2) Investments by investors of either Contracting Party may be expropriated, nationalized or subjected to other measures with effects equivalent to expropriation or nationalization only in the public interest and against compensation. Such compensation shall correspond to the value of the investment expropriated immediately before the date on which the actual or pending expropriation, nationalization or similar measure was made public. Compensation shall be paid without delay and

shall bear interest at the normal rate of bank interest; it shall be effectively convertible and freely transferable. Provision for the determination and payment of such compensation shall be made in an appropriate manner no later than the date of the expropriation, nationalization or similar measure. The legality of the expropriation, nationalization or similar measure and the amount of the compensation may be subject to review in a properly constituted legal proceeding.

[...]"

I. *The Relief Requested*

36. The Claimant seeks both declaratory relief and damages for alleged violations by the Respondent of the terms of the German-Czech BIT. In particular, the Claimant requests the following relief from this Tribunal (see Cl. Reply PHB, para. 178):

(a) DECLARE that the Tribunal has jurisdiction to decide the present dispute under the German-Czech BIT;

(b) DECLARE that the Respondent has breached Articles 2(1), 2(2), 3(2), 4(1) and 4(2) of the German-Czech BIT;

(c) ORDER the Respondent to pay the Claimant damages in the amount of € 84.424 million;

(d) ORDER the Respondent to pay the Claimant interest based on a return of 39.26% generated from an investment into German Government bonds in total for the period of 1 January 2005 until 29 April 2011, in the amount of € 33.14 million;

(e) ORDER the Respondent to pay the Claimant interest, based upon the investment into German Government bonds in an amount to be specified until the date of the payment of the Award;

(f) ORDER the Respondent to pay the costs of the arbitration, including all expenses that the Claimant has incurred or will incur in respect of the fees and expenses of the arbitrators, legal counsel and experts;

(g) ORDER the Respondent to pay the Claimant compound interest on the sum awarded under (f), at the rate indicated in (e), from the date of the Award until the date of full payment;

(h) ORDER such other and further relief as the arbitrators shall deem appropriate.

37. The Respondent, in turn, requests that the Tribunal grant the following relief (see Rejoinder, para. 353):

(a) DECLARE that the Tribunal does not have jurisdiction over any claim based upon Articles 2, 3 and 4 of the German-Czech BIT[1]; or, in the alternative,

(b) DECLARE that the Claimant has not made an investment within the meaning of the German-Czech BIT;

(c) DISMISS the Claimant's petition to declare that the Respondent has breached Articles 2(1), 2(2), 3(2), 4(1) and 4(2) of the German-Czech BIT;

(d) DISMISS the Claimant's petition to order the Respondent to pay the Claimant compensation for damages and interests thereon;

(e) DISMISS the Claimant's petition to order the Respondent to pay the costs of the arbitration; and

(f) ORDER that the Claimant shall be liable for all costs of the proceeding, including the Respondent's legal costs and expert fees on a full indemnity basis.

III. FACTUAL BACKGROUND

38. The Tribunal sets out a brief factual background in the form a chronology of events. Where disputed by the Parties, the Tribunal has established these facts primarily from the contemporaneous documentation adduced in evidence by the Parties, supplemented by the testimony of their factual and expert witnesses (both oral and written) as provided to the Tribunal in these arbitration proceedings.

A. *The Czech Forestry Industry*

39. Since 1989, the Czech Republic has undergone an important transformation from a centrally-planned and directed economy to a market economy. This transformation is

[1] The Tribunal notes that while not explicitly stated in the Respondent's request for relief, the Respondent seeks to have the case dismissed on the ground that the acts or omissions complained of are not attributable to the Czech State (see paragraphs 155 to 164 below).

mirrored in the forestry industry. In the Czech Republic, forested land covers approximately 33.7% of Czech territory. Prior to 1989, over 95% of that land was state-owned. Today, the State owns approximately 50-60% of all forested land (see Expert Opinion of J. Vasicek, paras. 1 and 53; Expert Opinion of R. Ramsauer, para. 1.2).

40. The Czech forestry sector is comprised of both silvicultural activities and wood processing. Silviculture is composed of both deforesting and afforesting activities. Deforesting involves the felling of trees and transportation of the resulting timber in the form of logs, sawn wood or pulp. Afforesting involves the maintenance of tree nurseries and the planting of young trees in areas designated by the owner of the forest. Both deforesting and afforesting activities are labour-intensive activities which yield low profit margins compared to wood processing. Wood processing involves the conversion of the harvested wood into finished wood products, such as boards, doors, window frames, floorboards and other products at sawmills and other specialized production facilities.

41. On 11 December 1991, pursuant to Protocol No. 6677/91-100, the Czech Ministry of Agriculture, the entity responsible for managing and administering State forests, established Lesy Ceske Republiky ("LČR"). LČR became responsible for the day-to-day management of State forests, while the Ministry of Agriculture retained ultimate responsibility for the deforesting and regeneration plan in respect of State forests.

42. At around the time when LČR was established, the regional State enterprises, which had previously been responsible for the administration of Czech forests (of which there were seven), were dismantled and their assets transferred to newly established joint-stock companies. These companies were subsequently privatised through a "coupon privatisation" in March 1995.

43. However, the new forestry companies inherited the liabilities of their centrally-planned predecessors, such as long-term obligations towards employees, loss-making housing management and redundant and unproductive property. In order to aid in this transition, the companies were provided with a 10 year "framework guarantee", that is, access to the forest units in which their predecessors had operated. LČR entered into a two-year contract with each forestry company at the end of which the performance of the forestry company was assessed and prices re-negotiated. Contracts were only terminated by LČR

if price re-negotiations, based on an industry pricing formula (the so-called "KALK formula"), were unsuccessful or a forestry company failed to fulfill its contractual obligations, the result being that few competitive tender proceedings, if any, were held (see Expert Opinion of J. Vasicek, para. 133).

44. In the 1990s, the price of timber in the Czech Republic was on a par with European prices, however, Czech labour costs were much lower. Accordingly, during this period forestry companies generally performed well financially. The KALK pricing formula, which established a minimum price for the purchase of timber in the Czech Republic, also regularly generated negative prices for lower quality timber, thereby requiring LČR to pay forestry companies for the wood they were purchasing. As a result, as of 2003, LČR's income was close to zero (see Witness Statement of para. 9; Witness Statement of para. 2).

45. In 2005, LČR managed approximately 86% of State-owned forests, or approximately 51% of all forests in the Czech Republic (see Expert Opinion of J. Vasicek, para. 78). Private companies had access to timber from the forests under LČR's management through two means. First, a company could purchase timber directly from the trading arm of LČR. Second, a company could contract with LČR to harvest wood and subsequently buy a portion of the wood, to a maximum of two thirds of the wood harvested, at prices agreed in advance. LČR offered two types of silvicultural contracts: long-term contracts (contracts of unlimited duration) and short-term contracts (contracts limited to a duration of two-years with a possibility of extension) (see Exhs. C-28 and C-29).

46. Following its accession to the EU in 2004, the Czech Republic was required to ensure the transparency and liberalisation of its forestry sector. The Czech government therefore adopted its first National Forest Programme ("NFP") in 2003, followed by a second NFP in 2008 (see Exhs. R-17 and R-18). The NFPs set out the Czech Republic's commitments in the forestry sector, as well as guidelines for its forestry policy. The NFPs also reflect the EU's Action Plan for forests and forestry (see Expert Opinion of J. Vasicek, paras. 29-31).

B. *The Company CE Wood*

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C. *The 2004/2005 Tender Proceedings*

53. In 2003, the Czech Supreme Audit Office ("NKU") undertook an investigation of the performance of LČR for the purpose of verifying "the state enterprise's management of state assets and financial resources provided from the state budget, in particular from the perspective of purposefulness and economy" (see Exh. R-49). The NKU's report was released in January 2004 (see ibid). Among its observations, the NKU noted that LČR had not carried out any competitive tender proceedings to assign forestry units, which had resulted in six companies dominating the field.

The NKU also observed that LČR was disadvantaged by the price paid to it for felled timber by forestry companies, becoming increasingly unprofitable by contrast to the forestry companies, which were able to sell the same felled timber at a higher price on the open market.

54. On 15 December 2004, LČR published a notice of tenders for the execution of logging and re-planting activities in 87 forestry units which were previously serviced under short-term contracts, which were slated to end with effect on 31 December 2004 (see Exh. C-1). LČR assigned temporary contracts to new companies for a six month intermediate period until the tenders had been awarded. CE Wood was offered an extension of its short-term contracts, however, the parties could not agree on the terms of the extension in

respect of all forestry units. Specifically, while the parties agreed on price in respect of four or five forestry units, they failed to reach agreement on price in respect of all other short-term contracts. In the case of the latter contracts, CE Wood insisted on maintaining negative prices for these contracts while LČR proposed the price of one (1) Czech Crown per m^3 of wood (see Tr. Day 4, pp. 61-62; 87). As a result, 19 forestry units previously under contract with CE Wood were reassigned.

55. On 21 December 2004, LČR notified all forestry companies that it intended to terminate all long-term contracts as well (see e.g., Exh. C-31). This notice triggered a one-year notification period (previously two years) included in all of CE Wood's long-term contracts with LČR. However, LČR cancelled all long-term contracts with immediate effect by letters of 12 January 2005, on the grounds that such contracts were contrary to the *Protection of Competition Act* (see Exh. C-4). These contracts, too, were eventually submitted to a tender process.

56. On 15 February 2005, CE Wood submitted a bid for short-term contracts in . for tender (see Exh. C-47). By this time, all but a handful of CE Wood's short-term contracts had been terminated, and all of its long-term contracts were at an end.

57. On 21 March 2005, CE Wood asked LČR for information regarding the composition of the tender evaluation committees (see Exh. C-38). Several days later, CE Wood wrote again to LČR formally objecting to the tender process and complaining that the process had violated the Public Procurement Act of 2004 ("**PPA**") (see Exh. C-12).

58. LČR responded to CE Wood's complaint on 6 April 2005, averring that the tender proceedings were conducted in accordance with EU rules applicable to the award of public contracts and not the standards of the PPA (see Exh. C-39). LČR declined to provide detailed information on the composition of the selection committees.

59. CE Wood pursued its request for further information on the composition of the evaluation committees on two other occasions, including through a Freedom of Information Petition

to the Ministry of Agriculture (see Exhs. C-40 and C-42). In its response, the Ministry explained the limited powers of control it has over LČR as a state enterprise and that, because the exercise of commercial activities concerning state-owned assets by LČR was not subordinate to the Ministry of Agriculture, the Ministry could not intervene in the tender process (see Exh. C-43).

60. LČR held a second round of tenders for the remaining contracts beginning on 24 June 2005. However, CE Wood declined to participate.

D. *The Administrative Challenge to the Tender Proceedings*

61. Prior to initiating tender proceedings, LČR sought legal advice as to its status as a public contracting authority for the purposes of new legislation on public tenders which was to enter into effect on 1 May 2004 (Act No. 40/2004 Coll.). Based on a review of the legislation, the Institute of the State and Law opined that LČR was not required to abide by the Act unless it organized a tender which was majority financed by the State (see Exh. R-83). LČR followed this advice and did not comply with the Act in the conduct of the tender proceedings.

62. On 9 December 2004, CE Wood filed a Petition for Protection against Unfair Competition Conduct with the Regional Court in Hradec Králové (see Exh. C-25). In this Petition, CE Wood alleged that LČR's conduct leading up to the tender proceedings, such as the shortening of the notice period for CE Wood's long-term contracts and price negotiations under the short-term contracts, was contrary to the Protection of Competition Act of 2001.

63. On 23 December 2004, CE Wood also submitted a petition to the Office for the Protection of Competition ("**UOHS**") requesting that it initiate an investigation into LČR's compliance with the PPA in the tender proceedings (see Exh. C-5).

64. CE Wood wrote to Minister . Head of the Government Legislative Council, on 6 January 2005, enclosing a copy of its petition to the UOHS (see Exh. C-9).

65. On 25 January 2005, UOHS informed LČR that it had determined it was a public tendering authority and therefore subject to the PPA. UOHS directed LČR to make

appropriate changes to its tender process and documentation. CE Wood was advised of UOHS's decision several days later, by letter (see Exh. C-6).

66. However, on 1 February 2005, UOHS advised CE Wood that its decision was preliminary and still under consideration (see Exh. C-7). UOHS subsequently wrote to CE Wood on 4 February 2005, advising it that, after further consideration, the tendered contracts did not meet the definition of a public contract, because no public funds were disbursed (UOHS considered that the mutual payments between the contracting parties ultimately represented income for LČR as opposed to an expense), and therefore the matter would not be pursued further (see Exh. C-8).

67. On 24 February 2005, CE Wood wrote to UOHS advising that LČR had taken the position during the legal proceedings before the Court in Hradec Králové that it was a public contracting authority and the provision of forestry services by a contractual partner could thus be considered a public contract. CE Wood reiterated its request that UOHS initiate administrative proceedings against LČR (see Exh. C-10).

68. The ČALPH, a Czech industry group, also wrote to Minister on 10 March 2005, demanding, *inter alia*, the suspension of the February tender proceedings and a review of LČR's actions by the Ministry of Agriculture (see Exh. C-11). On 17 March 2005, the Ministry advised, however, that it would not intervene as the matter was within the competence of the UOHS (see Exh. C-37).

69. On 15 April 2005, CE Wood again filed a petition with the UOHS, seeking, *inter alia*, a declaration that the tender proceedings were invalid (see Exh. C-13).

70. On 27 January 2006, following issuance of the European Commission's ("EC") decision in respect of the tender proceedings (see Section III.E below), UOHS again revised its position that the tender proceedings had been conducted correctly, also declaring LČR to be a public contracting authority under Czech law.

E. *The EC Challenge to the Tender Proceedings*

71. On 11 February 2005, CE Wood filed a formal complaint in respect of the tender proceedings with the EC on the grounds that the proceedings violated both the PPA and EU Public Procurement Legislation (see Exh. C-14). CE Wood supplemented its

complaint with further reasons on 23 and 24 February 2005 (see Exh. C-34 and C-35), and again on 4 March 2005 (see Exh. C-36), as the tender proceedings were ongoing.

72. On 18 April 2005, the EC advised CE Wood that its complaint had been registered (see Exh. C-41). The EC rendered its decision on 13 December 2005, confirming that LČR was a public contracting authority pursuant to Article 1(b) of Directive 92/50/EEC and that its silvicultural contracts were public service contracts pursuant to Article 1(a) of the Directive (see Exh. C-15). The Czech Republic was given two months to respond.

73. On 23 March 2007, the EC issued a Reasoned Opinion, confirming its above decision and observing that neither the Czech Republic nor LČR had taken steps to remedy the problems identified by the EC in its 2005 decision. Accordingly, the EC invited the Czech Republic to adopt measures to remedy the problems (see Exh. C-17).

F. *The Sale of CE Wood*

74.

75. InterTrade sold its shares in CE Wood to Awyn GmbH ("Awyn") for (see Exh. C-75; Exh. R-79). The exact date on which InterTrade sold its shares is disputed and is material to whether the Tribunal has jurisdiction over the present dispute. It shall therefore be discussed in detail below.

IV. ISSUES TO BE DETERMINED

76. The issues before the Tribunal for determination may be briefly summarized as follows:

(a) Jurisdiction: Does the Tribunal have jurisdiction *ratione materiae* and *ratione temporis* over the present dispute?

(b) Attribution: Are the acts and/or omissions of LČR attributable to the Czech Republic?

(c) Liability: If the answer to the above two issues is affirmative, did the Respondent breach Article 2(1), 2(2), 3(3), 4(1) and/or 4(2) of the German-Czech BIT?

(d) Causation: If the answer to the above question is affirmative in respect of any of the identified provisions of the German-Czech BIT, did the Claimant suffer loss or damage as a result of the Respondent's treaty breach(es)?

(e) Damages: If the answer to the above question is affirmative, to what sum of damages is the Claimant entitled?

(f) Interest: If the answer to the above question results in a positive value, to what sum of interest is the Claimant entitled?

(g) Costs: Based on the foregoing disposition of the dispute, how should costs be allocated as between the Parties?

V. ANALYSIS AND DISCUSSION

77. The Tribunal shall now discuss and determine each of these issues in turn. Due to the extensive nature of the Parties' written and oral submissions, the Tribunal does not intend to provide an exhaustive account of all arguments developed by the Parties in support of their respective positions. Rather, the Tribunal canvasses below the Parties' principal arguments and evidence in support thereof, focusing on those points which have proved material to the Tribunal's deliberations and conclusions.

A. *Jurisdiction*

1. The Respondent's Position

78. The Respondent submits as a preliminary point that the Claimant bears the burden of proof to establish the Tribunal's jurisdiction (see Resp. PHB, para. 50, citing *Phoenix Action Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award of 15 April 2009, para. 64 ("*Phoenix Action*")). In the Respondent's view, the Claimant has failed to meet its burden.

79. The Respondent's position on jurisdiction has evolved over the course of these proceedings. However, the Tribunal understands that the Respondent's position rests on three principal arguments: (1) the Claimant sold its alleged investment prior to the acts in issue (*i.e.*, jurisdiction *ratione temporis*); (2) there is no "investment" within the meaning

of Article 1 of the German-Czech BIT (*i.e.*, jurisdiction *ratione materiae*); and (3) the Claimant did not make a good faith investment.

a) *Jurisdiction Ratione Temporis*

80. The Respondent contends that the Claimant divested itself of any putative investment prior to January 2005, when the alleged wrongful acts were to have occurred. Specifically, the Respondent submits that the sale of shares in CE Wood took place in accordance with an SPA entered into prior to 30 June 2004 between InterTrade and Awyn. This share purchase is recorded in the Claimant's financial statements for the period 1 July 2003 to 30 June 2004 and 1 July 2004 to 30 June 2005 (see Resp. PHB, paras. 53-54; Exhs. R-40 / CB-132 and R-54 / CB-142).

81. Referring to the award in *Cementownia "Nowa Huta" S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/06/2, Award of 17 September 2009 ("***Cementownia***"), the Respondent observes that an ICSID arbitral tribunal recently faced a similar situation when asked to determine whether the claimant held the investment when the acts at issue were performed. The Respondent submits that, in that case, the claimant's failure to record the claimed transaction in its own financial statement for the year in which the transaction allegedly occurred proved fatal to its claim (see Resp. PHB, para. 59, quoting *Cementownia* at para. 129).

82. Notwithstanding the Claimant's position that the sale of shares in CE Wood was simply back-dated, and did not occur until March 2005 pursuant to a revised SPA, the Respondent avers that the evidence contradicts this position. First, the Respondent notes that confirmed during his oral testimony that the share purchase followed the payment structure set out in the 2004 SPA, not the 2005 contract (see Resp. PHB, paras. 65-69; Tr. Day 2, pp. 73, 135).

83. Second, the Respondent claims that Recital D to the 2004 SPA, which provides a timeline for the negotiation of collection of the receivable against the Claimant used to set-off the Claimant's payment obligation for the shares, is commercially reasonable, whereas the parallel recital in the March 2005 contract is not. Specifically, Recital D to the 2004 agreement provided for negotiations to commence in January 2004, the same month in which Awyn acquired the receivable, whereas Recital D to the 2005 contract provided for

negotiations to begin in March 2005, over a year after Awyn acquired the receivable (see Resp. PHB, paras. 70-73).

84. Third, the Respondent contends that the Claimant's rationale for backdating the share purchase transaction is a "fiction", referring to the oral testimony of who acknowledged during the Hearing that there were no tax reasons for such a step, nor was there more than one creditor with whom CE Wood had an outstanding receivable (see Resp. PHB, paras. 74-81; Tr. Day 2, pp. 30-37).

b) *Jurisdiction Ratione Materiae*

85. The Respondent contends that the Tribunal also lacks jurisdiction because Article 1 of the German-Czech BIT requires that assets be "contributed" in order for a protected investment to exist. The Respondent takes issue with the English language translation of the German-Czech BIT provided by the Claimant, which translates the operative language in Article 1 as "invested". The Respondent reasons that Article 2(3) of the BIT expressly provides for the protection of "investments" and "returns", therefore if Article 1(1) were to be interpreted to provide for a broad definition of assets invested in the sense of "directly or indirectly owned or controlled by the investor", returns would be included in the definition of "investments" and Article 2(3) would be redundant. Instead, the Respondent submits that Article 1(1) contains a narrower definition of investment, one which requires the "contribution" of assets in the territory of the Contracting State (see Resp. PHB, paras. 82-85).

86. The Respondent argues that the share sale transaction is best understood in two parts, the net result of which is that the Claimant never paid "a single Crown" and did not, therefore, contribute an asset in the territory of the Czech Republic. The first part is described as the transfer of shares in CE Wood from EPAS to InterTrade and the set-off of receivables acquired by InterTrade from EPAS's subsidiaries in payment for the shares. The second part of the transaction is described as the "parking" of substitute receivables against InterTrade in "non-transparent, off-shore structures" which were ultimately cancelled in a second set-off when InterTrade sold the shares in CE Wood to the same entity holding the substitute receivables (see Resp. PHB, paras. 86-87).

87. The Respondent submits that the "state of the evidence" on whether the Claimant "contributed" anything in the Czech Republic consists of the following, which it describes as "fatal" to the Tribunal's jurisdiction:

(a) A promissory note that the Claimant alleges to have destroyed;

(b) Two substitute promissory notes that were not produced; and

(c) An assumption about an around-the-world transaction with no transfer agreements documenting the existence of the transaction.

88. The Respondent adds that, even assuming the transaction occurred as alleged, the Claimant still did not "contribute" anything in the territory of the Czech Republic because it paid for its alleged investment with a promissory note as opposed to a capital infusion (see Resp. PHB, para. 113).

c) *The Claimant did not make a good faith investment*

89. The Respondent submits that an investment not performed in good faith cannot benefit from investment protection, relying on the arbitral awards in *Phoenix Action, Inceysa v. El Salvador*, ICSID Case No. ARB/03/26, Award of 2 August 2006 ("***Inceysa***"), and *Gustav FW Hamester GmbH & Co. KA v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award of 18 June 2010 ("***Gustav Hamester***") in support of its proposition.

90. In this case, the Respondent contends that the structure by which the Claimant bought and sold its alleged investment shows substantial indicia of an intent to conceal, referring to the "labyrinthine structure" in which EPAS's assets were transferred between "business friends", at less than fair market value and shortly before commencement of the bankruptcy proceeding. The Respondent thus submits that the Claimant's alleged investment is marked by several "badges of fraud". In making this plea, the Respondent urges the Tribunal to consider the circumstantial evidence surrounding the transaction, averring that direct proof of actual fraud is rarely available (see Resp. PHB, paras. 117-122).

2. The Claimant's Position

a) *Jurisdiction Ratione Temporis*

91. The Claimant submits that the Respondent's reliance on *Cementownia* is misplaced, for several reasons. In particular, the Claimant draws a distinction between the facts underpinning the *Cementownia* award and the facts adduced in the present proceeding. That is, the *Cementownia* claimant's admitted inability to prove its acquisition of a shareholding in the Turkish companies at the relevant time (see Cl. PHB, para. 53).

92. The Claimant submits that InterTrade sold its shares to Awyn . The sum actually transferred to InterTrade in payment of its shares amounted to , *i.e.* the difference between the purchase price agreed with Awyn and the monies still owed by InterTrade in the context of the receivable Awyn had purchased, plus the interest accumulated on this latter amount. It says that the shares were transferred to Awyn on 8 July 2005.

93. According to the Claimant, InterTrade and Awyn executed their SPA on 18 May 2005; however, because recording this transaction in the financial year 2005 could have had serious negative implications for InterTrade (*i.e.* negative capital showing in its 2004 financial statements), the Claimant decided to account for the transaction in 2004 and thus used an unexecuted version of the SPA concluded with Awyn on 18 May 2005, now carrying the date of 1 March 2004, to present for accounting purposes. The Claimant submits this was entirely legal pursuant to German law. Thus, while the annual reports of InterTrade reflect a sale of the shares in the year 2004, this was merely an accounting fiction, the real date of sale being 18 May 2005. The Claimant explains that the sale transaction was thus "split" over two fiscal years, such that the sale was recorded in fiscal year 2003/2004 and the receivable against Awyn was booked in this year, but payment of the receivable from Awyn was recorded in fiscal year 2004/2005. The Claimant confirms that this "split" was nonetheless initiated after the sale of CE Wood on 18 May 2005, and finalized when Mr. . InterTrade's tax adviser, filed the company's financial statements on 30 June 2005 (see Cl. PHB, paras. 18-21).

b) *Jurisdiction Ratione Materiae*

94. The Claimant contends that the Tribunal has jurisdiction over its claim pursuant to Article 1 of the German-Czech BIT, as InterTrade is an "investor", as that term is defined in Article 1(3) of the BIT (being a limited liability company incorporated under the laws of Germany with its seat in Germany) with an "investment", as that term is defined in Articles 1(1)(b) and (c) of the BIT (*i.e.* "shares and other kinds of participation in companies", "claims to money that has been used to create economic value", and "claims to services that have economic value and are related to an investment"). The Claimant rejects the proposition that any additional elements or criteria are required in order to satisfy the definition of an investment under the German-Czech BIT. Nonetheless, it submits that it has made a substantial commitment of capital by investing more than (see Statement of Claim, para. 126).

95. As regards the Respondent's interpretation of Article 1(1) of the German-Czech BIT, the Claimant avers that the treaty in evidence is the official UN translation of the BIT, as contained in the UN Treaty Series, and, in any event, the Respondent's proposed alternative interpretation of the treaty is either nonsensical or no more correct than that translation (see Cl. PHB, paras. 31-39).

96. As regards the Respondent's challenge concerning the validity of the share transaction for the share purchase in CE Wood, the Claimant explains that InterTrade entered into an SPA with EPAS on 3 September 2000 for the purchase of shares in EP Kapital (see Exh. C-12). The purchase was financed through a promissory note secured against the personal assets of Mr. the owner and managing director of InterTrade. As payment for the shares was not effected immediately, InterTrade entered into a custody agreement with Allwood, a.s. ("Allwood"), on the same date (see Exh. C-61). Thus, while the shares were legally transferred to the Claimant on 3 September 2000, they were held in trust by Allwood pending payment.

97. The Claimant explains that the shares in EP Kapital were released to InterTrade by Allwood in January 2001, following a series of transactions the effect of which was to set off payment against the full amount of the promissory note (see Statement of Reply, para. 15):

> "On 31 January 2001, InterTrade purchased from Allwood a receivable against EPAS worth CZK . At the same time, InterTrade also purchased a receivable from EP Kapital against EPAS over the amount of CZK. Both of these transactions were financed through promissory notes. Consequently, the claim which EPAS had against InterTrade for payment of the purchase price for the shares was set off against the receivables against EPAS which InterTrade had purchased. InterTrade no longer owed money to EPAS, but to Allwood and EP Kapital stemming from the purchase of the mentioned receivables. Therefore, also on 31 January 2001, InterTrade and EPAS signed an agreement stating that each party's claim against the other party shall be considered paid. Hence, InterTrade no longer owed money to EPAS for the purchase of the shares. Having thus fulfilled its payment obligation, it received the shares, which it had purchased, out of Allwood's custody." [footnotes omitted]

98. The Claimant rejects the proposition that the acquisition of assets under the German-Czech BIT must be financed in a particular way, pointing to the tribunal's analysis in *Saluka Investments Ltd. v. Czech Republic*, UNCITRAL, Partial Award (17 March 2006) ("*Saluka*") among other cases, where the investor's share purchase in a Czech company was financed through the exchange of promissory notes (see Statement of Reply, para. 72, quoting *Saluka*, paras. 205 and 211).

c) *The Investment Was Made in Good Faith*

99. The Claimant contends that the Respondent's "fraud theory" turns on the idea that EPAS was deprived of its "most valuable asset" (*i.e.*, EP Kapital), in a transaction among "business friends", for inadequate consideration. However, it alleges that the Respondent has disingenuously withheld evidence of the due diligence conducted by InterTrade into the EP Kapital's financial results, produced by the Claimant during the document discovery phase, as well as a portion of a valuation report commissioned by EPAS which found CE Wood's value to be substantially negative (see Cl. Reply PHB, paras. 42-45). The Claimant submits that, in raising this argument, the Respondent itself is guilty of severe procedural misconduct.

3. Discussion

100. As indicated above, the Respondent's jurisdictional challenge evolved over the course of these proceedings. The Tribunal addresses below those arguments in which the Respondent has persisted, namely jurisdiction *ratione temporis*, jurisdiction *ratione materiae*, and the existence of a "good faith" investment. It no longer appears to be

disputed that the Claimant is an "investor" within the meaning of the German-Czech BIT. For the avoidance of doubt, however, the Tribunal finds that the Claimant is and was at all material times an investor of a Contracting State within the meaning of the BIT.

a) *Jurisdiction Ratione Temporis*

101. The central issue related to jurisdiction *ratione temporis* is when the Claimant sold its interest in CE Wood. The Respondent contends that the Claimant sold its shares in CE Wood in June 2004, several months before the alleged wrongful acts occurred. The Claimant submits that it did not sell its interest in the company until June 2005, several months after the tenders.

102. The Tribunal's review of the evidence supports the finding that the Claimant sold its shares in 2005, after the tender proceedings in respect of which the Claimant complains. Beginning with the share transfer operation, the evidence of a Czech entrepreneur, is that he negotiated the purchase of the CE Wood shares from InterTrade on behalf of Awyn. There is undisputed evidence that first met at the end of 2004 (see Second Witness Statement of para. 2; Tr., Day. 2, pp. 146:24 – 147:5, 151:4 – 14). and both testified that the SPA was entered into on 18 May 2005 (see Second Witness Statement of , para. 4; Tr. 2, 163:18 – 20). The signed version of the SPA in evidence is dated 18 May 2005 (see CB-128, Exh. C-44). Other contemporaneous documents on the record indicate that payment for the shares was received on 29 June 2005 (see Exh. C-73) and the shares were transferred approximately one week later, on 8 July 2005 (see Exh. C-74).

103. This evidence alone is sufficient, in the Tribunal's view, to establish jurisdiction *ratione temporis*. However, there are other indicators which also support this finding. For example, on 10 November 2004, CE Wood's lawyer at the time wrote to LČR and advised it that InterTrade was the sole shareholder of CE Wood (see CB-62, Exh. R-47). There is also evidence that InterTrade, as shareholder, approved the CE Wood annual report in May or June 2005 (see Second Witness Statement of . para. 3).

104. The only inconsistency in the evidence is the existence of the 2004 SPA and the corresponding references to a sale in the InterTrade financial statements. The Parties agree that the 2004 version of the SPA was used by . InterTrade's tax advisor,

in the preparation of InterTrade's financial statements for the 2003-2004 and 2004-2005 fiscal years. It is undisputed that the financial statements for InterTrade which indicate that the sale of shares occurred in 2004 were prepared in 2005 and dated 30 June 2005 (see CB-132). The financial statements are thus not contemporaneous evidence that the sale took place in 2004. The alleged use of a backdated contract is consistent with the Claimant's chronology of events and the booking of the sale in the 2004 financial year does not necessarily mean that the sale took place that year. The Claimant has provided evidence as to why this inconsistency exists. testified that he did not want to have the books display negative capital for the years in question, which would have resulted from the exchange rate variability (see Tr. Day 2, pp. 34-36). explanation shows a lack of business experience or sophistication, but not, in the Tribunal's opinion, an intention to deceive either the tax authorities (as no negative tax consequences flowed from the way the sale was booked) or the Tribunal.

105. What is disputed is whether the 2004 SPA was the operative sale agreement, *i.e.* that it is evidence that InterTrade sold the shares in 2004 and not 2005. The Respondent has focused on two aspects of the 2004 SPA to reinforce its position that the shares were sold in 2004: (1) the payment structure and (2) references to the so-called "Savino Report". The Respondent has also complained that the 2005 SPA in evidence does not attach the appendices listed in that document, *i.e.*, the Receivable and the (first) Savino Report. With respect to this last point, the Tribunal notes that there is a version of the Savino Report in evidence, which the Claimant says is the report referenced in the SPA.

106. With respect to the payment structure in the 2004 SPA as compared to the 2005 SPA, this issue was only raised on cross-examination with who confirmed that the payments made by Awyn were consistent with the 2004 SPA payment structure. The Respondent did not ask about the different versions of the agreement or why he made the payment in two instalments and not three. Unfortunately, the Claimant did not address this issue on re-direct examination with . However, the Claimant states that backdated the agreement and made the payments consistent with the actual payments, one of which had already been made and the other which was made at about the same time that was given the 2004 SPA, in order "to harmonise the 1 March 2004 document with the two payments which would see when

reviewing the financial statements for the financial year 2004/2005" (see Cl. Reply PHB, para. 11; Resp. PHB, para. 66). Once again, this decision indicates a lack of business sophistication, but the Tribunal finds explanation consistent with the Claimant's overall sequence of events and the other contemporaneous evidence.

107. In focusing on the payment structure in the agreements, the Respondent also disregards the deadlines in Section 4.2. The Respondent would like the Tribunal to infer that because the actual payment amount transferred in June 2005 corresponded to the receivable amount less a deposit of which was required only under the 2004 version of the SPA in evidence, the shares were sold in 2004. However, that same version of the SPA requires that those payments be made no later than 31 December 2004 and 28 February 2005, respectively. Specifically, Section 4.2 of the 2004 SPA provides (see CB-46):

> "Terms of Payment
>
> 4.2 The Buyer shall procure and the Seller shall accept that the Consideration to the conditions given in this agreement shall be paid to the Seller.
>
> 4.2.1 The Payment of the first instalment of the Consideration by assignment of the Receivable and the set-off shall be executed by the Parties in agreed form not later than on 15 July 2004.
>
> 4.2.2 The Payment of the second instalment of the Consideration shall be executed by the Buyer no later than on 31 December 2004.
>
> 4.2.3 The Payment of the third instalment of the Consideration shall be executed after the closing of Due Diligence of the Company by the Buyer, however, no later than on 28 February 2005.
>
> 4.2.4 Should the Buyer withdraw from the Agreement (without being entitled to do so according to the Agreement), then the amounts paid by the Buyer as instalments under clause 4.1 here above shall not be paid back to the Buyer but remain with the Seller as penalty for Buyers withdrawal from the Contract." (emphasis added)

108. Neither party has addressed this inconsistency. It begs the question: if the Claimant sold its shares in 2004, why would it have waited until mid-2005 for payment? The timing of the payments is consistent with the 2005 version of the SPA, which required payment "not later than on 30 June 2005". Specifically, Section 4.2 of the 2005 SPA provides as follows (see CB-128):

> "Terms of Payment

> 4.2 The Buyer shall procure and the Seller shall accept that Consideration shall be paid to the Seller at terms as set out hereunder.
>
> 4.2.1 The Payment of the first instalment of the Consideration by assignment of the Receivable and the set-off shall be executed by the Parties in agreed form not later than on 30 May 2005.
>
> 4.2.2 The Payment of the second instalment of the Consideration shall be executed by the Buyer not later than on 30 June 2005.
>
> 4.2.4 Should the Buyer withdraw from the Agreement without being entitled to do so according to this Agreement, then amounts paid by the Buyer as instalments under clause 4.1 here above shall not be paid back to the Buyer but remain with the Seller as penalty for Buyers withdrawal. [sic]" (emphasis added)

109. As noted above, payment was made on 29 June 2005 and the shares were transferred on 8 July 2005.

110. The Respondent attempts to challenge the timing of the Savino Report referenced in the SPA, an Italian language document prepared by an Italian consulting firm. The Parties agree that the version of the Savino Report in evidence was prepared in August/September of 2004. The Respondent claims, however, that this version of the Savino Report was not the first, but rather the second due diligence report contemplated by the SPA. That is, the Savino Report in evidence was not the Savino Report referenced in the SPA as having been provided to the buyer and attached as an appendix to that document. If the report in evidence is the second due diligence report, this still does not explain why the Claimant would sell its shares in CE Wood for instead of the "maximum amount for the disposal value of the entire stake of the company" recommended in the Savino Report, which the Claimant had seen (see CB-77 (Savino Report), p. 59). This valuation is consistent with the value of CE Wood before the tender process and is consistent with it having been drafted in August/September of 2004. The recommended sale price is not consistent with a sale transaction that occurred in 2004.

111. The Respondent also argues that the "Claimant's case is that – rather than Mr. – was the potential purchaser of CE Wood in August 2004." (see Resp. Reply PHB, para. 36). However, this is clearly not the Claimant's case. In making this argument, the Respondent appears to conflate the sale of the InterTrade receivable by Mr.

to with the sale of InterTrade's shares in CE Wood. evidence, which was not challenged by the Respondent, was that he purchased the receivable in January 2004 from , but did not meet before December 2004, and negotiated the purchase of the CE Wood shares on behalf of Awyn in May 2005. was not, and was not alleged by the Claimant to be, the potential purchaser of the CE Wood shares in August 2004. It is also illogical to think that a due diligence report commissioned by or written for him would have been done by an Italian firm and drafted in Italian. The evidence indicated that Mr. had personal knowledge of CE Wood's operations from his affiliations with Czech consultants, which would have been better placed to provide a due diligence report on a Czech company to a Czech national. It is more likely, in the Tribunal's view, that an Italian businessman (now deceased) with commercial interests in the Czech Republic, was responsible for commissioning the Savino Report.

112. The Respondent has sought to expose what it considers to be inconsistencies in the two versions of the SPA in evidence to found its jurisdictional argument. However, it has not provided a coherent alternate theory or timeline that would result in a finding that the Claimant sold its shares in CE Wood before the bidding process in January 2005. The totality of the evidence in the record, including the two versions of the SPA, written and oral witness testimony, and other contemporaneous documents support the Claimant's version of the events. Moreover, the Claimant has provided a plausible explanation for the one inconsistency in its version of events, *i.e.*, the sale being booked in the financial statements for 2003-2004. Accordingly, the Tribunal dismisses the Respondent's objection to the Tribunal's jurisdiction *ratione temporis* over the dispute.

b) *Jurisdiction Ratione Materiae*

113. The crux of the Respondent's second objection to the Tribunal's jurisdiction appears to be the structure of the share transaction in which the Claimant acquired its interest in CE Wood and the absence of any capital infusion in the Czech Republic as a part of that transaction. While the Respondent's interpretation of what is required to qualify for investment protection under the terms of the Germany-Czech BIT has evolved over the course of these proceedings, it has consistently sought to impugn the Claimant's alleged

investment on the basis that no money nor any physical asset was brought into the Czech Republic by the Claimant.

114. The Respondent raised for the first time in its post-hearing submissions questions concerning the proper translation of the German-Czech BIT in evidence in these proceedings. In its view, the definition of investment under the BIT turns on whether a "contribution" was made in the territory of the Czech Republic. The UN Treaty Series translation of the BIT has been on the record since October 2008 when the Respondent was served with the Claimant's Request for Arbitration. Article 10 of the BIT establishes that disputes between "either Contracting Party and an investor of the other Contracting Party regarding investments shall, as far as possible, be settled amicably between the parties to the dispute", failing which the dispute may be submitted to arbitration.

115. Article 1 of the BIT, which contains the relevant definition of an "investment", states:

> "For the purpose of this Treaty
>
> (1) The term 'investments' comprises all kinds of assets that are invested in accordance with domestic legislation, particularly:
>
> (a) Movable and immovable property as well as any other rights *in rem* such as mortgages and liens;
>
> (b) Shares and any other kinds of participation in companies;
>
> (c) Claims to money that has been used to create economic value or claims to services that have economic value and are related to an investment;
>
> (d) Intellectual property rights, including, in particular, copyright, patents, registered designs, industrial designs and models, trademarks, trade names, technical processes, know-how and goodwill;
>
> (e) Concessions under public law, including concessions for prospecting and exploitation.
>
> (2) The term 'returns' refers to amounts yielded by an investment such as profits, dividends, interest, royalties or other remuneration;
>
> (3) The term 'investor' refers to an individual having a permanent place of residence in the area covered by this Agreement, or a body corporate having its registered office therein, authorized to make investments." (emphasis added)

116. The Respondent suggests that "invested" ought to be replaced with "contributed". It argues that its interpretation is reinforced by the definition of "returns" in Article 1(2) of the BIT, reasoning that if Article 1(1) were interpreted to provide for the "usual" broad definition it would include returns and Article 2(3), which provides that both "investments" and "returns" are protected under the terms of the BIT, would be redundant.

117. Despite the Respondent's argument that the Czech language version of the BIT would more appropriately be translated by replacing the term "invested" with "contributed", it has adduced no evidence to this effect. Nor has it adduced evidence that the German language version of the BIT is open to two different interpretations, *i.e.* either "invested or "contributed". The Claimant acknowledges that the German language version of the BIT is open to several possible interpretations, including the following: "the term 'investments' comprises all kinds of assets that are placed/made in accordance with domestic legislation ..."; however, it avers that "contributed" is no more appropriate a translation of Article 1 than "invested".

118. The Tribunal is not persuaded that the term "contributed" best or better reconciles the Czech and German texts of the BITs, nor does it see a redundancy in the terms of the BIT, as they appear above. The BIT appears to embrace a broad range of economic activities. The preamble to the BIT recognizes "that the promotion and reciprocal protection of investments serve to strengthen all forms of economic initiative, particularly in respect of private enterprise". It does not follow from this and the definition of "investments" in Article 1 that the Contracting Parties intended to restrict the protection of investments in the manner suggested by the Respondent.

119. In any event, the Respondent's linguistic arguments appear to be dressing for a deeper point that meaning must be given to the full definition of investment which would, in the Respondent's view, require more than a "mere holding of assets" to qualify for protection (see Resp. Reply PHB, para. 41). This squares the circle in the Respondent's theory that the Claimant must have invested or contributed an asset in the territory of the Czech Republic and, by structuring the share transaction as it did (characterized by the

Respondent as a "dummy" transaction), the Claimant has foreclosed recognition of its transaction as a protected investment.

120. The Tribunal does not agree, for the reasons expressed above, that the German-Czech BIT requires more than a holding of assets in order for an investment to benefit from the treaty's protection. However, the Claimant must demonstrate that it did, in fact, acquire shares in a Czech company in order to ground the Tribunal's jurisdiction over the subject matter of the dispute, and this requires detailed consideration of the share purchase transaction. The Claimant submits that it acquired the shares in CE Wood, a Czech company, from EPAS on 3 September 2000 pursuant to an Agreement on Transfer of Shares and a protocol thereto, which confirmed the transfer of the shares to a custodian (Allwood) pending payment of the purchase price for the shares. The purchase price was subsequently satisfied through the acquisition by the Claimant of two receivables from EPAS. As far as the Claimant is concerned, this is the end of the story.

121. The Respondent, however, divides the share transaction into two parts for the purpose of its jurisdictional analysis, the above transaction, in its view, constituting only one part of the entire transaction (see Resp. PHB, para. 86):

> "*The first part*, in which Exportní transferred the CE Wood shares to Claimant, and Claimant's payment obligation to Exportní was set-off against receivables that Claimant acquired from two of Exportní's subsidiaries; and
>
> *The second part*, in which two new substitute receivables against Claimant were 'parked' in non-transparent, off-shore structures and ultimately cancelled in a second set-off, when Claimant sold the shares to the same entity that held the substitute receivables against Claimant."

122. Beginning with the first part of the transaction, the Agreement on Transfer of Shares, dated 3 September 2000, provides as follows (see JB-3):

> "1. **Exportní průmyslová, a.s.**, with the registered office at Prague 6, Šlikova 18, Company ID No. 25136551, represented by the Chairman of the Board of Directors, Ing. (hereinafter referred to only as the "Transferor")
>
> 2. **InterTrade Im-& Export Beteiligungs-GmbH**, with the registered office at 53783 Eitorf, Am Hagen 37 b. The company is registered in the Commercial Register at the District Court of Siegburg under No. 51.68, represented by the company's executive (hereinafter referred to only as the "Transferee").

I.

The Transferor is the owner of of the EP Kapitál Group, a.s. company [eventually CE Wood], with the registered office at Zlín, Kvítková 4703, Company ID No.: 60745479. They are documentary ordinary bearer shares having the nominal value of

II.

The Transferor transfers by this Agreement the above documentary securities to the Transferee and the Transferee accepts these documentary securities.

III.

The Parties hereby agree the purchase price for the transfer of the above securities in the amount of "

IV.

The Parties hereby agree the right of the Transferor to withdraw from this Agreement, namely unilaterally, by 31 Nov. 2000 at the latest. The Transferor has reserved this right due to the intention to perform the valuation of the transferred shares based on an expert opinion.

The Parties hereby agree the due date for the purchase price to be by 31 Jan. 2001. The payment of the purchase price can be made also by offsetting receivables, if the purchaser buys receivables in respect of the seller of the companies ALLWOOD, a.s., EP Kapitál Group, a.s. and potentially of other companies. Unless a physical payment of the purchase price (including a bank transfer) is made, it is necessary to offset the purchase price, as the priority, against a receivable of the ALLWOOD, a.s. company in respect of a repayment of loans in the nominal value of over and only in case of the full payment of ALLWOOD's receivable, it is possible to make an offset against receivables of other companies.

...".

123. In his written and oral evidence, acknowledged that Exportní wished to sell its interest in EP Kapital Group as a result of financial difficulties, effectively to improve its balance sheet (see First Witness Statement of , para. 12; Second Witness Statement of I. Doubrava, para. 1; Tr Day 3, p. 161). testified during the Hearing that Exportní obtained a valuation opinion of the shares in EP Kapital Group, consistent with Article IV of the Agreement, from a company called A-Consult, which opined that EP Kapital had, at the time, a negative value of approximately 178

million Czech crowns, thereby reducing the value of its shares to zero (see Tr. Day 3, p. 156). also testified that, perhaps not surprisingly, EPAS was turned down by several potential buyers of the shares before it eventually entered into the Agreement with InterTrade (see Tr. Day 3, p. 161).

124. Mr. Clokey, the Respondent's quantum expert, who had questioned the arm's length quality of the transaction, agreed on cross-examination that the seeming incongruency of paying , for an entity with a negative value may be explained where an investor has reason to believe that an opportunity to make money through the transaction will materialize (see Tr. Day 5, pp. 86-87):

> "Q. ... Respondent has repeatedly argued that the would have been a genuine price if they had been paid out in cash to the seller, which was EPAS, the parent company of EPKG at the time. But this is not what happened, economically or factually or legally speaking. It was an assumption of debt by InterTrade vis-à-vis the company by a series of transactions. And therefore what respondent says is : this is in fact, if you want, not a cash payment; it's merely an assumption of debt.
>
> And what I am trying to put to you is: if a company can invest in the form of an assumption of debt, and that debt is with the target company it acquires, then would you look at it differently, that is if it has to hand out, as you said before, of cash to the seller?
>
> ...
>
> A. Yes. So if we are in a world of assumption of debt, if you've got exposure to this situation, I mean, there's like a host of facts that lie around the decision.
>
> Okay, so if I can swap of debt into this entity, into control of this entity, I am left with a view of – yes, in a limited liability world, the sort of hypothesis is not that you are buying a bucket with minus in it. So it could be that if I swap a debt for control of the entity, well, I've got the opportunity if something good happens, I might get some money back. But if I am owed by someone that's worth minus , I might think: well, my isn't worth very much".

125. This appears indeed to have been one of the factors in the Claimant's decision to purchase EP Kapital's shares, as explained by (see First Witness Statement of para. 5):

> "I started to deal with EP Kapital Group in 2000. My father told me that Exportní Průmyslová is going to sell EP Kapital Group. He brought the files of the group's results and asked me to analyse them. I analyzed the results for 1997-1999 and the actual numbers for 2000. Based on the Du-Pont analysis and benchmarking of companies within the group, we

could see easily that there are big differences in generating operating profit and that the results are influenced by extraordinary expenses. These models are used also by banks to understand where the profits are coming from to see the potentials of a company and estimate the future of the company. My conclusion was that the company had a chance to generate significant cash flows from operating business to cover its debt and to increase value. However, we would need some time to finance the deal. Because it was not possible and Exportní Průmyslová had to sell, my father came up with the idea to ask for a payment condition of weeks to secure financing and secure the purchase through a promissory note. It was usual at that time in the Czech Republic, because this is secured against all personal assets of the issuer." (emphasis added)

126. The evidence indicates that the share transfer was secured by a promissory note from (see e.g., Second Witness Statement of , para. 1; see also Tr. Day 2, p. 46 ; Tr. Day 3, p. 162). The Respondent makes issue of the fact that the promissory note is not in evidence in these proceedings. In his written evidence, explained that the note was destroyed once the debt vis-à-vis EPAS was settled (see Second Witness Statement of , para. 1):

"In light of the doubts which have been raised by Respondent in these proceedings in this regard, I herewith confirm that the purchase of the shares of the company EP Kapital Group from EPAS was financed with a promissory note over This promissory note made me liable with all my personal assets in Germany for the payment of the purchase price to EPAS. After the debt vis-à-vis EPAS had been settled, the promissory note was destroyed. Neither the original nor any copies are today in my possession."

127. This was confirmed by at the Hearing (see Tr. Day 2, p. 46):

"A. Yes, the promissory note was used as a security during the purchase. And after the purchase was done, my father received this promissory note in return, and the promissory note was destroyed, because it was a private document which had only been used as a security for this operation."

128. Following s testimony, the Respondent elected not to call who could have been examined on this first part of the share transaction, including the use (and existence) of a promissory note to secure the share purchase (see Tr. Day 2, p. 138). The Tribunal does not, in any event, consider it unusual for a promissory note to be destroyed once its purpose has been achieved. The Tribunal therefore accepts the explanation for why the promissory note was destroyed and does not consider its absence in this proceeding to be fatal to the Claimant's claim.

129. The Respondent also makes issue of the fact that the shares were acquired through the mutual set-off of receivables when InterTrade acquired debt owing to EPAS's subsidiaries, CE Wood and Allwood, rather than through the payment of cash (see CB-65 and CB-66; Tr. Day 2, p. 79). explained on cross-examination during the Hearing that (see Tr. Day 3, p. 163):

> "... we were looking for someone and we found someone who was willing to buy, to buy a company that had a problematic value. We had to allow for the consideration for the payment to be done through getting out of debt rather than through cash. For us, that had the very same value, because we in that way were able to get rid of that debt."

130. also explained on cross-examination that InterTrade had initially considered financing the acquisition of shares in order that it could pay cash, as this would ultimately have assisted EP Kapital, but decided against this approach when it "became clear that we could also operate EP Kapital without investing the money" (see Tr. Day 2, p. 82).

131. As with the Claimant's purchase of shares in EP Kapital, the acquisition of EPAS's receivables with CE Wood and Allwood was secured against two other promissory notes, neither of which has been produced in this proceeding. 's explanation for their absence among the documentary materials on the record is that they were immaterial from a financial point of view, as it was "irrelevant whether the liability took the form of a promissory note or not". Moreover, he averred that he did not decide which documents were placed on the record and which were not (see Tr. Day 2, p. 52).

132. While the absence of a "paper trail" is unfortunate insofar as understanding the chain of events is concerned, the Tribunal does not consider it to be determinative of the existence of an investment and therefore the question of jurisdiction. Moreover, the Respondent has failed to establish that the evidence is inconsistent with the Claimant's version of events or that lacunae in certain documentary evidence is the result of a deception.

133. As noted above, the Respondent nevertheless alleges for the purpose of establishing a protected investment that there are, in effect, two parts to the transaction, the second part involving a "journey around the world" by the receivables that InterTrade acquired to set off its payment obligation for the shares (see Resp. PHB, para. 100). The Respondent notes that the assignment agreements provided for payment of the receivables by 31 July 2002, failing which the assignments would become null and void. The Respondent

contends that payment was not made until the end of 2003, and therefore the first part of the share transaction was invalid because the Claimant set off its obligation to pay for the shares with liabilities against EPAS that were null and void (see ibid., para. 102). The Respondent reaches this conclusion "as a matter of logic", reasoning that "otherwise the liability of the Claimant towards Allwood could not have been transferred by Allwood to Nauli AG in Nieu on 30 November 2003. Had the Claimant paid for its liability prior to 30 November 2003 it would have ceased to exist and could not have been assigned to Nauli AG." (see Statement of Rejoinder, para. 97).

134. The Claimant, in fact, acknowledged in its Statement of Reply that InterTrade remained indebted to Allwood until 30 November 2003, at which time Allwood sold its receivable against InterTrade to Nauli, a New Zealand company, and to CE Wood[2] until 18 December 2003, at which time CE Wood sold its receivable against InterTrade to CCR Iniziative Sagi, which sold the receivable on the same day to Nauli. Nauli subsequently transferred both receivables to General European Consulting, a company incorporated in the British Virgin Islands ("GEC"), on 12 January 2004. GEC then sold the receivables to Awyn on 27 January 2004 – the same company to which InterTrade eventually sold its interest in CE Wood (see Statement of Reply, paras. 16-17). This is, in effect, the "journey around the world" that the receivables took following their acquisition by InterTrade.

135. The question remains whether the lapse of the date for payment of the receivables with Allwood and EP Kapital voided or invalidated the Claimant's investment for the purpose of its BIT claim. The Claimant has provided a copy of the Agreement on Mutual Set-Off of Receivables, dated 31 January 2001, in which InterTrade and EPAS agreed "the mutual set-off of receivables ... by which the receivables referred to ... become void in their entirety." The receivables in question were, respectively, InterTrade's payment obligation to EPAS for the shares it had received in EP Kapital and EPAS's re-payment obligation to its subsidiaries Allwood and EP Kapital in respect of loans it had received from them. There is no mention in the Mutual Set-Off Agreement of the payment

[2] It is recalled that EP Kapital and CE Wood, a.s., merged on 9 December 2003, taking the name CE Wood.

obligation in the assignment agreements. No evidence was adduced to the effect that those receivables reverted to EPAS or formed part of its eventual bankruptcy. Rather, the conduct of all relevant parties to the acquisition and sale of the shares in CE Wood collectively suggests that the Claimant did in fact acquire the shares in CE Wood at the time it has alleged and, as discussed above, sold those shares at the time it alleged.

136. Thus, while the matter is not without some doubt, the Tribunal does not believe that the absence of an explanation in respect of the date for payment of the assigned receivables voided its investment for the purpose of its BIT claim. The Tribunal agrees that the Claimant holds the burden of proving its claim, as well as establishing the Tribunal's jurisdiction over that claim. However, the standard of proof in investment treaty cases is not a criminal standard, *i.e.* beyond a reasonable doubt. The Tribunal must be satisfied that an investment was made within the meaning of the German-Czech BIT. Based on the totality of the evidence put before the Tribunal, the Tribunal finds that the constituent elements of an investment pursuant to Article 1(1)(b) of the BIT are present (*i.e.*, evidence that shares in a Czech company were acquired by the Claimant pursuant to an agreement for that purpose) and the Respondent has not persuaded the Tribunal that any apparent inconsistency in the date of payment of the assigned receivables and the date provided for in the assignment agreements is sufficient, in this case, to nullify that investment.

c) *An Investment Made in "Good Faith"*

137. The Respondent's third objection to the Tribunal's jurisdiction was made only in its post-hearing submissions and is based on the premise that an investment must be made in good faith in order to benefit from the protection of an investment treaty. The Tribunal takes no issue with the general principle of international law that, in order to benefit from investment protection, an investment must be made in good faith. As the Tribunal in *Gustav Hamester* observed, this is a general principle that exists independently of specific language to this effect in the treaty (see *Gustav Hamester*, para. 124).

138. While the Tribunal agrees with the Respondent that proving fraud can be difficult, the Respondent must marshal sufficient evidence of its so-called "badges of fraud" to persuade the Tribunal that an existing investment should nevertheless be denied

protection under the BIT. In this case, the Tribunal is not satisfied on the evidence before it that the Claimant's investment was fraudulent or otherwise not made in good faith. Accordingly, this last objection is also dismissed.

4. Finding

139. Based on the foregoing, the Tribunal concludes that it has jurisdiction over the Claimant's claims made under the German-Czech BIT.

B. *Attribution*

1. The Claimant's Position

140. The Claimant sets out both a domestic and international law basis on which to find the acts and omissions of LČR attributable to the Czech State.

141. The Claimant notes that, pursuant to Article 49 of the Forestry Act, the Ministry of Agriculture is the "central body of State forest administration" and, as a part of this function, "manage(s) the exercise of State forest administration" and supervises "compliance by State administration bodies, individuals and legal entities" with the provisions of the Act. LČR was established as a special purpose public entity pursuant to the Act on State-Owned Enterprises to meet the "societal, strategic or publicly beneficial interests" of the Czech State as defined in its "Foundation Decree" issued by the Ministry of Agriculture (see Exhs. C-77 and C-78). On the basis of this legislative and regulatory framework, the Claimant asserts that LČR was controlled at all relevant times by the Ministry of Agriculture.

142. Turning to international law principles of State responsibility, the Claimant submits that LČR's acts and omissions are effectively those of the Ministry of Agriculture, and therefore the Respondent is responsible by virtue of Articles 4, 5, 8 and/or 11 of the International Law Commission's ("ILC") Articles on Responsibility of States for Internationally Wrongful Acts, 2001 ("**Articles on State Responsibility**"). The Claimant avers that while it has acknowledged LČR is not an organ of the State for the purposes of Article 4(2), the Czech Republic nonetheless incurred responsibility under this provision with regard to the Ministry of Agriculture whose acts and omissions are attributable to the Czech State as an organ of the State.

143. The Claimant thus articulates the legal relationship for attribution purposes between LČR and the Ministry of Agriculture as follows (see Statement of Reply, paras. 141-142):

> "According to internal statements on this point within the Czech Republic, the tender which was organized and conducted aimed at a fundamental restructuring of the way the Czech forests were handled. [illegible] the Minister of Agriculture made various statements in this regard. According to Respondent's own words, this was a "change of paradigm" seeking to remedy a situation which was "unsatisfactory both in the light of antimonopoly legislation and economic effectiveness, and in the light of European law". The purpose of the tender was, as also indicated in the Master Contract no. 122/04/2005 on the Supply of Comprehensive Forestry Activities, to conclude with the successful participant of the tender so that the activities will be "ensuring the optimal performance of all functions of forests", thereby complying with the NPF which declared that one of the priorities must be "forest management in accordance with principles of sustainable management – a fundamental strategic priority".
>
> Hence, the Ministry of Agriculture was the state organ responsible for the administration of the State forests and thereby exercises the right, but had also the duties as the owner of the forest, *i.e.* the Czech State. The tender organized and conducted in 2004/2005 concerned the State forests and their management and thus fell squarely into the responsibility of the Ministry of Agriculture whose actions and omissions are those of the Czech Republic. Consequently, the conduct of the tender concerning the State forests falls into the ambit of responsibility of the Czech Republic."

144. The fact that LČR was founded with the mandate to carry out the above tasks does not, in the Claimant's view, absolve the Ministry of its responsibility for the tenders and their conduct. The Claimant avers that it "is precisely the purpose and function of state-owned enterprises such as LČR, which do not own any assets in their own right, nor decide finally how to carry out their functions to relieve the Ministry from the burden of the day-to-day performance of these tasks" (see Statement of Reply, para. 143).

145. The Claimant also relies on the NKU Report, in which the Supreme Audit Office concluded (see Cl. PHB, para. 131, quoting the NKU Report, Exh. R-49 / CB-78, p. 34):

> "• 'Another reason for the deficiencies determined in LČR was failure to conscientiously meet the obligations which ensue to MAg as the founder of LČR on the basis of the state enterprise act:
>
> ▪ insufficient inspection on the part of MAg concerning whether the requirements of the state safeguarded by LČR through its activity were being secured purposefully and economically:

- upon handling of certain assets MAg did not verify whether LČR was concluding contracts in accordance with the submitted proposal,
- MAg did not conduct any inspection in the period from 2001 to 2003 focusing on the area of business contracts or LČR's handling of temporarily free financial resources;
- Insufficient co-operation of MAg and the supervisory board of LČR;
- MAg did not evaluate how its appointed members of the SB [Supervisory Board] were representing the interests of the state;
- the SB did not find any fundamental deficiencies in the activity of LČR during the inspected period."

146. Finally, the Claimant observes that the Czech Chamber of Deputies adopted a resolution on 16 April 2010, in which it "calls on the government to, with regard to the tender for the performance of forestry activities with the sale of standing timber: 1. Cancel this tender of Lesy Ceske [R]epubliky [...]" (see Statement of Reply, para. 143).

147. As regards Article 5 of the Articles on State Responsibility, the Claimant submits that attribution turns on a "structural" and "functional" test. In terms of the "structural test", or whether LČR was empowered to exercise elements of governmental authority, the Claimant relies upon the Foundation Decree (see Exh. C-78), the Respondent's expert's assessment of LČR's activities and its role in the NFP as evidence that LČR was empowered to exercise elements of governmental authority. As regards the "functional test", or whether LČR exercised governmental authority when undertaking the acts complained of, the Claimant underscores the findings of the EC as set out in its 2007 Reasoned Opinion (see Exh. C-17):

> "LESY CR state enterprise was established to fulfil the state's interest in maintenance, protection and recovery of the forests. It is true that LESY CR state enterprise also performs planting and cutting activities that potentially lead to the sale of wood. These activities are necessary for fulfilling the tasks required by the state and therefore cannot be the primary reason for which LESY CR state enterprise was established."

148. The Claimant submits that the tender proceedings were organized and executed within the context of LČR's purpose to "meet important societal, strategic or publicly beneficial interests", the forestry sector involving one of the State's most important resources and the tenders for new forestry contracts directly implicating the public interest. The Claimant thus describes the assignment of silvicultural contracts as an important part of LČR's responsibility under the NFP to properly and sustainably manage the State forests.

149. The Claimant adds that any commercial contract concluded by LČR had to be approved by the Ministry of Agriculture. Accordingly, it reasons that LČR's business activities, even when carried out by way of commercial relationships, "warrant the State's interests" (see Statement of Reply, para. 154).

150. The Claimant distinguishes the cases relied upon by the Respondent, referring the Tribunal instead to *R.F.C.C. v. Morocco*, ICSID Case No. ARB/00/6 Award (22 December 2003) ("*R.F.C.C.*") and *Salini Costruttori S.p.A. et al. v. Morocco*, ICSID Case No. ARB/00/4, Award on Jurisdiction (23 July 2001) ("*Salini*"), which it submits deal with the parallel factual situation of tender proceedings. The Claimant also refers the Tribunal to the following discussion in *F-W Oil Interests, Inc. v. Republic of Trinidad and Tobago* (see Cl. PHB, para. 158, quoting *F-W Oil*, para. 203):

> "The Tribunal thus observes that, where the operation of a State enterprise is at the core of an international dispute, it is theoretically possible that the enterprise's conduct (acts and omissions) may engage the responsibility of the State either as an organ of the State; or as a body exercising elements of the governmental authority of the State; or as a body which is in fact acting on the instructions of the State, or under its direction or control (ILC draft Articles 4-8). There is in other words a whole gamut of possibilities, whose application to particular situations depends upon an amalgam of questions of law and questions of fact which will vary from case to case according to the circumstances. The internal law of the State will be the starting point, but not the end point. One obvious example may suffice, namely the question whether a State enterprise is or is not exercising the elements of the governmental authority; [...]. The Tribunal notes that the draft Articles contain no definition of the broad notion of 'elements of the governmental authority' (any more than does the BIT for the equivalent phrase 'other governmental authority delegated to it'). Indeed the ILC consciously refrained from including in the draft even elements towards defining its application in particular cases. Rather, the Commission took the view, as expressed in paragraph (6) of the Commentary to draft Art. 5, that the notion had to be judged in the round, in the light of the area of activity in question, and in the light of the history and traditions of the country in question. In short, the notion is intended to be a flexible one, not amenable to general definition in advance; and the elements that would go into its definition in particular cases would be a mixture of fact, law and practice. Moreover – and the point is of some importance – it is not the case that the same answer would necessarily emerge on every occasion; in some of its activities a State enterprise might fall on one side of the line, in others on the other."

151. Turning to Article 8 of the Articles on State Responsibility, the Claimant submits that "attribution under Article 8 is without prejudice to the characterization of the conduct

under consideration as either sovereign or commercial in nature. For the sake of attribution under this rule, it does not matter that the acts are commercial, *jure gestionis*, or contractual" (see Statement of Reply, para. 168, quoting *Bayindir v. Pakistan*, ICSID Case No. ARB/03/29, Award (27 August 2009) ("***Bayindir***"), para. 129).

152. Although the level of control required to satisfy Article 8 is not set out in the ILC's Articles, the Claimant refers to the tribunal's consideration of this criterion in *EDF Services Ltd. v. Romania*, ICSID Case No. ARB/05/13, Award (8 October 2009) ("***EDF***"), which in turn relied upon commentary to Article 8 (see Statement of Reply, para. 170, quoting *EDF*, para. 201):

> "Where there was evidence that the corporation was exercising public powers, or that the State was using its ownership interest in or control of a corporation specifically in order to achieve a particular result, the conduct in question has been attributed to the State."

153. The Claimant concludes that the Ministry of Agriculture is the founder of LČR and, by virtue of the State Enterprise Act, exercises considerable control over it and its performance. Moreover, as the Ministry initiated the tender proceedings, and was involved in all aspects of LČR's conduct at all relevant times, the Claimant contends this last hallmark of State responsibility is satisfied.

154. Lastly, the Claimant submits that , the Czech Minister of Agriculture in 2007, adopted LČR's conduct within the meaning of Article 11 of the Articles on State Responsibility through the following statement (see Cl. PHB, para. 168, quoting Exh. C-20 / CB-155):

> "The blame for the unfortunate state of affairs after the illegal tender proceedings is borne fully by my predecessors who reached a number of incorrect decisions. [...] The company is fully entitled to make such a claim."

2. The Respondent's Position

155. The Respondent contends that the acts of LČR are not attributable to the Respondent. The Respondent reasons that although the State founded LČR, the State and LČR, an enterprise, are two different legal entities. The Respondent analogizes this relationship to a person founding a trade company under the Commercial Code, or the state founding a joint-stock company. As such, the Respondent takes the position that the Czech State cannot incur responsibility for the acts of LČR under Article 4 of the Articles on State

Responsibility. Indeed, according to the Respondent, it is common ground among the Parties that LČR is not a State organ and Article 4 therefore has no application (see Resp. PHB, para. 126). The Respondent notes that its expert, Professor Černá, reached the same conclusion and her evidence has not been challenged by the Claimant.

156. Turning to the criteria under Article 5 of the Articles on State Responsibility, the Respondent reasons that the second criterion ("acting in that capacity [*i.e.* exercising governmental authority] in the particular instance") is dispositive. Relying upon the reasoning of the tribunal in *Gustav Hamester*, whereby the tribunal stated that it is "well established that for an act of a separate entity exercising elements of governmental authority to be attributed to the State, it must be shown that the precise act in question was an exercise of such governmental authority and not merely an act that could be performed by a commercial entity", the Respondent invites the Tribunal to reach the following conclusion in this case (see Statement of Rejoinder, paras. 28-29):

> "In fact acts of the same nature are being performed by commercial entities in the Czech Republic. As the Claimant has admitted in its Statement of Claim, private companies own 22-23% parts of the forests in the Czech Republic. Those companies are subject to the same laws as LČR regarding the forests (including the requirement to protect the forests) and they, too, hold tenders for third-parties to obtain forestry services contracts. As the tribunal in *Jan de Nul v. Egypt* held, "[i]n its dealing with the Claimants during the tender process, the SCA acted like any contractor trying to achieve the best price for the services it was seeking. It did not act as a State entity."
>
> That is *precisely* what Lesy CR did here. It acted like any contractor trying [to] achieve the best contract for the services it was seeking. It did not act as a State entity." [emphasis in the original; footnotes omitted]

157. As regards the influence that the State has on LČR, if any, the Respondent submits that, pursuant to the Act on State Enterprises (see Exh. C-77), a state enterprise handles assets without the direct interference of the State. The Respondent maintains that the State does not have the power to "impose an obligation on a state enterprise to act in a certain way, to influence tender documentation or to influence in any other way the manner of selection of contractual partners in the tender proceeding" (see Statement of Defence, para. 246). Moreover, as LČR is not tied to the State budget, the Respondent explains that the State does not guarantee payment of any damages caused by the illegal behaviour

of LČR (if any), nor of any mistakes that LČR may or may not have made in the tender proceedings.

158. The Respondent notes that, according to Article 12.1 of the Act on State Enterprises, the founder (*i.e.*, the Ministry of Agriculture), cannot act on behalf of LČR (see Resp. PHB, para. 135, quoting the Černá Expert Report, paras. 20-21):

> "By means of an exhaustive list the law only determines the decisions, which are in the founder's scope of authority. *The founder's scope of authority does not include giving orders to the Director on how to proceed in particular cases as regards the state enterprise's regular operation. Such an order is not binding for the Director.* The state (the founder) may influence the conduct of the state enterprise only by means of determination of the general framework, especially of the state enterprise's management rules. By means of refusing consent in the determined cases (see above) the founder may preclude the disposition of the property, which the enterprise is entitled to manage. *However, the founder may not command the Director of the state enterprise to dispose with the property in a certain way.*" (Respondent's emphasis)

159. Thus, as Professor Černá concluded in her expert report, "neither the State Enterprise Act ... nor special regulation on entering into contracts according to the Commercial Code or the Public Contracts Act grants the founder of a state enterprise the authority to intervene in the selection of a contractual partner or to determine terms and conditions of entering into a specific contract" (see Resp. PHB, para. 136, quoting Černá Expert Report, para. 56).

160. Turning to LČR's particular activities, the Respondent notes that the EC has, by a recent decision, exempted certain financial services in the postal sector in Italy from application of the Directive 2004/17/EC coordinating the procurement of procedures of entities operating in water, energy transport and postal services sectors. The Respondent reasons that it would be contrary to EU regulations if LČR were not treated in line with the rules of equal treatment and its acts were attributable to the Czech Republic.

161. The Respondent argues that *Jan de Nul N.V. v. Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Award (6 Nov. 2008) ("*Jan de Nul*") and *CSOB v. Slovakia*, ICSID Case No. ARB/97/4, Final Award (29 December 2004) ("*CSOB*"), demonstrate that even when a separate legal entity exercises certain governmental powers, its acts are not necessarily attributable to the State if those acts were connected only to commercial activities and not

to the exercise of its governmental powers. The Respondent relies on the following reasoning of the tribunal in *Jan de Nul* (see Statement of Defence, paras. 263-64, quoting *Jan de Nul*, paras. 169-170):

> "Consequently, the fact that the subject matter of the contract related to the core functions of the SCA, i.e., the maintenance and improvement of the Suez Canal, is irrelevant. The Tribunal must look to the actual acts complained of. In its dealing with Claimants during the tender process, the SCA acted like any contractor trying to achieve the best price for the services it was seeking. It did not act as a State entity. The same applies to the SCA's conduct in the course of the performance of the Contract.
>
> It is true though that the Contract was awarded through a bidding process governed by the laws on public procurement. This is not a sufficient element, however, to establish that governmental authority was exercised in the SCA's relation to Claimants and more particularly in relation to the acts and omissions complained of. What matters is not the 'service public' element, but the use of "prérogatives de puissance publique" or governmental authority. In this sense, the refusal to grant an extension of time at the time of the tender does not show either that governmental authority was used, irrespective of the reasons for such refusal. Any private contract partner could have acted in a similar manner." [footnote omitted]

162. Turning to Article 8 of the Articles on State Responsibility, the Respondent argues that the jurisprudence's interpretation of this provision of the Articles sets a demanding threshold, requiring both general control over the entity and specific control over the act in question (see Resp. PHB, para. 145). As in *Jan de Nul*, the Respondent submits there is no evidence of the State having given any instructions to LČR in regard to the acts and omissions complained of, emphasizing the following (see Statement of Rejoinder, para. 190):

> "- LČR is an independent legal entity separate from the State;
> - The State has no direct control over LČR's acts;
> - Non-commercial activities of the State are irrelevant in this case;
> - The nature of a State interest in a State enterprise is the same as interest of any other shareholder in a private business company;
> - State representatives have been aware that only the director of a State enterprise is responsible for running the enterprise and did not interfere with his rights of conducting LČR's business activities."

163. The Respondent submits that the evidence of both Parties' experts is consistent with the view that LČR had "freedom of autonomy" in establishing the terms and conditions of the tender (see Resp. PHB, paras. 146-147; see also Ramsauer Expert Report, p. 9 and Černa Expert Report, para. 21). This is buttressed by contemporary documents, such as

the minutes of the LČR Supervisory Board meeting held on 23 September 2004, in which the Ministry of Agriculture states that "how the tenders will take place is up to the State-owned enterprise [*i.e.* LČR]" (see Resp. PHB, para. 149, quoting CE-86/CB-57, p. 3).

164. In any event, the Respondent avers on the basis of the tribunal's reasoning in *Duke Energy*, that even when the State itself is acting, there can be no breach of a BIT if the State is acting as a "normal contract partner" and not using its "*imperium*" (see Resp. PHB, para. 151, quoting *Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award of 18 August 2008, para. 354).

3. Discussion

165. The Tribunal will now turn its attention to the issue of attribution. As noted earlier, the Claimant argues that the acts and omissions of LČR are attributable to the Czech State by virtue of Articles 4, 5, 8 and/or 11 of the Articles on State Responsibility, whereas the Respondent contends that they are not attributable to it. The Tribunal notes that while Czech law is relevant to its analysis of this issue, its inquiry in respect of attribution is made under international law and, in particular, the aforementioned Articles of State Responsibility.

a) *Article 4*

166. The Tribunal recalls that, as set out in Article 2 of the Articles on State Responsibility, in order to constitute a violation of the BIT, an act has to be both attributable to the State and a violation of an international obligation provided for in the BIT:

> **"Article 2. Elements of an internationally wrongful act of a State**
>
> There is an internationally wrongful act of a State when conduct consisting of an action or omission:
>
> - (a) is attributable to the State under international law; and
> - (b) constitutes a breach of an international obligation of the State."

167. Therefore, the first question to be addressed is the attribution of certain acts to the State. As States are juridical persons, the question necessarily arises whether acts committed by natural persons or separate entities, which are allegedly in violation of international law, are attributable to the State. Only after this question has been answered in the

affirmative, may the Tribunal address the second question, which is the qualification of the act attributed to the State as an illegal act. If the question is answered in the negative, it is, of course, unnecessary to analyze the question of legality/illegality of the acts complained of.

168. For the reasons which follow, the Tribunal determines that the acts and omissions of LČR, assuming they were found to be in breach of the German-Czech BIT, cannot be attributed to the Czech Republic whether under Articles 4, 5, 8 or 11 of the Articles on State Responsibility.

169. The Tribunal recalls that LČR, on 11 December 1991, pursuant to Protocol No. 6677/91-100, was established by the Czech Ministry of Agriculture as a special purpose public entity pursuant to the Act on State-Owned Enterprises (the "Act") to meet the "social, strategic or publicly beneficial interests" of the Czech State as defined in its "Foundation Decree". LČR is thus a legal entity known as a state enterprise under Czech law.

170. With respect to the status and legal characteristics of a state enterprise in the Czech Republic, the Tribunal has been greatly assisted by the opinion of Prof. Stanislava Černá, one of the Respondent's legal experts[3].

171. The following excerpts from Prof. Černá, in particular, have informed the Tribunal's conclusions on the issue of whether or not LČR's acts and omissions can be attributed to the Czech State:

> - "A state enterprise executes its business activities with state property on its own behalf and at its own liability"[sic] (Paras 4-6)
>
> - "The Term "on its own behalf" implies the fact that the state enterprise acts in legal relations as an independent entity detached from the state" (Para. 6.1)
>
> - "... the state enterprise disposes of independence in managing its property with which it executes its business activities." (Para. 6.2)
>
> - "The state enterprise's proprietary independence is inter alia represented by the fact that such enterprise is an independent accounting unit ... and a taxpayer." (Paras 7 and 8)

[3] The Tribunal notes that Prof. Černá was not cross-examined by the Claimant. Her opinion thus stands uncontradicted.

- [The Act] does not grant any rights to the founder to decide on the state enterprise's regular operations." (Para. 20)

- "... the founder's interventions in the state enterprise's operation are limited to the exhaustive list of cases defined by law (Article 16 Section 7, 9, Article 17 ZSP), while all other decisions are in the scope of authority of the state enterprise as a business entity or in the scope of authority of its Director and other internal managing authorities. Thus, the law doesn't grant to the founder any legal tools to directly influence regular commercial activity of the state enterprise." (Para. 21)

- "By law the state enterprise is an entrepreneur. Its function is generally formulated in Article 2 Section 1 ZSP, which explicitly defines the state enterprise as an entity created for the execution of business activities." (Para. 23)

- "... the legislator does not grant to the state enterprise any special rights or seigniorial authority but puts it in equal position with the other participants in legal relations." (Para. 26)

- "... the founder of a state enterprise may not give binding orders to the Director regarding the business management." (Para. 29)

- "We can therefore conclude that the business activity of a state enterprise is driven by the achievement of profit." (Para. 47)

172. Before turning to a review and analysis of the Parties' specific arguments invoked in aid of their respective thesis, the Tribunal also notes that, in answer to the specific question put to her as to whether the Czech State, as the founder of LČR, has the option of directly intervening in the terms and conditions and course of tenders announced by a state enterprise, Prof. Černá opined categorically that (see Černá Expert Report, para. 56):

> "Neither the State Enterprise Act (see answer above) nor special regulation on entering into contracts according to the Commercial Code or the Public Contracts Act grants the founder of a state enterprise the authority to intervene in the selection of a contractual partner or to determine the terms and conditions of entering into a specific contract."

173. Article 4 of the Articles reads as follows:

> **"Article 4. Conduct of organs of a State**
>
> 1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central government or of a territorial unit of the State.
>
> 2. An organ includes any person or entity which has that status in accordance with the internal law of the State."

174. While the Claimant acknowledges that LČR is not an organ of the Czech State for purposes of Article 4[4], it argues that the Ministry of Agriculture is an organ of the State whose acts are attributable to the State.

175. The Ministry of Agriculture is certainly an organ of the State. However, the Tribunal fails to see, on its review of the facts and on the basis of the opinion of Prof. Černá traversed above, how the Ministry can be held responsible for the management and the conduct by LČR of the tenders.

176. The Claimant avers that since the Ministry of Agriculture was the State organ responsible for the administration of the State forests and the tender by LČR concerning the State forests and their management, "the conduct of the tender concerning the State forests falls within the ambit and responsibility of the Czech Republic ... and [because] the Ministry failed to ensure that it was carried out in a legal and transparent fashion ... [it] is thus directly responsible for the illegal conduct of this tender." (see Statement of Reply, paras. 141-153; see also Cl. PHB, para. 129).

177. The Tribunal cannot agree with the Claimant's argument. On the one hand, the Claimant failed to adduce any evidence of specific acts of the Ministry in the conduct of the tender which engaged its responsibility. On the other hand, the Ministry's alleged failure to supervise how LČR actually conducted the tender demonstrates precisely that the "founder" of LČR respected the independence of the State enterprise in the management of its regular business activity. The "founder" bears no responsibility for LČR's management of the tender process. If the Claimant's analysis were be accepted, *i.e.* that a State is automatically responsible for all the acts of its separate public entities, this would completely blur the distinction between Article 4 and 5, and the provision of two distinct bases of responsibility.

178. The Claimant's claim based on Article 4 therefore fails.

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[4] See Cl. PHB, para. 129: "Claimant has previously stated that it does not consider Lesy CR a State organ through which the Czech State would incur any responsibility pursuant to Art. 4 of the Articles on State Responsibility."

b) *Article 5*

179. Article 5 of the Articles reads as follows:

> **"Article 5. Conduct of persons or entities exercising elements of governmental authority**
>
> The conduct of a person or entity which is not an organ of the State, under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority ["*à exercer des prérogatives de puissance publique*", in the French version] shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance."

180. In order for the Tribunal to find attribution under Article 5, it must determine that the acts of LČR in the conduct of the tender involved the exercise by LČR of governmental authority or, in French, "*l'exercice de prérogatives de puissance publique.*" As the Claimant itself recognized, this is "the relevant test." (see Cl. PHB, para. 157).

181. There is no doubt that LČR was empowered to exercise elements of governmental authority, but what the Tribunal must determine is whether, in performing the actions which the Claimant complains of in this particular instance, LČR in fact exercised those elements of governmental authority.

182. The Tribunal notes the Claimant's submission that "LČR's task was not simply to exploit the State Forests to its maximum financial advantage but that it had clearly the purpose of benefiting wider public interest and it is in this context that its actions, including the tender, have to be viewed." (see Cl. PHB, para. 147). The Tribunal cannot agree with this submission, which is far too sweeping. State entities are always deemed to act in the public interest, but this, in and by itself, is not sufficient under Article 5 to attribute all their acts to the State. In some of its activities, a state enterprise might exercise elements of governmental authority, in others it might not. The specific activities need to be scrutinized. Accordingly, the Claimant's reliance on the opinion of Prof. Černá, who observes generally that the motivation to found a state enterprise is the public interest, is misplaced (see Cl. PHB, para. 148).

183. It is well settled that, even when a separate legal entity exercises certain governmental powers, all its acts are not necessarily attributable to the State; in particular, they are not

attributable if those acts were connected only to commercial activities and not to the exercise of its governmental powers.

184. The Tribunal finds most apposite and adopts the reasoning of the *Jan de Nul* tribunal relied on by the Respondent, in a case where some of the facts were strikingly similar to the present one (see *Jan de Nul*, paras. 169-170):

> "Consequently, the fact that the subject matter of the contract related to the core functions of the SCA, i.e., the maintenance and improvement of the Suez Canal, is irrelevant. The Tribunal must look to the actual acts complained of. In its dealing with Claimants during the tender process, the SCA acted like any contractor trying to achieve the best price for the services it was seeking. It did not act as a State entity. The same applies to the SCA's conduct in the course of the performance of the Contract.
>
> It is true though that the Contract was awarded through a bidding process governed by the laws on public procurement. This is not a sufficient element, however, to establish that governmental authority was exercised in the SCA's relation to Claimants and more particularly in relation to the acts and omissions complained of. What matters is not the "*service public*" element, but the use of "*prérogatives de puissance publique*" or governmental authority. In this sense, the refusal to grant an extension of time at the time of the tender does not show either that governmental authority was used, irrespective of the reasons for such refusal. Any private contract partner could have acted in a similar manner." [footnote omitted]

185. In the opinion of the Tribunal, in the particular instance of conducting the tender operations in respect of which the Claimant complains, LČR engaged in commercial activities "on its own behalf and at its own liability", to quote Prof. Černá, and with a view of being profitable (see Cl. PHB, para. 129) in the very same way as private owners of forested land who, concurrently, were also performing tenders for forestry activities (see Resp. Reply PHB, para. 77).

186. The Tribunal notes that the Claimant itself, in trying to describe the main activities of LČR which demonstrate that it was exercising governmental authority, actually described commercial activities which could be performed by any economic actor engaged in forestry activities. It stated in its First Post-Hearing Brief (see Cl. PHB, para. 200):

> "Almost at the same time, , the Minister of Agriculture, declared that **Lesy CR's operations should be profitable and the trading of timber should be its major activity.** Mr. issued clear directions to Lesy CR's management that the situation had to be changed and that the state-enterprise had to become a timber trader in its own name.

...

> Thus, in a market where Lesy CR was an absolute dominant force and the major source of the raw material, the clear policy statement of the government became that Lesy CR should develop into **a major timber trading firm, with the aim of making high profits.**
>
> ...
>
> However, Lesy CR and the Minister of Agriculture had no desire to sell wood to CE Wood. As previously shown, Lesy CR did not want to sell the timber to CE Wood, and following the manipulated tenders did not have to. **With CE Wood out of the picture, Lesy CR became a more active trader of timber.**"

187. The fact that the creation of LČR happened in the context of the transformation of a centralized economy to a market economy does not change the Tribunal's conclusion, on the contrary. The tribunal in the *CSOB* case was faced with a similar process and it found the following (see *Ceskoslovenska Obchodni Banka, a.s. v. The Slovak Republic*, ICSID Case No. ARB/97/4 (Czech Republic/Slovak Republic BIT), Decision of the Tribunal on Objections to Jurisdiction, 29 May 1999, para. 23):

> "It cannot be denied that a State's decision to transform itself from a command economy to a free market economy involves the exercise of governmental functions. The same is no doubt true of legislative and administrative measures adopted by the State that are designed to enable or facilitate the privatization of State-owned enterprises. It does not follow, however, that a State-owned enterprise is performing State functions when it takes advantage of these State policies and proceeds to restructure itself, with or without governmental cooperation, in order to be in a position to compete in a free market economy. Nor does it follow that the measures taken by such an enterprise to achieve this objective involve the performance of State or governmental functions. In both instances, the test as to whether or not the acts are governmental or private turn on their nature."

188. In other words, the fact that the Ministry of Agriculture had the overall responsibility for the administration of the forests under the Forestry Act, even though it delegated the overseeing of the contracts to LČR, does not render the State responsible for all the acts of LČR. The Claimant has pointed to no acts involving the use of governmental powers. Its main complaints focused on what it alleged was an unfair commercial tender.

189. The Tribunal notes that the Claimant has produced two opinions of the Commission of the European Communities, in which the Commission finds that LČR is a "public contracting entity" for the purposes of Article 1(b) of Directive 92/50/EEC, with the

result that the Czech Republic is in breach of its obligations under EC law in respect of the conduct of the same tenders in issue in this arbitration (see Exhs. C-15 and C-17). Article 1(b) of Directive 92/50/EEC stipulates that "public contracting authorities" mean the State, regional or local authorities, bodies governed by public law and associations formed by one or more such authorities or bodies governed by public law. "Body governed by public law" for the purposes of the Directive means the following (see Exh. C-15, p. 8):

> "- established for the specific purpose of meeting the needs of public interest, not having an industrial or commercial character, and
>
> - being a legal entity, and
>
> - financed, for the most part, by the State, or regional or local authorities, or other bodies governed by public law; or subject to management supervision by those bodies; or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities or other bodies governed by public law."

190. The Commission stated that this term, "body governed by public law", must be understood in a functional sense, focusing in particular on whether the entity bears the "full risk connected with operations on the market" (see ibid.). The Commission determined that LČR would likely be provided protection against possible market sanctions and therefore did not face the full extent of risk relating to its activity on the market. The Commission further rejected the proposition that LČR should only be considered a public contracting authority in respect of that part of its activities which are pursued in the public interest, referring to European Court of Justice case law which provides that an entity which partly pursues activities meeting the needs in public interest, in addition to ordinary business activities, is considered a public contracting authority in relation to all of its activities (see Exh. C-15, p. 9; Exh. C-17, p. 17).

191. The Tribunal notes that the test for attribution of a State entity's acts and omissions under international law is different from the test under EC law. In particular, Article 5 of the ILC Articles contemplates that acts and omissions will be attributed "provided the person or entity is acting in that capacity in the particular instance". In other words, contrary to EC law, international law recognizes that a State entity may engage the responsibility of the State in connection with certain of its activities, but will not necessarily do so in

connection with all of its activities. The decisions of the Commission do not, therefore, persuade the Tribunal to alter its analysis or conclusions under international law.

192. The Claimant's claim based on Article 5 therefore fails.

c) *Article 8*

193. Article 8 of the Articles reads as follows:

> **"Article 8. Conduct directed or controlled by a State**
>
> The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of that State in carrying out the conduct."

194. In respect of this Article, the Tribunal finds the opinion of Prof. Černá to be dispositive (see *supra*, para. 170). There is not a scintilla of evidence in the record pointing to instructions or directions from the Ministry to LČR or to the Ministry exercising any control over that State enterprise; quite the opposite.

195. Indeed, at a meeting of the Supervisory Board of LČR, held on 23 September 2004, the Minister of Agriculture, Mr. . stated (see CE-86, CB-57):

> "... how the tenders will take place is up to the State-owned enterprise."

196. Furthermore, the Claimant's own "independent forestry expert", Mr. Richard Ramsauer, opined in his report that, in setting the terms and conditions of the tenders, LČR enjoyed "absolute freedom of autonomy." (see Ramsauer Expert Report, p. 9).

197. The Claimant's claim based on Article 8 therefore fails.

d) *Article 11*

198. Article 11 of the Articles reads as follows:

> **"Article 11. Conduct acknowledged and adopted by a State as its own**
>
> Conduct which is not attributable to a State under the preceding articles shall nevertheless be considered an act of that State under international law if and to the extent that the State acknowledges and adopts the conduct in question as its own."

199. The Tribunal recognizes that a State may, subsequent to the conduct in question, by words or actions, demonstrate that it endorses that conduct and adopts it as its own. But those words or actions must be clear and unambiguous.

200. In his commentary on Article 11, Professor Crawford writes:

> "The phrase "acknowledges and adopts the conduct in question as its own" is intended to distinguish cases of acknowledgement and adoption from cases of mere support or endorsement ... as a general matter, *conduct will not be attributable to a State under article 11 where a State merely acknowledges the factual existence of conduct or expresses its verbal approval of it.* In international controversies, States often take positions which amount to "approval" or "endorsement" of conduct in some general sense but do not involve any assumption of responsibility. The language of "adoption", on the other hand, carries with it the idea that the conduct is acknowledged by the State as, in effect, its own conduct ... However such acceptance may be phrased in the particular case, the term "acknowledges and adopts" in article 11 makes it clear that what is required is something more than a general acknowledgement of a factual situation, but rather that the State identifies the conduct in question and makes it its own." (emphasis added)

201. There is no such language or action on the part of the Minister in the present case. The Tribunal has no hesitation in rejecting the Claimant's submission that the statement by the new Minister of Agriculture, apologizing for the acts of the former government, constituted "acknowledgement and adoption" pursuant to Article 11.

202. The Claimant's claim based on Article 11 therefore fails.

4. Finding

203. In conclusion, the Tribunal finds by a majority that, even assuming that the Claimant were able to prove to the satisfaction of the Tribunal that some of the acts of LČR complained of could be analyzed as breaches of a provision of the German-Czech BIT and that the loss or damage which it suffered was caused by such breach, the Claimant's claim is dismissed because, on the evidence before the Tribunal, none of LČR's alleged acts or omissions can be attributed to the Czech State by virtue of Article 4, 5, 8 or 11 of the Articles on State Responsibility, nor can the Ministry of Agriculture be held responsible for any act in relation to LČR's management of the tender process.

204. As a majority of the Tribunal has found that the acts or omissions complained of are not attributable to the Czech State under the German-Czech BIT, the Tribunal determines

that all claims for loss or damage by the Claimant caused by an alleged breach of the German-Czech BIT must be dismissed.

C. *Liability*

205. Based on the Tribunal's above findings, there is no need for the Tribunal to discuss the merits of the Claimant's claim. For the sake of completeness, however, the Tribunal finds it appropriate to record here the principal arguments advanced by the Parties in respect of liability, causation and damages.

1. Fair and Equitable Treatment

a) *The Claimant's Position*

206. Taking into consideration the statements of various investment treaty tribunals in applying the Fair and Equitable Treatment ("**FET**") standard found in many BITs, the Claimant contends that the following concrete principles are implied by Article 2(1) of the German-Czech BIT: (1) transparency, stability and the protection of the investor's legitimate expectations; (2) procedural propriety and due process; and (3) good faith (see Statement of Claim, para. 169).

207. The Claimant submits that, as the Czech Republic became a full member of the EU on 1 May 2004, it could legitimately expect that the tenders which are the subject of the present arbitration proceedings would be conducted in accordance with the Czech public procurement law, as well as European law. However, it points to the EC's 2005 Notice to the Czech Republic, its 2007 Reasoned Opinion, and, more recently, the appeal by the Czech Parliament Deputy Chamber to the Czech government in April 2010 to cancel the current tender proceedings and organize a new tender that will respect public procurement law, as evidence of the Czech Republic's continuing violation of Czech and European procurement law. The Claimant adds that the conduct of the Czech authorities was entirely non-transparent and inconsistent, pointing in particular to UOHS' changing view on the application of the Czech PPA.

208. With regard to the tender process itself, the Claimant identifies four principal factors which, in its view, violated the FET standard contained in the BIT:

(a) Ambiguity arising from the late changes made by LČR to the bid criteria, including the striking through of the term "comparable" from the definition of average references;

(b) The invention of criteria by the evaluation committees according to which bidders had to show references from a corresponding regional inspector from the given region;

(c) Ambiguity in the drafting of tender documentation such that bidders did not know precisely what they were bidding for; and

(d) Inconsistency and non-transparency of the evaluation process as compared to the tender documentation.

209. With respect to this latter factor, the Claimant reasons as follows (see Statement of Claim, para. 181):

> "... [I]t was not the company with the most competitive price or the most experience which won. Neither was the case. With price and references being equally important in the tender, one might think that the fact that a company which was far from offering the best price might have won because its references were outstanding. However, at least in the units Lysa, Silherovice and Ostravice this was not the case. There, with Lesy Beskydy a.s., a company won which barely owned any equipment, had a very limited workforce and no prior experience of working in the Czech State forests administered by LČR. Another company, Dušan Panaček – INTER PAN, ranked better than CE Wood although pursuant to the Czech commercial register it did not officially exist at the time of the 2004/2005 [sic] so that Claimant wonders how it could have provided any decent references. Other companies won although they did not meet the formal criteria for participating." [footnotes omitted]

210. In its Statement of Reply, the Claimant seized on three axes of argument in support of its various claims, including the Respondent's alleged breach of the FET standard: (1) the criteria used to evaluate the bids were not those which should have been used pursuant to the tender documentation; (2) even on the basis of the criteria actually used to evaluate the bids, CE Wood should not have lost all but two units; and (3) the companies that won did not have the best results (see Statement of Reply, Sec. C.I).

211. Beginning with this first argument, the Claimant contends that the reference criterion in the tender documentation did not envisage that the evaluation of bidders by regional

inspectors for work done in units in previous years would be one of the decision-making factors for the tender committees. From a practical perspective, the Claimant notes that simply by relying on previous years' evaluations of a company for the work performed on a unit in order to assess the reference criteria in a bid for that same unit, it is more probable that bidders would win their previous units back, which is contradictory to the declared aim of the tender to open the market to new entrants and break up alleged monopolies. The Claimant also points out that the use of previous years' evaluations for bidders lends itself to manipulation, as the regional director sitting on a tender committee for a particular region would assess the companies' bids on the basis of evaluations that he or she made during preceding years in that same region, likely tending to favour the companies with which the director had already established relations (see Statement of Reply, paras. 184-187).

212. According to the Claimant, this is precisely what occurred in respect of at least four companies: Lesy Hluboka, Lesostavby Frydek-Mistek, Opavska Lesni and LESS & Forest, each of which won back all of their previously held "home" units in the February 2005 tender. By contrast, CE Wood submitted bids for 23 of its "home" units but did not win a single one, despite being a market leader, having complied with the tender rules and submitted numerous positive references with its tender, and having more equipment and trained personnel than any other company in the market (see Statement of Reply, para. 188).

213. In addition, the Claimant notes that the contracts ultimately offered were not based on the conditions stipulated for those contracts in the tender documentation. Referring to the analysis conducted by ČAPLH, a Czech industry association, the Claimant observes that several key terms changed relating to contracts for the eventual sale of timber and transport conditions, among others (see Statement of Reply, para. 190).

214. With respect to its second argument, the Claimant submits that even if the previous year's evaluations received from regional inspectors were relevant for the evaluation of the references criterion, the reviews and evaluations of CE Wood were not worse than those of its peer group companies (see Statement of Reply, paras. 194-202).

215. Finally, the Claimant argues that the four companies identified above were not better positioned than CE Wood on the basis of their respective evaluations, yet they each received contracts in their home units (see Statement of Reply, paras. 203-209).

216. The Claimant concludes that the Czech Republic violated the FET standard through its overall conduct, but in particular the conduct of the tender proceedings, helping companies to win tenders for which they were clearly not qualified.

b) *The Respondent's Position*

217. The Respondent submits that while the term "fair and equitable treatment" in Article 2(1) of the German-Czech BIT is subject to interpretation, it is not open to the Tribunal to make a decision *ex aequo et bono*. The Respondent relies on several NAFTA awards, including *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award (11 October 2002) ("*Mondev*"), *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Final Award (30 April 2004) ("*Waste Management*"), and *S.D. Myers, Inc. v. Canada*, UNCITRAL (NAFTA), First Partial Award (13 November 2000) ("*S.D. Myers*"), as well as the award in *Saluka*, for an articulation of the FET standard, observing that the circumstances of the specific case always play a key role in determining whether the standard has been violated.

218. The Respondent avers that alleged breaches of European law are outside of the scope of the BIT and cannot, in any event, form the basis of a breach of the BIT's FET standard in this case (see Statement of Defence, para. 275). The Respondent refers to the ICJ's reasoning in *Case concerning Elettronica Sicula (ELSI)*, ICJ, 20 July 1989, ICJ Rep (1989) 15 ("*ELSI*"), among other arbitral authority, in support of its position (see Statement of Rejoinder, para. 228, quoting *ELSI*, para. 124):

> "Yet it must be borne in mind that the fact that an act of a public authority may have been unlawful in municipal law does not necessarily mean that that act was unlawful in international law, as a breach of treaty or otherwise. A finding of the local courts that an act was unlawful may well be relevant to an argument that it was also arbitrary; but by itself, and without more, unlawfulness cannot be said to amount to arbitrariness. It would be absurd if measures later quashed by higher authority or a superior court could, for that reason, be said to have been arbitrary in the sense of international law. To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right."

219. The Respondent argues that the Claimant has offered no authority or support for the position that violations of domestic law, such as the PPA, or EU law, constitute *ipso facto* violations of the FET standard. In any event, the Respondent notes that neither a Czech Court nor the European Court of Justice has held that LČR was in breach of the PPA or EU law, explaining that a reasoned opinion of the EC is just that, an opinion, not a legally enforceable decision (see Statement of Reply, para. 231).

220. With respect to the legitimate expectations element of the Claimant's FET claim, the Respondent submits that protected legitimate expectations are those expectations that the investor takes into account when it makes the investment. Relying on the tribunal's reasoning in *PSEG v. Turkey*, ICSID Case No. ARB/02/5, Award (19 January 2007) ("*PSEG*"), at paragraph 241, the Respondent adds that legitimate expectations can only be based on specific assurances given to the investor by the host State. As the Claimant does not allege that it received any specific commitments from the Czech Republic when it made its investment, the Respondent reasons that whatever the Claimant's alleged expectations, they did not constitute protected "legitimate expectations" under the German-Czech BIT (see Statement of Reply, paras. 238-240).

221. The Respondent submits that the recent decision in *AES Summit Generation Ltd. et. al. v. Republic of Hungary*, ICSID Case No. ARB/07/22, Award (23 September 2010) ("*AES*"), provides guidance as to the standard under international law governing tender processes. In that case, the tribunal determined that not every alleged "process" failure amounts to a failure to provide FET under international law (see Statement of Rejoinder, para. 242, quoting *AES*, paras. 9.3.37 and 9.3.40):

> "... [T]he Tribunal has concluded that there was nothing so irrational or otherwise unreasonable in Hungary's policy decision to reintroduce administrative prices in 2006 as would constitute a breach of its Treaty obligation to ensure that Claimants were treated fairly and equitably and that their investments were not impaired by unreasonable or discriminatory measures.
>
> [...]
>
> The Tribunal has approached this question on the basis that it is not every process failing or imperfection that will amount to a failure to provide fair and equitable treatment. The standard is not one of perfection. It is only when a State's acts or procedural omissions are, on the facts and in the context before the adjudicator, manifestly unfair and

> unreasonable (such as would shock, or at least surprise a sense of juridical propriety) ... that the standard can be said to have been infringed."

222. The Respondent further explains that, in reaching its decision, the tribunal emphasized that while a government cannot force a private party to give up existing contractual rights, parties cannot complain if, in the process of the government exercising its authority, private contractual rights are affected (see Statement of Rejoinder, para. 244, quoting *AES*, para. 10.3.13):

> "[I]t cannot be considered a reasonable measure for a State to use its governmental powers to force a private party to change or give up its contractual rights. If the State has the conviction that its contractual obligations to its investors should no longer be observed (even if it is a commercial contract, which is the case), the State would have to end such contracts and assume contractual consequences of such early termination. This does not mean that the State cannot exercise its governmental powers, including its legislative function, with the consequence that private interests – such as the investor's contractual rights – are affected. But that effect would have to be a consequence of a measure based on public policy that was not aimed only at those contractual rights. Were it to be otherwise, a State could justify the breach of commercial commitments by relying on arguments that such breach was occasioned by an act of the State performed in its public character."

223. Thus, in *AES*, the tribunal concluded that Hungary's decision to reintroduce administrative pricing was not intended to affect the Claimants' contractual rights, but was rather motivated by concerns relating to excessive profits earned by generators and the burden this placed on consumers. Applying these principles to the present case, the Respondent argues that the "process" at issue did not appear to be "so flawed as to amount to a breach of the fair and equitable treatment standard", if it was flawed at all.

224. The Respondent concludes that the Claimant did not succeed in the tenders because its bids were non-competitive, not because the tender proceedings were manipulated. Indeed, the Respondent takes the position that "CE Wood lost market share because it failed to adjust its cartel-like business model to the newly-competitive Czech forestry market" (see Statement of Rejoinder, para. 14).

2. Arbitrary or Discriminatory Measures

a) *The Claimant's Position*

225. Noting that Article 2(2) of the German-Czech Republic BIT does not define arbitrary or discriminatory measures, the Claimant relies on the interpretation of arbitrariness offered by the ICJ in *ELSI* (see Statement of Claim, para. 185, quoting *ELSI*, p. 76):

> "Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. [...] It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety."

226. The Claimant further contends that arbitrariness is largely referable to "unreasonableness", turning to the tribunal's discussion of this criterion in *Saluka* (see Statement of Claim, para. 186, quoting *Saluka*, paras. 460-461):

> "The standard of 'reasonableness' has no different meaning in this context than in the context of the 'fair and equitable treatment' with which it is associated; and the same is true with regard to the standard of 'non-discrimination'. The standard of 'reasonableness' therefore requires, in this context as well, a showing that the State's conduct bears a reasonable relationship to some rational policy, whereas the standard of 'non-discrimination' requires a rational justification of any differential treatment of a foreign investor.
>
> Insofar as the standard of conduct is concerned, a violation of the non-impairment requirement does not therefore differ substantially from a violation of the 'fair and equitable treatment' standard. The non-impairment requirement merely identified more specific effects of any such violation, namely with regard to the operation, management, maintenance, use, enjoyment or disposal of the investment by the investor."

227. The Claimant submits that the preparation and conduct of the tender proceedings was contrary to the rule of law and would shock any sense of judicial propriety. The Claimant contends that its investment, CE Wood, was, at the time of the tenders, the most successful forestry company in the Czech Republic. Yet, in a tender for approximately 60 forestry units, it won only two with a minor volume of wood. By contrast, newly founded companies with little experience in forestry received better marks for their references and companies which failed to fulfill the formal participation requirements for the tender won important units. The Claimant takes the position that such conduct bears no rational justification, but rather finds explanation only in the intentional destruction of CE Wood.

b) *The Respondent's Position*

228. The Respondent notes that, under Article 2(2) of the German-Czech BIT, the Czech Republic has the obligation to avoid impairing the management, maintenance, use or enjoyment of investments in its territory by German investors. The Respondent relies on the *Saluka* tribunal's interpretation of "impairment" in a similar treaty clause, quoting as follows (see Statement of Defence, paras. 281-82, quoting *Saluka*, paras. 458 and 461):

> "Impairment means, according to its ordinary meaning ... any negative impact caused by 'measure' taken by the Czech Republic.
>
> ...
>
> Insofar as the standard of conduct is concerned, a violation of the non-impairment requirement does not therefore differ substantially from a violation of the 'fair and equitable treatment' standard. The non-impairment requirement merely identifies more specific effects of any such violation, namely with regard to the operation, maintenance, use, enjoyment or disposal of the investment by the investor."

229. The Respondent contends that the Claimant has failed to substantiate its claim with any specific evidence. The Respondent also relies upon the standard for arbitrariness set out by the ICJ in *ELSI* and, applying this standard to the present case, contends that the tender process was conducted in good faith and did not shock the sense of juridical propriety.

230. The Respondent further reasons that even if a law was violated in the tender proceedings, this could not establish a breach of Article 2(2) because the violation would have affected all forestry companies participating in the tender and could not, therefore, be viewed as arbitrary or discriminatory. The reference criterion about which the Claimant complains only helped CE Wood, in the Respondent's view, because CE Wood could not compete on price alone.

231. While the Respondent acknowledges a degree of subjectivity to the reference criterion, it avers that steps were taken to ensure due process by the evaluation committees (see Statement of Defence, para. 208). Moreover, the Respondent notes that, prior to the tender proceedings, a meeting was held with potential bidders, including CE Wood, in which the evaluation criteria were discussed. The minutes of this meeting, produced by

the Respondent, indicate that the application of the reference criterion in particular was discussed and agreed (see Statement of Rejoinder, para. 266, n. 131, quoting Exh. R-51):

> "... individual criteria for each contract (the entrepreneur's individual contracts may be evaluated differently) which include: payments discipline regarding the contract, performing of the contract with subcontractors and assessment of the contract by the Forest Authority and Regional Inspectorate. (Such evaluation of the entrepreneur's each contract shall reflect the general profile of the company as well as the detailed behaviour of the entrepreneur's employees in respect to the contract) ..."

232. As regards the Claimant's allegation that bidders in their home units had a clear advantage over non-home unit bidders, the Respondent avers that approximately 30% of the 87 units were acquired by bidders that previously held and operated those units. Thus, the Respondent reasons as follows (see Statement of Rejoinder, para. 277):

> "- that only one third of bidders whose bid was evaluated succeeded in acquiring the unit they operated before initiation of the tender;
>
> - that many of the successful bidders in particular units had to transfer their equipment and labor to newly acquired units and were happy to do so even when they acquired one unit only;
>
> - The tender achieved its intended result of creating a fair and open competition environment enabling 'new players' to effectively enter the forestry market if they submitted a competitive bid." [footnotes omitted]

233. The Respondent concludes that, since its inception, the management of CE Wood had "an illegitimate expectation of preferential treatment" and that notwithstanding the Claimant's allegation of discrimination and unfair treatment, it was treated in exactly the same manner as its competitors in the Czech forestry sector (see Statement of Rejoinder, para. 293).

3. National Treatment

a) *The Claimant's Position*

234. The Claimant submits that Article 3(1) of the German-Czech BIT and treaty clauses like it require a host State to treat foreign investments or investors as well as similarly situated national investors. Thus, the Claimant contends that the following two criteria are central to the Tribunal's analysis of whether a violation has occurred (see Statement of Claim, para. 192):

> "... (1) whether the foreign investor and the domestic investor are placed in a comparable setting or as often said 'like circumstances' and (2) whether the conduct of the State results in a treatment less favourable than that accorded to the domestic comparator, thereby precluding *de facto* or *de jure* discrimination."

235. As regards the first criterion, the Claimant states that CE Wood was engaged in the forestry business like several other companies, all of which operated in the same environment, *i.e.* in the state-owned forests administered by LČR, the only difference being that CE Wood was foreign-owned.

236. Secondly, the Claimant submits that conditions for the tenders contained in the tender documentation were the same for all participants, however, the outcome of the tenders clearly disfavoured CE Wood over other, less qualified Czech companies. Thus, the Claimant concludes that the Respondent treated foreign and domestic investors in like circumstances differently on a *de facto* basis, which treatment could not be justified because, in certain cases, the winning bidders did not even meet the formal requirements of the tenders.

b) *The Respondent's Position*

237. The Respondent submits that as LČR gave CE Wood only average scores in most of its annual valuations, it is clear that the company was not a top performer even prior to the tenders. Moreover, the Respondent contends that the outcome of the tenders did not disfavour CE Wood in comparison to other companies, rather, "[i]t only reflects that other bidders in the respective contractual units submitted more competitive offers" (see Statement of Defence, para. 295).

238. The Respondent adds that there is no evidence that all of the companies who won units in the tender were owned by Czech nationals, that national ownership was the reason any successful bidder won a unit, or that any differentiation in treatment was not based on a reasonable justification, *i.e.* the winners bid better prices than CE Wood (see Resp. PHB, para. 210).

4. Full Protection and Security

a) *The Claimant's Position*

239. The Claimant submits that the German-Czech BIT contains two separate provisions requiring the Contracting Parties to provide full protection and security. The first, at Article 4(1), requires each Contracting State to provide "full protection and full security" to all investments made by the nationals of another Contracting Party in the territory of the host State. The second, at Article 2(3), provides that "[i]nvestments and returns thereon together with returns on any reinvestment shall enjoy full protection under the Treaty." The Claimant contends that this latter provision must be interpreted as extending protection to returns on investment and reinvestment, with the result that the obligation in Article 4(1) must be interpreted as a separate and independent obligation on the part of the host State (see Statement of Claim, para. 211).

240. While the concept of "full protection and full security" is not defined in the German-Czech BIT, the Claimant contends that it has generally been interpreted as placing a duty of due diligence on a Contracting party to "take such measures protecting foreign investments as reasonable under the circumstances." (see Statement of Claim, para. 197, quoting R. Dolzer and C. Schreuer, *Principles of International Investment Law* (OUP, 2008), pp. 149-50).

241. The Claimant reasons that while this standard has traditionally been associated with the obligation of a host State to ensure the physical protection of an investor and its assets, it has since been broadened to include "legal security". The Claimant relies in this regard upon the award in *Vivendi*, where the tribunal found that "[i]f the parties to the BIT had intended to limit the obligation to 'physical interferences,' they could have done so by including words to that effect", the absence of any such limiting words meaning that acts or measures which deprive an investor of protection and security so as to violate the standard "need not threaten physical possession or the legally protected terms of operation of the investments" (see Statement of Claim, para. 205, quoting *Compania de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina*, ICSID Case No. ARB/97/3, Award (20 August 2007) ("***Vivendi***"), para. 7.4.15).

242. The Claimant states that LČR "thwarted the legal security and directly harmed the commercial and financial interests" of the Claimant by changing the existing legal operating environment so as to drastically reduce the position of CE Wood in the Czech forestry sector. By way of example, the Claimant observes that the 2004 tenders were announced two weeks before the expiration of the short term contracts. In this short period of time, the Respondent undertook "a dramatic overhaul of an existing contractual scheme that was the sole source of the raw material" of the Claimant, a scheme on which the Claimant relied for almost five years prior to the overhaul. This was, in the Claimant's view, reckless at best, if not deliberately aimed at CE Wood (see Statement of Claim, para. 214).

243. The Claimant states that the Respondent failed to provide protection against the conduct of LČR when it failed to rein in its illegal and abusive conduct, both at the level of the UOHS and the Ministry of Agriculture. The Claimant recalls that the UOHS issued conflicting decisions on the status of LČR and the legality of the tender and, when it finally determined that LČR was a public contracting authority, following issuance of the EC's 2005 decision, no actions were taken by LČR, the Ministry of Agriculture or the Ministry of Finance to remedy the damage caused to CE Wood as a result of the wrongfully conducted tenders.

b) *The Respondent's Position*

244. The Respondent submits that the standard of full protection and security is still invoked almost exclusively in cases regarding physical protection, referring here to *Saluka*, *PSEG*, *Wena Hotels Ltd v. Arab Republic Egypt*, ICSID Case No. ARB/93/1, Award (21 February 1997) ("*Wena Hotels*"), and *Asian Agricultural Products Ltd (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award (27 June 1990) ("*AAPL*"). In those cases where the standard has been considered, the Respondent notes that it is always – or at least usually – limited to the context of physical security, barring exceptional circumstances.

245. The Respondent avers that it is at a loss to understand why changes that were general and affected every forestry company in the Czech Republic in the same way as CE Wood could have been "deliberately aimed at CE Wood", as the Claimant contends.

246. The Respondent also submits that it is normal and in accordance with the rule of law that specific judicial bodies deal with specific issues. Accordingly, the Claimant cannot blame the Ministry of Agriculture for not taking up an issue at CE Wood's behest which falls outside of the limits of its authority.

5. Indirect Expropriation

a) *The Claimant's Position*

247. The Claimant submits that Article 4(2) of the German-Czech BIT covers not only direct but indirect expropriations, relying on the definition of indirect expropriation articulated by the tribunal in *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award (30 August 2000) ("*Metalclad*") (see Statement of Claim, para. 223, quoting *Metalclad*, para. 103):

> "expropriation [...] includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."

248. The Claimant argues that the Respondent interfered with its business activities by way of a *de facto* expropriation which deprived it in significant part of the reasonably-to-be-expected benefit of its investment, and created a hostile business environment which prevented CE Wood from carrying out successful business dealings, ultimately leading to the Claimant's loss of investment and, as a mitigating measure, the sale of its remaining shares in CE Wood for The Claimant states that the effects of the Respondent's acts are permanent, as CE Wood never recovered and is in bankruptcy today.

249. In considering the nature of the property allegedly expropriated, the Claimant explains that when it invested in CE Wood, EP Kapital held contractual rights for forestry services which far outnumbered its competitors, two thirds of its contracts with LČR were unlimited in duration, and those contracts conferred the right to purchase timber from LČR up to 66% of the wood harvested. As a result, the Claimant contends that its assets encompassed not only the shares purchased in CE Wood but CE Wood's contractual

rights, including access to raw material and the business potential which this entailed (see Statement of Claim, paras. 231-232).

250. The crux of the Claimant's expropriation case, as with its other claims, lies in the conduct of the tender proceedings, which it submits were manipulated so as to privilege certain parties over others. The Claimant argues that companies which had questionable qualifications and references were ranked higher than CE Wood and companies which did not meet the formal requirements of tender participation or offered non-competitive prices won in several units. Whereas, CE Wood won only in two of the 58 units for which it submitted a tender.

251. The Claimant takes the view that the Respondent's intention is irrelevant to determining whether an expropriation occurred. However, even should the Tribunal find that intention is relevant, the Claimant contends that an expropriation has still occurred, arguing that the tenders furthered the interests of a few rather than furthering the public interest and the Minister of Agriculture announced publicly that it was its intention to destroy CE Wood (see Statement of Claim, para. 244).

252. As a final point, the Claimant argues with equal force that it is irrelevant whether the Respondent seized the Claimant's investment to the obvious benefit of the host State, referring again to tribunal's approach in the *Metalclad* case. Thus, the Claimant concludes that its investment was indirectly expropriated, averring that none of the requirements for a lawful expropriation were satisfied.

b) *The Respondent's Position*

253. The Respondent submits that a claim for expropriation requires a State action that (i) constitutes a "taking" of a claimant's property rights; (ii) has a substantially severe impact on the claimant's investment as a whole, and (iii) does not fall into any of the categories of permissible (non-compensable) expropriation, such as *bona fide* regulatory action within the police powers exception. (see Statement of Rejoinder, para. 295).

254. The Respondent submits that the only measure that the Claimant specifically identifies as expropriatory is the tender process. However, in the Respondent's view, the tender did not take anything from the Claimant, nor did it substantially interfere with it in any way.

Similarly, the tender did not interfere with the Claimant's ownership of the shares in CE Wood. Relying on the reasoning of the tribunals in *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006) ("***LG&E***") and *Pope and Talbot v. Canada*, UNCITRAL (NAFTA), Interim Award (26 June 2000) ("***Pope and Talbot***"), the Respondent contends that the Claimant's indirect expropriation claim must fail because the Claimant has not demonstrated that any taking interfered with the Claimant's investment to a sufficient degree so as to neutralize its ownership or enjoyment of the investment or deprive it of its ability to use, enjoy or dispose of its property.

D. ***Causation***

1. The Claimant's Position

255. In determining whether an act caused damage to the Claimant, the Claimant observes that the Tribunal must be satisfied that "the causal relationship is sufficiently close (*i.e.* not too remote) to satisfy the applicable standard of causation" (see Statement of Reply, para. 250, quoting Mark Kantor, *Valuation for Arbitration: Compensation Standard, Valuation Method and Expert Evidence* (2008), p. 106).

256. The Claimant highlights the testimony of , who remarked as follows on the devastating effect of the tender results on CE Wood (see Tr. Day 1, p. 151):

> "PROFESSOR STERN: My second question is I was a little bit struck by what you say in two different paragraphs. In paragraph 13 you say: 'I am convinced that in 2004 and before the bidding process the company was in very good condition.' And then before, in 11, you say: 'Given the liquidity situation in April 2005, CE Wood was close to insolvency ...'
>
> So does that mean that the situation has changed in four months, from a very good condition to bankruptcy -
>
> A. Well, not to bankruptcy.
>
> PROFESSOR STERN: It was "close to insolvency",
>
> A. Yes, it was close to if somebody filed bankruptcy -
>
> PROFESSOR STERN: In four months?
>
> A. Yes. Because from one day to the other one the tender proceedings were published, we lost one-third of the company business, from one day to the other. Because we've got so many employees, at the end of 2004, and we were, our outlook was that we have to reduce by one-third, then the cashflow was dramatically influenced by that. And if somebody

> will file bankruptcy on CE Wood we will not be able to pay our payables on time. So there as a risk for that. And in 2004, presuming that the condition will stay the same, I think we were in a good condition.

257. The Claimant contends that if CE Wood had secured even a modest number of units it would have had a sufficiently positive outlook for future cooperation with LČR and would have been able to secure bank financing.

258. As regards the interim contracts, the Claimant submits that LČR set unreasonable timelines for negotiating the agreements and the contracts as proposed were "demonstrably invalid". The Claimant therefore contends that it made a reasonable effort to re-negotiate the contracts in good faith, and it was not simply a "business decision" that led to the non-signing of the contracts.

259. Contrary to the Respondent's assertion that there is no nexus between being successful in the tender and gaining access to the timber felled in a forestry unit successfully won in the tender, the Claimant avers that the right to purchase timber was a part of the Master Contract, the only element left to negotiation being the price to be paid for that timber. Article 10.1 of the Master Contract thus provided that the contractual partner "shall have the right to conclude the Contract on the Sale of Timber in the scope of the maximum of 60% of the SUJ's harvesting project in the current calendar year ...". The Claimant also notes that the purpose of the Master Contract is to establish the right of the contractual partner to conclude the contract on the sale of timber (see Cl. PHB, para. 354; Exh. C-46/CB-116).

2. The Respondent's Position

260. The Respondent asserts that the Claimant has failed to establish a causal link between the alleged damage and the alleged wrongful conduct of the Respondent. The Respondent submits that any loss of timber supply was more likely the result of a managerial failure to adjust CE Wood's business model to the newly-competitive Czech forestry sector than any manipulation of the tender proceedings. The Respondent calls in aid the tribunal's discussion of this proposition in *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008) ("***Biwater***") (see Statement of Rejoinder, para. 305, quoting *Biwater*, para. 786):

> "The key issue in this case is the factual link between the wrongful acts and the damage in question, as opposed to any issues as to remoteness or indirect loss. The Arbitral Tribunal notes in this regard the approach of the ICJ in the *ELSI* case. In that case, the ICJ held that the primary cause of the Claimant's difficulties lay in its own mismanagement over a period of years, and not the act of requisition imposed by the governmental authorities. In reaching this conclusion, the Court applied an 'underlying' or 'dominant' cause analysis. ..."

261. The Respondent argues that the Claimant's case blindly assumes that, but for the alleged wrongful conduct, CE Wood would have won all 58 of the bids in which it participated and that it would have won them at the high price it bid. However, the Respondent observes that even if the reference criteria were removed from the tender and its weighting was assigned to the price criteria, the evidence indicates that CE Wood still would have lost each of the tenders because it never had the lowest price (see Resp. PHB, para. 218).

262. As regards the interim short-term contracts, the Respondent notes that while other forestry companies accepted the terms of the interim contracts offered by LČR, CE Wood did not. Thus, even if CE Wood had won every tender, it would not change the fact that it did not have the contracts for the first six months of 2005. The Respondent reasons that the economic impact of refusing to sign the interim contracts is a commercial decision for which the management of CE Wood alone bears responsibility. Accordingly, if there was a decrease in the cash flow of CE Wood in the first half of 2005 due to a decrease in harvested wood, the Respondent argues that this was caused by the management's decision not to sign the interim contracts offered to it on the same conditions as they were offered to all other forestry companies (see Statement of Rejoinder, para. 329; Resp. PHB, paras. 225-227).

263. The Respondent also submits that there is no nexus between being successful in the tender and gaining access to the timber felled in the contractual unit for which a forestry company submitted a successful bid, as no contract of sale of lumber nor the sale of lumber as such was the subject of the tender. Rather, the subject of the tender was the signature of a master agreement which included a contract on foresting activities and a contract on harvesting activities. In essence, the Respondent contends that the Master Agreement does not convey a direct right to sell lumber, but rather provides for a

negotiation between the forestry company and LČR which may ultimately result in no agreement to sell the lumber harvested. In any event, had CE Wood wished to procure timber to address shortfall in its supply, the Respondent submits that it could have done so by purchasing wood from neighbouring European countries (see Resp. PHB, paras. 237-240.

264. Finally, the Respondent submits that the Claimant was already in a critical financial situation in 2004, as evidenced by the Savino Report, therefore it is incorrect to assume that CE Wood's cash flow problems are caused by LČR's acts or omissions in the tender proceedings.

E. *Damages*

1. The Claimant's Position

265. The Claimant notes that the relevant principles of compensation, save for compensation for a lawful expropriation, are not spelled out in the German-Czech BIT, but are rather to be found in the ILC's Articles on State Responsibility. Among those provisions relied upon, the Claimant highlights Articles 36 and 38 which establish the basic obligation of a State to compensate an investor for damage caused by the State, and to pay interest on such compensation. The Claimant relies upon these basic principles in connection with its claim for compensation in respect of the violation of the FET provision, full protection and full security provision, national treatment provision and prohibition of arbitrary and discriminatory measures contained in the BIT (see Statement of Claim, paras. 251-253, 259).

266. As regards its expropriation claim, the Claimant notes that international law distinguishes between a legal and an illegal expropriation, submitting that Article 4(2) of the BIT sets the standard of compensation only for a lawful expropriation. As the Claimant's case is based on an unlawful expropriation, the Claimant contends that the appropriate measure of compensation is the same as that set out above (see Statement of Claim, paras. 254-255).

267. Turning to the valuation of its claims, the Claimant contends that the reparation standard set out by the Permanent Court of International Justice in the *Chorzow Factory* case

applies, requiring compensation for the fair market value of its investment. Compensation is assessed by the Claimant's expert, using the Discounted Cash Flow ("**DCF**") Method, as at 31 December 2004, the date when the Claimant's investment was still largely unaffected by the steps taken by the Respondent, to be €87.304 million, plus interest (see Statement of Claim, para. 256; Cl. Reply PHB, para. 177).

2. The Respondent's Position

268. The Respondent identifies through its quantum expert a number of flaws in the Claimant's quantum calculations, not least of which is the Claimant's use of the DCF method, which the Respondent describes as "not consistent with common practice and therefore not reliable" (see Statement of Defence, para. 301).

269. The Respondent contends rather that the "actual investment" method should be preferred to quantify any damages, relying upon the approach taken by the tribunals in *Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre*, 95 ILR 184 (UNCITRAL Rules, 1990) ("***Biloune***"); *Phelps Dodge Corp. v. Iran*, 10 Iran-U.S. CTR 121 (1986) ("***Phelps***"), and *Metalclad*. Taking this approach, the Respondent contends that the Claimant is entitled to no damages (see Statement of Rejoinder, paras. 348-352).

270. The Tribunal has summarized the Parties' submissions on liability, causation and damages in order to reflect all of the issues placed before the Tribunal in this arbitration. It is, however, recalled that the Tribunal has found, by a majority, that the acts and/or omissions of LČR are not attributable to the Czech Republic and that, on the evidence presented, the Ministry of agriculture is not responsible for any act in relation to LČR's management of the tender proceedings (see paragraph 203 above). As the acts and/or omissions complained of are not attributable to the Czech Republic under the German-Czech BIT, all claims of loss or damage caused by an alleged breach of the BIT by the Czech Republic must be dismissed (see paragraph 204 above).

VI. COSTS

271. The Claimant claims its costs of the arbitration totalling CHF1,781,511.15, €384,480.45 and £400,061.30, which include legal fees and disbursements, Tribunal fees, experts fees and disbursements, translation and interpretation services, witness travel and

accommodation expenses, court reporting and ICC hearing services expenses (see Cl. letter, dated 9 January 2012).

272. The Respondent claims its costs of the arbitration totalling €210,000.00 and CZK95,671,235.09, which include legal fees and disbursements, experts fees, Tribunal fees, interpretation services, witness travel and accommodation expenses, banking fees, travel expenses for party representatives and taxes (see Resp. letter, dated 9 January 2012).

273. Article 38 of the UNCITRAL Rules provides that the Tribunal "shall fix the costs of arbitration in its award". Article 40 further provides as follows in respect of the apportionment of costs:

> 1. "Except as provided in paragraph 2, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.
>
> 2. With respect to the costs of legal representation and assistance referred to in article 38, paragraph *(e)*, 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.
>
> 3. When the arbitral tribunal issues an order for the termination of the arbitral proceedings or makes an award on agreed terms, it shall fix the costs of arbitration referred to in article 38 and article 39, paragraph 1, in the text of that order or award.
>
> 4. No additional fees may be charged by an arbitral tribunal for interpretation or correction or completion of its award under articles 35 to 37."

274. While, at the end of the day, the Respondent has been successful in having the Claimant's case dismissed on the ground that the acts and/or omissions of LČR complained of are not attributable to the Czech State, the Tribunal notes that the Respondent's jurisdictional challenges based on jurisdiction *ratione temporis*, jurisdiction *ratione materiae* and the existence of a "good faith" investment have all been dismissed by the Tribunal.

275. In addition, the Tribunal recalls that while the Respondent has prevailed in its jurisdictional objection based on attribution, it only raised this objection in its Statement of Defence, approximately six months after the date on which the Respondent was directed to identify its jurisdictional objections and one week before the teleconference scheduled between the Parties and the Tribunal to address the matter of bifurcation. The Respondent has variably treated the issues of attribution as a merits issue (see Statement of Defence, paras. 239-265) and an issue on par with jurisdiction (see Statement of Rejoinder, paras. 162-205). Its submissions in this respect, as with its arguments on jurisdiction, also evolved over the course of the proceedings.

276. Taking these and other circumstances of the case into account, the Tribunal determines to exercise its discretion under Article 40 of the UNCITRAL Rules in respect of costs by ordering that each party bear its own costs of the arbitration, as well as its own costs of legal representation. The Tribunal considers that this apportionment is reasonable.

VII. OPERATIVE PART

277. For the reasons set out above, the Tribunal awards as follows:

(a) The Tribunal dismisses the Respondent's jurisdictional challenge and declares that it has jurisdiction to decide on their merits all claims advanced by the Claimant against the Respondent in this proceeding;

(b) The Tribunal finds and declares that the acts and/or omissions complained of by the Claimant to constitute breaches of the Respondent's obligations under the German-Czech BIT are not attributable to the Respondent;

(c) In view of the Tribunal's finding in paragraph 277(b) above, the Tribunal hereby dismisses all other claims made by the Claimant and the Respondent in these arbitration proceedings, save as to costs;

(d) The Tribunal orders that each Party shall bear its own costs.

Place of Arbitration: Paris, France

[Dissenting Opinion attached]

Mr. Henri Alvarez, Q.C.
Co-Arbitrator

Date: _____

Prof. Brigitte Stern
Co-Arbitrator

Date: _____

J. Yves Fortier

L. Yves Fortier, C.C., Q.C.
Chairman

Date: 23 May 2012

Place of Arbitration: Paris, France

[Dissenting Opinion attached]

Mr. Henri Alvarez, Q.C.
Co-Arbitrator

Date: 25 May 2012

Prof. Brigitte Stern
Co-Arbitrator

Date: _____

L. Yves Fortier, C.C., Q.C.
Chairman

Date: _____

Place of Arbitration: Paris, France

[Dissenting Opinion attached]

Mr. Henri Alvarez, Q.C.
Co-Arbitrator

Date: _____

Brigitte Stern.

Prof. Brigitte Stern
Co-Arbitrator

Date: 29 May 2012

L. Yves Fortier, C.C., Q.C.
Chairman

Date: _____

INTERTRADE HOLDING GMBH V. THE CZECH REPUBLIC
SEPARATE OPINION OF HENRI ALVAREZ

1. I have had the opportunity to read in draft the reasons of my esteemed colleagues in this arbitration, which, as a result of the conclusion reached, deal only with jurisdictional issues and the question of attribution. While I agree with most of the reasoning in the Majority Decision and recognize the desirability of unanimity, I am compelled to write this brief separate, dissenting opinion to address the reasoning and conclusions reached on attribution with which I must respectfully disagree. I consider the issue of attribution an important one and one which requires a careful, detailed review of the relevant facts and arguments.

2. My disagreement would likely not lead to a different result in the arbitration. Having reviewed all of the evidence and arguments carefully, I am not persuaded that InterTrade demonstrated sufficient linkage between the acts complained of and the consequences alleged. Therefore, in my view, InterTrade has probably failed to prove causation. However, on the reasoning of the Majority Decision, this issue does not arise for determination. For this reason, my comments in this separate opinion will be brief and focused only on the issue of attribution.

3. In this arbitration, the Claimant alleges that the Czech Republic "held illegal, manipulated tenders in the forest sector in 2004 which ultimately led to CE Wood losing its business and hence forced InterTrade to give up its investment."[1] The Respondent has raised a number of jurisdictional objections. The objection relevant to this separate opinion is the allegation that the acts complained of are not attributable to it and, therefore, the Tribunal does not have jurisdiction to decide the Claimant's claims under the BIT. The Claimant submits that the alleged treaty breaches are attributable to the Respondent under one or more of Articles 4, 5, 8 and 11 of the ILC Articles on State Responsibility. I agree with the majority's reasoning and conclusion in respect of Articles 8 and 11, but respectfully disagree in respect of Articles 4 and 5 for the following reasons.

4. As mentioned, the claim in this arbitration relates to tenders in the forest sector conducted in 2004. The ministry ultimately responsible for forests in the Czech Republic is the Ministry of

[1] Request for Arbitration at para. 1.

Agriculture.[2] Approximately 60% of the forests in the Czech Republic are State owned.[3] In 1992, the Ministry of Agriculture founded a State enterprise, Lesy České Republiky, S.P. ("Lesy CR"), to perform the State's functions with regard to preserving, protecting and regenerating the Czech forests.[4] The Ministry of Agriculture delegated the day-to-day management of the State-owned forests to Lesy CR, but, in accordance with the *State Enterprise Act*, it maintained control over Lesy CR through the power to appoint and dismiss the Director and two-thirds of the Supervisory Board.[5] Also in accordance with this Act, the Ministry of Agriculture had both "the right and the obligation to request information on the business activities ...of the Enterprise and to check and verify the information...".[6] The evidence in the arbitration demonstrated that the Ministry of Agriculture actively controlled the management of Lesy CR at the management level. Between October 2003 and January 2009, the Ministry of Agriculture replaced the Chief Executive Director of Lesy CR six times.[7] There were also a number of changes to the Supervisory Board.[8]

5. The evidence also demonstrated that the day-to-day management of the forests fell to Lesy CR. After it was founded, Lesy CR entered into contracts with private companies for logging and reforestation services.[9] According to the Foundation Decree, Lesy CR was responsible for not only ensuring that the forests were managed in a cost effective way, but also that the forest land resources were protected, that regulations were complied with and that systems in the forest, including watercourses, were ameliorated, maintained and managed. CE Wood held a number of these contracts for many years.

6. In late 2004, Lesy CR published on its website a notice of tender for the execution of logging and re-planting activities in 87 territorial units. The tender documents made clear that the tenders were for "a general contract for delivery of complete forestry activities, a contract for

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[2] Czech Forest Act, Article 49; National Forest Programme, Exh. R-17, p.2. Also see Reply at paras. 131, 139 - 140.

[3] Request for Arbitration at para. 5. According to the Respondent, the figure may be as high as 77%; see Respondent's Statement of Rejoinder, para. 28.

[4] See Foundation Decree dated 11 December 1991 (Exh. CLM-78); Request for Arbitration at para. 5; Statement of Defence at para. 135; Reply at para. 112.

[5] See State Enterprise Act, sections 15, 12(2) and 13(2) and Reply at paras. 123 – 124.

[6] State Enterprise Act, section 15(g).

[7] Exh. C-84, "State Forests will be Managed by Sykora", January 1, 2009.

[8] See Statement of Reply at para. 129.

[9] See Statement of Defence at para. 142.

performing silvicultural activities and a contract for performing logging activities in [each territorial unit]."[10] CE Wood submitted tenders for all 87 units and was awarded two, although it previously had contracts for 40 of those units.[11] InterTrade says that the tenders were illegal and manipulated and that it lost its investment as a result of this tainted process. InterTrade alleges that the Respondent is responsible for the tenders either through the acts or omissions of the Ministry of Agriculture (Article 4) or the acts of Lesy CR directly (Article 5).

Article 4

7. Article 4 provides:

> 1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State.
>
> 2. An organ includes any person or entity which has that status in accordance with the internal law of the State.

8. As stated in the Majority Decision, the Czech Republic is responsible for all of the acts of the Ministry of Agriculture because it is an organ of the State. Thus, the Tribunal has the jurisdiction to determine whether the acts of the Ministry of Agriculture are acts that breached the BIT. The Majority has reviewed the evidence and found that "the Claimant failed to adduce any evidence of specific acts of the Ministry in the conduct of the tender which engaged its responsibility." The Majority then goes on to say, "the Ministry's alleged failure to supervise how LCR actually conducted the tender demonstrates precisely that the "founder" of LCR respected the independence of the State enterprise in the management of its regular business activity." In my view, these conclusions do not fully address all of the submissions made by the Claimant.

9. The Claimant argues "that the actions and omissions complained of in this arbitration, namely the planning and execution of a tender as well as the failure to remedy its harmful effects – are those of the Ministry of Agriculture as much as they are those of Lesy CR."[12] The purpose

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[10] Exh. R-61, Notice of Preparation of a Tender Announcement.

[11] Request for Arbitration at para. 12.

[12] Reply at para 134.

of the tender was described as a "change of paradigm"[13] and stated to be a restructuring of the management of the forests because the then current system "was unsatisfactory both in the light of antimonopoly legislation and economic effectiveness, and in the light of European law."[14] Although it is true that the Claimant did not adduce any evidence of specific acts of the Ministry of Agriculture in the conduct of the tender, it is clear from the evidence that the Ministry was integrally involved in the decision to conduct a tender for the express purpose of changing the way the forests were managed. It was also clear that the Ministry of Agriculture reacted to the industry outcry after the tender was conducted by removing the Chief Executive Director of Lesy CR. The evidence also indicates that the Ministry of Agriculture refused to intervene to assess whether the tenders had been conducted properly after asked to do so by the Claimant. I am troubled that an organ of the State would avoid responsibility for the conduct of an illegal tender (if proved) simply because it macro-managed the tender process rather than micro-managed the tender process. Despite the Respondent's protestations to the contrary, the tender process at issue was not just a commercial exercise in which an entity independent from the State was seeking to maximize its profits. That is clear from the stated purpose in the call for tender, as well as the Ministry's keen interest and involvement in the process at the management level. Unlike the Majority Decision, I would have found that the Ministry was sufficiently involved in the tender process to require a closer examination of its failure to oversee the acts of Lesy CR, as it is obliged to do by statute, to ensure that the change in paradigm it directed for the management of the State forests be conducted in such a way as to not breach any treaty obligations.

10. I note that this case differs from *Jan de Nul* v. *Egypt* to the extent that it is not disputed that the Ministry of Agriculture is an organ of the State. In this case, the Claimant relies on Article 4 alleging that the Ministry of Agriculture itself, through its acts and omissions, and not Lesy CR alone, breached the Claimant's treaty rights. The same can be said for the *Hamester* v. *Ghana* case upon which the Respondent also relies. As noted in those cases, under Article 4, States are responsible for all acts of State organs, whether those acts are acts *de jure gestionis* or *de juri imperii*. Thus, the Respondent is responsible for any acts or omissions of the Ministry of

[13] Statement of Defence at p.41.

[14] Statement of Defence at para. 149.

Agriculture in relation to the tender regardless of whether the tender was for commercial or governmental purposes.

11. In light of the Majority Decision, I make no comment about the merits and whether the tenders were run in a non-transparent or illegal manner, as alleged. However, I am of the view that the Ministry of Agriculture, as the State organ designated by the State to manage the forests is responsible for how that management occurs. The Ministry of Agriculture remained responsible for the administration of the forests under the Forestry Act even though it delegated the overseeing of contracts to Lesy CR. The Respondent is responsible for the acts and omissions of the Ministry of Agriculture. The Claimant alleges that the Ministry of Agriculture failed to properly oversee the tender which was an integral part of its obligation to manage the forests. Further, the Claimant asserts that once the tender was conducted, the Ministry of Agriculture failed to address concerns raised by the unsuccessful bidders.[15] Whether the alleged acts and omissions amounted to internationally wrongful conduct through a breach of the BIT is a matter that required, in my view, further review and analysis.

Article 5

12. Article 5 provides as follows:

> The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.

13. With respect to the question of whether the Respondent is responsible for the acts of Lesy CR, the analysis is somewhat different. As noted in the Majority Decision, under Article 5, a State can be responsible for a non-State entity that has been delegated governmental authority, but it is only responsible for acts *de jure imperii* – exercise of governmental authority in English or *l'exercise de prérogatives de puissance publique* in French. I agree that not all of the acts of Lesy CR can be attributed to the State and that the fact that Lesy CR has as one of its goals benefitting the wider public interest is not, in and of itself, sufficient to attribute responsibility for its acts to the Respondent. The acts complained of must be an exercise of governmental

[15] I note that on 23 March 2007, the Commission of the European Communities issued a reasoned opinion on the basis of Art. 226 of the Treaty establishing the European Community, stating that the procurement proceedings breached several obligations under the Directive 92/50/EEC and Directive 2004/18/EC. See Exh. C-17.

authority. There is no dispute in this case that Lesy CR was empowered to exercise elements of governmental authority. Where I disagree with my learned colleagues is in their assessment of the conduct of the tender process as a purely commercial activity and not an exercise of governmental authority.

14. As discussed above, I consider that the goal of the tender process went beyond generating funds or maximizing profit for Lesy CR. In addition to representing a paradigm shift in how the forests were managed, the criteria for selecting the successful bidder included more than just the best price. The tenders were designed to find bidders that would properly manage the forests, albeit in an economically advantageous manner. In my view, applying the label "tender" to the acts complained of and saying that it is therefore commercial overly simplifies the necessary factual analysis and does not properly perform the functional test required to determine whether Lesy CR was exercising governmental authority through the tender process. Although a tender process may appear to be connected only to commercial activities, it is necessary to analyse the purpose of the tender in question.

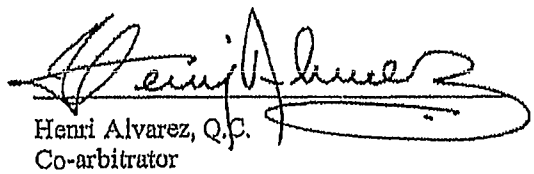
15. I am of the view that there are few functions more intimately related to governmental authority than the management of natural resources, such as State-owned forests. This view appears to have been shared by the Czech Minister of Agriculture at the time of the impugned tenders, Jaroslav Palas, who was quoted in an interview at the time as saying, "[t]he Czech government and I personally consider the forest wealth of the country an integral part of what we sometimes aptly call "the family silver" which shall not be sold out under any circumstances because of a vision of immediate profit."[16] This tender process was not a purely commercial one, as might be a tender conducted to identify a firm that would provide legal services or office supplies to Lesy CR. Through this tender process, the Ministry of Agriculture hoped to change how the State-owned forests were managed by deciding which firms would be awarded the contracts to harvest timber based on criteria that went beyond the best price. The determination of who will be granted the right to perform complete forest services, including not only logging activities, but also silvicultural activities to protect, preserve and ameliorate the forests, is central to the management of the forests. I consider this an exercise of governmental authority.

[16] Exhibit C-83, "Palas Claims: We Shall Not Sell Lesy CR Out", Silvarium, 17 March 2005.

16. The Majority Decision has referred to and adopted the reasoning of the *Jan de Nul* tribunal. I note that, surprisingly, the two paragraphs quoted in the Majority Decision constitute the entire reasoning of that tribunal on the issue of attribution under Article 5. Further, I cannot agree with that tribunal's conclusion that "the fact that the subject matter of the contract related to the core functions of the SCA, ...is irrelevant." In my view, this cannot be correct, as the logical conclusion is that a State cannot be responsible for any dispute arising out of a contract or, in other words, an entity cannot exercise governmental authority through a contractual process. As noted in the commentary to the Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001:

> Article 5 does not attempt to identify precisely the scope of "governmental authority" for the purpose of attribution of the conduct of an entity to the State. Beyond a certain limit, what is regarded as "governmental" depends on the particular society, its history and traditions. Of particular importance will be not just the content of the powers, but the way they are conferred on an entity, the purposes for which they are to be exercised and the extent to which the entity is accountable to government for their exercise. These are essentially questions of the application of a general standard to varied circumstances.[17]

17. Article 5 was adopted to take account of para-statal entities.[18] While States should not be held responsible at international law for acts that are purely commercial, they should not be able to avoid responsibility by exercising governmental authority through contractual or commercial means. If, through the tender process, Lesy CR was managing the State-owned forests, then it was exercising governmental authority. The fact that the subject matter of the tender process relates to the core function of Lesy CR is of fundamental importance.



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[17] Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001 at p. 43 (6). http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf

[18] Ibid at p. 42.