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December 29, 2004

By Courier
Ceskoslovenska obchodni banka, a.s.
c/o Mr. Charles N. Brower,
Ms. Abby Cohen Smutny,
Mr. Francis A. Vasquez, Jr. and
Ms. Anne D. Smith
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701 Thirteenth Street, NW
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The Slovak Republic
c/o Professor Emmanuel Gaillard
Shearman & Sterling
114 avenue des Champs-Elysées
75008 Paris
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and
Mr. Henry Weisburg
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599 Lexington Avenue
New York, NY 10022

Re: Ceskoslovenska obchodni banka, a.s. v. Slovak Republic
(ICSID Case No. ARB/97/4)

Dear Sirs and Mesdames,

The Tribunal has now drawn up and signed its Award.

In accordance with Rule 48(1)(a) of the Arbitration Rules of the Centre, I have authenticated the original text of the Award and deposited it in the archives of the Centre.

In accordance with Rule 48(1)(b) of the Arbitration Rules, I am dispatching to you herewith a certified copy of the Award. I have indicated the date of this dispatch on the original text and on all copies.

In accordance with Article 49(1) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States and Rule 48(2) of the Arbitration Rules, the Award is deemed to have been rendered on this date, December 29, 2004.

Sincerely yours,

Roberto Dañino
Secretary-General

Enclosure

cc: Professor Hans van Houtte
Professor Piero Bernardini
Professor Andreas Bucher

International Centre for Settlement of Investment Disputes
1818 H Street, N.W., Washington, D.C. 20433, U.S.A.
Telephone: (202) 458-1534 FAX: (202) 522-2615/2027

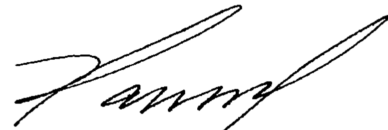
CERTIFICATE

Ceskoslovenska obchodni banka, a.s.

v.

Slovak Republic
(ICSID Case No. ARB/97/4)

I hereby certify that the attached document is a true copy of the original of the Award of the Arbitral Tribunal in the above case.



Roberto Dañino
Secretary-General

Washington, D.C.
December 29, 2004

Date of dispatch to the parties: December 29, 2004

International Centre for Settlement of Investment Disputes

ČESKOSLOVENSKÁ OBCHODNÍ BANKA A.S.
(Claimant)

versus

THE SLOVAK REPUBLIC
(Respondent)

Case No. ARB/97/4

AWARD

RENDERED BY THE TRIBUNAL

composed of
Professor Hans van Houtte, President
Professor Piero Bernardini
Professor Andreas Bucher

Secretary of the Tribunal

Ms. Margrete Stevens

Representing the Claimant:

Mr. Charles N. Brower
Ms. Abby Cohen Smutny
Mr. Francis A. Vasquez Jr
Ms. Anne D. Smith
White & Case LLP, Washington, D.C.

Representing the Respondent:

Mr. Henry Weisburg
Shearman & Sterling, NewYork, NY

Professor Emmanuel Gaillard
Mr. John Savage
Mr. Peter Griffin
Shearman & Sterling, Paris, France

and, as co-counsel

Ms. Alena Černejová
Mr. Peter Bartošík
Černejová & Hrbek,
Bratislava, Slovak Republic

Table of Contents

I. Introduction
II. Background of the Dispute
  A. CSOB's Privatisation
  B. The Three Phases of the Restructuring and Privatisation Process
  C. The Agreements Relating to the Second Phase
  D. The Cover Losses Provision of Article 3 of the CA at the Core of this Dispute
  E. CSOB's Claims and the Slovak Republic's Request
  F. The Scope of the Tribunal's Jurisdiction
  G. The Petition for the Declaration of SI's Bankruptcy
III. The Law Applicable to the CA
  A. The CA is a Legal Agreement
  B. The Role of International Law in Respect of the CA
  C. Is the CA Governed by Czech Public Law ?
  D. Czech Private Law Is Applicable to Article 3 CA
IV. The Meaning and Scope of Article 3 CA
  A. Introduction
  B. The Rules of Czech Law Applicable to the Interpretation of Article 3 CA
    1. In general
    2. The relevance of the wording
  C. The Legal Nature of the Cover Losses Provision of Article 3 CA
  D. The Notion of "Losses" that Triggers a "Cover Losses" Obligation
    1. The losses related to the assigned non-performing receivables
      a. The relevant schedule of payments
      b. The occurrence of losses
      c. The selection and collection of the receivables assigned
        i. The Slovak Republic's involvement, knowledge and acceptance
        ii. The 6.25% capital adequacy ratio
    2. The losses related to the operating costs
  E. The Obligation to Cover Losses Under Article 3 CA
    1. The Slovak Republic's involvement in the negotiation of the cover losses provision
    2. The meaning of "cover losses"
    3. The Slovak Republic's obligation to cover SI's losses
    4. CSOB's right to claim
V. The Receivables that Could Trigger Losses Under Article 3 CA
  A. On-Balance Sheet Receivables
    1. The devaluation loans
    2. The receivables concerning Polnopo / Mykroprogres
    3. Later transfer of receivables
  B. Off-Balance Sheet Receivables
    1. CSOB's internal instructions
    2. Absence of signature on OBS Technopol loans
    3. Later transfer of receivables
VI. CSOB's Claim For Compensation
  A. Obligation to Pay Full Compensation

B. The Claim Based on the Principal Amount of the Loan
C. The Claim Based on Interest Related to the Loan
1. Article 4 of the Loan Agreement
2. Methods (a) and (b)
3. Method (c)
4. The actually fixed interest rates
5. Interest calculation related to the currency split of the loan
6. Capitalization of interest
a. The agreement of the parties to the LA
b. Capitalization as "common business practice"
c. Other arguments
7. The amount of interest included in the Slovak Republic's cover losses obligation
8. Article 8 of the Loan Agreement
D. Lost Profits and Interest on CSOB's Damage Claim
1. Procedural standing of CSOB's claim for lost profits
2. Concrete and abstract lost profits
3. The issue of evidence of CSOB's lost profits
4. Interest of CSOB's damage claim
E. Operating Costs and Other Fees
F. Taxes
VII. The Division of Costs
VIII. Decision

I. INTRODUCTION

1. The Claimant in this case is the Československá Obchodní Banka A.S. (hereinafter "CSOB"), a commercial bank organized under Czech law; the Respondent is the Slovak Republic. CSOB filed its "Request for Arbitration" with the International Centre for Settlement of Investment Disputes (hereinafter "ICSID" or "Centre") on April 18, 1997, charging the Slovak Republic with a breach of the Agreement on the Basic Principles of a Financial Consolidation of Československá Obchodní Banka dated December 17, 1993 (hereinafter the "Consolidation Agreement"), that was concluded between the Ministry of Finance of the Czech Republic, the Ministry of Finance of the Slovak Republic and CSOB. CSOB alleged that the breach consisted in the failure of the Slovak Republic to cover the losses incurred by the Slovenská inkasná spol. s.r.o. (the Slovak Collection Company), as agreed to in the Consolidation Agreement and claimed dam-

ages for the losses sustained, plus costs. The Request was registered by the Centre on April 25, 1997.

2. In accordance with Rule 6(1) of the ICSID Rules of Procedure for Arbitration Proceedings (Arbitration Rules), the Tribunal was deemed constituted and the proceedings to have begun on August 20, 1997, the date on which the Parties were notified by the Acting Secretary-General of ICSID that Professor Andreas Bucher, appointed by CSOB, Professor Piero Bernardini, appointed by the Slovak Republic, and Professor Thomas Buergenthal, designated as President of the Tribunal by the Centre, had accepted their appointments. On that date, the Acting Secretary-General also informed the Parties that Ms. Margrete Stevens, Senior Counsel, ICSID, would serve as Secretary of the Tribunal.

3. On May 24, 1999, the Tribunal rendered a first decision on jurisdiction (hereinafter the "First Decision on Jurisdiction"),[1] holding that the Parties had consented in the Consolidation Agreement to ICSID jurisdiction and that, accordingly, the dispute was within the jurisdiction of the Centre and the competence of the Tribunal.

4. On December 23, 1999, the Slovak Republic filed a Further and Partial Objection to Jurisdiction under ICSID Arbitration Rule 41.

5. After having heard the Parties' written and oral submissions on this Request, the Tribunal, on December 1, 2000, rendered its Decision on Respondent's Further and Partial Objection to Jurisdiction (hereinafter the "Second Decision on Jurisdiction").[2] In this Decision, the Tribunal confirmed its jurisdiction regarding the dispute as framed by CSOB to the extent that the same arises under the Consolidation Agreement and is to be settled according to its provisions, including its governing law clause. On February 20, 2001, the Tribunal informed the Parties that further directions, as they had been requested by the Slovak Republic on February 12, 2001, were not necessary to enable the Slovak Republic to proceed with its defense; the Tribunal therefore concluded that it had nothing to add to its Second Decision on Jurisdiction.

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[1] 14 *ICSID Review, Foreign Investment Law Journal*, at 251 (1999).
[2] 15 *ICSID Review, Foreign Investment Law Journal*, at 530 (2000).

6. By letter dated October 4, 2001, Judge Thomas Buergenthal confirmed his decision to resign as President of the Tribunal. In accordance with Arbitration Rule 10(2), the proceeding was suspended until the vacancy had been filled.

7. In a joint letter dated December 3, 2001, both Parties requested that the Centre appoint Professor Hans van Houtte to replace Judge Buergenthal on the Tribunal. By letter dated December 11, 2001, the Centre informed the Parties that Professor van Houtte had accepted his appointment and that, accordingly, the Tribunal was deemed to have been reconstituted and the proceedings to have resumed as of that date.

8. After the First Decision on Jurisdiction had been rendered and the merits phase of these proceedings opened for the presentation of written submissions, the Parties filed the following memorials, together with supporting documentation, within the time limits fixed by the Tribunal:

CSOB:	Claimant's Memorial on the Merits, dated November 15, 1999;[3]
Slovak Republic:	The Slovak Republic's Counter Memorial, dated April 19, 2001;
CSOB:	Claimant's Reply, dated August 31, 2001;
Slovak Republic:	The Slovak Republic's Rejoinder, dated February 28, 2002.

9. In Procedural Order No. 6 dated February 16, 2001, the Tribunal granted, with modifications, the Slovak Republic's request for the production of documents by CSOB. A set of documents was filed by the CSOB on March 12, 2001. In its Procedural Order No. 7 dated October 14, 2002, the Tribunal confirmed that Procedural Order No. 6 continued to govern the production of documents, including the denial of the Slovak Republic's request for production of documents relating to the finances and performance of Česka inkasní s.r.o.; the Tribunal ruled therefore that in respect of the latter category of materials, it considered irrelevant documents and paragraphs whose removal from the file had been requested by the Slovak Republic and would not take them into account, without, however, ordering that such documents and paragraphs were to be actually removed from the files already submitted.

3 This Memorial was re-submitted on February 15, 2000, including corrections to the Expert Report of Timothy H. Hart (Arthur Andersen) submitted January 20, 2000.

10. On October 1, 2002, the Tribunal held a meeting at the Centre in Washington, D.C. that dealt with procedural issues regarding the conduct of the first oral hearing on the merits to be held on November 8-12, 2002.

11. The first oral hearing on the merits was held on November 8-12, 2002 in Prague, at a venue agreed by the Parties. The hearing of witnesses and experts, followed by the Parties' respective pleadings, was recorded and documented by a transcript (hereinafter "TR, November 2002").

12. Following the first oral hearing held in Prague, the Parties filed on January 31, 2003 the following submissions, within the time limit fixed by the Tribunal:

CSOB's Post Hearing Submission on Issues Addressed at the Hearing of November 8-12, 2002;
The Slovak Republic's First Post Hearing Memorial.

13. The second oral hearing on the merits was equally held in Prague, as agreed by the Parties. It took place on April 14-18, 2003. The hearing of witnesses and experts, followed by the Parties' respective pleadings, was again recorded and documented by a transcript (hereinafter "TR, April 2003").

14. Following the second oral hearing on the merits, the Parties filed the following submissions, within the time limits fixed by the Tribunal:

On June 20, 2003: CSOB's Post Hearing Submission on Issues Addressed at the Hearing of April 14-18, 2003; The Slovak Republic's Second Post Hearing Memorial;

On July 18, 2003: CSOB's Reply to the Slovak Republic's Second Post Hearing Memorial; The Slovak Republic's Third Post Hearing Memorial.

On June 20, 2003, the Slovak Republic further filed a brief under the title "The Slovak Republic's Proposed Findings of Fact and Conclusions of Law", to which CSOB submitted a Reply on July 18, 2003.

15. Upon the invitation by the Tribunal, the Parties submitted on October 18, 2004 an update of the quotations of the inter-bank rates on three-months loans (BRIBOR).

16. On October 29, 2004, each Party submitted a statement of costs incurred or borne by it in this proceeding and on November 15, 2004, each Party made comments on the other Party's statement.

17. By letter dated November 19, 2004, the Parties were informed that the proceeding had been closed.

II. BACKGROUND OF THE DISPUTE

A. CSOB's Privatisation

18. In the early 1990s, banks in Central and Eastern Europe had great difficulty remaining solvent and competitive as their markets evolved from state-run economies to private market economies. In order to remain viable, they needed restructuring. Most state-owned banks thus became subject to privatisation processes in their respective countries.

19. The present dispute relates to the privatisation of one such bank, CSOB, the Foreign Trade Bank of the former Czeskoslovak Republic, that changed its name to the "Czech and Slovak Federal Republic" in 1990. After this Republic was dissolved in December 31, 1992, CSOB remained active in the succeeding Czech and Slovak Republics.

20. In 1992, with a view to future privatisation, the Czech and Slovak Republics had begun the restructuring of CSOB. In fact, the restructuring of CSOB was the first of several re-structuring operations of former Czechoslovak state-owned banks so as to prepare them for privatisation.

21. At the end of 1992, after the dissolution of Czechoslovakia, the succeeding Czech and Slovak Republics had become involved in the restructuring of CSOB. Both Republics

became shareholders of CSOB which was pursuing its activity in the territory of both States.[4]

B. The Three Phases of the Restructuring and Privatisation Process

22. The restructuring and privatisation process was organized in three phases:

23. During the first phase, which was initiated under the Federal Czechoslovak Government, non-performing state-related assets and liabilities from CSOB were transferred to the Czech and Slovak Republics at the ratio of 2:1, reflecting the respective population of both successor states. As of January 1, 1993, the central foreign exchange resources and the assets and liabilities of non-convertible currencies were transferred to the Czech and Slovak Republics at the same ratio of 2:1. Problems connected with foreign exchange assets and liabilities of state character within CSOB's balance were thus resolved and CSOB was relinquished from its former role as the Government's financier of foreign trade.

24. During the second phase, CSOB's forthcoming privatisation came under preparation. It was contemplated that such privatisation would take place within two to four years. This phase included, *inter alia*, the increase of the registered capital of CSOB; the establishment of a Czech and Slovak Collection Company to whom non-performing receivables of CSOB would be transferred; and the establishment of a CSOB subsidiary in the Slovak Republic. To implement the second stage of the restructuring, the Consolidation Agreement (abbreviated "CA") was concluded between the Ministry of Finance of the Czech Republic (hereinafter the "MF CR"); the Ministry of Finance of the Slovak Republic (hereinafter the "MF SR"); and CSOB. The Czech National Bank, the National Property Fund of the Czech Republic and the National Bank of Slovakia declared their consent to this Agreement. Contrary to the later restructuring of other Czech and Slovak banks, where restructuring assets were written down to the real value, CSOB's assets

[4] The main shareholders of CSOB were the Czech National Bank (26.51%) and the National Bank of Slovakia (24.13%), the Czech Ministry of Finance and the Czech National Property Fund (each 19.59%), as well as private shareholders (10.18%).

were maintained at nominal value and non-performing assets were replaced by performing receivables.

25. The third and final phase of CSOB's transformation was its privatisation. This privatisation would require that at least 51% of the remaining state participation in CSOB were sold to one strategic investor. In 1997, the actual privatisation of CSOB was undertaken. CSOB was subsequently privatised in 1999 when the Czech State shareholders (*i.e.* the Czech National Property Fund, the Czech Ministry of Finance, and the Czech National Bank) as well as the National Bank of Slovakia sold their shares to KBC, a Belgian bank.

26. The restructuring and privatisation of CSOB has been profitable to both the Czech Republic and the Slovak Republic. Before the restructuring, the privatisation of CSOB would have been difficult and not very lucrative. The Tribunal notes that the Slovak Republic contributed an amount of Czech Crowns 1,055 million to the increase of CSOB's capital. CSOB claims that the Slovak Republic undertook a commitment to cover the losses incurred by the Slovak Collection Company and that its obligation to cover these losses amounted to SKK 13,523,712,976. In this Award the Tribunal will analyze whether indeed the Slovak Republic was required to cover such losses for such amount. It may be born in mind that regardless whether the Slovak Republic would have to cover the full amount as claimed by CSOB, the privatisation of CSOB, that has yielded more than 17 billion SKK to the Slovak Republic, has been a profitable operation for the Slovak Republic.

C. The Agreements Relating to the Second Phase

27. The Consolidation Agreement that was the basic agreement to implement the second stage of CSOB's restructuring provided, *inter alia*, for the assignment by CSOB of non-performing loan portfolio receivables to two so-called "Collection Companies", one to be established by the Czech Republic (Česka inkasní s.r.o., hereinafter "CI"), and the other by the Slovak Republic (the Slovenská inkasná spol s.r.o., hereinafter "SI"), in their respective national territories. This operation led to the conclusion of a number of

agreements which, in respect of SI, have been described collectively as the "CSOB/SI Agreements".

28. The "Agreement on the Assignment of Certain Receivables of a Loan Portfolio" (hereinafter the "Assignment Agreement"), and the "Agreement to Conclude Future Agreements on the Assignments of Certain Receivables under Off-Balance Sheet Instruments" (hereinafter the "Future Assignment Agreement" or "FAA"), that became effective on December 31, 1993, organized the assignments. On the one hand, the Assignment Agreement assigned actual balances of loans and payments made under guarantees. Two amendments to this Agreement were concluded subsequently, with the effect of changing the amount of receivables assigned. On the other hand, the FAA covered receivables that were to be created by a future payment by CSOB, *e.g.* when a letter of credit was drawn. These receivables were therefore assigned at a later stage, through several specific agreements (hereinafter the "OBS Assignment Agreements"). The FAA identified the amounts of receivables as specified and determined that they were related to: Technopol a.s., Slovart a.s., Chirana Export-Import, Drevoúnia a.s., Istroconti a.s., Martimex a.s., Elteco Zdruzenie.

29. Other agreements had to organize the financing of the assignments. The Czech and Slovak Collection Companies were to receive the necessary funds from CSOB by way of a loan in order to allow them to finance the assigned receivables and to pay their nominal value to CSOB.

30. SI and CSOB thus concluded a "Loan Agreement on the Refinancing of Assigned Receivables" (hereinafter the "LA"), also effective as of December 31, 1993. The LA was amended ten times in relation to the financing of the assignment of receivables arising from the on-balance sheet instruments, some of these amendments being more relevant to this dispute than others, as will be seen below.

31. The actual assignment of the off-balance sheet instruments was carried out by the OBS Assignment Agreements, each of which relates to one particular Foreign Trade Organization (hereinafter "FTO"). In parallel, OBS Loan Agreements were concluded between CSOB and SI, again in respect of each FTO, providing for loan disbursements in accor-

dance with the payments to be made for the receivables. The LA provided in Article 1(b) for the conclusion of these agreements; on the other hand, the OBS Loan Agreements stated that they were related to the LA and that both documents should only be interpreted in their mutual interconnection (Art. V). When the underlying guarantees had to be paid and CSOB's exposure materialised, SI had to pay for the transferred receivable. A corresponding Amendment to the respective OBS Loan Agreement was then concluded pursuant to which CSOB loaned SI an amount equal to the consideration part for the transferred asset.

32. Uncertain receivables were thus removed from CSOB's balance sheet and were replaced by payments made by the Czech and Slovak Collection Companies, financed with funds provided as a loan by CSOB.

33. Finally, CSOB and SI also concluded an "Agreement on securing activities of Slovenská inkasná" (hereinafter the "Operation Agreement"). Under this agreement CSOB had to take care of the administration of SI and secure the collection of the receivables CSOB had transferred to SI. For this purpose, CSOB had to put at the disposal of SI the necessary number of employees, one of which would act as executive of SI (Art. III[2]). CSOB employees performing activities for SI were subject only to orders and instructions of the executives of SI in accordance with the resolution of the General Meeting and the Supervisory Board of SI; however, they were not to act against the business interest of CSOB (Art. III[1][2]). The activities of SI's executives were to be subject, *inter alia*, to the control and other authority of the Supervisory Board of SI (Art. III[2]). Since the MF SR was the sole shareholder of SI, it had full authority in the General Meeting and the power of appointment of the members of the Supervisory Board.

34. On the part of the Slovak Republic, the preparation and implementation of stage II of CSOB's restructuring was the responsibility of a Working Group appointed by Resolution No. 937 of the Government of the Slovak Republic of December 15, 1993. This Group was composed of selected Ministers of the Slovak Republic and the Governor of the National Bank of Slovakia.[5] The Group authorized the Slovak Republic's Minister of

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[5] CSOB's Memorial, Exh. 6.

Finance to found SI; to enter into a "master agreement" with the MF CR and CSOB (which later became the CA); and to prepare and enter into the required partial agreements for the purpose of securing the implementation of stage II of CSOB's transformation.[6] The Working Group also charged the Minister of Finance with making provisions for the expenditures needed for the coverage of the losses of the Collection Company in the State budget for the years 1995 to 2003. SI had to be "administered by the Ministry of Finance of the Slovak Republic", according to the draft resolution relating to the proposal for the project for stage II[7] that was "recognized" by the Government of the Slovak Republic and "approved" by the Working Group, as well as according to the report attached to this draft. The CA states in its Preamble that it was "based on" Resolution No. 937 of the Government of the Slovak Republic of December 15, 1993, as well as on the corresponding Resolution No. 689 of the Government of the Czech Republic of December 1, 1993.

D. <u>The Cover Losses Provision of Article 3 of the CA at the Core of this Dispute</u>

35. One of the essential features of the assignments and their financing was that the Czech Republic and the Slovak Republic had agreed in the CA that they would "cover any losses" of the Collection Companies. Article 3, II, 5th paragraph of the CA stated -

> The losses of the Collection Company shall be compensated for over the period 1995-2003. The MF CR [Ministry of Finance of the Czech Republic] and the MF SR [Ministry of Finance of the Slovak Republic], each undertakes to cover any losses made by the Collection Company in its respective territory.

36. The Collection Companies that had to take over the non-performing receivables at their nominal value risked never to realize these receivables. This risk was covered by the commitment from the Czech and Slovak Republics that they would "cover" the losses of the Collection Companies.

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[6] Conclusion with respect to the Proposal for the project for Stage II of the restructuring of CSOB, December 16, 1993, CSOB's Memorial, Exh. 7.

[7] Statement of P. Kavánek, Exh. 1.

37. The present dispute thus turns on the meaning, scope and effect of the "cover losses" commitment from the Slovak Republic. CSOB claims that the Slovak Republic did not "cover losses" of SI as this had been agreed. Moreover, prospects of SI repaying are nil, as the SI has been subject to bankruptcy proceedings and has stopped all activities. The Slovak Republic is of the view that the "cover losses" provision is unenforceable as it does not satisfy the certainty requirement of Czech law. It contends that it has no liability to CSOB under this provision.

E. CSOB's Claims and the Slovak Republic's Request

38. In its Memorial of November 15, 1999, CSOB claimed compensation of -

1. *The sum of SKK 24,659,907,271, being equal to the principal and interest due to June 30, 2000 under the SI Loan Agreement;*
2. *The sum of SKK 9,064,537,958, being the additional losses of CSOB it may claim pursuant to Section 379 et seq. of the Commercial Code of the Czech Republic, measured by the Slovak Government bond yield to June 30, 2000;*
3. *The additional sums due when the damages under 1 and 2 above are carried forward from June 30, 2000 to the date of the award to be issued in this case;*
4. *Such additional sums as may be calculated and submitted to the Tribunal prior to the closure of this proceeding representing CSOB's further damages, including lost productive management time and professional fees and expenses incurred relating to*
    a. *all proceedings relating to SI's bankruptcy,*
    b. *obtaining, documenting, implementing, and maintaining Czech shareholder financial support of the Bank;*
    c. *this proceeding; and*
    d. *otherwise asserting its rights under the Consolidation Agreement;*
5. *Interest at a rate (or rates) to be determined on all sums awarded from the date of the award until the date it is paid.*

39. In its final submission of June 20, 2003, CSOB has specified its claim to be awarded as compensation the following -

1. *The sum as of March 31, 2003 of SKK 40,300,940,576, consisting of:*

   (a) SKK 32,443,747,036 in 'actual damage', being equal to the diminishment in value of CSOB's rights under the SI Loan Agreement caused by the Slovak Republic's breach of the Consolidation Agreement; and

   (b) SKK 7,857,193,540, reflecting the additional gains that CSOB would have realised had the Slovak Republic satisfied its obligation to CSOB in April 1997 and if CSOB had invested the amounts then due and owing in Slovak Government bonds;

2. *CSOB's costs including all the costs and expenses of this arbitration proceeding; and*

3. *Interest at a rate (or rates) determined with reference to Section 735 of the Commercial Code of the Czech Republic, as amended, on all sums awarded from the date of the award until the date of payment.*

40. The Slovak Republic argues on various grounds that CSOB's claims are unfounded. In its submission, the Slovak Republic requested the Tribunal to issue an award -

- *dismissing all of CSOB's claims;*
- *ordering CSOB to pay all the Slovak Republic's costs associated with this proceeding, including attorney's fees and expenses, and*
- *grant the Slovak Republic any further relief that the Tribunal deems appropriate.*

F. <u>The Scope of the Tribunal's Jurisdiction</u>

41. In front of the complex legal structure of the second stage of CSOB's restructuring and privatisation, it may be useful to recall that the jurisdiction of this Tribunal is limited to claims arising under the CA. In its Second Decision on Jurisdiction, the Tribunal confirmed its First Decision and stated that it holds –

that its competence covers, and is confined to, issues arising out of the Consolidation Agreement (No. 32)

42. The Second Decision further explained –

> 33. - For the guidance of the parties in the merits phase of these proceedings, the Tribunal reiterates that it has jurisdiction to determine the validity, nature and scope of Respondent's obligation to cover SI's losses as provided by Article 3(II) of the Consolidation Agreement, to establish whether Respondent has breached that obligation, and to assess damages, if any, payable by Respondent to CSOB for any such breach.

G. The Petition for the Declaration of SI's Bankruptcy

43. On May 6, 1998, SI was declared bankrupt by the Regional Court in Bratislava. CSOB submitted an Application for registration of receivables in bankruptcy proceedings on June 23, 1998.[8] CSOB also requested that the bankruptcy proceeding be dismissed on the ground that SI had only one creditor. The Supreme Court of the Slovak Republic affirmed the decision of the Bratislava Regional Court by its ruling dated September 13, 1999.

44. By its Procedural Order No. 5 of March 1, 2000, the Tribunal, upon CSOB's request, recommended that the bankruptcy proceedings be suspended to the extent that such proceedings might include determinations as to whether SI has made a loss resulting from the operating costs and the schedule of payments for the receivables assigned to it by CSOB, including payment of interest, as contemplated in the Consolidation Agreement at issue in this arbitration. It also invited the Parties to keep the Tribunal informed of the implementation of this Order.

45. Ultimately, the Regional Court in Bratislava cancelled the bankruptcy by its decision of June 7, 2001. The Supreme Court of the Slovak Republic upheld this decision on Sep-

8 Statement I. Cestr, Tab C, filed with CSOB's Request for Provisional Measures of September 4, 1998; the Slovak Republic's Observations on CSOB's Request for Provisional Measures of January 19, 2000, Exh. B; the Slovak Republic's Hearing Exhibits, November 2002, Tab 9.

tember 19, 2001 and the cancellation of bankruptcy became effective on November 16, 2001.

46. On October 23, 2002, SI filed a second bankruptcy petition and sought to have its assets declared bankrupt. However, by decision of January 20, 2003, the Regional Court in Bratislava discontinued the proceedings as SI had not submitted the necessary evidence to sustain its request for bankruptcy. This decision of the Regional Court was upheld on appeal by the Supreme Court of the Slovak Republic on March 12, 2003.

III. THE LAW APPLICABLE TO THE CA

47. The present dispute concerns the rights and obligations in respect of CSOB and the Slovak Republic arising under the CA that was concluded to implement phase II of CSOB's restructuring and privatisation. This phase was a product of phase I and a condition precedent to phase III. Both phases I and III are essential to understand the economic purpose of phase II and the CA under which it was implemented. However, as a legal instrument, the CA stands on its own.

A. The CA is a Legal Agreement

48. The Slovak Republic has argued that the CA was not a legal agreement but a mere political resolution, expressing the political intention of the Czech and the Slovak Republics to proceed with phase II of CSOB's restructuring. It has also argued that the CA was a mere "framework agreement" that does not contain legally binding and enforceable obligations.

49. The nature of the CA as a legal agreement is no longer in dispute. In its First Decision on Jurisdiction, the Tribunal has indeed recognized that the CA contains legally binding obligations at least in its parts relevant for this dispute -

> While it is true that investment disputes to which a State is a party frequently have political elements or involve governmental actions, such disputes do not lose their legal character as long as they concern legal rights or obligations or the consequences of their breach. Given these considerations, the Tribunal is satisfied that CSOB's claim is legal in character.[9]

50. By deciding that CSOB's claim - based upon the Consolidation Agreement - is legal in character, the Tribunal thus has confirmed that the CA, at least in its relevant parts which include its Article 3, contains legally binding provisions. In view of the Parties' further arguments developed in this respect, the Tribunal adds the following observations.

51. The CA undoubtedly was entered into for a public purpose, *i.e.* to privatise CSOB pursuant to Government resolutions and to the benefit of the public finances of both the Slovak Republic and the Czech Republic. As the Tribunal has stated in its First Decision, the fact that the Czech and the Slovak Republics acted for a public purpose does not exclude that the CA contains rights and obligations of a legal nature.

52. By naming the document they signed a "Consolidation Agreement" and by submitting it to Czech law (Art. 7), the Parties themselves indicated that they considered it to be an "agreement" governed by law, and not a mere political resolution. Moreover, the reference contained in Article 7 CA to the Treaty on the Promotion and Mutual Protection of Investments between the Czech Republic and the Slovak Republic dated November 23, 1992 (hereinafter the "BIT"), which, as the Tribunal has stated in its First Decision (No. 55, 59, 67, 89), had the effect of submitting disputes arising under the CA to settlement by ICSID arbitration, likewise confirms that the Parties understood the CA as containing legal rules and making it legally binding. Indeed, as indicated in Article 42 of the ICSID Convention, ICSID arbitrators have to apply rules of law to the dispute, unless the parties agreed that the Tribunal decide their dispute *ex aequo et bono*. No such an agreement was concluded in the instant case.

[9] First Decision on Jurisdiction, No 61.

53. The Slovak Republic has accepted on various occasions that the CA was intended to be a legal instrument and not a mere political promise. On the bottom of the LA, the Slovak Republic's Minister of Finance declared that he "in particular, confirms the obligation under Section 7 of this Agreement", *i.e.* a provision which in turn states that under the CA, "the repayment of the loan including interest thereon is secured by an obligation of the Ministry of Finance of the Slovak Republic". Although this provision cannot, in itself, determine the legal nature of the relevant rule of the CA, it demonstrates that the Slovak Republic knew and accepted the fact that it was bound by an obligation arising under the CA, relating to the repayment of the loan. This declaration was addressed to SI and CSOB as signatories of the LA. Together with SI and CSOB, the Ministry of Finance received one of the originals of the Agreement (Art. 13 LA). Further, the Slovak Republic's Minister Kozlik has stated in his letter of May 17, 1996 that the obligations of the CA were not "legally ambiguous".[10] Moreover, several statements made on behalf of the Slovak Republic have admitted that the Slovak Republic had an obligation to pay CSOB.

54. The Slovak Republic argued that – as a matter of principle – the CA could not be a binding agreement of a legal nature because it was a "framework" agreement that established nothing more than the basic principles and essential features of CSOB's consolidation during phase II. The CA had indeed been envisaged by the Czech Republic[11] and the Slovak Republic[12] as an agreement limited to the basic commitments in respect of CSOB's consolidation and privatisation. As Article 7(1) of the CA confirms, many specifications relevant for the actual relationships and procedures to be followed had to be agreed upon in later agreements. The CA did not and was not designed to spell out all the necessary details of the transaction. Indeed, it often instructed the Parties to make further arrangements, in particular as to the establishment of Collection Companies,[13] the further assignment of off-balance receivables,[14] the grant of loans,[15] the mechanism

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[10] Statement of P. Kavánek Exh. 18.

[11] Resolution No. 689 of the Government of the Czech Republic of December 1, 1993.

[12] Conclusions of December 16, 1993 of the Working Group created by the Government of the Slovak Republic.

[13] Art. 3 (II) (1)

[14] Art. 3 (II) (2 and 3)

[15] Art. 3 (II) (4)

to cover losses,[16] the further relations between the shareholders[17] and any other more detailed regulation of the various parties' relationships or on appropriate technical procedures.[18]

55. However, the assertion that an agreement is not a legally binding agreement when it leaves open some matters to be specified later cannot be sustained. The fact that an agreement imposes obligations to do something at a future time does not mean, in itself, that such an obligation is not legally binding, even when such obligation only specifies the target to reach and leaves the contracting Parties or one of them free to determine the means and mechanism to do so.

56. The obligations of the Consolidation Agreement that required further specification (*e.g.* Article 3 - Improvement in CSOB's balance; Article 4 - Privatisation of CSOB; Article 5 - Development of CSOB in the Slovak Republic; Article 6 - Institutional Form of CSOB's Activity in the Slovak Republic) imposed sufficiently specific obligations upon the parties in the nature of legally binding agreements, and they also specified how they had to be implemented.

57. The comparison made by the Slovak Republic, following one of its legal experts,[19] with the "Agreement on Economic Cooperation" between Czechoslovakia and Yemen of March 24, 1978[20] and the "Arrangement" concluded between CSOB and the Bank of Yemen "on behalf of their respective governments" on May 7, 1979,[21] does not allow another conclusion in respect of the legal nature of the CA. The fact that this Cooperation Agreement is called a "framework agreement" by the Slovak Republic does not mean that it is similar in nature to the CA, even if the term "framework agreement" is also used in respect of the CA. This Arrangement is a mere instrument for the implementation and completion of the Economic Agreement between Czechoslovakia and

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16 Art. 3 (II) (5)
17 Art. 7 (1)
18 Art. 7 (1)
19 Rejoinder Opinion of Professor Sturma, No. 28/29.
20 Rejoinder Opinion of Professor Sturma, Exh. 10.
21 Rejoinder Opinion of Professor Sturma, Exh. 11.

Yemen,[22] whereby two banks, on behalf of their respective Governments, established accounting and financial procedures as provided for in the bilateral Cooperation Agreement. The CA, on the contrary, although created to carry out the resolutions of each of the two States, is the basic agreement concluded between the Czech Republic and the Slovak Republic, as well as CSOB. It was concluded by CSOB in its own capacity and contains primary obligations that do not just complement another agreement. Therefore, CSOB's position as a party to the CA is different from its position as a party to the Arrangement mentioned above. The Slovak Republic's legal expert accepts that the CA was signed as a tripartite agreement, with CSOB as a direct party thereto, and that the CA, therefore, differs from the bilateral agreement signed between Czechoslovakia and Yemen that he characterizes as a "framework agreement".[23] This demonstrates that the "model" consisting of the agreements relating to the cooperation with Yemen does not apply to the CA which has a different nature and content. Therefore, if the term "framework agreement" is used in respect of the CA and one or both of the above mentioned agreements, it does not have the same meaning.

B. The Role of International Law in Respect of the CA

58. The question has been raised whether and if so, to which extent, the CA was governed by public international law.

59. The CA, as a whole, is not a Treaty between States, governed by international law. The fact that two States, *i.e.* the Slovak Republic and the Czech Republic, concluded an agreement is not sufficient to make such agreement subject to international law, especially as a commercial entity - *i.e.* CSOB - was also party thereto.

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22 The provisions of the Arrangement referred to the corresponding provisions of the Economic Agreement (except Article 3 of the Arrangement that specified Article 1 of the same Arrangement).

23 Cf. Rejoinder Opinion of Professor Sturma, No. 29. The expert's conclusion is anyhow rather vague when he states that the alleged fact that the CA was a "framework agreement" is "obviously a more probable interpretation" than the construction that the cover losses obligation is a "comfort letter". Even if such a conclusion would be correct, it does not demonstrate that the CA was a framework agreement of the type described by the expert.

60. The Slovak Republic's experts on Czech law envisaged the possibility that the CA was "an agreement of a mixed nature, containing both public international law duties between the two States, and private law obligations of the individual Parties".[24] In their view, the state-to-state obligations and rights contained in the CA - *i.e.* those between both Republics - would be governed by international law. Thus the engagement of the Czech Republic and the Slovak Republic to cause their respective shareholders to increase CSOB's capital (Art. 2 CA) would be subject to international law. However, even in the hypothesis that international law were to apply to the relationship between the two Republics, the Slovak Republic's experts concede that the rights and obligations of individual Parties, *i.e.* CSOB, were governed by national law.

61. The concept of "State Contracts" has also been used by one of the Slovak Republic's experts to characterise the CA.[25] In this respect, the reference to the BIT as included in Article 7(4) CA has been seen as a "manifestation of increased protection of a private legal entity signing a contract with two sovereign states".[26] However, this expert has also admitted that the space left for the application of international law was significantly narrow, in light of the reference to Czech law contained in the choice of law clause of Article 7(4),[27] which reads as follows -

> This agreement shall be governed by the laws of the Czech Republic and the Treaty on the Promotion and Mutual Protection of Investments between the Czech Republic and the Slovak Republic dated November 23, 1992.

62. The Tribunal need not engage in a broad discussion about the relevance of international law in respect of the CA and of the possible characterization of the latter as a "State Contract" concluded between two States and a private law entity. The law applicable to the provision relevant to this dispute, *i.e.* Article 3 CA, is determined by Article 7(4) as being Czech Law and the BIT. Any further focus has to be on these two sets of rules. CSOB has stated that international law could also be applicable as a matter of Czech

24 Rejoinder Opinion of Professors Pohunek, Stuna and Švestka, No. 11-12, 33.
25 Rejoinder Opinion of Professor Sturma, No. 38; TR, November 9, 2002, 67:2-68:23 (Sturma).
26 Rejoinder Opinion of Professor Sturma, No. 39; TR, November 9, 2002, 68:16-71:8 (Sturma).
27 TR, November 9, 2002, 69:5-18 (Sturma); Rejoinder Opinion of Professor Sturma, No. 50.

law. Such an application of international law through Czech law is, however, not relevant for the resolution of this dispute.

63. Pursuant to Article 42(1) of the ICSID Convention, "The Tribunal shall decide the dispute in accordance with such rules of law as may be agreed by the parties". An implied submission to international law can be seen in Article 7(4) CA where it is stated that the CA shall be governed by the BIT, in addition to the laws of the Czech Republic. In its First Decision on Jurisdiction (No. 55), the Tribunal concluded that by referring to the BIT in Article 7(4) CA, the Parties intended to incorporate the arbitration clause of Article 8 of the BIT into the CA. As the reference to the BIT in Article 7(4) is not limited to this particular provision, such incorporation into the CA is equally pertinent in respect of any other provision of the BIT that may be relevant for the interpretation and application of the CA. Even to the extent the CA is not governed by international law as such, the BIT, as it is incorporated into the CA, has to be interpreted in the context of the legal system under which it has been drafted. Consequently, the incorporation of the BIT includes the rules of international law that are relevant for its interpretation. Article 2(2) BIT states -

> Investments of investors of each Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Party. .

C. Is the CA Governed by Czech Public Law ?

64. The CA expressly states in Article 7(4) that it "shall be governed by the laws of the Czech Republic". The Slovak Republic has argued that this reference, in light of the two States being parties, had to be understood as a choice of Czech public law.

65. The fact that the conclusion of the CA involved two States and that it was a consequence of several public law instruments, such as constitutional provisions, government resolutions, regulatory decisions and government authorizations, does not make the CA itself an agreement governed by Czech public law. Such acts of public law by the Czech

Republic and the Slovak Republic do not make the CA, which is a different legal instrument that stands on its own, an agreement governed by the public law of the Czech Republic or the Slovak Republic. It is equally irrelevant whether other banks in the Czech and the Slovak Republics were later restructured and privatised on the basis of instruments governed by public law (*i.e.* by governmental resolutions) and not by private law agreements. In those later instances, one State only was acting as shareholder and ordered the privatisation. In the case of CSOB, to the contrary, the consolidation could not be ordered on the basis of a resolution of one State; it had to be managed by the two State-shareholders on the basis of an agreement involving both States and CSOB.

66. The Slovak Republic also argued that the CA was a public law instrument as it raises rights and obligations between the two Republics only, whereas CSOB did not have any rights arising from the imposed obligations, in particular under the provisions of Article 3 CA. This argument appears to be linked to the proposition that the CA constitutes a framework agreement of a type that is allegedly often used in state-to-state relations, and which does not confer direct actionable rights on private parties, *e.g.* CSOB.

67. The Tribunal notes that the term "framework agreement" has been used in these proceedings with different meanings (as this has been illustrated hereinbefore in respect of the comparison between the CA and the Economic Cooperation Agreement concluded between Czechoslovakia and Yemen). One of these meanings at least corresponds to a type of agreement that contains particular rights and obligations notwithstanding the fact that they need further implementation through negotiation and more specific agreements. The Tribunal has stated that the CA is a legal agreement and that it contains rights and obligations of a legally binding nature. When the Slovak Republic contends that the CA, by its nature as a framework agreement, is a public law instrument not conferring any right on CSOB, the Slovak Republic draws a general and conceptual conclusion that is not supported by a detailed analysis of the particular provisions of the CA that are relevant for this dispute.

68. In the Tribunal's view, the pertinent approach must be different. CSOB's claim is of a legal nature and based on the cover losses provision of Article 3 CA. The fundamental

issue in these proceedings is whether CSOB can derive any right to claim under this provision against the Slovak Republic. This matter has to be examined on the basis of the rules of Czech law that are capable of creating rights in favor of private parties such as CSOB, *i.e.* Czech private law, provided all legal requirements are met. In fact, the Slovak Republic adopted this approach when advocating the opinion that the cover losses provision of Article 3 CA was not valid to the extent it was based on the relevant provisions of the Czech Civil and Commercial Codes. Indeed, as Czech public law, as alleged by the Slovak Republic, does not create substantive rights for private parties like CSOB,[28] Czech private law is the only source of law that could support the existence of such rights.

69. A State's public law regulates the State's organization and its relation with the population living in the same territory. It is not intended to govern the relations to other States. One of the Slovak Republic's legal experts pointed out that the fact that Czech public law assumes unequal positions between the parties renders its application in relation to the Slovak Republic impossible. This was because the Czech Republic could not have a higher legal position than the Slovak Republic which had to be legally in an equal position. He concluded that Czech public law was therefore not applicable to the CA.[29]

70. The Tribunal shares the view that Czech public law is not applicable to the provisions of Article 3 CA that are relevant to the resolution of this dispute. It does not and does not have to make a statement on the question of whether the CA may contain some other provisions that may call for the application of Czech public law and that would thus allow the CA to be characterized as a "mixed agreement".

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28 It may be noted that the argument that legal instruments governed by Czech public law do not create any right on private parties has been put forward by the Slovak Republic's legal experts without being further supported. The underlying documentation confirms that under public law, the State and the individual party do not enjoy equal status or position. This, however, seems not to allow the conclusion that the private party would have "no right" in such a public law relation.

29 Rejoinder Opinion of Professor Sturma, No. 44; TR, November 9, 2002, 31:1-8 (Sturma).

D. Czech Private Law Is Applicable to Article 3 CA

71. As it is stated above, the reference in Article 7(4) CA to Czech law cannot be found to have the meaning that Czech public law would govern CSOB's claim under Article 3 CA, with the effect that CSOB would be deprived of any right arising under this provision. This dispute is therefore governed by Czech private law. The Tribunal adds that this conclusion is the only way to give effect to the Parties' choice to have the BIT applicable by incorporation into the CA. Indeed, Article 2(2) BIT which ensures CSOB "full protection and security" for its investment in the territory of the Slovak Republic would be without any useful effect if CSOB were to have no right in respect of the CA under Czech public law, as this has been argued by the Slovak Republic.

72. It may further be added that the Slovak Republic's legal experts on Czech law, despite the fact that they contend that CSOB has no rights as a private party under Article 3 CA,[30] nevertheless accept that the CA has a private law part and that the provisions of Article 3 CA, to the extent they may create rights of CSOB, are to be interpreted on the basis of Czech private law.[31] They add in this respect the following -

> After all, all the parties considered the Consolidation Agreement as a commercial law agreement and confirmed this fact also in the course of these arbitration proceedings, doing that they in fact made a subsequent choice of law under Section 262 of the Commercial Code.[32]

The Tribunal does not need to examine whether the Parties have concluded effectively a subsequent choice of Czech private law in the course of these proceedings. Indeed, such a choice was already made when they accepted the choice of law clause in Article 7(4) CA. This was also the conclusion of another expert, presented by the Slovak Republic during the jurisdictional phase of these proceedings, who stated that -

> ... the nature of the Consolidation Agreement is a private law agreement, i.e. a civil law or commercial law agreement.[33]

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30 Opinion by Professors Pohunek, Stuna and Švestka, No. 41-50.
31 Opinion by Professors Pohunek, Stuna and Švestka, No. 51-56; Rejoinder Opinion, No. 11, 34.
32 Opinion by Professors Pohunek, Stuna and Švestka, No. 56.
33 Affidavit of A. Banyaiová, January 27, 1998, No. 17.

> ... the Consolidation Agreement is a special agreement that, in terms of its strict legal nature, falls into the category of private law agreements.[34]

IV. THE MEANING AND SCOPE OF ARTICLE 3 CA

A. Introduction

73. This dispute turns on the meaning of Article 3 of the CA that aimed at the "Improvement of CSOB's Balance". It relates in particular to part II of the second section of the same Article, under the heading "Establishment of Collection Companies and Transfer of CSOB's Non-Performing Assets to the Collection Companies". There is no controversy about the fact that these Collection Companies have been established as agreed and that SI was the Company operating for the purposes determined in Article 3(II) in the Slovak Republic. In the second (not numbered) paragraph of the same provision, it was agreed that CSOB's non-performing receivables were to be transferred to the Czech and the Slovak Collection Companies in a ratio of about 3 : 1, each Company being assigned receivables from entities domiciled in the respective Republic. The amount of such receivables had to be specified as of December 31, 1993, "so that the actual capital adequacy of CSOB as of the same date amounts to 6.25%". On the basis of this provision, CSOB and each Collection Company had to specify in a subsequent agreement which receivables had actually to be transferred.

74. In order to improve CSOB's balance, the third paragraph of Article 3(II) CA stipulated that the Collection Companies had to pay to CSOB as a "consideration" the nominal value of the assigned receivables, together with the interest accrued thereupon until the time of the assignment. In respect of this payment, it was further provided as follows -

> The payment for the assigned receivables shall be made by the Collection Companies on the basis of a schedule of payments for the assigned receivables over the years 1995 to 2003. CSOB shall provide a loan to cover the 1994 operating costs of the Collection Companies and secure the refinancing of the Collection Companies by making advances under a loan facility up to the sum of considerations for

[34] Reply Affidavit of A. Banyaiová, July 17, 1998, No. 27.

the receivables assigned to the Collection Companies. The terms and conditions for the refinancing shall be determined under special agreements to be entered into by and among CSOB and the Czech and Slovak Collection Companies.

75. As the receivables to be assigned were defined as non-performing and in fact were recoverable for small amounts only, the Collection Companies could never be placed in a position to recover the full nominal value of the assigned receivables which would have allowed the repayment of the loan to CSOB. The Parties to the CA undertook in paragraph 4 of Article 3(II)[35] to identify this consequence in the following terms -

> It follows from the nature of the assigned receivables that the Collection Companies will make a loss. Such loss will result from the operating costs and the schedule of payments for the receivables assigned by CSOB to the Collection Companies, including payments of interests.

76. Furthermore, Article 3(II) stated in its paragraph 5 the so-called "cover losses provision" -

> The losses of the Collection Companies shall be compensated for over the period 1995-2003. The MF CR and the MF SR each undertakes to cover any losses made by the Collection Company in its respective territory. For this purpose, the MF CR, in co-operation of the NPF CR [National Property Fund of the Czech Republic], shall prepare a mechanism for covering any losses of the Czech Collection Company and the MF SR shall prepare a mechanism for covering any losses of the Slovak Collection Company.

77. CSOB has submitted its claim based on an alleged undertaking by the Slovak Republic in the provision just quoted to cover any losses made by the Slovak Collection Company. The Slovak Republic, from its side, contends that this cover losses provision does not have such meaning and legal effect. For the Slovak Republic, this provision lacks any required precision, is too vague, not sufficiently specific, not intelligible and it does not identify adequately and in a legally binding way what CSOB holds to be the object of the Slovak Republic's obligation.

[35] This provision will be referred to as Article 3(II)(4) CA. The same applies, *mutatis mutandis*, to the other paragraphs of Article 3(II) CA.

78. The Parties thus have different views as to the meaning and effects of the cover losses provision. This controversy can be centered on two issues. One issue relates to how the cover losses provision has to be understood and interpreted. The other issue, which is linked to the first issue, relates to the question of whether the content of the cover losses provision was certain enough to be legally binding.

79. For the Slovak Republic, the CA - or at least the cover losses provision - is thus null and void because its meaning is uncertain. The Slovak Republic relies in this respect on Section 37(1) of the Czech Civil Code that states -

> An act in law must be made ... in a definite and intelligible [also expressed as "understandable"] manner; otherwise the act is invalid.

80. The Slovak Republic also refers to Section 269(2) of the Czech Commercial Code that states specifically for innominate contracts that -

> If the Parties fail to identify adequately the object of their obligations, such a contract is not considered as concluded.

81. On the basis of these provisions of Czech law, the Slovak Republic objects that the cover losses provision - or the whole CA - does not satisfy Section 37(1) of the Civil Code and Section 269(2) of the Commercial Code, and is therefore null and void. The Slovak Republic argues forcefully that no interpretation can revive an imprecise and therefore invalid contractual provision as the cover losses provision of the CA.

B. The Rules of Czech Law Applicable to the Interpretation of Article 3 CA

1. In general

82. The requirement that a contract provision is "definite and intelligible" (Section 37 Civil Code) and that it should adequately identify the obligations undertaken (Section 269

Commercial Code), does not require that the text of the provision is so detailed and precise that it would be entirely sufficient to simply read the provision in order to understand its content. If that were the case, the rules of Czech law on the interpretation of contracts, laid down in Sections 35 Civil Code and 266 Commercial Code and discussed hereafter, would be meaningless.

83. Section 37 Civil Code and Section 269 Commercial Code have to be read in the light of, respectively, Section 35 Civil Code and Section 266 Commercial Code. These provisions give room, in particular, to the Parties' own intentions and understanding. Section 37 Civil Code and Section 269 Commercial Code only require that the Parties' agreement is sufficiently definite and clear to define the Parties' mutual obligations. The interpretation tools indicated in Section 35 Civil Code and Section 266 Commercial Code may serve to understand that the agreement meets the requirements in respect of the precision of its content under Section 37 Civil Code and Section 269 Commercial Code.

84. Both Parties accept that to the extent that the CA may create rights for which CSOB has title to sue, the Czech Commercial Code applies to the CA. To construe the meaning of the relevant provisions of the CA, Section 266(3) of the Czech Commercial Code instructs the Tribunal as follows -

> When interpreting a manifestation of will under subsections (1) and (2), due account shall be taken of all the circumstances related to the manifestation of will, including the negotiations about conclusion of the contract in question and the practice which the parties have introduced between themselves, as well as the subsequent conduct of the parties, if the nature of the case so permits.

Thus, all the relevant circumstances, including the context and purpose of the agreement, the history of the negotiation and the Parties' subsequent conduct, are relevant to reconstruct the Parties' intentions and to identify the meaning of their agreement.

2. *The relevance of the wording*

85. The Slovak Republic, through the first Opinion of its legal experts on Czech law, submitted that the CA was a commercial agreement, governed by the Commercial Code.[36] Only at a later stage[37] did it argue that equally relevant for the construction of the CA was Civil Code Section 35. The Slovak Republic then argued that indeed both Section 35 Civil Code and Section 266 Commercial Code applied to commercial contracts.

86. Section 35(2) Civil Code states in respect of the interpretation of an expression of a will in words the following -

> Acts in law expressed in words shall be construed not only according to the verbal expressions but shall also in particular take into account the intention [also translated as "will"] of the person who performed the act, provided that such intention is not conflicting [also translated as "inconsistent"] with the wording.

87. The Slovak Republic argues that Section 35 Civil Code differs from Section 266 Commercial Code in respect of the last part of the provision where it is emphasized that the intention of the parties shall not be upheld if it would be contrary to the wording of the agreement. It contends that under Section 35 Civil Code, the Tribunal cannot take into account the alleged intention of the Parties to give a meaning to the cover losses provision when this alleged intention is contradicted by the wording of their agreement. In this respect, Section 35 Civil Code does, in the Slovak Republic's view, prevail over Section 266 Commercial Code.

88. The Tribunal is aware that the relationship between Section 35 Civil Code and Section 266 Commercial Code is a delicate and debated matter under Czech law. The starting point is that commercial agreements are governed by the Commercial Code as the Czech Commercial Code Section 1(2) clearly indicates. This first Section of the Czech Commercial Code reads, under the title "Scope of the Code", as follows -

36 Opinion Pohunek, Stuna & Švetska, No. 56 and 187.
37 Rejoinder, Pohunek, Stuna & Švetska, No. 60.

> (1) This Code regulates the status of entrepreneurs, business obligations and some other relationships connected with business activities.
> (2) The legal relationships specified in subsection (1) above are subject to the provisions of this Code. Should it prove impossible to resolve certain issues according to the provisions of this Code, they shall be resolved in accordance with the civil law provisions. In the event that such issues cannot be resolved in accordance with the civil law provisions, they shall be considered according to trade usage (commercial practice) and, in the absence of this, according to the principles upon which this Code is based.

Pursuant to this provision, the CA, that the Parties agree to be subject of the Czech Commercial Code, is governed by this Code. This includes Section 266 of the same Code on the matter of interpretation of the Parties' will, and in particular paragraph 3 of this Section. The Slovak Republic has not argued that Section 266 would not allow the resolution of issues of interpretation in respect of the CA. This would be the only case where the Civil Code could come into play according to Section 1(2) Commercial Code.[38] The Slovak Republic argues that Section 35 Civil Code shall apply as it is more restrictive in matters of interpretation than Section 266 Commercial Code. This, however, is not a situation for which Section 1(2) Commercial Code provides for the application of the Civil Code to commercial agreements.

89. Three recent decisions of the Czech Supreme Court do not support the view that Section 35 Civil Code may prevail over Section 266 Commercial Code. They rather indicate that the latter provision prevails, or that both Sections may be combined and lead to the same result of the interpretation. In its decision of November 15, 2000,[39] the Czech Supreme Court decided that in a case where it was not clear between the parties whether a contractual penalty or default interest was agreed upon by the word "penalty" used in their agreement, "it was appropriate to consider the arrangement in question under the provi-

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[38] Professors Pohunek, Stuna and Švetska, who support in their Rejoinder Opinion the application of Section 35 Civil Code (No. 60), confirm that the general rules of the Civil Code are applicable only if there are no special rules in the Commercial Code and, in other words, that the Civil Code can be applied only if the rules of the Commercial Code are incomplete (No. 56); see TR, November 11, 2002, 77:5-21 (Pohunek). See further the Reply Affidavit of A. Banyaiová, of July 17, 1998, No. 31, that recalls the same interpretation, accepting, however, that both provisions (Sec. 35 Civil Code and Sec. 266 Commercial Code) apply jointly (No. 35) and that a manifestation of will is interpreted according to the intention of the parties, but not inconsistently with the wording used by the acting party. The intention of the acting party is taken into account to the extent it was known to the other party (No. 36). The same view has been expressed by Professor K. Eliáš, *A Course of Commercial Law*, 2nd edition 1999, page 42, Annex 22 of the Rejoinder Opinion of Professors Pohunek, Stuna and Švetska.

[39] No. 29 Cdo 2735/99.

sion of Section 35(2) of the Civil Code and Section 266(1) and (3) of the Commercial Code". The decision did quote, but did not further examine, these provisions, the judgment of the appellate court being reversed and the case remanded for further trial. The decision also indicates that the appellate court, in regard to the sanctions agreed by the parties upon the occurrence of a default in payment, referred to both the Civil Code (Sections 544-588) and the Commercial Code (Sections 297-323), and concluded that the agreement was not contrary to any mandatory legal rule. In a decision of February 7, 2001, the Supreme Court criticized the appellate court that came to the conclusion that in the particular case, the legal act was uncertain pursuant to Section 37 Civil Code "without interpreting this act pursuant to Section 266 of the Commercial Code".[40] In a more recent decision, dated November 5, 2002,[41] the Czech Supreme Court had to deal with an applicant who claimed commission payments based on a brokerage contract and who reproached the appellate court "for failing to proceed in accordance with Section 35(2) of the Civil Code by interpreting the wording of the said brokerage contract". The Supreme Court referred the matter back to the appellate court, stating that the appellate court's "fundamental error" was "that it completely failed to apply Section 266 of the Commercial Code to the case at hand, which Section 266 sets out rules governing the interpretation of manifestations of will in business relations". No mention of Section 35 Civil Code was made in this finding of the Czech Supreme Court.

90. The Tribunal is of the view that on the basis of Section 1(2) Commercial Code and in light of these decisions, the argument cannot be retained that Section 35 Civil Code prevails over Section 266 Commercial Code in matters governed by the latter Code. It cannot be retained that Section 35 Civil Code, to the extent it is considered more restrictive than Section 266 Commercial Code with regard to elements of interpretation that might differ from the agreement's wording, would render inapplicable the pertinent provision of Section 266 Commercial Code to the interpretation of an agreement governed by this Code.

91. That Section 266 Commercial Code prevails over Section 35 Civil Code, however, is not alone decisive to reach a conclusion on this issue. Indeed, Section 35 of the Civil

40 No. 29 Cdo 1402/99.
41 No. 29 Odo 512/2002.

Code, that states that the Parties' intention shall not be contrary to the wording of the agreement, does not require that the Parties' intention is somehow reflected or recognizable in the terms used in the agreement. It only excludes intentions that are contrary to these terms. Section 35 thus allows retaining the intention of the Parties, even if it has not been reflected in the wording of the agreements. The only restriction to this is that the Parties' intent must not be contradicted by the wording of the agreement as such wording may be interpreted.

92. For the Slovak Republic, in a case where a contract provision is too vague, it cannot become valid by later specification from the Parties. Interpretation only allows specifying the content of an existing contractual provision; it cannot turn a vague and therefore legally unbinding commitment into a valid contract by making an imprecise and therefore ineffective manifestation of will more precise. In brief, it cannot rescue a provision that was vague and therefore non-existent. However, interpretation can help to understand the meaning of a contract provision. This has been confirmed by a decision of the Czech Supreme Court of October 7, 1998,[42] quoted by the Slovak Republic, where it is stated that "by interpretation it is not possible to supplement a legal act", while "by interpretation it is only possible to determine the content of a legal act". In another case the Czech Supreme Court decided on November 26, 1998 that interpretation can be used to see whether the agreement was sufficiently certain and definite to be valid.[43] It ruled that –

> ... it is precisely the process of interpretation that is to dispel doubts as to the content of the legal act, even in case that the written manifestation of will contains an expression permitting multiple interpretations.[44]

In the decision referred to above, of February 7, 2001, the appellate court was criticized because it considered a legal act uncertain without interpreting the act pursuant to Section 266 Commercial Code. In another example, a clause that "the price may be altered" was in itself not *per se* unclear, insufficient and thus uncertain; it all depended on what the parties understood under this provision. Because in that case it was clear for the par-

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[42] No. 1 Odon 110/97.
[43] Czech Supreme Court, November 26, 1998, No. 25 CDO 1650/98.
[44] For a similar ruling see Czech Supreme Court, May 30, 2000, No. 32 Cdo 2061/99.

ties that such clause meant that the price would be adapted to changes in the currency rate, it was sufficiently clear to be binding.[45] In a more recent decision, rendered on November 5, 2002 and referred to above, the Czech Supreme Court explained that a clause that used a clear term can still be a matter for interpretation, as follows –

> The fact that the parties used a statutory term (contractual fine) in the contract, with reference to the applicable provisions of the law, does not in itself rule out the application of Section 266 of the Commercial Code and cannot justify the court interpreting the legal act in question solely according to the meaning of the verbal expression ensuing from the referenced legal norm, without regard to the acting parties' intent, or the circumstances relevant for the interpretation of the parties' manifestation of will within the meaning of Section 266 of the Commercial Code, as the case may be.

Another decision of the Czech Supreme Court, dated October 27, 1999, stated –

> If the principle that the content of a legal action may only be determined by interpretation, and that the demonstration of will cannot be amended thereby, is respected (cf. ....), the will of the person/entity who undertook the action, can be determined, *inter alia*, with regard to subsequent conduct of the contractual parties (cf. ...).[46]

93. The Tribunal concludes therefore that the interpretation of Article 3 of the CA is to be done in light of all relevant circumstances as mentioned in Section 266(3) Commercial Code. Elements of interpretation other than the wording of the agreement may prevail over verbal expressions used in the text unless the wording in itself represents the Parties' understanding and intention in respect of the agreement. Even if Section 35(2) Civil Code would be of some relevance in this dispute, it does not impose a strictly literal understanding of the CA, nor does it support that expressions contained in Article 3 CA would be interpreted without considering the Parties' intention in concluding this provision.

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[45] Czech Supreme Court, August 31, 1999, No. 29 Cdo 2400/98-41.

[46] No. 2 Cdon 824/97.

C. The Legal Nature of the Cover Losses Provision of Article 3 CA

94. In the Parties' submissions and in the oral debate, various legal terms have been used to characterize the cover losses provision of Article 3 CA. CSOB mentioned that this provision is or comes close to a guarantee, a security or a comfort letter. The Slovak Republic voiced objections to such terms, either because the CA did not comply with the legal requirements related to a particular type of contract, or because Czech law does not know a particular undertaking, like "comfort letters". In his declaration set fourth at the end of the Loan Agreement, entered into between SI and CSOB, the Ministry of Finance of the Slovak Republic accepted Article 7 LA that uses the term "secure" in this respect. Mr. Magula, representing the MF SR, initialed the Operation Agreement that uses the term "guarantee" (Art. IV/3). The Slovak Republic also argued that none of the available types of contracts could be relevant, as the CA was a mere "framework agreement" that provided for nothing more than general principles requiring further implementation in order to be legally binding.

95. The Tribunal does not uphold the submission that Article 3 CA were to represent a "framework agreement" that does not contain obligations of a legally binding nature. In the course of the proceedings, both Parties came to accept the view that Article 3 CA, respectively the CA as a whole, did not represent a particular type of contract known in Czech law as a nominate agreement. Such an agreement is regulated by law as an individual type of contract containing "the essential elements of a contract as specified in the fundamental provisions for each of these contracts" (Section 269(1) Commercial Code). The legal undertaking in dispute has therefore to be qualified as an innominate agreement. The expressions used by the parties are as a consequence not to be linked to a particular nominate agreement and to its specific legal requirements. The conclusion of an innominate agreement is a matter for the parties' autonomy, as stated in Section 269(2) Commercial Code that reads as follows -

> Parties may also conclude a contract which is not specified as a particular type of contract. However, if the parties fail to identify adequately [also translated as: "sufficiently define"] the object of their obligations, such a contract is not considered as concluded.

96. As has been noted above, the Slovak Republic did also refer in this respect to Section 37(1) Civil Code that states that an "act in law" is valid only if it is made in a "definite and intelligible" manner. The Tribunal finds, however, that the agreement contained in Article 3 CA is based upon and has to be examined in respect of the relevant provisions of the Commercial Code. The Parties have accepted that the CA is a commercial agreement. In light of Section 1(2) Commercial Code, there is no particular reason that would allow to have Section 269(2) Commercial Code supplemented by Section 37(1) Civil Code.

97. Section 269 Commercial Code also deals in paragraph 3 with cases where the content of an obligation is identified in subsequent agreements. This provision reads as follows -

> An agreement regarding a certain part of a contract may be replaced by an agreement of the parties on the method allowing the content of the obligation to be defined subsequently, provided that such method does not depend on the will of one party only. If a missing part of a contract is to be established by a court or a particular person, the agreement must be in writing and the provisions of Section 291 shall apply *mutatis mutandis*.

It may be recalled that this provision follows paragraph 2 that declares an innominate agreement not concluded if it fails to identify adequately the object of the parties' respective obligations. Nothing in the text of these provisions prevents the conclusion that a further agreement on the identification of the content of an innominate agreement may also allow the adequate identification of the object of the parties' obligations in an agreement that otherwise would not meet the requirement on precision as stated in paragraph 2. Section 269(3) Commercial Code constitutes therefore a further confirmation that an agreement can contain legally binding rights and obligations even if their identification may be in part contained in subsequent agreements like those referred to in Article 7(1) CA. Therefore, the issue of whether the CA may be called a "framework agreement" or not is not relevant.

D. The Notion of "Losses" that Triggers a "Cover Losses" Obligation

98. The Slovak Republic has argued that it is uncertain as to which "losses" Article 3 CA refers and what that term means. As this expression did not sufficiently define the Slovak Republic's alleged obligation to "cover" the "losses" of SI, no agreement was validly concluded that would create any liability of the Slovak Republic towards CSOB in respect of the repayment of the loan extended to SI.

99. The inquiry into the meaning of "losses" has to start from what the CA says about this notion. Article 3(II)(4) specifically indicates that the loss will be attributable to each Collection Company and that it results from the operating costs and from the schedule of payments for the receivables assigned by CSOB to the Collection Companies, including payments of interest.

100. The dominant part of such a loss is related to the payment for the receivables assigned to SI. This will be dealt with first. The payment of SI's operating costs will be dealt with thereafter.

1. The losses related to the assigned non-performing receivables

101. What the Parties meant by the notion "loss" in connection to "schedule of payments for the assigned receivables" follows from the economics of the assignments and the place of the references to the term "loss" within the text of Article 3(II) CA. Indeed, Article 3(II)(3) first states that the non-performing receivables had to be paid at their nominal value (including any interest accrued). The payment was to be made on the basis of a schedule of payments over 1995 to 2003. In order to allow the Collection Companies to make such payment effectively, CSOB undertook to make advances under a loan facility up to the sum of "consideration" for the receivables assigned to the Collection Companies. Immediately thereafter, Article 3(II)(4) CA continues and specifies -

> It *follows* from the nature of the assigned receivables that the Collection Companies will make a *loss*. [emphasis added]

102. The term *"follows"* clearly indicates that the Parties considered the loss to be triggered by the fact that the nominal value (including interest) of the receivables, payable by the Collection Companies to CSOB, would be higher than the amount for these receivables actually received by the Collection Companies from third parties.

a. The relevant schedule of payments

103. Article 3(II)(4) CA further specifies that the losses will result from "the schedule of payments for the receivables assigned by CSOB to the Collection Companies, including payments of interest". In the preceding sub-paragraph, it is stated that the Collection Companies' payment for the assigned receivables had to be made "on the basis of a schedule of payments for the assigned receivables over the years 1995 to 2003".

104. It is undisputed that no "schedule of payments for the assigned receivables" was established in conformity with the literal reading of the agreement. In fact, the payment for the receivables has immediately been made in full as a "consideration" upon their respective assignment. Such assignment occurred, as foreseen in Article 3(II)(2), on December 31, 1993 for the on-balance sheet receivables (under the Assignment Agreement). For the off-balance sheet receivables, the payment for the full nominal value was to be made at their respective maturity dates for these receivables (under the OBS Assignment Agreement, Art. IV).

105. For the Slovak Republic, however, the provisions of the CA, and Article 3 in particular, should be understood literally. When Article 3 refers to "losses" resulting from payments under a "schedule of payments for the receivables assigned", losses out of payment of a loan are excluded because *contra verba*.

106. For CSOB, the Parties intended and understood this reference to a "schedule of payments for the receivables assigned" as a reference to the loan payment schedule.

107. It is obvious – in spite of the *prima facie* meaning of the reference to a "schedule of payments for the receivables assigned", that the Parties did not intend that the receiv-

ables would be paid by the Collection Companies in installments from 1995 to 2003. Indeed, the purpose of the whole transfer of receivables was to improve CSOB's balance by replacing the bad assets by good ones as per the end of December 1993 in order to make CSOB's privatisation more attractive and profitable for its shareholders, *i.e.* mainly the Slovak Republic and the Czech Republic. An outstanding claim for payment of non-performing receivables would not fit that purpose. A "schedule of payment for the receivables assigned" is indeed incompatible with the ultimate goal of the consolidation, *i.e.* to replace CSOB's bad receivables by performing assets equivalent to the full nominal value of the assigned receivables. The transaction thus required that the non-profitable receivables had to be paid in full as of December 31, 1993 - and not in installments covering many years.

108. When the receivables were actually assigned by CSOB to SI, the loans under which SI obtained the funds to pay for the receivables were accepted by CSOB and SI to be closely interconnected with the assignments. Indeed, the loan for the assignment of the on-balance receivables was recognized by CSOB and SI to be a "follow-up" agreement to the Assignment Agreement, both agreements having to be read "in their mutual conjunction" (Art. 13 LA); the declaration of the Minister of Finance of the Slovak Republic includes this statement in his consent. The OBS Loan Agreements as well mention that they are related to the respective OBS Assignment Agreement and that both agreements "shall only be interpreted in their mutual interconnection" (Art. V).

109. Moreover, the CA itself confirms that the Parties in fact did not intend the receivables to be paid in installments. Indeed, the "consideration" for the assignment of the receivables, *i.e.* the nominal value of the receivables (and the interest accrued until the time of the assignment) had to be *advanced under a loan facility* "up to the sum of considerations for the receivables assigned". In other words, the CA itself provided for an advance of the total sum of receivables under a loan agreement.

110. Article 3 CA expressly instructed CSOB and the Collection Companies to determine the terms and conditions of the refinancing under special agreements. As for the on-balance receivables, the repayment schedule attached to the Loan Agreement clearly functions as such "schedule of payments for assigned receivables". In fact, the Slovak Ministry of

Finance expressly recognised in its confirmation of Article 7 of the Loan Agreement that the CA involved the repayment of the loan (and not of receivables) and that the Slovak Republic had an obligation to this effect. This consent and acknowledgement in the LA helps to construe the Parties' intentions and understanding pursuant to Section 266(3) of the Czech Commercial Code. Although the seven OBS Loan Agreements do not contain a similar (signed) acknowledgment, this does not remove the fact that in consenting to Article 7 LA, the MF SR accepted that the obligation referred to, based on the CA, consisted in the repayment of a loan and not in the payment for the assigned receivables. The Assignment Agreement, initialled on behalf of the Slovak Republic, confirms the same understanding when it states in Article III that the consideration to be paid at the day of the assignment was the amount of 100% nominal value of the receivables; such payment leaves no room for any schedule of payments in respect of these receivables.

111. Furthermore, in the OBS Assignment Agreements (Art. IV), that became effective on December 31, 1993, *i.e.* the same day as the CA, SI recognised that SI's payment for the receivables would be covered by a loan from CSOB. Consequently, SI has confirmed that installment payments were to reimburse the loans and not the receivables. The Agreement on a Repayment Schedule Mechanisms for Off-Balance Instruments of March 1, 1996, clearly confirms that the Parties intended SI to repay the loans and not the off-balance receivables. Although the Slovak Republic was not a party to the agreement, it was aware of the mechanism through its executive and controlling function exercised within the Supervisory Board of SI.

112. In fact, the repayment of the loan was a full substitute for the payment for the assigned receivables including interest accrued until the date of assignment. The schedule for both repayments would have been identical. However, the fact that the loss also included payments of interest on the amount paid for the receivables according to the agreed schedule confirms that the parties had in mind the schedule of repayment of a loan rather than a schedule of payment for the receivables.

113. The Tribunal has stated that the interpretation of Article 3 CA is governed by the provisions of Section 266 Commercial Code. Under paragraph 3 of this Section 266, the

agreement has to be interpreted according to the intention of the Parties, taking into account all the circumstances related to the manifestation of will, including the negotiations about the conclusion of the contract in question and the Parties' subsequent conduct. It clearly was not the Parties' actual intention that the receivables would be paid in installments. When account is taken of all circumstances related to the manifestation of the Parties' will, it becomes apparent that when they used the term "schedule of payment for the receivables" they in fact intended "schedule of payment of the loans obtained to pay the receivables".

114. Even if Section 35(2) Civil Code would be of some relevance for the interpretation of Article 3 CA, as contended by the Slovak Republic, this would not mean that the literal wording would become decisive. Indeed, as the Tribunal has stated, Section 35(2) Civil Code does not have the effect that verbal expressions used by the parties would prevail over their intention and understanding of the text. Moreover, contrary to the Slovak Republic's view, there is no such clear wording in Article 3 CA in respect of the schedule of payments referred to. Indeed, Article 3(II)(3) CA stipulates that a "consideration" is to be paid for the nominal value of the assigned receivables. Such consideration must cover the full value of the receivables. The "schedule of payments" must, therefore, refer to a payment to be made through installments. The only payment pertinent in this respect is the repayment of the loan. Further, when the same provision states that CSOB and the Collection Companies shall agree on a schedule for payments, reference is made to the "refinancing", *i.e.* the loan and not the receivables. Finally, the "cover losses" provision of Article 3(II)(5) CA refers to "any losses" made by the Collection Companies, not referring to any specific schedule of payments. The wording of these provisions is therefore not as clear as contended by the Slovak Republic and anyhow not clear enough to leave room for a strictly literal interpretation if Section 35(2) Civil Code would be considered as applicable and understood as calling for such an interpretation.

b. The occurrence of losses

115. CSOB argued that the term "losses" had in the context of the CA a specific meaning. It should not be understood in the sense of "negative economic result, lack of funds or

damage". For the Slovak Republic, the term loss is capable of more than one meaning, producing different results. As the amount to be paid under the cover losses provision is not clearly stated or at least capable of determination, this provision is null and void.

116. For the Tribunal, the proper understanding of the term "losses" follows from the intermediate conclusion, also shared by the Parties, that the CA is to be analyzed as an innominate agreement. By its text, Article 3(II) CA attributes the losses to the respective Collection Companies. These Companies are designated in sub-paragraphs 4 and 5 as the entities that will "make losses". As those losses derive from the "nature of the assigned receivables" and result from the schedule of payments and the operating costs (Art. 3(II)(4) CA), they are clearly identified as the Collection Companies negative balance (or shortage of funds), due to the fact that the amounts collected from third party debtors (the FTOs) for the assigned receivables (representing the only income to be made) did not cover the repayment of the loan to CSOB and the operating costs. Such occurrence of losses made by the Collection Companies was a fact that explains the very essence and purpose of Article 3(II) CA.

117. The losses of SI would occur each time SI had to pay to CSOB under the schedule of payments but could not pay because of a negative balance that emerged in SI's accounts between the amount of receivables collected from third parties and the amount of payments to be made to CSOB. The occurrence of losses was thus related to the schedule of installments to be paid to CSOB, minus the (small) income produced by some of the receivables, and SI's operating costs. Such losses were therefore not equal to a single amount nor were they equal to installments for fixed amounts. The amount of SI's losses did further depend upon variables as SI's income and operating costs. Such a situation was envisaged by the drafters of Article 3(II) CA. The cover losses provision relates, indeed, to "any losses" and it ordered the Ministry of Finance of the Slovak Republic to prepare a "mechanism for covering any losses" of SI (Art. 3(II)(5) CA). Such a "mechanism" makes sense only in a hypothesis where the amount representing the coverage changed in the course of the evolution of the loan facility extended to SI.

c. The selection and collection of the receivables assigned

118. The Slovak Republic further argues that the term "losses" and, consequently, the "cover losses" provision was inherently uncertain and the latter provision therefore null and void because the amount of losses is dependent on another set of uncertain factors, that relate to the volume of receivables to be assigned (which in turn depended upon the amount of reserves created by CSOB and CSOB's profitability in 1993), the allocation of receivables between SI and CI, the capital adequacy ratio to be achieved and the extent to which SI was able to make recoveries on its claims against FTOs. When the CA was concluded, the Slovak Republic contends, it was impossible to predict and to calculate the amount the Slovak Republic would have to cover. This amount could not objectively be calculated. Moreover, CSOB had a free hand in manipulating many factors so as to arrive at the result it wanted. In particular, CSOB had full discretion to select the most doubtful receivables to be transferred to CI or SI. The "cover losses" provision was thus non-binding because the losses to be paid were unknown at the moment the CA was entered into; nor could the respective amounts be calculated in an objective way later.

i) The Slovak Republic's involvement, knowledge and acceptance

119. There is no doubt that the process for the selection of non-performing receivables to be assigned by CSOB to SI and the volume of assets to be transferred, as well as their value, had an impact on the potential losses of SI and the amount of losses to be covered under the provision of Article 3(II)(5) CA. The Parties to the CA had accepted that the selection of the receivables to be assigned was to be made on the basis of an agreement entered into by CSOB and SI (respectively CSOB and CI), such agreement containing also the "specification of the various Non-Performing Assets" (Art. 3(II)(2) CA). In fact, as this has been explained, the receivables were identified, depending the date of their respective maturities, in two distinct agreements, *i.e.* the Assignment Agreement (later completed by two amendments) and the Future Assignment Agreement (subsequently followed by the OBS Assignment Agreements). These agreements can be considered as part of the "particular bilateral or multilateral agreements" to be executed "in

the event that the performance of this Agreement [the CA] necessitates a more detailed regulation of the relationships among the various parties", as stated in Article 7(1) CA. It was further stated specifically in Article 3(II)(2) *in fine* that the transfer of the assigned receivables was made "pursuant to the above-referenced Government Resolutions", which are those referred to in the Preamble.

120. Thus, it was accepted by all Parties to the CA, including the Slovak Republic, that the receivables to be transferred to SI were to be identified in agreements entered into by CSOB and SI, including the specification of their nominal value (plus interest accrued until the time of the assignment). It was therefore perfectly clear what the potential loss of SI would amount to, at least as a maximum figure (in case no receivable could be recovered). This disposes of the Slovak Republic's argument that the process of selection of receivables was such that SI's losses were uncertain.

121. As the Slovak Republic argues that there existed a fatal uncertainty at the time of the conclusion of the CA, it may still be argued that the certainty provided by the agreements subsequently concluded did not yet exist at that precise moment. However, Section 266(2) Commercial Code does not specify that the requirement for adequate identification of the object of the parties' obligations has to be met on the day of the conclusion of the agreement. Further, paragraph 3 of the same provision accepts that proper identification of part of a contract may be made in subsequent agreements. Moreover, as will be explained below, the maximum exposure to cover losses was also determined by the capital adequacy ratio of 6.25% specified as of December 31, 1993.

122. Indeed, the Slovak Republic had precise knowledge of the potential losses of SI as it was involved in the selection of receivables to be assigned. The Slovak Republic was urged to appoint experts and bank examiners from the National Bank of Slovakia to inspect CSOB's loan portfolio and any other records pertinent to a proper implementation of the Consolidation Agreement, including the capital adequacy issue.[47] A representative of the MF SR had been invited to participate in a working group to examine

[47] Cf. Statement of P. Kavánek, No. 14-17, Exh. 3-5.

CSOB's portfolio of non-performing receivables in September 1993.[48] As Mr. Magula has indicated,[49] as a member of the Supervisory Board of CSOB, he was, like the other members of this Board, entitled to inspect all documents and to insure that the shareholders' instructions were complied with. The MF SR, in exercising the function of Supervisory Board of SI, was invited to negotiate the assignment of CSOB's OBS receivables.[50] The Slovak Republic was aware of the commitments SI had undertaken through SI's Supervisory Board, composed of high ranking officials of the MF SR. All the major SI agreements were presented to it. The Supervisory Board never has protested that the instructions of SI's sole shareholder, *i.e.* the Slovak Republic, had not been followed. Neither has the Slovak Republic objected. Besides, on February 13, 1997, an expert commission, established by CSOB and the MF SR, which included Dr. Papunova, a staff member of the MF SR, confirmed that the receivables had been correctly assigned to and accepted by SI.[51]

123. To make the Slovak Republic's involvement and acceptance of the transfer of receivables even more clear, the Assignment Agreement and the Future Assignment Agreement were initialed by Mr. Magula, then Chief Executive Director of the Section of Economic Policy of the MF SR. The Slovak Republic, through the person of Mr. Magula, was thus aware of the specifics of the receivables to be assigned and it accepted such transfer to SI and, consequently, the potential losses suffered by SI.

124. Equally explicit is the declaration signed by Mr. Filbus, then the Slovak Republic's Minister of Finance, on the bottom of the Loan Agreement, where he acknowledges the content of the LA that states specifically the details of SI's repayment obligation for the loan. Here again, the Slovak Republic declared to be perfectly aware of the amount of repayments owed by SI to CSOB.

125. The Slovak Republic furthermore argues that CSOB had not only a free hand in the selection of the receivables, but also in their collection. However, the collection was made

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48 Letter of CSOB to the National Bank of the Slovak Republic and to the MF SR, of September 10, 1992, Statement of P. Kavánek, Exh. 4.

49 Affidavit of J. Magula, supporting the Slovak Republic's Memorial on Jurisdiction, January 27, 1998, No. 5.

50 Letter of CSOB, March 31, 1994, Statement of E. Kalinová, Exh. 5.

51 Statement of E. Kalinová, Exh. 34.

by CSOB's employees performing activities for and on behalf of SI and under instruction of SI. The recovery of the transferred receivables was SI's activity and duty. SI was governed by its Supervisory Board, which was under the control of representatives of the Slovak Republic, SI's sole shareholder. SI's activity had an impact on its need for refinancing and the size of the loan extended by CSOB, but it did not interfere with the understanding and actual application of the CA.

126. One could still say that the amount of SI's losses was uncertain to the extent the result of SI's activity to collect the non-performing receivables was uncertain. However, this situation was an inherent part of the process set up in Article 3(II) CA and it was agreed upon by all Parties. The potential reduction of SI's exposure and loss was of no harm to the Slovak Republic, as it had the effect of reducing the amount of the repayment of the loan it had accepted to "secure" and did not, in fact, leave the Slovak Republic with any uncertainty. Indeed, when funds were collected from non-performing receivables and used to repay the loan, they had the immediate effect of reducing SI's potential loss. There did not exist any uncertainty at any given point in time about the amount of SI's payment obligation and loss in this respect. Consequently, there did not exist any uncertainty for the Slovak Republic either.

ii) The 6.25 % capital adequacy ratio

127. The privatisation plan required CSOB to reach an overall capital adequacy ratio of 6.25% by the end of 1993 to improve the financial standing of CSOB and to make it more attractive for privatisation. That explains also why the capital adequacy ratio had to improve to 7% at the end of 1994 (Art. 3(I) CA). In Article 3 CA, the ratio of 6.25% is relevant in two respects. First, CSOB had to create reserves to cover part of the non-performing assets at an amount such that its capital adequacy at the close of 1993 was to be 6.25% (Art. 3(I) CA). Second, the amount of non-performing assets to be transferred to the Collection Companies was to be specified as at December 31, 1993, "so that the actual capital adquacy of CSOB as of the same date amounts to 6.25%".

128. In fact, more receivables were transferred to SI than necessary to reach the capital adequacy ratio of 6.25 %. As both Parties have told the Tribunal, a capital adequacy ratio of

6.49 % had actually been reached.[52] The Slovak Republic argues that the assignments thus had gone beyond what was contractually foreseen and that the role of this capital adequacy ratio shows again how uncertain the content of the Parties' respective obligations under the CA were. This uncertainty is also demonstrated, in the Slovak Republic's view, by the fact that CSOB had full discretion to compose the bank's own capital, as the starting point for the calculation of the capital adequacy ratio.

129. Despite the difficulties of monitoring the process of its determination, the 6.25% capital adequacy ratio was in itself precise and imposed a clear target. Indeed, the drafters did use the direct notion "amount" and did not qualify it with "about" as they did in the same provision when they provided that for an "about 3:1 ratio" the receivables would be allocated between CI and SI.

130. However, it is one thing to have a clear target; another whether the performance should never go beyond that clear target. It is admitted that the capital adequacy ratio is a regulatory minimum that CSOB was required to achieve. As the CA was concluded in order to prepare CSOB for privatisation and to make its acquisition financially more attractive, the capital adequacy ratio had a specific meaning in the consolidation operation. It would have been against the purpose of the CA had the capital adequacy ratio of 6.25% not been reached at the end of 1993. It would, however, not have been against this purpose had the ratio at the end of 1993 been higher, *e.g.* 6.49%, so that it would have been easier to reach the 7%, or an even higher ratio, at the end of 1994. The actual rate of 6.49% complies with the minimum requirement fixed by the CA. In fact, it is very difficult to reach exactly a target capital adequacy. Indeed, many components influence a capital adequacy calculation. Changes in any one component can significantly alter the final ratio. As a practical matter, the banks never achieve a ratio at the exact regulatory minimum, because, as one of CSOB's expert stated –

> ... in order to hit that exactly, you would have to spend incredible amounts of money to monitor profit and monitor risk weighted assets. .... It will not be cost effective.[53]

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52 Cf. Statement of K. Cloughsey, No. 6.

53 TR, April 15, 2003, 131:7-11 (Cloughesy).

131. The 6.25% rate had to be implemented on an overall basis, *i.e.* for the totality of assignments to CI and SI. It does not necessarily follow that the 6.25% rate also had to apply separately to each group of receivables assigned to CI and SI, respectively. The CA itself does not instruct to do so. Moreover, the receivables to be assigned to make CSOB reach the 6.25 % rate had to be allocated in a ratio of *about* 3:1 between CI and SI. SI had to agree on the exact division of receivables to be assigned to implement this "about" 3:1 ratio. In other words, SI had to explicitly accept the assignment of the specific receivables. Once the receivables were accepted, SI could no longer raise an objection that more receivables had been assigned to CI and SI than strictly required under the 6.25 % standard, nor that the assignments were not in conformity with the "about 3:1" split.

132. It is a fact that CSOB initially had all the necessary information about the receivables, their specification and the impact their transfer had on CSOB's capital adequacy ratio. CSOB's assessment of its capital adequacy at the close of 1993 was subject to the scrutiny and approval of the Bank's own Supervisory Board, which included a representative of the MF SR.

133. Moreover, the receivables to be assigned had been audited, and information had been formally shared with the Czech Republic and the Slovak Republic. CSOB had to propose the receivables to be selected for their assignment. SI and CI were given the opportunity to examine such proposals before giving their approval. CI and SI undoubtedly were in a position to oppose any over-transfer of receivables whenever not in conformity with the 6.25 % capital adequacy rate and the "about 3:1" ratio. They did not do so and they accepted the transfer of receivables as identified in the Assignment Agreement and the Future Assignment Agreement and their collateral agreements. Thus, CSOB and SI had selected and decided to transfer the non-performing assets as provided in Article 3(II)(2) CA. No criticism can be addressed to either SI or CSOB for having "over transferred" assets in light of the actual capital adequacy ratio compared to the ratio as fixed in that provision. Indeed, such a target was very difficult to reach at the precise date of December 31, 1993, and the ratio fixed at 6.25% was to be understood as a minimum

and not as a maximum requirement, at least in the relations between CSOB and the Collection Companies.

134. The question has to be addressed, however, whether the Slovak Republic, given the fact that CSOB and SI accepted assignments over the 6.25% ratio, is bound by such an agreed "over-assignment". In other words, what are the effects of such "over transfer" on the meaning and operation of the cover losses provision of the CA ?

135. CSOB has stated correctly that the Slovak Republic knew about the volume of the assignments through the information provided by CSOB and the executive functions it exercised in the Supervisory Board of SI. However, the obligation to cover SI's losses that is at issue in the instant case is exclusively based on the provisions of Article 3 CA. The involvement of the Slovak Republic in the asset selection process and its approval of the assignments to SI were not intended to and did not change the nature and scope of the cover losses obligation contained in Article 3(II)(5) CA, which is interrelated with the notion of losses as it is to be understood in light of paragraphs 2 to 4 of Article 3(II) CA, as explained above.

136. In respect of the assigned non-performing receivables, SI's losses relevant in the context of Article 3(II) CA could not go beyond the nominal value (plus interest accrued) on December 31, 1993 (without considering SI's operating costs). The overall scope of the assignments was determined, *inter alia*, by the precise figure of an actual capital adequacy of the amount of 6.25%. This figure was to be understood as a maximum figure, determining the extent to which the assigned receivables were able to trigger SI's losses relevant in respect of the cover losses obligation. If such a limitation had not been agreed upon by the parties to the CA, the CSOB/SI Agreements could have extended the volume of assets to be transferred without limit, thus extending equally without limit the cover losses undertaking stated in Article 3(II)(5) CA.

137. As has been stated, the 6.25% target was not necessarily directed as such to the sole assets to be transferred to SI. It was an overall figure relating to both CI and SI, the split between these Companies not being fully precise, because it had to be "about" 3:1 only. However, the Parties have not contended that this element plays a role in this respect

and would not allow to retain the actual figure of 6.49% in respect of SI. The Tribunal notes that in this respect the amount of CSOB's FTO credit exposure was a main variable of its capital adequacy position as of December 31, 1993.[54] As the Parties have not indicated either on what precise amount of transferred receivables they rely when referring to this 6.49% ratio, the Tribunal includes those receivables that CSOB identified as receivables transferred to SI.

138. In order to determine how to deal with the "over-draw" of 0.24%, the Tribunal is of the view that the capital adequacy ratio served to fix a limit on the total exposure under the "cover losses" undertaking of Article 3(II)(5) CA. Therefore, the total loss to be covered was not to go beyond an amount that would raise this ratio over 6.25%. There is no need to identify any receivable that might represent the "over-draw". This matter will have to be dealt with further when the amount of receivables relevant in this respect is identified.

2. *The losses related to the operating costs*

139. Article 3(II)(4) CA states that the Collection Companies' loss will result from the "operating costs", in addition to the losses resulting from the schedule of payments to be made to CSOB. The preceding sub-paragraph that deals with the payment for the receivables as "consideration" and CSOB's loan facility towards the Collection Companies, mentions that "CSOB shall provide a loan to cover the 1994 operating costs". The Operation Agreement concluded between CSOB and SI included a quarterly fee of SKK 1.5 million and a percentage of the amount collected to be agreed upon for each collection on an individual basis (Art. IV/1). It also stipulated that CSOB would provide a loan for the purpose of the payment of fees, if the collection of assets of SI during 1994 was not sufficient to cover such payment (Art. IV/3.1). It was added that the repayment of such a loan was "guaranteed" by the MF SR under the CA (Art. IV/3.2). The Operation Agreement was one of the various collateral agreements implementing the CA. Its content was fully known to the Slovak Republic, as it was initialed by Mr. Magula, rep-

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[54] Statement of K. Cloughesy, No. 18.

resenting the MF SR, and had as contracting party SI, directed by the Slovak Republic as its sole shareholder.

140. The CA, as explained, included SI's operating costs in the notion of losses. This did not create any uncertainty or lack of identification of the obligation based on the "cover losses" provision. Indeed, the contracting parties to the CA agreed to have the amount of operating costs to be settled between CSOB and the respective Collection Companies. As the Operation Agreement shows, this has been done in respect of SI, to the full knowledge of the Slovak Republic. There existed therefore complete legal clarity about the costs accruing and their determination and, consequently, about their impact on the amount of losses to be covered under the cover losses provision. In fact, CSOB charged SI the quarterly fee through SI's accounts, reducing accordingly the amount of collected assets on these accounts. Thus, the balance of SI's obligation towards CSOB was recognizable, in this respect as well, and the Slovak Republic was in a position to know at any time the exposure triggered by the concept of "losses" under the CA. The Slovak Republic had every opportunity to object to the handling of SI's management fees; it did never do so at the relevant time.

141. It has been argued, on behalf of the Slovak Republic, that parts of SI's management fees were charged unduly and should be credited to SI, thus reducing SI's loss.[55] However, such a matter relates to the legal relations between CSOB and SI, governed by the Operation Agreement, and that is outside this Tribunal's jurisdiction. What matters in respect of CSOB's claim against the Slovak Republic is exclusively the actual state of SI's loss as it appears on the face of SI's assets and liabilities. Merely potential claims of SI, that are anyhow, as will be explained later, unsupported, do not constitute assets to be taken into account for the determination of SI's losses.

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[55] Expert Opinion of D. Frishberg (Deloitte & Touche), Nos 38, 39; Rejoinder, Nos 75-78.

E. The Obligation to Cover Losses under Article 3 CA

142. The Slovak Republic argues that in addition to the unclear meaning of the term "losses" it is equally not clear what the CA means by the "coverage" of the losses. Does "cover losses" mean that the Slovak Republic had to pay to SI or did it have to pay directly to CSOB ? Would the Slovak Republic have "covered" the losses when it were to pay SI, had SI not passed the funds on to CSOB ? Does the "cover losses" provision contain any payment obligation, or did it oblige the MF SR only to prepare a mechanism that would allow implementation of a payment obligation agreed upon at a later stage ?

143. The Slovak Republic further argues that even if the "cover losses" provision contained an obligation of the Slovak Republic to make payments in support of SI, such obligation did not have CSOB as beneficiary, as no mention of CSOB was made in this provision. Therefore, CSOB had no title (or "standing") to sue as it does in this dispute.

144. For CSOB, when the Slovak Republic had to "cover" the losses, it meant that it had to provide CSOB with some kind of security for the repayment of the loan, but the specific form that security and payment had to take was not determined by the CA itself, with the proviso, however, that the MF SR was obliged to prepare the necessary "mechanism". For CSOB, there is no doubt that it was the beneficiary of the "cover losses" obligation and thus entitled to direct its claim against the Slovak Republic.

145. The Tribunal has dealt above with the Slovak Republic's further suggestion that the "cover losses" obligation of the CA was intended to be a security but failed to be in the proper form of a "security", *i.e.* the nominate contract under Czech law. As it was not a proper security for CSOB, it was not valid and the loans granted by CSOB therefore unsecured. However, the "cover losses" obligation is not a "guarantee" or a "security" of this kind. Despite various controversies on terminology, the Parties both based their argumentation on the understanding that the CA is an innominate contract that parties could agree upon pursuant to their contractual liberty.

1. The Slovak Republic's involvement in the negotiation of the cover losses provision

146. The CA was negotiated extensively over five months. Mr. Magula, at that time Chief Executive Director of the Section of Economic Policy of the MF SR,[56] as well as a member of CSOB's Supervisory Board, was present at six of the meetings. As the CA itself indicates, all Parties, including the Slovak Republic, were aware that "It follows from the nature of the assigned receivables that the Collection Companies would make a loss." The certainty of the Collection Companies' losses was the very basis for and the genesis of the CA.[57] The Slovak Republic had full opportunity to participate and intervene in this process, as negotiator and party of the CA and through its presence on the Board of CSOB.

147. During the negotiations - a period very relevant to the interpretation of an agreement according to Section 266 Commercial Code – the Slovak Republic knew what was understood by the losses it had to cover. Indeed, on the basis of the draft agreement of December 1993, it has estimated its expenditure till 2003 under the CA, in other words it was aware of the amount of losses it expected to have to cover. Consequently, the Slovak Republic's own behavior shows that the Slovak Republic understood what was covered by the notion of "losses". Moreover, the initial draft agreement, that was prepared by the MF SR, provided already that the contracting parties (then the Czech and the Slovak Republics) had to agree that the Finance Ministries of both Republics "shall bear the losses of the collection unit equally" and that the "planned distribution of losses coverage spans from the year 1995 until the year 2003".[58] The subsequent drafts prepared by CSOB contained the cover losses provision as it was adopted in Article 3(II) CSOB.[59] Therefore, there could not exist any surprise, doubt or lack of clarity in respect of the Slovak Republic's undertaking.

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56 Affidavit of J. Magula, supporting the SR's Memorial on Jurisdiction, January 27,1998, No. 4.

57 For the negotiation history of the CSOB see, in particular, Statement of P. Kavánek in support of Claimant's Counter-Memorial on Jurisdiction, April 30, 1998, together with the Annexes containing the Minutes of meetings and the draft proposals.

58 Statement of P. Kavánek in support of Claimant's Counter-Memorial on Jurisdiction, April 30, 1998, Exh. J.

59 Statement of P. Kavánek in support of Claimant's Counter-Memorial on Jurisdiction, April 30, 1998, Exh. M and N.

148. The Working Group that was appointed by the Slovak Republic's Government to deal with stage II of the restructuring of CSOB charged the Minister of Finance –

> to make provisions for the expenditures intended for the coverage of losses of the collection company in the State budget, commencing in the year 1995 and ending 2003.

The Resolution No. 937 of the Government of the Slovak Republic of December 15, 1993 that appointed the Slovak Republic's Working Group, also recognized the proposal for the project for stage II that had been prepared by the Minister of Finance and the Governor of the National Bank of Slovakia. This proposal stated in its rationale –

> With account taken of the fact that CSOB is active in both Republics, the participation of both states in the coverage of losses from bad loans and guarantees will be necessary. (page 6, emphasis in the original)

It was further stated that bad assets in a total amount of approximately SKK 9.3 billion would be transferred to the Collection Company in the Slovak Republic and that the total estimated net expenditures of the state budget of the Slovak Republic would amount to at most approximately SKK 13.3 billion until 2003 (page 7). As a result, no doubt can remain that the Slovak Republic had therefore full knowledge, not only of its obligation to cover SI's losses, but also of the scope of its exposure and the need to provide for the necessary budget.[60]

2. *The meaning of "cover losses"*

149. As the Tribunal has stated on various occasions, the CA stands on its own and Article 3 CA constitutes an innominate agreement to be considered under the pertinent provisions of the Czech Commercial Code. When Section 269 of this Code requires that such agreement identifies "adequately" the object of the parties obligations, this does not

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[60] As Mr. Knapp put it: "... this required final calculation and final approval, but the magnitude was known already. ... The exact figure of course was not known but in general both parties had very good knowledge of what it is about and what will be the total costs and what also is expected then from [the] privatisation process." TR, April 15, 2003, 98: 17/18, 22-25.

mean that all details have to be spelled out. It is sufficient that the parties, in light of the pertinent elements for the interpretation of the manifestation of their will (Section 266 Commercial Code) understand the essentials of their obligations or know the pertinent elements of their further determination or implementation.[61] Furthermore, under Czech contract law – in conformity with general principles of contract law –, it is not required that the amount to be paid should be known when the agreement is entered into; it is sufficient that at the moment when the performance is due, it is objectively quantifiable (*e.g.* Art. 409(2) Czech Commercial Code in respect of contract of sale). As the Slovak Republic was in a position to measure precisely SI's loss and its evolution at any point in time (at least at each quarter), the Slovak Republic surely was able to objectively quantify its obligation to cover SI's losses.

150. As the language of the cover losses provision shows, the Slovak Republic had been offered more than one way to implement its obligation to cover losses. Indeed, this obligation directed the Slovak Republic to achieve the goal of "covering", *i.e.* removing or replacing SI's losses, but it did not impose on the Slovak Republic a particular method to achieve this goal. It requested the Slovak Republic, however, to prepare a mechanism that would permit reaching the required result. It is not disputed that the Slovak Republic did not implement such a mechanism nor provide for the necessary funds on the State's budget. It is clear that the non-existence of such a prepared mechanism cannot serve as an argument to raise an objection based on an alleged lack of clarity of the basic obligation to cover losses when required.

151. The decisions of the Czech Supreme Court, which the Slovak Republic invokes to sustain its argument that Article 3 does not indicate what is meant by "cover losses" and therefore is illegal, are not relevant. All these decisions concerned flagrant cases where it was not clear whether parties intended a gift or a sale;[62] or where there was no objective way to determine the ultimate sales price;[63] or where all relevant elements in respect

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61 Section 37 Civil Code, that requires that the parties' declaration be "definite and intelligible", is, contrary to the Slovak Republic's view, not applicable to Article 3 CA, and it would anyhow not lead to another conclusion than Section 269 Commercial Code.

62 Decision of October 7, 1998, No. 1 Odon 110/97.

63 Decision of August 31, 1999. In this case, no ruling on the validity of the agreement was made. The case was remanded to the appellate court to complete the facts in relation to the price arrangement.

of the rights and duties associated with the membership of a cooperative building society were missing.[64] In the case at stake, on the contrary, it was clear that the Slovak Republic would cover SI's losses, in order to protect CSOB against the most probable risk that loaned sums to SI most likely would not be reimbursed. As the Slovak Republic would ultimately make a profit from the transaction, it had to make this investment.

152. As an equivalent to the MF SR's undertaking to "cover" SI's losses, Article 3(II)(5) CA uses the expression that such losses shall be "compensated". The same undertaking covers "any" losses. This means that all of SI's losses, as identified under the provisions of Article 3(II) CA, are to be covered, respectively compensated, and this at any time they occur. The undertaking to cover SI's losses implied payments to be made at regular intervals, corresponding to the intervals fixed in the agreed schedule of payments, when SI had to pay the installments of CSOB's loan, over the period 1995-2003, but lacked the funds necessary to meet its obligation. That is the reason why the MF SR was required to prepare a "mechanism" to ensure a periodic flow of coverage for SI's losses. The Slovak Republic thus had to provide SI with funds or assets to compensate for the loss it had to suffer because the recovery from the assigned receivables was insufficient to fully repay the loan and the operating costs. In this way, SI would keep the proper financing to meet its obligations towards CSOB.

153. The losses to be covered were SI's losses. In the ordinary course of dealings, the payments to be made by the Slovak Republic to cover those losses would have to be directed to SI. The Slovak Republic has argued, however, that this demonstrates that the cover losses provision hereby shows another face of its inherent uncertainty, as such payments made to SI would not have ensured that CSOB ultimately would be paid. The Tribunal does not accept this argument. First, as the Slovak Republic has not made any payment to cover SI's losses, such assertion is purely hypothetical. Second, and more importantly, such a refusal of SI to transfer the Slovak Republic's payment to CSOB would imply that the Slovak Republic, after it had paid the amount necessary to cover SI's losses, would refuse, when acting within SI's Supervisory Board, to forward the same money to its final destination, CSOB. Such a behavior would represent a gross

[64] Decision of February 7, 2001, No. 29 Cdo 1402/99.

violation of the principle of good faith and of Article 2(2) of the BIT, resulting in a breach of the Consolidation Agreement.

154. As a matter of fact, another way to effectively cover SI's losses could have been a direct payment from the Slovak Republic to CSOB, to the benefit of SI, thus reducing SI's repayment obligation and its potential loss. As the Slovak Republic had not prepared any mechanism for the coverage of SI's losses nor the necessary funds on its budget, this variant to allow compliance with the cover losses obligation need not to be further discussed.

155. The Tribunal concludes, therefore, that the cover losses provision of Article 3(II)(5) CA identifies adequately and in a definite and understandable manner the Slovak Republic's obligation to cover SI's losses as soon as and to the extent as the recovery of the assigned receivables did not allow to repay CSOB's loan according to the agreed schedule of payments and taking into account SI's operating costs.

3. *The Slovak Republic's obligation to cover SI's losses*

156. Considering again the basic rules on the interpretation of the manifestation of will of Section 266 Commercial Code, the Tribunal finds that all relevant circumstances for the understanding of the content of the cover losses provision of Article 3(II)(5) CA lead to the conclusion that the Slovak Republic had accepted a legally binding undertaking to make the necessary payments in order to allow the coverage of SI's losses.

157. During the negotiations leading to the conclusion of the CA, as explained, the representatives of the Slovak Republic were aware of the precise operation of Article 3(II) CA, the need for each Republic to cover the losses of its respective Collection Company and the budgetary funds needed to give effect to such undertaking, as much as the Slovak Republic was aware of the profit it was going to make through the consolidation and subsequent privatisation of CSOB. The documentation supporting Resolution No. 937/93 of the Government of the Slovak Republic, referred to and quoted above, represents the most pertinent evidence in this respect.

158. The wording of Article 3(II)(5) CA leaves no doubt about the basic obligation of each Republic, acting through its Ministry of Finance, to provide for the "compensation" of the Collection Companies' losses over the period 1995-2003 and to "cover any losses" made by these Companies in its respective territory.

159. Equally clear is the declaration signed by Mr. Filbus, then the Slovak Republic's Minister of Finance, at the end of the Loan Agreement, where he "consents to and acknowledges the contents" of the LA that states specifically the details of SI's repayment obligation for the loan. This declaration confirms the MF SR's obligation to "secure" such repayment under the CA. This means that the Slovak Republic had full knowledge of SI's exposure to CSOB and declared to confirm that the repayment would finally be "secured" by the Slovak Republic. As no other provision than Article 3(II)(5) of the CA is related to such an obligation, this confirmation, declared by the Slovak Republic, is clearly based on and refers to the CA's cover losses provision. The fact that a similar declaration attached to the Future Assignment Agreement has not been signed on behalf of the Slovak Republic does not remove the Slovak Republic's obligation under the CA, which did not require any further confirmation. The declaration attached to the LA shows that the Slovak Republic accepted that an obligation to secure the repayment of the loan existed under the CA. Such an obligation covers necessarily all receivables assigned pursuant to the provisions of Article 3(II)(2) CA, including both on-balance and off-balance sheet receivables. This is further confirmed by Articles 1(b) and 2 LA, that refer expressly to loans related to OBS items and that are included in the MF SR's consent declaration.

160. The Slovak Republic did argue that under Slovak law, the Slovak Minister of Finance had no power to make such a declaration on behalf of the Slovak Republic.[65] The evidence shows, to the contrary, that the Minister of Finance of the Slovak Republic was authorized by the Working Group appointed by virtue of Resolution No. 937 of the Government of the Slovak Republic of December 15, 1993 to enter into a master agree-

[65] Opinion of J. Drgonec, No. 25, 128, 211, 214; Rejoinder Opinion J. Drgonec, No. 27, 33. This expert advise does not contain any mention of the cited Government Resolution No. 937.

ment and to prepare and to enter into the required partial agreements for the purpose of implementing stage II of CSOB's restructuring.

161. The main line of the Slovak Republic's argumentation in these proceedings,[66] *i.e.* that the cover losses obligation is in various respects not definite, not understandable and uncertain, and thus null and void, is contradicted by the position taken by the Slovak Republic's representatives over an extended period of time. Thus, during the negotiations preparing for the conclusion of the CA, as well as in the years of the CA's subsequent practical application, they never raised doubts or objections in respect of the Slovak Republic's cover losses obligation. In this way they demonstrated effectively that the provisions of the CA were fully understandable, certain and definite to the Slovak Republic. Any contrary position, as taken by the Slovak Republic in these proceedings, is unsupported by all relevant circumstances of interpretation under the applicable Czech law and, moreover, it does not comply with Article 2(2) of the BIT, which was incorporated into the CA and requires the Slovak Republic to treat CSOB fairly and in an equitable way and to give its investment full protection and security in the Slovak Republic.

162. The Slovak Republic's subsequent conduct - another source on which to assess and construe the meaning of a contract provision under Section 266 Commercial Code - confirms that the Slovak Republic clearly knew and accepted what was meant by its obligation to "cover losses". Through various set-off agreements concluded between the MF SR, SI and FTOs (Technopol, Chirana, Martimex) in 1994 and 1995,[67] the Slovak Republic confirmed that SI did dispose of a receivable validly assigned by CSOB to SI. The MF SR accepted to enter into discussions with CSOB on the provision of resources on the state budget that would allow the repayment of CSOB's loan. CSOB was ensured by the Slovak Republic's Minister of Finance that in 1996, the proposed budget would include an amount for SI covering both 1995 and 1996.[68] By the end of 1995, the MF SR agreed to propose to the Government that SKK 3 billions from the budget of the

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66 At least in the merits phase. In its Reply Memorial on Jurisdiction (p. 68), the Slovak Republic submitted "that the meaning of the Consolidation Agreement is clear on its face and, if any further evidence were needed, it is supplied by the negotiating history. Because the contract is not ambiguous, no further rules of contractual interpretation are necessary."

67 Statement of E. Kalinová, Exh. 18-20.

68 Minutes of meeting of September 4, 1995, Statement of P. Kavánek, Exh. 7.

Slovak National Property Fund could be used for SI.[69] The MF SR had been provided by SI with "detailed quantification required from the state budget for 1995-1996".[70] At no time during these discussions did any representative of the Slovak Republic question the nature or the extent of the Slovak Republic's cover losses obligation under the CA.[71] However, the Slovak Republic failed to include in the budget amounts for funding SI.

163. The Slovak Republic's Minister Kozlik recognized in his May 17, 1996 letter that, following expert review, "there were no legally ambiguous obligations in the CA."[72] In a bond prospectus dated December 16, 1996,[73] the Slovak Republic accepted that under the CA, the MF SR was obliged to cover the losses incurred by SI in such a way that SI has sufficient funds to make the payments on the loans to CSOB. In a "Guarantor's Letter of Information", issued on December 22, 1997 by the State Secretary of the MF SR,[74] it was stated that the MF SR was obliged to ensure that SI had sufficient funds to make payments on SI's of some SKK 10.7 billions, and that the MF SR recognized that "to date such payments have not been made in a timely manner". In statements made to the press, on May 25, 1998, June 1, 1998 and August 11, 2001, as well as in the "Black Book" released in January 1999, the Slovak Republic repeatedly recognized that it had to pay CSOB because of SI's failure to reimburse the loans.[75]

164. In the bond prospectus referred to above, it was also stated that CSOB had not yet fulfilled its obligations under the CA to provide documentation to prove the amount owed to CSOB with respect to the receivables assigned to SI. Other complaints of this kind had been raised in late 1996 and early 1997,[76] but no statement made by the Slovak Re-

[69] Minutes from meeting of December 1, 1995, Statement of P. Kavánek, Exh. 12; Reply Statement of P. Kavánek, Exh. 2.

[70] Statement E. Kalinová, Exh. 17

[71] Statement of P. Kavánek, No. 22-26.

[72] Statement of P. Kavánek, Exh. 18. Contrary to what the Slovak Republic contends (TR, November 12, 2002, 172:16-173:16), this statement was not a general statement, inspired by practical considerations and not considered as a legal acknowledgement. This is unconvincing as the purpose of the statement was to assure third parties. Indeed, the statement was legally significant as it had the purpose to assure CSOB about the MF SR's willingness to complete stage II of CSOB's restructuring and to recognize the Slovak Republic's obligation under the CA. It further served CSOB to satisfy its auditors (Statement P. Kavánek, Exh. 19, TR, November 11, 2002, 156:9-25) and to classify the SI loan as a "standard" loan (Reply Statement P. Kavánek, No. 23).

[73] CSOB's Memorial, Exh. 8.

[74] CSOB's Memorial, Exh. 9.

[75] Cf. CSOB's Memorial, Exh. 10-14; TR, November 12, 2002, 85:3 – 90:9.

[76] Cf. Statement of P. Kavánek, No. 35, 36, 38, 39, 41, 42, Exh. 26, 27, 29, 31, 32, 34.

public in this respect disputed the MF SR's cover losses obligation under the CA.[77] The expert commission jointly set up by CSOB and the MF SR concluded on February 13, 1997 that no imperfections in respect of the assigned receivables had been discovered.[78] In response to CSOB's letter of April 10, 1997, calling SI to pay all drawn loans, SI asked in its letter of April 24, 1997 for postponement of the due payments until December 31, 1997 because it was "unable to pay its obligation to your bank".[79] No objection to the existence and scope of this obligation was raised.

165. The Slovak Republic has argued that these repeated confirmations of the Slovak Republic's duty to pay are set aside by the fact that CSOB did not request firm compliance with Article 3 CA. On the contrary, *e.g.* on September 4, 1995, when SI was in default of payments, CSOB explored the possibility of whether the Slovak Republic would grant a specific state guarantee.[80] In October, CSOB again invited the Slovak Republic to ensure repayment of CSOB's loan to SI. A letter was addressed by SI to the MF SR on December 22, 1995, requesting the MF SR to regard its liability towards SI as being secured by a State guarantee. For CSOB, such an endorsement by the MF SR of its obligation would have allowed the SI loan to be given a classification that would have satisfied CSOB's auditors and the bank regulating authorities of the Slovak Republic. Ultimately, the MF SR's letter stating that there "were no legally ambiguous obligations" in the CA resolved the auditing and reporting requirements and the proposed agreement was not signed.[81]

166. For the Slovak Republic, these requests for an explicit guarantee, which remained unsuccessful, indicate that the Slovak Republic was not obliged under the CA to pay CSOB. Article 3 did not specify the mechanisms to cover losses; any number of methods could have been employed.

167. The Tribunal finds that the request for a specific guarantee is a - belated - request to the Slovak Republic to secure properly its existing obligation for covering SI's losses. The

[77] Statement of P. Knapp, No. 22 and Exh. 4.
[78] Statement of E. Kalinová, Exh. 34
[79] Statement of P. Kavánek, Exh. 37.
[80] Minutes of meeting, Statement of P. Kavánek, Exh. 7.
[81] Cf. Reply Statement of E. Kalinová, No. 3-14.

fact that the Slovak Republic did not issue a guarantee is no indication that Article 3 is not binding. It means only that the Slovak Republic was not prepared to undertake such a further step to strengthen the enforcement of its liability under the CA. The December 22, 1995 proposal stated clearly that it "will merely endorse the obligations of the MF SR" pertaining to the CA. The purpose was manifestly to provide SI, and ultimately CSOB, with a security that, while assuring the Slovak Republic's compliance with an already existing and at that time not disputed obligation of the Slovak Republic to cover SI's losses, would have satisfied CSOB's regulatory requirements.

4. CSOB's right to claim

168. The Slovak Republic further contends that CSOB is not designated as the beneficiary of the cover losses provision and that even if CSOB had had any title to claim, it has no actual interest on the basis of which it can bring a claim against the Slovak Republic.

169. In respect of the first item, the Slovak Republic notes that the cover losses provision does even not mention CSOB. It is argued that this is in line with the nature of the CA that can create mutual obligations and rights between states only.

170. The Tribunal observes that it cannot be disputed that CSOB is a party to the CA with its own rights and obligations. It contracted various obligations towards the Slovak Republic (as well as the Czech Republic). In particular, CSOB undertook to call a General Meeting that would resolve to increase the registered capital (Art. 2 CA), it accepted to improve its balance (Art. 3 CA), to develop its business in the Slovak Republic (Art. 5 CA), and to establish a subsidiary in the Slovak Republic (Art. 6). In respect of the cover losses provision, while it is true that it does not mention CSOB expressly, it is said in the provisions above that CSOB undertakes to transfer non-performing assets to SI (Art. 3(II)(2) CA), that CSOB will be paid for these assets and will provide SI with a loan (Art. 3(II)(3) CA), which will ultimately create SI's loss that the Slovak Republic undertakes to cover. The heading of part II of Article 3 CA mentions the "Transfer of CSOB's Non-Performing Assets to the Collection Companies", a transaction that could not be envisaged without having CSOB as a party to it. Moreover, the above stated

heading of Section 2 of Article 3 CA states that "the parties hereto have agreed to cover the Non-Performing Assets", thereby referring necessarily to the parties of the CA, including CSOB. The Slovak Republic did not explain how the cover losses provision of the Consolidation Agreement could operate as a state-to-state undertaking from the Slovak Republic towards the Czech Republic. The Slovak Republic's cover losses obligation can only make sense if it entitles CSOB to claim from the Slovak Republic that it effectively provides SI with the funds necessary to meet SI's obligation to repay CSOB's loan. The fact that CSOB had to be involved and that it had to grant a loan to the Collection Companies, implies that CSOB had to be secured in the likely occurrence that the Collection Companies were to make losses. The Slovak Republic's denial of CSOB's title to request from the Slovak Republic that SI's losses are covered would deprive CSOB from any meaningful protection for its loan and thus breach the Slovak Republic's commitment to let CSOB "enjoy full protection and security" as stated in Article 2(2) BIT that the parties agreed to incorporate into the CA. Therefore, the Tribunal rejects the Slovak Republic's contention that CSOB has no title to claim under the cover losses provision of the CA.

171. The Slovak Republic also denies CSOB any actual interest on the basis of which it can bring a claim against the Slovak Republic under the cover losses provision of the CA. Indeed, after the present arbitration proceedings had commenced in 1997, CSOB concluded an assignment agreement with the Czech Republic on April 24, 1998,[82] which was superseded on June 25, 1998[83] by a second agreement. The purpose of these agreements was to improve CSOB's financial situation in view of its privatisation.

172. Under the second assignment agreement, CSOB undertook to assign to the Czech Republic on a so-called "effective date" all claims CSOB had against SI under the LA relating to the receivables transferred to the latter as well as the claims CSOB had against the Slovak Republic under the CA. The "effective date" is three days after the date on which the Czech Republic receives in writing CSOB's request for delivery of the receivables and the rights attached thereto. However, the Czech Republic does not have the right to request the assignment prior to the completion of the instant arbitration proceed-

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[82] Reply Statement of P. Kavánek, Exh. 9.
[83] Reply Statement of P. Kavánek, Exh. 10.

ings. In case of these proceedings not being completed by December 31, 2002, the Czech Republic was required to pay a deposit for the payment of the "consideration" amounting to 90% of the agreed upon nominal value of the receivables at that date. Were CSOB to receive any payment in settlement of the receivables, 75% of the consideration related to such payment has to be reimbursed to the Czech Republic. Whenever the Czech Republic obtains such payment after the assignment of any receivable, CSOB remains entitled to 25% of any amount received.

173. The second assignment agreement was amended on October 31, 2001.[84] The due date for payment to CSOB of the deposit for the consideration for the assignment of receivables to the Czech Republic was postponed until after completion of the arbitration proceedings, but no earlier than December 31, 2004. The Amendment denominated the consideration in Czech crowns. It established a variable component of the consideration based on interest on the outstanding fixed component of the consideration. Further, the percentage of the consideration to be reduced in case of payments collected by CSOB was increased from 75% to 85% for payments received as from January 1, 2003; the same percentage were to apply to the amount of the Czech Republic's deposit that would have to be returned to the latter after January 1, 2005.

174. The Slovak Republic has argued that, because of these assignment agreements, CSOB has no longer standing to claim in this arbitration as in fact the Czech Republic became the party interested to obtain a payment from the Slovak Republic. The circumstance that the assignments would not take place before three days after the termination of the arbitration proceedings was - in Slovak Republic's view - a mere artifice to maintain CSOB as a party in the present proceedings. In fact, the Czech Ministry of Finance has stated on its web site that the Czech Republic - *i.e.* not CSOB - would win the dispute. Moreover, in its Annual Report 2001, CSOB has dropped the receivable related to SI from its balance sheet and has replaced it by a Czech Republic receivable. The receivable against SI was transferred to the off-balance sheet.

[84] Additional documents produced by CSOB pursuant to Procedural Order No. 1, on June 13, 2002, Tab 1.

175. However, the Arbitral Tribunal already has decided in its First Decision on Jurisdiction that CSOB is the real party in interest.[85] Consequently, CSOB has standing and title to claim.

V. THE RECEIVABLES THAT COULD TRIGGER LOSSES UNDER ARTICLE 3 CA

176. The losses that the Slovak Republic had to cover could result from SI's operating costs and from the payments to be made to CSOB to repay CSOB's loan, the amount of which was equivalent to the amount of the consideration paid by SI at the time of the assignment of the selected non-performing receivables. Such selection was based on two distinct agreements, *i.e.* the Assignment Agreement (later completed by two amendments) and the Future Assignment Agreement (subsequently followed by the OBS Assignment Agreements). The Slovak Republic as a party to the CA was bound by these CSOB/SI Agreements in respect of the identification of the assigned receivables as provided for in Article 3(II)(2) CA.

177. The Slovak Republic and CSOB disagree on which receivables have actually been properly assigned as provided for by Article 3(II)(2) CA. The assignments of some "On-Balance Sheet" receivables as well as of some "Off-Balance Sheet" receivables are in dispute.

A. On-Balance Sheet Receivables

178. The total amount of CSOB's receivables transferred to SI through the Assignment Agreement was 6,521,108,081.91 Slovak Crowns (hereinafter "SKK"), representing the "balances of contractual and forced loans denominated in Crowns and foreign currencies as of December 31, 1993" (Art. I). The Amendment No. 1 dated August 16, 1994 reduced this amount by SKK 51,668,195. The Amendment No. 2 dated May 31, 1995 in-

[85] First Decision on Jurisdiction, No 28-32.

creased the amount by SKK 86,948,277.04, corresponding to a newly transferred receivable from Omnia.

179. The Slovak Republic argued that CSOB had engaged in aggressive lending to the FTOs in late 1993, years after the end of the command economy, and then shunted those late loans to SI. The Slovak Republic contended that this was inconsistent with the agreed purpose of the CSOB/SI Agreements and that therefore a reduction of CSOB's claim of SKK 7,022,989,051 (including interest) should be made. It is not certain whether this request that does not appear in later submissions, has been formally withdrawn by the Slovak Republic. However, the Tribunal notes that the provisions of Article 3(II) CA do not give room to investigate into the origin and nature of the respective non-performing receivables. In the Tribunal's view, the Slovak Republic is bound by the assignments that have been validly agreed upon by CSOB and SI in compliance with Article 3(II)(2) CA.

1. The devaluation loans

180. The Slovak Republic argues that among the "On-Balance Sheet" receivables, there were receivables for a value of SKK 1,011,426,185 that were not "non-performing" as of December 31, 1993 and thus did not fall under the qualification of the "Non-Performing Assets" to be transferred under Article 3(II)(2) CA.

181. These receivables were related to devaluation loans, granted by CSOB to three FTOs (Technopol, Chirana and Martimex) in order to allow them to honour their obligations in foreign currencies after the devaluation of the Czechoslovakian Crown in 1990. On December 30, 1992, CSOB and the MF SR had entered into a "Devaluation Agreement"[86] whereby the Slovak Republic accepted to reimburse CSOB certain of the FTO's devaluation related losses, for a total amount of 1,900,980,000 Czechoslovakian Crowns (hereinafter "KCS"); the reimbursements were meant to reduce the indebtedness of the FTOs to CSOB (Art. II). Consequently, in the Slovak Republic's view, because CSOB had obtained a direct guarantee from the Slovak Republic to reimburse these loans, the

[86] Reply Statement of P. Kavánek, Exh. 18; Expert Opinion of D. Frishberg, Exh. 21.

receivables could not be considered as non-performing. Thus, in the Slovak Republic's view, the damage claimed by CSOB should have been reduced by SKK 3,068,497,860, consisting of SKK 1,011,426,185 of principal and SKK 2,057,071,675 of interest as of December 31, 2002.[87]

182. The Tribunal notes that the Devaluation Agreement, concluded in 1992, foresaw that the Slovak Republic would pay KCS 833,100,000 to CSOB for these receivables in 1993 and KCS 1,067,880,000 in 1994. On October 25, 1993, CSOB and Konsolidacna Banka (KBB) concluded an agreement whereby the latter purchased for SKK 724,020,000 part of these receivables and obtained from CSOB a loan for the same amount at an interest rate of 16.5% until October 31, 1996.[88] This arrangement had the effect of reducing the outstanding obligations that were later transferred to SI. At the time of the CA's conclusion, the Slovak Republic had agreed to the inclusion of the remaining receivables related to the devaluation losses in the CA that was then under preparation.[89] It is not contested that the Slovak Republic agreed to such inclusion while it had full knowledge of the Devaluation Agreement and the agreement concluded with Konsolidacna Banka. The handling of the respective assets by the Supervisory Board of SI shows that their transfer was made properly and was accepted.[90] The Slovak Republic's argument presented in these proceedings appears therefore as the opposite to its prior position.

183. The argument now raised by the Slovak Republic is that the Devaluation Agreement operated as a "guarantee" to give CSOB full protection with regard to the payments of the devaluation loans. The Tribunal observes that the Devaluation Agreement states an obligation to "reimburse" and does not contain the notion of a "guarantee". Further, the particulars of the agreement with Konsolidacna Banka show that the Slovak Republic did not satisfy its direct payment obligations toward CSOB under the Devaluation Agreement as they were agreed. In fact, the Slovak Republic never did so even later. As Section 266 Commercial Code indicates, the practices introduced between the Parties and the subsequent conduct are important parts of the circumstances of the interpretation

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87 Rejoinder of D. Frishberg, para. 87.

88 Reply Statement of E. Kalinová, Exh. 2. See further TR, April 15, 2003, 72:12-76:2, 122:14-128:3 (Knapp).

89 These loans were put on the list of receivables assigned and they were mentioned in the KPMG report on CSOB's credit exposures as well as in the Proposal of the Slovak Republic of December 1993. Cf. Reply Statement of P. Kavánek, No. 43 and 44, Statement of P. Knapp, Exh. 2.

90 Cf. Reply Statement of E. Kalinová, No. 18-24.

of an agreement. In the instant case, the Slovak Republic's own conduct demonstrates that it was perfectly aware and had fully agreed upon the inclusion of the devaluation loans as non-performing receivables into the assets assigned to SI. Indeed, in 1994, three tri-partite set-off agreements were concluded whereby the MF SR paid an obligation it had towards each respective FTO through the set-off of FTO receivables held by SI (after their assignment from CSOB). This operation had the effect of reducing SI's receivables and entitlement to collect from these FTOs. While this had the advantage for the MF SR and the FTOs of reducing their respective liabilities, it had the collateral effect of reducing SI's ability to repay CSOB's loan from collections from those FTOs. Such an operation and its implied increase of CSOB's exposure to get SI's loan repaid could make sense only because of the Slovak Republic's undertaking to provide SI with the funds necessary to meet its loan obligation to CSOB. The Slovak Republic knew, when it accepted the transfer of those receivables to SI, that the Devaluation Agreement was not an appropriate instrument to ensure performance of these receivables and it acted subsequently on the same basis. The Slovak Republic alleges that there had been some indications that through 1994 the Slovak Republic would have repaid some SKK 1.4 billion for these receivables. No specific evidence has been submitted in this respect, and the reduction claimed by the Slovak Republic in respect of the principal is below this amount.

184. Finally, the Tribunal does not share the Slovak Republic's view that proof should be given that the receivables assigned effective on December 31, 1993 were in fact actually non-performing. The content of Article 3(II)(2) CA does not go so far. It requires CSOB and SI to identify the non-performing receivables. If a receivable so selected were later to appear as performing, in full or in part, it would have the effect of increasing SI's collection and allow the repayment of CSOB's loan. No adverse effect would occur that would put the actual operation of Article 3(II)(2) CA into question. Moreover, the Slovak Republic has no interest in challenging the transfer of receivables because they were performing. As the Slovak Republic had to cover the losses caused by non-performing receivables, the more performing receivables that were transferred, the less substantial its obligation to cover SI's losses would be.

2. *The receivables concerning Polnopo / Mykoprogres*

185. Another on-balance sheet receivable assigned for an amount of SKK 121,085,371.50 concerned Polnopo. This receivable had been guaranteed by Mykoprogres in an amount of SKK 118,476,874. Mykoprogres became subject of bankruptcy proceedings, initiated by SI. In the course of these proceedings Mykoprogres requested the District Court in Bratislava to declare that SI had no valid claim against Mykoprogres. The Slovak Republic invokes this request to argue that it should not be held to cover losses from the Polnopo receivables as these receivables had not properly been assigned to SI. However, the objection raised by Mykoprogres is not more than an argument of a third party opposing a guarantee payment, that may be based on grounds unrelated to the relationship between the creditor and the debtor of the disputed asset. It does not specifically support a view that no claim of SI exists against its debtor Polnopo. Mykroprogres' objection has no legal effect on the validity of the transfer of the Polnopo receivable as it was agreed between CSOB and SI and is consequently binding on the Slovak Republic.

186. The Supreme Court of the Slovak Republic decided on June 26, 1998 to overturn a decision of the Regional Court in Bratislava that failed to examine Mykoprogres' objection to SI's claim; the matter was therefore returned to the lower court for further proceedings.[91] This Court subsequently reopened the bankruptcy on November 20, 1998, in the course of which the trustee of Mykoprogress challenged SI's receivable. No evidence has been produced about the outcome of these proceedings. One of the Slovak Republic's legal experts confirms that there is no final decision on the merits and he abstains from offering a conclusion in this respect; he states, however, that the trustee's challenge enables him to assert that the validity of Mykoprogres' receivable is "seriously questioned".[92] This expert does not consider, however, nor did the Slovak Republic, that Mykoprogres' refusal to settle SI's claim has been examined in detail by an Expert Commission directed by Ms. Papcúnová, an executive of SI appointed by the MF SR, at a meeting held on February 13, 1997, that concluded unanimously that no imperfections to the particulars with respect to the assignment of balance sheet receivables from

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[91] Reply Opinion of O. Ovečková, Exh. 9.
[92] Rejoinder Opinion of J. Drgonec, No. 70-72.

CSOB to SI were discovered.[93] As it has been reported to the Tribunal, at no time during its negotiations with SI did Mykoprogres question the validity of its obligations to SI.[94]

187. Therefore, the Tribunal does not retain the objection raised by the Slovak Republic in this respect.

3. *Later transfer of receivables*

188. Under Article 3(II)(2) CA, the receivables to be assigned had to be specified as of December 31, 1993. However, on May 31, 1995, CSOB and SI agreed to transfer receivables to SI that had not been identified on December 31, 1993. Pursuant to Amendment No. 2 to the Assignment Agreement, effective as of June 1, 1995, CSOB assigned to SI a receivable from Omnia for SKK 86,948,277.04. On this basis, Amendment No. 4 to the LA increased the SKK part of the loan by the same amount and it modified the amount of the installments correspondingly.

189. On August 16, 1994, CSOB and SI agreed in Amendment No. 1 to the Assignment Agreement to retract part of the assignment of receivables related to AVEX and listed in the receivables transferred to SI as of December 31, 1993 under the Assignment Agreement. The amount of the assigned receivables was thus reduced by SKK 51,668,195 and became a total of SKK 6,469,439,886.91. With effect on August 1, 1994, the same reduction in SKK was agreed in Amendment No. 2 to the LA, thus reducing the SKK part of the total loan to SKK 5,233,127,586.91 (the other part in Czech Crowns remaining unchanged at 1,055,000,000). The revised payment schedule in Amendment No. 3 of the LA did take account of this reduction. The Slovak Republic's claim for a reduction of approximately SKK 14 million paid as interest on the loan is based on the erroneous assumption that the reduction was effective on December 31, 1993. As stated above, this reduction occurred on August 1, 1994. This claim cannot, therefore, be upheld by the Tribunal.

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93 Statement of E. Kalinová, Exh. 34.

94 Reply Statement of E. Kalinová, paras. 26-32 and documents referred to.

190. The withdrawal of the AVEX receivable, however, did not create new opportunities to change the Slovak Republic's coverage for losses of assigned receivables. Indeed, the Slovak Republic had only undertaken to cover losses out of the assignment of receivables, as selected on December 31, 1993. Receivables thus selected but no longer assigned to SI, surely reduce the Slovak Republic's commitment to cover the losses resulting from these receivables. On the other hand, such withdrawal of receivables cannot make room under Article 3 CA to cover receivables not selected as of December 31, 1993, but transferred by an agreement between CSOB and SI after this date.

191. The fact that SI's Supervisory Board has approved the transfer of new receivables to SI does not imply that the Slovak Republic has agreed to extend its obligation to cover these receivables, *i.e.* beyond what was provided in Article 3(II) CA.

192. Therefore, the Tribunal finds that it cannot agree that the receivable from Omnia forms part of the on-balance sheet receivables that can trigger SI's losses that the Slovak Republic had to cover.

B. Off-Balance Sheet Receivables

193. The Future Assignment Agreement (also referred to as the "FAA") that became effective on December 31, 1993, identified the off-balance sheet instruments under which CSOB might be obliged to make payments to the payees of such an instrument, whereupon the respective amount would become due and payable by the domestic instructing party (the FTOs) to CSOB. The FAA specified the OBS liabilities that could oblige CSOB to make payments after 1993 because of guarantees and letters of credit granted to third parties. When CSOB had to make such a payment, it assigned the OBS receivable to SI against payment of a consideration in the amount of 100% of the nominal value of such receivable, on the basis of an OBS Assignment Agreement. To finance such assignment, CSOB advanced SI the funds through an OBS Loan Agreement. The receivables exposed to a later assignment have been selected during the negotiations that took place before December 31, 1993 and that involved, *inter alia*, CSOB, SI and repre-

sentatives of the Slovak Republic, in the same way as this was done in respect of the selection of the on-balance sheet receivables.

194. The Future Assignment Agreement set the total amount of SI's payment exposure at SKK 4,229,367,000. It identified the FTOs holding such instruments to be assigned to SI as: Technopol, Slovart, Chirana Export-Import, Drevoúnia, Istraconti, Martimex, Elteco Zdruzenie.

1. CSOB's internal instructions

195. The Slovak Republic argues that OBS instruments had been created and/or paid by CSOB in breach of its own internal control regulations.

196. The issuance of the OBS instruments was governed by CSOB Order No. 7/78.[95] This Order required CSOB to follow a specific procedure to issue a guarantee (*e.g.* the use of specific written forms, signatures, specific processing). The Slovak Republic notes that a KPMG audit for 1992[96] had stated that there were significant differences between the bank's records and counter party confirmations and that therefore CSOB's procedures had not been applied. The Slovak Republic asserts that of the 420 OBS items assigned by CSOB to SI, 18 OBS files did not have a request by the FTO for the issuance of a guarantee, in 9 files this request had not been signed by the FTO and in 11 files, there was no guarantee agreement signed by CSOB.[97]

197. The Slovak Republic also contends that CSOB Internal Regulation 6/93,[98] that applied to the guarantee payment, was not followed either. For instance, the rule that payments could only be made when there was a guarantee agreement, signed by CSOB, was not followed for 17 OBS payments. Contrary to the instructions, 42 OBS files did not contain a request for payment from the FTO, 52 files had no payment order, 297 files had incomplete payment orders, 119 files did not mention the third party beneficiary, 32

95 CSOB's Hearing Exh. 7 for I. Čermáková (English translation).
96 Statement of P. Knapp, Exh. 1.
97 Cf. Rejoinder Opinion of D. Frishberg, Exh. 3-28.
98 Statement of I. Čermáková in Reply, Exh. 1.

files had no proof of a non-payment guarantee and 13 files lacked an original copy of the non-payment guarantee.

198. The Slovak Republic further notes that these deficiencies could overlap, as some OBS files breached several rules. In 352 of the 420 OBS transactions, the CSOB's procedures on issuing and paying thus appear not been followed on one or more points. For that reason, in the Slovak Republic's view, SI should not have been bound to these irregular receivables, and CSOB's claim against the Slovak Republic for covering the losses resulting from assigned OBS receivables should be reduced by SKK 10,371,262,716 (including interest).

199. CSOB objects to the Slovak Republic's allegations that they are not correct and anyhow not relevant in respect of the validity of the assignments to SI and the Slovak Republic's cover losses obligation. CSOB affirms that the Slovak Republic did not produce any evidence in support of its objection that payments were made that had not to be made or that other payments were made to the wrong entity. Despite the accumulation of alleged documentary failures, wholly rejected by CSOB, the Slovak Republic and its accounting expert failed, in CSOB's view, to identify even a single disbursement error.

200. The Tribunal finds that the deficiencies alleged by the Slovak Republic are of a purely technical nature and relate to CSOB's internal method of processing this line of business. Under testimony, the Slovak Republic's accounting expert had to accept that a number of what he identified as deficiencies did in fact not reveal any irregularity. He also admitted that much less is required by way of documentary proof when CSOB had to honor abstract guarantees, as most of the guarantees were in fact.[99] It was also established that issues raised by KPMG were not raised again after the 1992 report, and in particular in 1993 and the years when the OBS items reached maturity.[100] The Slovak Republic's argumentation was directed to raise doubts about the quality of CSOB's method of handling the guarantees underlying the OBS items. The Tribunal finds that this matter is anyhow not relevant and that the objections raised by the Slovak Republic

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99 TR, April 17, 2003, 53:23 – 60:8 (Frishberg).

100 Statement of P. Knapp, Exh. 2; TR, April 14, 2003, 155:11-157:18 (Hart); TR, April 15, 2003, 103:19-104:15 (Knapp).

did not demonstrate that payments were made to creditors to which the CSOB should not have paid. It also observes that the Slovak Republic did not raise similar objections to the processing of guarantees before December 1993 and related to the on-balance sheet instruments.

201. The Slovak Republic did not challenge CSOB's assertion that none of the beneficiaries of the underlying guarantees that it alleged to be inherently irregular objected to CSOB's conduct. The Slovak Republic did not consider either the fact that none of the FTOs has ever filed a claim or otherwise complained that CSOB had not properly handled payments under the guarantees and that CSOB thus had not received title to claim the respective amounts from the FTOs.

202. Under the OBS Assignment Agreements, SI was entitled to claim the delivery of the complete documentation concerning the FTO and the assigned receivables (Art. VIII). On March 1, 1996, SI and CSOB concluded the Agreement on a Repayment Schedule Mechanism for OBS Instruments and the Method of Source Document Delivery. Under this agreement CSOB committed itself to deliver to SI all documents evidencing and documenting the amounts of the assigned OBS, as from January 1, 1994. On March 31, 1994, CSOB transmitted a complete documentation on the transfer of the OBS items to the MF SR.[101] The Slovak Republic has not reported that SI had indicated that it had not received these documents or had objected to the assignment of OBS receivables on the ground that they had not been sufficiently documented.

203. In late 1996, the Slovak Republic made a declaration that CSOB was not providing documentation to prove the amounts owed to it.[102] A request of SI for documentation was addressed to CSOB on December 10, 1996.[103] The expert commission, mentioned above, headed by a representative of the MF SR, unanimously confirmed on February 13, 1997 that "no imperfections to the particulars with respect to the assignment of off-balance sheet and on-balance sheet receivables from CSOB to SI were discovered".[104]

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[101] Statement of E. Kalinová, Exh. 5.

[102] Letter of the MF SR of November 8, 1996, Statement of P. Kavánek, Exh. 26; Bond prospectus issued on December 16, 1996, CSOB's Memorial, Exh. 8.

[103] Statement of E. Kalinová, Exh. 32.

[104] Statement of E. Kalinová, Exh. 34.

When the MF SR was invited, in a letter of May 30, 1997, to send documentation on its objection in respect of the transfer of certain receivables, that it had promised to submit in a meeting held on May 16, 1999, no further reaction occurred.[105]

204. The Tribunal recalls that SI had every opportunity to inquire into the status of each of the receivables before accepting its assignment. In this respect, it was irrelevant whether all the internal procedural rules had been followed when these receivables had been created. As they existed, they were on CSOB's books. As for CSOB's payment of the OBS receivables after 1993, SI could at any time have challenged these payments if they were not due, but it did not do so. On the contrary, without any objection it accepted their assignment after CSOB's payment. The relevant OBS instruments have been listed in the Future Assignment Agreement, in the subsequent OBS Assignment Agreements and again in the numerous Amendments to the OBS Loan Agreement. The Slovak Republic acknowledged the OBS receivables when Mr. Magula initialed the FAA. By entering into these transactions, SI accepted and confirmed that CSOB had acquired valid title to the respective receivables and that they were thus validly transferred to SI. This is all that matters under Article 3(II)(2) CA. The Slovak Republic is indeed bound by the transfer of assets as they were negotiated, specified and agreed upon between CSOB and SI. The legal effect of these agreements upon the Slovak Republic, which is an essential element of the operation of Article 3(II) CA, is explained by the fact that the Slovak Republic, as having complete control over SI, had full opportunity to object to the transfer of any particular OBS item to SI or to request any further information it might have thought to be relevant. The Slovak Republic has not done so and cannot do so years later in the course of these proceedings. Therefore, the Tribunal rejects the Slovak Republic's objections in this respect.

2. *Absence of signature on OBS Technopol loans*

205. The Slovak Republic has argued that the SI is not bound by the Amendments No. 37 through 42 and Amendment No. 46 to the Technopol OBS Loan Agreement No.

[105] Statement of P. Knapp, No. 22 and Exh. 3 and 4.

01/02/95 because these Amendments have not been signed by SI. Nor is it bound by Amendments No 43, 44, 45, 47, and 48 of said Agreement, as these Amendments were not signed by any of the parties.

206. The Slovak Republic notes correctly that the Technopol OBS Loan Agreement No 01/02/95 is governed by Slovak law. It is governed by the same law as the Loan Agreement of May 25, 1994 (LA), that contains a choice of law clause in favour of Slovak law and of which it is an integral part. Under Section 40(3) of the Slovak Civil Code a written agreement or written amendment to an agreement is only binding when it has been executed by the parties thereto.

207. As the requirement of both parties' signature has not been met in respect of Technopol OBS Loan Amendments No 37 through 48, the Slovak Republic contends that SI is not bound by these Amendments. Therefore, CSOB's damage claim against the Slovak Republic, as calculated as of December 31, 2002, must be reduced by SKK 683,553,309 (including interest).

208. CSOB has argued that the Amendments No 37 through 48, created from October 1996 till December 1997, had not been signed because SI's Board of Supervisors no longer convened and refused to supervise SI's activities.

209. The Tribunal notes in this respect that such refusal of SI's Board to operate may be a breach of the duty to co-operate and to implement the Agreements concluded between CSOB and SI. It does not compensate for the missing signatures.

210. Under Section III of the Technopol OBS Assignment Agreement No. 01/1/1995, CSOB assigned all Technopol OBS receivables to SI, including those due in the future. Section IV stipulated that for each assigned receivable, upon provision of payment in favor of the beneficiary under an OBS instrument, SI shall pay consideration to CSOB in the amount of 100% of the nominal value of the receivable. Concurrently with each such payment, in accordance with Section 1(b) LA –

> … the Assignor [CSOB] shall provide the Assignee [SI] with a loan for such re-accounted payment in the corresponding amount pursuant to a separate loan agreement ("partial disbursement of the loan by the Assignee").

In the second part of the same Section IV, it was stated that the same procedure "shall be applied for each partial monetary payment in favor of a beneficiary under a specific off-balance sheet instrument". Similarly, Article 2 LA provided that the OBS loans "shall be drawn as the need arises".

211. Under the Technopol OBS Loan Agreement No. 01/02/95, concluded the same day as the respective assignment agreement, it was stated that the loan shall be disbursed gradually in accordance with the payments of OBS receivables from Technopol (Section II/1) and it was specified that -

> Each individual (partial) disbursement of the loan shall be regulated by the amendments thereto.

212. It follows from these undertakings that upon payment of the beneficiary of a guarantee, SI had to pay the full nominal value of the respective Technopol receivable and was provided by CSOB, for this purpose, with a loan in the same amount. CSOB's obligation to provide for such a loan and SI's acceptance were agreed upon in the Technopol OBS Loan Agreement. However, the individual provision of a loan for each particular receivable reaching maturity required a procedure to be applied for each partial payment (Section IV of the Technopol OBS Assignment Agreement). In addition, the loan had to be disbursed on the basis of a specific amendment to the Technopol OBS Loan Agreement, the latter thus operating as a kind of umbrella instrument.

213. The legal framework agreed upon by CSOB and SI required therefore the execution of a specific agreement, *i.e.* an amendment. This is confirmed by the actual practice followed in the relations between CSOB and SI as demonstrated by the Technopol Amendments No. 1-36 that are all signed by both parties. The Amendments No. 37-48 that have not been signed by SI all contain the following sentence –

By signing this Amendment, the Client accepts such loan.

It is thus demonstrated that for CSOB as well, SI's signature was considered as a legal requirement for the existence and disbursement of each partial loan.

214. CSOB's position in these proceedings is not consistent with the Application for registration in SI's bankruptcy proceedings it filed on June 23, 1998 with the Regional Court in Bratislava.[106] In respect of the list of outstanding loans related to Technopol OBS instruments, this Application does not refer to any Technopol OBS Loan Amendment above No. 36. The Application states in a separate section V that under the Technopol OBS Assignment Agreement, SI was to pay CSOB consideration in the amount of 100% of the nominal value of the receivables assigned, and that SI violated this Agreement in October 1996 when it refused to conclude amendments to the loan agreement, thus not paying the consideration for the receivables assigned. Consequently, CSOB registered a receivable "ensuing from the failure to pay the consideration for assignment", and it offered as documentary evidence, *inter alia*, "draft Amendments No. 37 through to 48 to the Loan Agreement No. 01/02/95, including the related correspondence". In the Section VI below, this receivable was identified as "Receivable by virtue of the unpaid purchase price" (No. 9). It was thus stated and confirmed by CSOB that the loans based on these amendments, that were not signed on behalf SI, never came into existence. Similarly, CSOB's acceleration letter of April 10, 1997 that listed all relevant contractual documents, does not refer to the Technopol OBS loan amendments above No. 36.

215. Article 3(II)(3) CA provided for full payment (as "consideration") of 100% of the nominal value of the assigned receivable. As has been explained above, such payment was financed by the provision of a loan, that was designed to have SI making a loss that the Slovak Republic undertook to cover. The Slovak Republic's obligation to cover SI's losses required the conclusion of a loan agreement between CSOB and SI, creating an obligation for SI to repay the loan that triggered its losses and consequently the Slovak Republic's obligation for compensation. The existence of a loan agreement was there-

[106] Statement I. Cestr, Tab C, filed with CSOB's Request for Provisional Measures of September 4, 1998; the Slovak Republic's Observations on CSOB's Request for Provisional Measures of January 19, 2000, Exh. B; the Slovak Republic's Hearing Exhibits, November 2002, Tab 9.

fore a requirement, a *conditio sine qua non* of the Slovak Republic's cover losses obligation. This requirement has not been met in respect of Amendments No. 37-48 to the Technopol OBS Loan Agreement. Therefore, the Tribunal rejects CSOB's claim in this respect.

3. Later transfer of receivables

216. In relation to the late transfer of the Omnia receivables, referred to above, CSOB explained that this transfer was also to be adjusted, in addition to the credit given for the AVEX receivable, in taking into consideration the partial assignment of the receivable for Intercoop that was agreed between CSOB and SI on April 21, 1995, in an amount of SKK 31,661,730.53. This transfer was also balanced by the assignment back to CSOB of the OBS receivable Drevoúina for SKK 43,661,000. This last assignment has not been documented before this Tribunal otherwise than through the Minutes of the SI Supervisory Board held on August 31, 1994,[107] where it was agreed to accept CSOB's proposal to exchange the Drevoúnia receivable for the Intercoop OBS receivable which did result in the transfer of the entire Intercoop debt exposure to SI.

217. The Tribunal understands that these transfers were made in a way to keep an overall balance of the amount of receivables transferred to SI and resulted in a decrease of this amount of about SKK 14 million to the benefit of SI. These operations are not, as contended by the Slovak Republic, evidence of CSOB's failure to manage SI, all the more so as SI was governed by its Supervisory Board, composed by representatives of the Slovak Republic. However, the receivables newly added to SI after December 31, 1993 did not comply with Article 3(II)(2) CA that fixed the receivables to be identified at that time-limit, not providing for any later exchange. The losses to be covered by the Slovak Republic had to be caused by receivables assigned to SI in compliance with all provisions of Article 3 CA, including the requirement that they had to be identified on December 31, 1993 at the latest. Therefore, the Tribunal finds that it cannot consider the above mentioned receivable from Intercoop as part of the OBS-assets that can trigger SI's losses that the Slovak Republic had to cover.

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[107] Statement of E. Kalinová, Exh. 8.

218. The Slovak Republic contended, moreover, in its Third Post-Hearing Memorial submitted on July 18, 2003, that it had identified five payments made under three separate guarantees (two relating to Martimex and one to Technopol) which were not included in Schedule A of the OBS Future Assignment Agreement, but were nevertheless assigned to SI. The Tribunal observes, however, that this Memorial was submitted on the condition, expressed by the Chairman, that it shall "only address issues raised in the post-hearing brief of the other side"; thus, "no new elements" were admitted.[108] The argument made by the Slovak Republic in its last brief in respect of these guarantees was new. Therefore, it cannot be decided by the Tribunal.

VI. CSOB'S CLAIM FOR COMPENSATION

219. CSOB claims full compensation for the damages it suffered because of the Slovak Republic's breach of its cover losses obligation under Article 3(II)(5) of the CA. CSOB's alleged damage is composed of various elements related to the structure of SI's payment obligation and loss, and to the consequences of the Slovak Republic's failure to pay on CSOB.

A. Obligation to Pay Full Compensation

220. Under Section 373 of the Czech Commercial Code, the obligation to compensate for damages is determined as follows –

> Who ever breaches a duty arising from a contractual relationship is obliged to provide compensation for the damage caused to the other party, unless he proves that such a breach was caused by circumstances excluding his liability.

108 TR, April 18, 2003, 231:5-10 (Chairman).

221. In the instant case, no other compensation than through payment of money is to be considered (Section 378 Commercial Code).

222. Section 379 Commercial Code states that unless provided otherwise, compensation consists of "actual damage" and "lost profit". Damage also includes any expenses which the injured party has incurred by having to expend funds due to the breach of obligation of the other party (Section 380 Commercial Code).

223. It is not disputed that the Slovak Republic did not provide SI with funds necessary to allow SI to repay CSOB's loan nor did the Slovak Republic in any other way, *i.e.* by direct payments to CSOB, reduce SI's payment obligation towards CSOB and thus SI's loss. As CSOB was not paid according to the CSOB/SI Agreements, it suffered damage caused by the Slovak Republic's failure to cover losses in a way that allowed the repayment of the loan. SI's default on its loan from CSOB and CSOB's damage arising from this default was thus caused by the Slovak Republic's breach of its cover losses obligation. The Tribunal has now to determine the amount of CSOB's prejudice arising from SI's default that can be attributed to the Slovak Republic's default on its cover losses obligation under Article 3(II)(5) CA.

224. The Tribunal recalls that the Slovak Republic's cover losses obligation and its duty to provide compensation for CSOB's damage is based on and limited by the relevant provisions of Article 3(II) CA.[109] The Slovak Republic had to "cover", respectively to "compensate" SI's losses (Art. 3(II)(5) CA), such losses being identified as resulting –

> ... from the operating costs and the schedule of payments for the receivables assigned by CSOB to the Collection Companies, including payments of interest.

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[109] CSOB has repeatedly argued that its claim was exclusively based on the CA, cf., *inter alia*, CSOB's Reply, p. 30. This has to be held against CSOB's pleadings at the April 2003 hearing where it was contended that CSOB's actual damage resulting from the Slovak Republic's breach of its obligation to cover losses as required under the CA was necessarily [sic] what SI was bound to pay pursuant to the LA (TR, April 18, 2003, 61:13-20, 63:1-8), while it was also argued that CSOB was in no way seeking to enforce the LA itself (TR, April 18, 2003, 62:23-25). CSOB then stated that its claim for actual damage is "for the value of the Loan Agreement" (CSOB Post Hearing Submission on issues addressed at the hearing of April 2003, No. 34) and that "it seeks compensation based upon a factual finding as to the value of its rights under the SI Loan Agreement" (CSOB's Reply to the Slovak Republic's Second Post Hearing Memorial, No. 10).

As this has been explained above, the payments hereby referred to relate to the loan that CSOB was required to provide "up to the sum of considerations for the receivables assigned to the Collection Companies" (Art. 3(II)(3) CA). To the extent that SI was not in a position to repay this loan and therefore made a loss, the Slovak Republic was required to compensate for such loss in the same amount as determined by paragraphs 3 and 4 of Article 3(II) CA.

225. The Tribunal shares the Parties' view that as a matter of principle, the burden of proof for CSOB's damage is on CSOB. The Slovak Republic further argues that the applicable standard of proof is determined by Czech law, as the law chosen in Article 7(4) CA. CSOB, on the other hand, is of the view that under Czech law, the burden of proof relates to procedure as opposed to substance, and that the CA's choice of law clause does not extend to matters of procedure; therefore, the only rule to be applied by this Tribunal would be ICSID Arbitration Rule 34(1) which states –

> The Tribunal shall be the judge of the admissibility of any evidence adduced and of its probative value.

226. The Tribunal is of the view that while Arbitration Rule 34(1) must prevail, it has not to open a discussion on an issue whether this Rule leaves room for the application of Czech law in respect of the assessment of evidence, respectively the required standard of proof. Section 132 of the Czech Procedural Code states that the court assesses the evidence at its own discretion. There does therefore not exist any discrepancy in comparison with Arbitration Rule 34(1). However, it has been argued by the Slovak Republic that in some respects, *i.e.* on the matter of lost profits, Czech law requires specifically high probability in assessing evidence. This may be related to the law applicable to the merits and will be dealt with at the appropriate place.

227. After SI's failure to meet its payment obligations that had been deferred to that date, the situation deteriorated and lead CSOB to formally request from SI, in a letter dated Au-

gust 22, 1996, payment of the then outstanding amounts.[110] This letter was followed by another letter, dated September 5, 1996 and addressed to the MF SR, requiring payment of the amount of which SI was in default.[111] As no further progress was made, in the relation with SI as well as in the course of the exchange of views that took place between CSOB and the MF SR, CSOB, by a letter of April 10, 1997 to SI declared the entirety of the outstanding principal and interest due and payable as of that date, with reference to Article 11(a) LA.[112] In another letter of the same day, CSOB requested the MF SR, with reference to Article 3 CA, to fulfill immediately its duty to cover the losses of SI and to secure the payment of the due receivables of CSOB from SI in the amount of SKK 13,710,273,571.88. CSOB further declared that in the event no payment was received by April 17, 1997, it would undertake the necessary steps for collection of the MF SR's obligation and compensation for damages.[113]

228. In the light of these developments, SI became liable for payment, as from April 10, 1997, for the full amount of the loan. Indeed, pursuant to Article 11(a) LA, and given SI's default, CSOB was entitled to declare the full amount of the loan immediately due and payable. The CA does not require CSOB to exhaust any method of recoverability from SI, including the conclusion of the bankruptcy proceedings against SI. As SI had no funds available to repay even part of its loan, it made a loss corresponding to the amounts outstanding on April 10, 1997. As SI did not pay within a week as required by CSOB, the latter confirmed by its letter of April 18, 1997 that all its receivables from SI were mature and payable, pursuant to Article 11(a) LA, as from April 10, 1997. The same letter stated that the total amount of the due receivables was SKK 13,710,273,571.88 and that this figure did take account of a set-off CSOB operated with funds maintained by SI on its sub-accounts and its current account in the total amount of SKK 2,792,822.85. It was further indicated that the global amount included SKK 1,500,000 for unpaid fees under the Operation Agreement, with the effect that the receivable relevant under the loan was of SKK 13,708,773,551.88 (principal and interest).

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[110] Statement of P. Kavánek, Exh. 20.
[111] Statement of P. Kavánek, Exh. 21.
[112] Statement of P. Kavánek, Exh. 35.
[113] Statement of P. Kavánek, Exh. 36; Opinion of O. Ovečková, Exh. 11.

229. The Slovak Republic's obligation was to cover SI's losses in the amount specified, in compliance with Article 3(II) CA, in the LA and its collateral agreements. Therefore, when the full amount of the loan was called on April 10, 1997, the Slovak Republic had to perform its cover losses obligation in respect of the total amount of the loan on the same day. As from that day, the Slovak Republic, failing to perform its obligation, was in delay according to Sections 365 and 367 Commercial Code, thus creating CSOB's title to claim damages under Section 373 of this Code.

230. The Tribunal will successively analyze the different claims for actual damages that CSOB has based upon the Slovak Republic's failure to cover the losses SI has sustained in respect of the loan extended by CSOB. After this examination of CSOB's claim for actual damage, it will focus on CSOB's claim for lost profits.

B. The Claim Based on the Principal Amount of the Loan

231. For CSOB, the advances under the Loan Agreement for on-balance sheet receivables were SKK 6,556,388,163.95.[114] This amount does not include the portion of the AVEX receivable that had been retransferred in 1994 to CSOB in the amount of SKK 51,668,195.00. It does include the Omnia receivable of SKK 86,948,277.04.

232. The total exposure in respect of the seven OBS Assignment Agreements was SKK 4,217,744,329.42.[115] The actual total amount of the exposure, *i.e.* the loan disbursements made effectively is SKK 4,090,848,277.35.[116] The retracted Drevoúnia receivable of SKK 43,661.00 is not included in this amount.

233. On this basis, for CSOB, the total principal amount of the loan is SKK 10,647,236,441.30.

[114] Cf., *inter alia*, CSOB's Memorial, Tab B, No. 7.
[115] Cf., Expert Report of T.H. Hart, No. 16, table 3.
[116] CSOB's Memorial, Tab B, No. 11, 51; Statement of J. Štěrbová, No. 11, p. 6; Expert Opinion of T.H. Hart, No. 16, table 3.

234. In light of the Tribunal's decision relating to the receivables that cannot be taken into account as triggering SI's losses to be covered by the Slovak Republic under Article 3(II) CA, the above mentioned amounts have to be adjusted. First, extracting the Omnia receivable, the on-balance sheet portion of the loan amounts to SKK 6,469,439,886.91. Second, the Technopol Loan Amendments No. 37 through 48, in the cumulated amount of SKK 258,272,280, and the Intercoop exposure of SKK 31,661,730.53 have to be deducted (both amounts together: SKK 289,934,010.53) from the OBS portion of the loan, that becomes then a total of SKK 3,800,914,266.82. In the light of these figures, the total principal amount of the loan becomes SKK 10,270,354,154.

235. The reductions made above from the total amount claimed by CSOB are in an amount of SKK 376,882,288. As indicated earlier, the question has now to be raised whether this amount can compensate for the overturn by 0.24% of the capital adequacy ratio. As CSOB accepts that a capital adequacy ratio of 6.49% was actually hit at December 31, 1993, when the principal amount of the loan for on-balance and off-balance receivables was, in CSOB's view, reaching an exposure of SKK 10,750,475,082,[117] it follows that a reduction for 0.24% is in an amount of SKK 397,552,237. This leads to a result of SKK 10,352,922,845 as the amount corresponding to a capital adequacy ratio of 6.25% at December 31, 1993. Therefore, as the capital adequacy reduction leads to a commitment of an amount higher than the amount of SKK 10,270,354,154, reached as the actual amount of receivables to be covered under the provisions of Article 3(II)(2) CA, it is this lower amount that is to be considered by the Tribunal.

236. SI's obligation to repay the loan was admittedly decreasing to the extent SI was able to collect money from the debtors of the poorly performing or non-performing receivables. The payments made on SI's sub-accounts for the FTOs were later used to repay the loan.[118] CSOB's accounting expert presented in his first report a figure of SKK

117 This figure refers to the on-balance sheet portion (SKK 6,521,108,081.91) and the off-balance sheet portion (SKK 4,229,367,000) as they were agreed upon on December 31, 1993. It does not include the Omnia and Intercoop receivables that are included in CSOB's claim but were admittedly transferred after December 31, 1993. On the other hand, for the purpose of this calculation, the Avex receivable of SKK 51,668,195, and the Drevoúnia receivable of SKK 43,661,000, that were transferred at the relevant date, are to be included.

118 After FTOs made deposits on their sub-accounts, SI directed CSOB to transfer the balance from the sub-accounts to SI's main current account that served the repayment of the loan. The payments on the sub-accounts with CSOB was secured by Agreement No. 001/1996 on the Creation of Pledge over Receivables.

1,768,360,036,[119] whereas another source mentioned an amount of "over SKK 1.7 billion".[120] In the letter dated April 18, 1997, whereby CSOB confirms to SI the precise amount of the full amount of the due receivables under the loan, it is stated that a total of SKK 2,792,822.85 "were used to set off a part of CSOB's due receivable from SI". This confirms CSOB's practice, agreed upon by SI, to use the balance of the subaccounts where payments from the FTOs were collected for the repayment of the loan.[121] Taking into account collections made on April 10, 1997, CSOB's accounting expert indicated in his reply a total amount of SKK 1,770,462,989.[122] He also reported in respect of these FTO payments that an amount of SKK 1,592,059,556 was collected until April 10, 1997, and another amount of SKK 187,889,159 after that date,[123] resulting in repayments on the loan of SKK 1,584,073,830 before and on April 10, 1997, and of SKK 186,389,159 after that date.[124] CSOB's claim for the total principal amount does not include such repayments, while other statements made on behalf of CSOB do. Where no reduction was made to take account of SI's repayments funded by the collections from the FTOs, this has to be done by the Tribunal, where relevant.[125] However, the Tribunal cannot take account of later collections that may have been made by SI's bankruptcy trustee, leading to a positive balance in SI's account with CSOB, as the allegation made by the Slovak Republic in this respect was contained in its Third Post Hearing Memorial and therefore submitted too late to be considered by this Tribunal. Further, The Slovak's Republic's allegation that repayments funded by collections made by the bankruptcy trustee have been effectively been made to CSOB is not supported by evidence.

Cf. Statement J. Štěrbová, No. 13/14. A small part of the money collected from the FTOs was used to pay CSOB's bank and management fees.

[119] Expert Report of T.H. Hart, No. 46, Table 7.

[120] Statement of J. Štěrbová , No. 21. CSOB's Reply to the Slovak Republic's Second Post Hearing Memorial, No. 161: "approximately 1.7 billion".

[121] In reply to a question from the Tribunal, CSOB indicated that the letter sent on September 5, 1996 from CSOB to the Slovak Republic, requesting payment of the outstanding loan, referred to an amount established after CSOB had reconciled the balances of all of the SI accounts into the main SI current account (CSOB Post-hearing Submission on issues addressed at the hearing of November, 2002, Tab A, p. 16).

[122] Expert Reply of T.H. Hart, Exh. 39.

[123] This amount includes a remaining balance as of May 6, 1998 on SI's account in the amount of SKK 28,901.19 (Expert Report of T.H. Hart, Exh. 4) that was later corrected into SKK 68,169.95 (Expert Reply of T.H. Hart, Exh. 39).

[124] Expert Reply of T.H. Hart, Exh. 39. See also part of the correspondence in Statement of J. Štěrbová, Exh. 2-5, 8, 9.

[125] Part of the collection from the FTO may relate to the Omnia and/or Intercoop assets that are to be excluded from the principal amount of the loan. However, the Tribunal's file does not allow to trace such a relation.

237. The Tribunal determines therefore that the amount of SKK 8,686,280,324 is the principal amount of the loan as of April 10, 1997. Repayments made after this date in the amount of SKK 186,389,159 will also have to be further considered.

C. The Claim Based on Interest Related to the Loan

238. Pursuant to Article 3 (II)(4) CA, the Slovak Republic's cover losses obligation included "payments of interests". The interest related to the repayment of the loan constituted, together with the schedule of payments and the operation costs, the "losses" that the Collection Companies would make and that would have to be covered by the Slovak Republic, whenever necessary.

1. Article 4 of the Loan Agreement

239. The Loan Agreement sets out in Article 4(II) the following provisions for the fixing of interest rates and the method for their calculation -

> The loan shall bear interest at an annual interest rate. The interest shall be payable, along with the installment of the principal of the loan, always at the end of each calendar quarter commencing on March 31, 1995. The interest rate shall be determined as a floating rate to be fixed at regular three-month intervals for the subsequent period. The first interest rate shall be fixed at the time of loan drawdown, the second fixation shall be made as of March 31, 1994 and, thereafter, the interest shall be fixed at regular three-month intervals, as mentioned above.
>
> The interest rate shall be determined by using one of the following methods or a combination thereof. Such interest rate shall be increased by a uniform surcharge to cover the Bank's overhead costs at a rate of 3/4 (three-quarters) % per annum.
>
> a. The loan made hereunder shall be refinanced for each subsequent three-month period (until the next interest rate fixation) on the interbank market. The interest rate shall be determined at the rate 'sale' indicated in the table Interest-Rate Fixing in the Market of Interbank Deposits for a Three-Month Period as published in HOSPODARSKE NOVINY two business days prior to the fixation date. In the event that such rate is not quoted in the future or the quotation is not adequate, a similar interest rate shall be used.

b. If there is not sufficient liquidity in the inter-bank market to allow the refinancing of the Bank to the required extent, the interest rate shall be calculated as the average price of the Bank's resources with a residual maturity of more than two years.

c. If the interest rate as calculated by the methods referred in Section 4a or 4b is not sufficient to cover the cost of the Bank's refinancing, the interest shall be determined so as to reflect the price of the specific resources used by the Bank to refinance the loan.

Paragraph 1 of this provision was modified on April 18, 1996 in Amendment No. 7 in order to take account of situations when the relevant calendar day was a non-banking day.

240. In the first of many objections raised in relation to Article 4 LA, the Slovak Republic contends that this provision is too imprecise and unclear to be binding under Slovak law, the law that governs the Loan Agreement. The Slovak Republic's legal expert on Slovak law was not so outspoken; he concluded that the terms of Article 4 were "not unambiguous".[126] He admitted that the interpretation given by the Slovak Republic's accounting expert "is consistent with the wording of Section 4 of the Loan Agreement".[127] This demonstrates that in this legal expert's view, Article 4 LA can be given a meaning and is thus precise enough to be valid.

241. CSOB's accounting expert admitted that the implementation of Article 4 LA could be different according to the person who had to fix the actual interest.[128] CSOB stated, however, that between CSOB, SI and the MF SR, the meaning of this provision was very well understood and that the methods to determine the interest rates had been agreed upon when the CA was concluded. That is confirmed by the parties' behavior at the time the provision had to be implemented and the interest rates had to be fixed. Moreover, so CSOB argues, SI and thus also the Slovak Republic would not have been in a better position if ever Article 4 would have been of no use to determine the interest rate. Indeed, under the Slovak Commercial Code, Section 502, SI would then have been

126 Rejoinder Opinion J. Drgonec, No. 39.
127 Rejoinder Opinion J. Drgonec, No. 40-42.
128 TR, April 14, 2003, 201:12-203:1 (Hart).

obliged to pay interest at the market rates, that would have been higher than the interest provided for under Article 4.

242. For the Tribunal, Article 4 LA gave a choice of methods to determine interest rates that were to be applied depending on the circumstances and by the competent representatives of both parties. It follows from the purpose and the object of the LA, and also from the CA with which the LA was closely connected, that CSOB should not make losses on the loans granted to SI. The interest on the loan had to be set accordingly. Article 4, and especially method (c), contained the mechanism to ensure that the loan granted by CSOB was not at a loss but yielded sufficient interest to make it cost-neutral. This goal was clearly stated and the method to achieve it a matter for specialists to decide. The parties' conduct in the practical application demonstrates that, albeit with or after some debate on particular items, the provision of Article 4 LA was clear enough to be handled by those involved in matters of financing on the side of CSOB as well as for SI.

2. *Methods (a) and (b)*

243. The Slovak Republic also argued that even if Article 4 LA were valid, CSOB did not apply this provision correctly as it made use of method (c) only. For the Slovak Republic, methods (a) and (b) were available and had to be applied.

244. Method (a) envisaged that the loan would be refinanced on the inter-bank market so that the interest rate had to be determined "on the basis of the three-month inter-bank rate". Method (a) that established the most advantageous interest rate for SI, had to be followed whenever the inter-bank market was sufficiently liquid "to allow the loan's refinancing". The three-month BRIBOR rates, to which method (a) referred, were publicly available as of June 23, 1994. Even if they were not quoted, a similar interest rate could be used under method (a). For the Slovak Republic, the Slovakian inter-bank market had generally known an excess of liquidity from 1994 to 2000.[129] For the first and second quarters of 1994, during which only a one-month BRIBOR was quoted, the interest rate

[129] Cf. Reply Statement of S. Majlingová, Exh. 14.

could be determined on the basis of the "similar rate" provision of Article 4(II)(a) LA. According to the Slovak Republic, nowhere does Article 4(II)(a) LA require that the Slovak inter-bank market is stable; stability of the interest rate is not a criterion for using method (a), the application of which only depends on sufficient liquidity. For the Slovak Republic, the evidence presented at the April hearing demonstrated that the Slovak inter-bank market was sufficiently liquid through most of the relevant period. Therefore, method (a) should have been applied in all but four quarters (*i.e.* Q 3/97, Q 4/97, Q1/98, Q 2/98) during the life of the loan. During those four quarters, CSOB should have used method (b) to calculate the interest rate on the SI loan.

245. For CSOB, method (a) was unavailable due to the "repeated illiquidity and instability of the money market in the Slovak Republic over the relevant period".[130] The three-month BRIBOR interest rates were hypothetical as they were extrapolated. They were never actually available. There was insufficient liquidity in the inter-bank market to enable CSOB to finance the SI loan balance. When the Slovak Republic asserted that there was sufficient liquidity in the market, it referred to volumes of trade with the same loan being bought and sold repeatedly over short periods of time and with none of the funds trading for 3 months terms, but most often relating to overnight or one day deposits. According to CSOB, the evidence offered by the record that CSOB was never in a position to purchase enough 3 months deposits on the inter-bank market to fund the SI loan stands unrebutted, particularly in view of the fact that the SI loan balance continued to increase rather than decrease over time.[131]

246. During the four quarters that method (a) could not be used, for the Slovak Republic, method (b) should have been followed, *i.e.* the interest rate should be calculated as "the average price of the bank's resources with the residual maturity of more than two years." CSOB has argued that it never had resources with a residual maturity of more than two years in an amount sufficient to fund the SI loan and thus the conditions were never met to apply method (b). For the Slovak Republic, however, method (b) did not require that these resources amount to a certain percentage of the loan; method (b) could be used for a small portion of the financing.

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[130] Statement of S. Majlingová, No. 10.

[131] Statement of S. Majlingová, No. 6-15; Reply Statement of S. Majlingová, No. 6-20.

247. The Slovak Republic's accounting expert has demonstrated what interest would have been due under method (a), starting in June 1994, for all but four quarters during which method (b) should have been used.[132] For the Slovak Republic, his analysis shows that it would have been appropriate to follow methods (a) and (b). Because methods (a) and (b) would have yielded substantially smaller amounts of interest, CSOB's damage claim must be reduced by SKK 1,989,641,433. However, this calculation purports to demonstrate what CSOB should have done and not what CSOB and SI actually did in respect of interest rates fixed in the years 1994 to 1997.

3. *Method (c)*

248. CSOB has followed method (c), *i.e.* based upon the costs of refinancing, to calculate the interest due. For each quarter the interest was calculated on the basis of the costs of the funds used by CSOB to cover the amounts outstanding.[133] Whenever there was no sufficient liquidity in the inter-bank market (method a) and CSOB did not have sufficient resources with a residual maturity of more than two years (method b), the actual costs of refinancing was higher than the interest provided for by methods (a) and (b). In that event, method (c) became relevant, *i.e.* the interest rate were to reflect "the price of the specific resources" CSOB actually used to refinance the loan. Method (c) encompassed methods (a) and (b). Interest due on loans taken in the BRIBOR inter-bank market (method a) and the costs of financing with CSOB resources with a residual maturity of over two years (method b) were part of the price of "specific" resources actually used. In this way, the interest rate was determined by a "combination" of the three different methods, as Article 4(2) LA itself provides for.

249. The Slovak Republic argues in this respect that – even when CSOB was entitled to follow method (c) – that it did not apply this method correctly. Indeed, although CSOB argues that it calculated the interest on the basis of the actual costs of financing the loan, there was a substantial gap between the specific resources identified by CSOB to that

132 Rejoinder D. Frishberg, No. 105-118.
133 Cf. Statement of S. Majlingová, No. 6-14; Reply Statement of S. Majlingová, No. 3-20.

end, and the loan balance.[134] In order to carry out the method (c) calculation, CSOB had to first quantify the balance of the SI loan for each quarter, and then to identify the specific resources to be used to match the loan volume. CSOB has not proven that the interest were related to the costs of using the "specific resources used by the bank to refinance the loan", as required by method (c). According to the Slovak Republic, the evidence in the record shows that the method used by CSOB consistently failed to match specific resources to the balance of the SI loan. It was in fact a pointless and artificial exercise. There was a continuing mismatch between the loan balance and the supposed "specific resources" "used" by CSOB. The Director of the Risk and Funds Management Subdivision of CSOB in Bratislava attempted to explain this shortfall by claiming that no one within CSOB knew the actual balance of the SI loan for the whole of 1994 and the first quarter of 1995.[135] CSOB's Finance Director, who was at the time working for KPMG, has admitted that the interest claimed did not match the funds used.[136] For the Slovak Republic, this clearly demonstrates that CSOB breached the terms imposed on the use of method (c) and instead engaged in an artificial exercise.

250. CSOB has offered in these proceedings a review calculation of interest based on the analysis of its accounting and damages expert, who "reconstructed" the interest rates and made assumptions on the "specific resources" that had been available and that he used on some occasions to "plug the difference" between the loan balance and the specific resources CSOB had earmarked at the time.[137] This expert observed that the balance of the SI loan used for CSOB's interest rate calculations did not exactly match the total sources of financing used to develop the interest rates.[138] The interest calculated by CSOB's expert and based upon an electronic model, additional records and on recalculated data,[139] were intended to reflect better the real cost of refinancing the loan.

251. For the Slovak Republic, it is impossible "to restructure *post factum* a claim for historical costs, that was manifestly erroneous". No adequate and true picture of the actual and

[134] Cf. Rejoinder D. Frishberg, No. 125-130, including charts 1 and 2.
[135] TR, April 16, 2003, 75:1-15, 87:17-21 (Majlingová).
[136] TR, April 15, 2003, 173:11-175:10 (Cloughesy), referring to a memorandum of Mr. Cloughesy of May 14, 1997 (the Slovak Republic's April 2003 Hearing Documents for Mr. Cloughesy, Tab 2).
[137] Cf. TR, April 14, 2003, 49:5-14, 50:1-15, April 15, 2003, 18:1-24:13 (Hart).
[138] Expert Report of T.H. Hart, No. 54.
[139] Cf. TR April 14, 2003, p. 43-51, 84 (Hart).

precise historic costs of the refinancing can be based upon gaps in the historical cost analysis that were complemented with simulated added resources. The Slovak Republic objects that CSOB, based on the calculations of its expert, claims in these proceedings for each single quarter of the 38 quarters that the SI loan was in effect, interest rates different from the historical interest. For the Slovak Republic, CSOB's "recalculation" of the interest rates is a clear admission that the historical interest rate, as claimed in its time, had been erroneous. The Slovak Republic therefore challenges CSOB's new calculations as they fabricated the "specific resources" that were to be used for the refinancing. These calculations were spurious, *a posteriori* and not in conformity with method (c) of Article 4 LA or any other method provided for by this provision. For the Slovak Republic, these new interest rates have never been approved by CSOB, SI or the Slovak Republic.

4. The actually fixed interest rates

252. The Tribunal notes that the interest rates determined by CSOB's staff under Article 4 LA were communicated to SI on a regular quarterly basis.[140] In some instances, CSOB also sent estimations about rates that had to be expected in a near future. The specific interest rates for each of the quarters of 1994 and for the first quarter of 1995 had been partly approved, partly acknowledged at meetings of the SI Supervisory Board.[141]

253. As the Slovak Republic has noted, the Supervisory Board did not approve interest rates for any other subsequent quarters. However, in its very first meeting, *i.e.* on July 1, 1994, the SI Supervisory Board, before specifying the specific interest rates for the first and second quarter of 1994, had agreed more generally that method (c) would be followed.[142] This agreement is confirmed by the fact that the specific interest rates for the third quarter could not be determined at that time in advance for the only reason that the actual costs were not known yet. As Article 4 LA specifies, method (c) required "fixing the interest rate so as to reflect the price of the sources used by the Bank to refinance the

[140] See Statement of S. Majlingová, Exh. 2.
[141] Cf. Statement of E. Kalinová, Exh. 7, 11 and 13.
[142] Statement of E. Kalinová, Exh. 7.

loan." The Board decided that for the 3rd quarter of 1994 "the interest rates will be fixed after CSOB determines the price of the sources."

254. As CSOB pointed out, Article 4 LA does not require any agreement of the parties on the interest rate to be applied for each quarter.[143] Indeed, this provision states that the rate shall be "floating" and "to be fixed" quarterly, following one of the methods indicated under (a), (b) and (c). In the modified version of paragraph 1, as agreed upon in Amendment No. 7 of April 18, 1996, the term "adjustment" was used instead of "fixed". Further, there is a reference to the Bank's need for refinancing. This indicates not only that the Bank had to reach a level that permitted it to keep the loan cost-neutral, but also, as a matter of policy and practical application, that the Bank was the pertinent entity to determine its own need for refinancing the loan. The methods provided under (a), (b) and (c) were sufficiently precise in this respect not to allow the Bank to fix interest rates not in compliance with the ultimate goal of the LA. In one of its answers given to questions raised by the Tribunal at the April 2003 hearing, the Slovak Republic stated that the LA "does not afford SI any opportunity to approve, reject, or even comment on the interest rates set by CSOB".

255. The method used by CSOB and SI for the practical implementation fully confirms this reading of Article 4 LA. All communications sent by CSOB to SI on the fixing of the interest rate for each relevant quarter were sent for the purpose of "information". No agreement of SI was requested nor required. The fact that the first five quarterly rates were "approved" by SI's Supervisory Board is of no influence on the understanding that no such acceptance was required. Therefore, all rates communicated later, when the Supervisory Board no longer approved interest rates, were valid acts for the implementation of Article 4 LA in the relations between CSOB and SI. This was all the more so as neither SI nor the Slovak Republic's representatives who exercised control over SI never raised an objection as to the actual fixing of the interest rates on the loan by CSOB. The Tribunal adds that such mutual understanding and conduct of the parties involved in these dealings further demonstrates that there can be no room for any hypothetical *a*

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143 On its meeting held on December 1, 1994, the SI Supervisory Board ordered the executive to prepare an amendment to the LA where the interest rate would be fixed by an agreement between CSOB and SI (Statement E. Kalinová, Exh. 10). Such amendment has not been concluded. This confirms that at the time, no acceptance of the rates by SI was formally required.

posteriori fixing of interest rates that would not comply with the actual (or also called historical) rates as they were fixed pursuant to the provisions of Article 4 LA.

256. For the Tribunal, the interest rates under the loan that are relevant to determine the loss SI actually suffered and that triggered the Slovak Republic's obligation for coverage are the interest rates that were actually charged by CSOB to SI on the basis of Article 4 LA. Relevant in this respect is the understanding that both CSOB and SI had of the proper operation of this provision at the time of its conclusion as well as in light of their subsequent conduct during its practical implementation. SI's conduct is particularly relevant in this regard, as SI acted under the full control of the Slovak Republic that had ultimately to cover the losses composed of CSOB's interest charges. As this is a matter of interpretation of the LA under Slovak law, the Tribunal notes that the pertinent factors under Section 266 of the Slovak Commercial Code are in this respect the same than those referred to in the corresponding provision of the Czech Commercial Code, that have been explained above.

257. For the sake of completeness, it has to be mentioned that CSOB has moreover argued that the costs it sustained on the loan were much more substantial than the interest payments granted under Article 4 LA, especially when such interest was not paid. As the SI loan grew to constitute as much as 70% of CSOB's total SKK asset portfolio, CSOB ultimately had to raise funds to satisfy existing liabilities through the issuance of bonds, conversion of foreign currency and borrowing overnight deposits on the inter-bank market. For the Tribunal, these considerations are not material. In order to know what interest SI had to pay on the loan, only the provisions of the LA and their implementation by the Parties are relevant.

5. Interest calculation related to the currency split of the loan

258. On May 25, 1994, CSOB and SI concluded Amendment No. 1 to the LA to modify section 1(a) of the LA as follows -

> On July 1, 1994, the Bank has provided the Client with the following loans:
> - SKK 5,284,795,781.91
> - CZK 1,055,000,000
> for the covering of receivables assigned to its Client as of December 31, 1993...

259. The SI loan was thus split into two currencies, with the Czech crown (hereinafter "CZK") bearing an interest rate of 5 basis points lower than the Slovak crown portion. This was done to address partially the high costs to CSOB for refinancing a loan exclusively in SKK, while the interest for CZK was lower.

260. For the Slovak Republic, Amendment No. 1 clearly stated that the Bank *has provided* SI on July 1, 1994 with the loan amounts specified. Consequently, interest would only accrue as from that date. Therefore, in the Slovak Republic's view, CSOB has improperly computed interest before July 1, 1994. Consequently, CSOB has overstated its claim for interest to the extent of SKK 2,180,627,907.

261. CSOB admits that the terms of Amendment No. 1 may be "somewhat ambiguous". For CSOB, this ambiguity is, however, corrected by the fact that the Minutes of SI's Supervisory Board of July 1, 1994 did not indicate that the loans would be newly made on July 1, 1994. These Minutes only approved the denomination in CZK of part of the existing loan granted in SKK.

262. The Slovak Republic has pointed out that the fact that these Minutes did not indicate that the loans were new, is not a reason to conclude that SI would have accepted a mere adjustment of the existing loans, contrary to the text of the Amendment itself. Indeed, Amendment No. 1 considered the CZK loan as new, where it determined the interest rate that had to be paid and the repayment that had to be made.

263. However, it follows from the text of Amendment No. 1 itself that it only split the existing loan. Firstly, the "Amendment" indicated that it "modified" on May 25, 1994, "the amount of the loan" granted under the Loan Agreement, concluded on December 31, 1993. Consequently, the loan of SKK 6,521,108,081.91 was merely divided into a loan denominated in SKK and one denominated in CZK.

264. Secondly, the Amendment only contained provisions for the CZK loan: its interest rate was fixed on the basis of the existing interest rate for the SKK loan (Section 4). Its conditions of repayment were a modification of the existing conditions for the SKK loan. Consequently, the SKK loan remained governed by the loan agreement. Amendment No. 1 only reduced the amount of the principal in SKK and introduced a separate CZK loan. Therefore, Amendment No. 1 offers no ground to argue that interest on the SKK Loan was only due as of July 1, 1994.

265. The Tribunal also fails to see how it could deduce from Amendments No. 2–9 that no interest was due before July 1, 1994. On the contrary, Amendment No. 3, approved by SI, indicates that interest were calculated on the SKK loan as from January 1, 1994. Besides, the Slovak Republic's argument that is based upon the use, in Amendment No. 1, of the terms "On July 1, 1994, the bank has *provided* ... with the following loans", is not convincing. Amendment N° 4 of May 31, 1995 similarly states that "On July 1, 1995, the bank has *provided* the following loans." But none of the Parties has argued that in fact the loans started on July 1, 1995. Consequently, for the Parties, "provide" did not mean "create", but "keep at disposition".

6. Capitalization of interest

266. CSOB has included in its claim the capitalization on a quarterly basis of the interest allegedly overdue (Art. 4 LA).[144]

267. The capitalization was retroactively carried out on April 10, 1997, the date of the loan call. As of December 31, 2002, this capitalization was evaluated by the Slovak Republic to amount to SKK 11,574,157,624.[145] CSOB alleged that this amount was incorrect and that the compound interest amounted to SKK 9,225,784,406.[146]

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[144] For the SKK-loans, the quarterly capitalization of interest started on June 28, 1996, the date of default, although SI had not paid interest for the first and second quarter of 1995 (cf. Expert Opinion of T.H. Hart, Exh. 14 and 15; Expert Reply, No. 100). For the CSK-portion of the loan, capitalization occurred on September 29, 1995, March 29, 1996, and April 30, 1995 (cf. Rejoinder of D. Frishberg, No. 101).

[145] Cf. Rejoinder D. Frishberg, Exh. 34.

[146] CSOB Post Hearing Submission on issues addressed at the hearing of April 2003, No. 190.

268. Before entering into this analysis, a preliminary issue needs to be clarified, that is the difference between "compound interest", *i.e.* the term often used by CSOB in the present proceedings, and "capitalization of interest", *i.e.* the term used by the Slovak Republic.

269. Under Slovak and Czech law, there is apparently a difference between "capitalization of interest" and compounding "interest on interest". Under the former, the outstanding interest is converted into the loan principal; under the latter, interest is charged on overdue and unpaid interest amounts. However, although both techniques are different, they have a similar effect. Consequently, for the present analysis, the term "capitalization of interest" will be used.[147] This semantic choice, however, does not prejudge the later discussion of CSOB's argument with regard to its title to charge interest on overdue interest amounts on SI's current account with CSOB.

270. Under Slovak law, which, it may be recalled, governs the LA, interest may only be capitalized with the agreement of the parties (Commercial Code, Section 502) or when it is a "common commercial practice in the particular line of business and is not contradicted by the agreement of the parties" (Commercial Code, Section 264).

271. The Tribunal will first explore the possibility that the parties have agreed upon capitalization (a), thereafter whether capitalization is a "common commercial practice" pertinent for the instant case (b) and, finally, whether other arguments would justify capitalization (c).

a. The agreement of the parties to the LA

272. The analysis starts from Article 5 of the Loan Agreement which reads as follows -

147 Also CSOB has used the term capitalization, *e.g.* its Reply of August 31, 2001, p. 74; Expert Reply of T.H. Hart, No. 112; Reply Opinion of Professor Ovečková, No. 19.

Capitalization of Interest
Until December 31, 1994, interest shall be capitalized by adding it to the principal of the loan on each of the following dates:
March 31, 1994
June 30, 1994
September 30, 1994
December 31, 1994.

273. The agreement contained in Article 5 LA to capitalize interest up to December 31, 1994 relates to the fact that under Articles 3 and 6, as well as under the Repayment Schedule, the first installment to repay the loan was deferred until March 31, 1995. For the Slovak Republic, any capitalization after March 31, 1995 is therefore *a contrario* excluded by Article 5.

274. In the Tribunal's view, however, no decisive conclusion on capitalization in the event of default can be drawn from Article 5 LA. Indeed, this provision addressed a completely different hypothesis, *i.e.* capitalization for the period in respect of which the parties, in common agreement and as provided for in the LA itself, had deferred any payment of capital and interest.

275. On the other hand, it is correct to say that the Parties did not explicitly agree on a capitalization of interest after December 1994.

276. CSOB, for its part, has alleged that such agreement could be inferred from the stipulations in Articles 4 and 6 of the LA that interest had to be paid on a quarterly basis as of March 31, 1995. The fact that interest had to be paid on a quarterly basis as of March 31, 1995 offers, however, no basis for capitalization in case of default. The Tribunal notes that in Appendix No. 1 to the Second Assignment Agreement concluded between CSOB and the Czech Republic on June 25, 1998,[148] it is stated expressly that the loan principal was increased by capitalized interest for the year 1994. If capitalized interest was agreed and effectively made as from 1995 or later as from the date of SI's default, one would expect that this would have been mentioned in this Agreement.

[148] Reply Statement of P. Kovánek, Exh. 10.

277. CSOB furthermore relied on its own General Terms and Conditions in effect in the Slovak Republic[149] to claim capitalization of interest. The LA, however, did not refer to these General Conditions. Therefore, they cannot be considered incorporated by reference into the agreement of the Parties. Moreover, even if these Conditions had been part of the agreement, they would not allow CSOB to capitalize overdue interest. Article 7 of Part I of the Conditions only provides for "positive" capitalization, not "negative" capitalization, as does Section 714 Slovak Commercial Code. It only provides for posting earned interest (so that accrued interest are compounded); it does not provide for capitalization of interest to be paid. In a separate provision of the Conditions, *i.e.* Article 4(5) of Part III, that covers interest to be charged on an overdue negative balance, only a penalty interest rate – and no negative capitalization – is provided for. A similar provision on penalty was agreed upon in the current account agreement concluded between CSOB and SI.[150]

278. Therefore, the Tribunal finds that CSOB has failed to show that the Loan Agreement allows for capitalization of overdue interest.[151]

b. Capitalization as "common business practice"

279. The question has been raised whether there is a "common business practice" in banking loans to capitalize interest in the event of default.

280. For CSOB, the capitalization of interest after March 31, 1995 resulted moreover from Section 264 of the Slovak Commercial Code. Under this provision, "common business practices, generally observed in the particular line of business, have to be taken into account to determine contractual obligations, if they are not contradicted by the content of the contract". CSOB contends that capitalization was such common practice. CSOB and

[149] Further Statement of J. Štěrbová, Exh. 1 (effective as of March 1, 1996), Exh. 2 (effective as of January 1, 1994).

[150] Statement of J. Štěrbová, Exh. 1.

[151] See also Reply Opinion of Professor Ovečková, No. 19, where it is said that the parties to the LA "expected" that interest would automatically be capitalized. However, this expert later admitted that the LA does not contain an agreement on compound interest after December 31, 1994 (TR, November 10, 2002, 43:12-44:13, 62:6-9, 65:15-18, 67:2-25, 68:1-18). She also did not find any specific business practice (TR, November 10, 2002, 45:22-25).

SI had agreed not only on what the text of the LA explicitly states, but also on what the parties intended and what was customary trade practice.

281. For the Slovak Republic, no evidence was given that such practice existed in the Slovak banking world. At most, CSOB stated in general terms that capitalization was a general practice of the banking world at large.

282. For the Tribunal, CSOB did not submit convincing evidence as to the existence of a common business practice that was therefore by implied agreement also applicable to CSOB in its relationship to SI. Indeed, CSOB's own behavior towards SI has indicated that it did not consider capitalization the general rule that was also applicable to SI. As CSOB stated in these proceedings, interest capitalization was adopted by its accounting expert starting with the date of SI's default on June 28, 1996. This capitalization was thus introduced *a posteriori*, while it was not claimed at the actual time when interest were adjusted quarterly by CSOB and communicated to SI. This confirms that there was no "common business practice" to support interest capitalization in the instant case.

c. *Other arguments*

283. CSOB has argued that there is a substantial difference between "capitalization", *i.e.* the conversion of outstanding interest into loan principal, and compounding interest-on-interest, *i.e.* charging interest on overdue interest amounts. In this perspective, Article 5 LA has only indicated that interest would be capitalized for 1994; it does not affect the compounding of interest-on-interest. Even if Slovak law were to exclude CSOB's capitalization in the absence of an agreement to that effect, compounding interest-on-interest would still be possible. This distinction between "capitalization" and "interest-on-interest" would be crucial in view of SI's current account, which was debited to cover SI's payments. According to CSOB, negative interest-on-interest could be charged on this current account.

284. For the present dispute, however, it is irrelevant whether interest is charged on negative interest in current accounts. Before April 10, 1997, when the loan was called, no capi-

talization was claimed; on the contrary, all documents emanating from CSOB and addressed to SI and to the MF SR referred to non-capitalized interest. As of April 10, 1997, the Slovak Republic's obligation to cover losses was triggered for the losses that existed at that date. Therefore, it is irrelevant to determine whether SI's current account was actually closed on April 18, 1997, as the Slovak Republic alleges, or after May 18, 1998, as CSOB argues.

285. CSOB has also invoked the fact that third parties, such as KPMG, SI's Bankruptcy Trustee, an Expert Commission and the National Bank of Slovakia, all allegedly have accepted that the interest due under the LA could be capitalized.

286. However, acceptance by third parties is no proof that the lender was entitled to capitalize interest to be paid by the borrower. Moreover, the KPMG audit did not address the issue whether the interest CSOB claimed was legally due. Moreover, when, in the bankruptcy proceedings, SI had included interest-on-interest in its declaration of debts towards CSOB, SI's Trustee in Bankruptcy objected globally to CSOB's calculation of interest, thus including the capitalization.[152] Furthermore, the Expert Commission did not ratify capitalization either. It had only to decide whether the receivables had been assigned in conformity with the agreement between the Parties and not whether interest could be capitalized.[153] Finally, the National Bank only examined the changed accounting treatment of the SI loan when it was transferred from the Bratislava branch to the Prague branch of CSOB; it did not render a statement on the capitalization.

287. CSOB contended that it regularly accounted for compound interest and informed SI as well as the MF SR of the status of SI's account, but that neither of them raised any objection. However, CSOB did not submit contemporary documents to prove that it claimed capitalization from SI, nor that the MF SR was informed of this capitalization at that time.[154]

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[152] Exh. A to the Slovak Republic's Observations on CSOB's Request for Provisional Measures, January 19, 2000.

[153] Cf. Report of February 13, 1997, Statement of E. Kalinová, Exh. 34.

[154] *E.g.* the letter sent by SI to the MF SR on September 11, 1995, containing a quantification of funds required from the state budget, does not mention capitalization (cf. Statement of E. Kalinová, Exh. 17).

288. Finally, CSOB relied on another argument of its accounting and damages expert, namely that SI would have had no incentive to bring the loan out of default without capitalization. The additional 2% interest was ineffective to secure a timely payment because it would over time be neutralized by the absence of capitalization so that the interest-sanction would be well below the actual benefit of not paying.[155]

289. However, under the CA, CSOB could request the Slovak Republic at any time to cover SI's losses and to provide SI with sufficient funds to cover the payments that were due. In the event that SI were to continue to be in default, CSOB could rescind the LA and declare the loan and other amounts immediately payable (Art. 11 LA). This was the most effective deterrent to secure timely payments.

7. *The amount of interest included in the Slovak Republic's cover losses obligation*

290. The Parties' respective experts have offered their own analysis of the proper application of Article 4 LA that are based on calculations made *a posteriori* for the purpose of these proceedings. As they are admittedly different from the interest rates that were applied effectively in the relation between CSOB and SI and to the full knowledge of the MF SR's representatives, the Tribunal finds that they cannot constitute a basis for a decision on this matter.

291. The Tribunal, at the April 2003 hearing, asked the Parties –

> if possible, the Tribunal would appreciate to receive the interest rates asked by the Bank, quarter by quarter, since 1994 until now. If possible, also, with details, for instance, we are thinking of the document which has been submitted and how this amount could be financed by the different sources of funds available. If this documentation is available.[156]

One important item for calculation is the actual amount of the outstanding loan for each quarter that takes account of the progress in reaching maturity of the OBS receivables

155 Expert Reply of T.H. Hart, No. 102-106.
156 TR, April 17, 2003, 170:7-14, see also April 18, 2003, 87:16-23.

and of the repayments made by the FTOs and credited to SI's account with CSOB. In reply, CSOB referred to the calculations of its accounting expert, to CSOB's letters fixing quarterly interest rates and to the SI Supervisory Board meetings.[157] However, this documentation does not allow a new calculation of the interest evolution with the rates actually used, as CSOB's expert used his own and different rates and as the other materials contain very little and anyhow insufficient information about the evolution of the principal loan amount. In response to the Tribunal's question, the Slovak Republic observed that CSOB had not produced any contemporaneous documents showing the total running balance of the SI loan.[158] CSOB's accounting expert did not recall an overall summary and he referred to the KPMG report,[159] that is, however, not periodic and did not serve as support for CSOB's quarterly calculations. For some quarters, the loan balance was not available at the time when the refunding had to be determined and the quarterly interest rate to be fixed.[160]

292. Until the day, on April 10, 1997, when CSOB called the full amount of the loan from SI and claimed damages in the corresponding amount from the Slovak Republic, the actual quarterly rates determined under Article 4 LA were as follows, for each quarter -

1994: 18.84%, 18.59%, 21.27%, 18.91%;
1995: 17.73%, 17.75%, 8.86%, 8.61%;
1996: 12.70%, 14.19%, 12.05%, 13.70%;
1997; 12.91%, 14.53%.

293. The Tribunal has to apply these rates to the amount of the loan principal. As the amount relied upon differs from the amounts on the basis of which the Parties' calculations were made, no documentation is on the Tribunal's file that would show the result of such a detailed calculation. The principal amount to be retained is the amount accrued on April 10, 1997. However, this amount does not reflect the variations that occurred during the relevant period from 1994 through April 10, 1997, and that were caused, as

157 CSOB's Post Hearing Submission on issues addressed at the hearing of April 2003, Tab A, No. 20.
158 The Slovak Republic's Second Post Hearing Memorial, Tab A, Question 18, p. 10; TR, April 18, 2003, 162:15-163:17.
159 TR, April 15, 2003, 9:12-10:9 (Hart).
160 TR, April 16, 2003, 75:1-15, 87: 17-21 (Majlingovà).

mentioned above, by the increase, at irregular intervals, of the amount of the OBS loans and by the decrease of the loan, at equally irregular intervals, caused by repayments from the FTOs that amounted to a total of SKK 1,770,462,989 (respectively SKK 1,584,073,830 as of April 10, 1997). To run a calculation using actual interest rates, the Tribunal has to consider firstly the period covering the year 1994 when pursuant to Article 5 LA interest had to be capitalized by adding it to the principal at each quarter.

294. The only comprehensive statement from CSOB filed with the Tribunal and stating the full amount of all interest accrued and capitalized in 1994, including the OBS items, is contained in CSOB's application addressed to the Regional Court in Bratislava on June 23, 1998.[161] According to this document, when adding all interest capitalized determined for each portion of the loan, the total amount is SKK 1,588,098,324.45.[162] The Tribunal relies on this amount. Other documents contain different figures, relating to parts of the loans only and are therefore less reliable, in respect of the on-balance[163] as well as the off-balance[164] receivables. From the amount indicated above, an amount of SKK 1,749,967.77 has to be deducted that corresponds to capitalized interest for 1994 charged in relation to the Intercoop receivable that is not included by the Tribunal. The Omnia receivable is not to be considered in this respect, as it was transferred with effect in 1995 only. The total amount of capitalized interest for 1994 is therefore SKK 1,586,348,356.68.

295. For the interest calculation relating to the subsequent period, from January 1, 1995 to April 10, 1997, the Tribunal has to take account of three different "floating" factors, *i.e.* the interest rates fixed quarterly, the repayments in the total amount of SKK 1,584,073,830 and the irregular accrual of the loan relating to the OBS assets.

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[161] Statement I. Cestr, Tab C, filed with CSOB's Request for Provisional Measures of September 4, 1998; the Slovak Republic's Observations on CSOB's Request for Provisional Measures of January 19, 2000, Exh. B; the Slovak Republic's Hearing Exhibits, November 2002, Tab 9.

[162] As CSOB's application also refers to Amendment No. 9 to the LA, the Tribunal understands that this figure already includes the correction of the interest for 1994 on the Czech portion of the loan as it was agreed.

[163] Cf. Amendment No. 3 to the LA; CSOB's Memorial, Tab B, No. 24; Statement of E. Kalinová, Exh. 14, Development of the loan in 1994, document to be reviewed at the meeting of the Supervisory Board of SI on May 22, 1995. The amounts mentioned in this documentation are at variance to CSOB's bankruptcy application mostly in respect of the exchange rate applied to the CZK portion.

[164] Some amounts, close to those mentioned in CSOB's bankruptcy application, can be found in some Amendments to OBS Loan Agreements, *i.e.* No. 3 (Slovart), 3 (Intercoop), 3 (Istroconti), 5 (Chirana), 4 (Elteco).

296. On December 31, 1994, the outstanding loan principal was composed of the on-balance loan portion (as adjusted) of SKK 6,469,439,886.91, an amount of SKK 2,341,923,443.23,[165] corresponding to the at that time extended loans for OBS items, and the 1994 interest of SKK 1,586,348,356.68, resulting in a total of SKK 10,397,711,687.

297. In order to run an interest calculation as from January 1, 1995, account has to be taken of the CZK portion of the loan which produces, pursuant to Amendment No. 3 of the LA, an interest of 5% lower than the interest applicable to the SKK portion.

298. According to Amendment No. 3 to the LA, the amount of the CZK portion of the loan was at December 31, 1994 CZK 1,144,555,351.16, including capitalized interest for 1994 in the amount of CZK 89,555,351.16.[166] Expressed in SKK, the corresponding full amount is SKK 1,276,179,217.[167] The SKK portion of the loan to be retained as of January 1, 1995 is therefore SKK 9,121,532,470.

299. In respect of the CZK portion of the loan, *i.e.* CZK 1,144,555,351.16, when taking account, as explained above, of repayments[168] and a reduction effective on March 29, 1996,[169] the total accrual, as of April 10, 1997, is for the principal CZK 976,880,012,

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165 Cf. Expert Report of T.H. Hart, Exh. 15 (Summary of SI loan activity, off balance sheet portion). For a slightly different amount (SKK 2,312,328,356.83), provided with few details only, cf. Statement of E. Kalinová, Exh. 14, Development of the loan in 1994, document to be reviewed at the meeting of the Supervisory Board of SI on May 22, 1995.

166 Cf. CSOB's Memorial, Tab B, No. 24. The figure referred to does not include the correction agreed upon in Amendment No. 9 LA.

167 To the Tribunal's knowledge, the exchange rate at that time was 1.115 (cf. Expert Opinion of T.H. Hart, Exh. 5). Another rate (1.1798) results from the document on the development of the loan attached to the Minutes of meeting No. 6 of the SI Supervisory Board of May 22, 1995 (Statement of E. Kalinová, Exh. 14), but it is qualified as an estimated rate for 1995.

168 It has been reported to the Tribunal that repayments on the CZK portion (principal and interest) had been made between April 3, 1995 and August 30, 1996, at irregular intervals, in a total amount of CZK 228,473,804.52 (principal CZK 161,192,027.45, interest CZK 67,281,777.07), cf. Expert Report of T.H. Hart, Exh. 14, and Expert Reply, Exh. 39, where the portions per quarter can be found. (For a slightly different principal amount – CZK 158,966,021 -, cf. CSOB's Memorial, Tab B, No. 17, 19, 23, 24). The amount retained corresponds to SKK 256,142,705.03 (principal SKK 179,924,101.21, interest SKK 76,218,603.82), cf. Expert Report of T.H. Hart, Exh. 4 and Expert Reply, Exh. 39.

169 As mentioned above, a reduction of the loan amount by CZK 6,483,311.27 had been agreed upon in Amendment No. 9 to the LA, effective on March 29, 1996, in order to rectify an incorrect application of capitalized interest for 1994.

corresponding to SKK 1,094,105,613, and for actual quarterly interest CZK 126,749,082, corresponding to SKK 141,958,972.[170]

300. In respect of the SKK portion of the loan, *i.e.* SKK 9,121,532,470, when taking into account, as indicated above, the OBS loan accrual[171] and the repayments[172] related to the relevant period, the total accrual, as of April 10, 1997, is for the principal SKK 9,252,592,171 and for the actual quarterly interest SKK 2,875,959,936.

301. As of April 10, 1997, the principal amount became, when taking account of the OBS loan accrual, the repayments and a loan reduction, SKK 10,346,697,784. At the same date, the accrued interest amounts to a total of SKK 3,017,918,908.

302. Therefore, the Tribunal concludes that CSOB's title to principal and interest as of April 10, 1997 is in an amount of SKK 13,364,616,692.

8. *Article 8 of the Loan Agreement*

303. CSOB has claimed an additional SKK 1.2 billion based on Article 8 of the Loan Agreement.

304. Article 8 LA reads as follows -

> *Contractual Penalty*
> The Customer and the Bank have agreed that if there is an event of default under this Agreement, the Bank shall be entitled to exercise vis-à-vis the Cus-

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170 The exchange rate retained as for April 10, 1997 is 1.12. It is lower than the rate provided by CSOB's accounting expert for March 27, 1997 (1.128; cf. Expert Report of T.H. Hart, Exh. 5). At the relevant time, the exchange rate decreased significantly; this allows a reduction occurring after two weeks only.

171 Cf. Expert Report of T.H. Hart, Exh. 15. However, the Tribunal does not include the loan accrual related to receivables it does not retain in respect of the Slovak Republic's cover losses obligation. Thus, the amounts related to Technopol loan amendments above No. 36, all dated later than October 14, 1996, are not computed. The same applies to the Intercoop receivable in the amount of SKK 31,661,730.53; as the Tribunal cannot identify the date as from which the respective loan disbursement had been computed, and considering that it was agreed that this loan produced capitalized interest in 1994, the Tribunal operates the corresponding reduction for its interest computation together with the first accrual of interest in 1995.

172 The repayments on the SKK portion are, as of April 10, 1997, in a total amount of SKK 1,584,073,830, less the repayments computed with the CZK portion of the loan, SKK 256,142,705, *i.e.* SKK 1,327,931,125.

tomer a sanction remedy consisting of an increase in the interest rate pursuant to Section 4 hereof by two percent per annum.

305. On the basis of this provision and the information given by its accounting expert, CSOB has claimed 2% of the interest on the balance of the loan outstanding as of December 31, 1996. In fact, the loan was in default already on June 28, 1996. CSOB's payment request addressed to SI on August 18, 1996 informed SI that due to the breach of the Credit Agreement and in accordance with its Article 8, it would be charging interest increased by 2%.[173] On the basis of CSOB's notification of quarterly interest rates to SI, it appears that the 2% interest increase was claimed for the first time on July 1, 1997 for the third quarter of 1997.[174]

306. The Slovak Republic denies CSOB the right to claim this amount under the CA. It argues that Article 8 LA is a "penalty clause" and not a default interest provision.

307. Under Slovak law, a default interest provision, governed by Section 735 of the Commercial Code, is an appurtenance to the receivable. Under Section 121(3) of the Slovak Civil Code: "The appurtenances of a receivable are interest due, default interest ...". The interest is due and no separate security needs to be established to claim the amount from the debtor. A penalty clause, on the contrary, governed by Sections 544 and 545 of the Civil Code and Sections 300-302 of the Commercial Code, is distinct from the underlying loan. It is not an appurtenance to a receivable.

308. The fact that the heading of Article 8 is "contractual penalty", by itself, may not be compelling evidence. Nevertheless, this heading is important, at least, as the expression of the parties' understanding at the time of the conclusion of the LA. The wording of Article 8 LA clarifies the meaning of the title. Indeed, the terms "a sanction remedy consisting of an increase in the interest rate", indicate that the parties had a sanction of a penalty type in mind. CSOB's Slovak law experts equally envisaged that Article 8 LA was a penalty clause.[175]

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173 Statement of P. Kavánek, Exh. 20.

174 Statement of S. Majlingová, Exh. 2.

175 Opinion of Professor J. Bejček, No. 107; TR, November 10, 2002, 75:5-9 (Ovečková).

309. It was mentioned that the qualification of Article 8 LA as a "penalty clause" had an advantage for SI, because a penalty clause could be reduced whenever it was judged to be excessive in the actual circumstances. It has, furthermore, been suggested that the interest rate of Article 4 LA was rather low so that CSOB sustained losses when SI did not repay capital and interest on time and that, therefore, the 2% should not be reduced. CSOB has also argued that it was entitled under the CA to claim from the Slovak Republic the 2%, even when it was not able to claim payment of the penalty clause directly from the Slovak Republic. In CSOB's view, CSOB remained entitled to claim the 2 % from the Slovak Republic under the CA, because the Slovak Republic's breach of the CA made it impossible for CSOB to obtain from SI these 2%.

310. In the Tribunal's view, what is decisive in these proceedings are not the legal implications of Article 8 LA in the relation between CSOB and SI, but the Slovak Republic's obligation to cover SI's losses as determined by Article 3(II) CA. The Slovak Republic's obligation to "secure" the loan was explicitly recorded in Article 7 LA and was covered specifically by the Slovak Republic's Finance Minister's approval declaration at the end of the LA. The Tribunal finds that weight has to be given to the place attributed to this provision by the parties to the LA, with the consent of the MF SR. Indeed, Article 7 LA follows all relevant provisions of this Agreement on interest and repayment (Articles 3 through 6). It is placed before Article 8 on "Contractual Penalty". This indicates that the "security" clause of Article 7 and the statement made by the MF SR in this respect was not intended to cover also SI's contractual penalty undertaking under Article 8.

311. Further, the parties' conduct does not reveal an understanding that the penalty under Article 8 LA was an inherent part of the Slovak Republic's cover losses obligation. Already when SI was in default on June 28, 1996, CSOB claimed that it would add a 2% default charge, but it did not mention the additional 2% when it informed SI of the interest rates for the third and fourth quarter of 1996 and for the first and second quarter of 1997. The 2 % were claimed from SI for the first time in CSOB's acceleration letter of April 18, 1997 and charged for the first time on July 1, 1997 for the third quarter of

1997.[176] In the course of these proceedings, the 2% have retroactively been calculated as of December 31, 1996, but no claim has been addressed to SI in this respect. The Tribunal notes also that while SI was informed of the 2% penalty in the above mentioned letter of April 18, 1997, the letter sent by CSOB to the Slovak Republic on April 10, 1997, where the Slovak Republic was called to secure the total amount of the outstanding loan receivable, does not contain any mention of a 2% interest increase.[177]

312. Moreover, as this has already been recalled, the Slovak Republic's obligation consisted in the coverage of SI's losses resulting from its obligation to pay CSOB's loan that was extended "up to the sum of considerations for the receivables assigned to the Collection Companies" (Article 3(II)(3) CA). The Tribunal finds that SI's payment obligation under Article 8 LA towards CSOB goes beyond the "sum of considerations for the receivables assigned". Moreover, even if payments under Article 8 LA were considered as part of SI's loan repayment obligation, they do not relate, as they should under Article 3(II) CA, to a receivable specified at the latest on December 31, 1993. CSOB's claim for compensation of its damages arises under the CA and it cannot serve to extend indirectly the Slovak Republic's contractual obligations beyond the terms and content of Article 3(II) CA.

313. For the reasons given above, the Tribunal concludes that a claim based on the CA against the Slovak Republic that would allow CSOB to recover payments provided for between CSOB and SI as parties to the LA and consisting of a 2% interest increase must be dismissed.

D. Lost Profits and Interest on CSOB's Damage Claim

314. For CSOB, compensation of the actual damages suffered because the Slovak Republic did not cover losses when requested in 1997 does not wipe out all the consequences of the Slovak Republic's default. CSOB claimed for SKK 13,175,225,718 billion "lost

176 Statement of S. Majlingová, Exh. 2.

177 A similar understanding seems to be correct in respect of the letter sent by CSOB to the MF SR on September 5, 1996 (Statement of P. Kavánek, Exh. 21).

profits" as of December 31, 2002. It reduced this claim to SKK 7,857,193,540 for "lost profits" as of March 31, 2003.[178] This claim is based upon the rate obtained if the money received from the SI loan would have been invested in Slovak Government Bonds.

315. CSOB offered flexibility in respect of the relevant rate to be retained when it referred to alternative solutions, in particular to Section 735 Czech Commercial Code, and further invited the Tribunal at the April 2003 hearing to "take any rate you want".[179]

1. Procedural standing of CSOB's claim for lost profits

316. At the April 2003 hearing, counsel for CSOB has indicated that CSOB would limit its claim to SKK 32,443,747,036 for actual damages, as he indicated that –

> in an effort, after these six years, now to render this phase of these already somewhat complex proceedings as simple as possible and to give the Tribunal a considerable measure of comfort in the correctness and in the justness of CSOB's claim, CSOB desires to assure the Tribunal that it will feel that justice has been done if it is awarded the full amount that it asserts as actual damages, the sum I have mentioned, as 32.443 billion Slovak Crowns.[180]

317. The Slovak Republic relies on this statement to conclude that CSOB has withdrawn the "additional damages" or additional losses claim.[181]

318. Immediately after the statement quoted above, counsel for CSOB continued –

> You may rightly ask then: does the concept of lost profits then any longer have a role here ? My answer to that is: yes, most definitely.[182]

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178 CSOB Post Hearing Submission on issues addressed at the hearing of April 2003, p. 103. This amount is the difference between the "Slovak Bond Rate" calculation (CSOB Hart Examination, Exh. 66) and the actual damage of SKK 32,443,747,036.

179 TR, April 18, 2003, 78:8.

180 TR, April 18, 2003, 68:1-23.

181 The Slovak Republic's Second Post Hearing Memorial, p. 124.

182 TR, April 18, 2003, 68: 24-25, 69:1.

CSOB's counsel then elaborated extensively on these lost profits. While CSOB declared thus that it was upholding its lost profit claim, its statement would nevertheless allow the interpretation that CSOB would accept that its total claim would not reach a figure above SKK 32,443 billion. Moreover, CSOB maintained its claim for lost profits in the restatement of claim in its post-hearing submissions.[183]

319. The Tribunal finds that CSOB's oral statements were contradictory and partly confusing. However, they do not allow the conclusion that CSOB has withdrawn its "lost profits" claim, as such withdrawal would require a clear statement to that effect.

2. *Concrete or abstract lost profits*

320. For CSOB, under Czech law, a claimant may base its profit claim either on the specific profit lost in a particular case (the so-called "concrete" lost profit) or on the profit attained in the line of business under conditions similar to those of the breached contract (the so-called "abstract" lost profit). Whether a claim is admitted on the basis of "concrete" or "abstract" lost profit depends upon the nature of the available evidence.

321. Section 381 Commercial Code specifies the "abstract" lost profit as the –

> profit usually achieved in fair business practices on terms and conditions in the line of business in which the injured party engages, which terms and conditions are similar to those breached.

322. For the Slovak Republic, it is the average profit for the entire operations of a business without regard to the specific type of transaction.

323. For CSOB, this "abstract" profit is the transactional profit expected to be made on the performance of the contract at issue. CSOB argues that the language of Section 381 confirms that the abstract profit relates to the type of transactions involved. In business,

[183] CSOB's Post Hearing Submission on issues addressed at the hearing of April 2003, No. 258-263 and request on p. 103, part V 1(b); CSOB's Reply to the Slovak Republic's Second Post Hearing Memorial, No. 6, 150-153.

profit follows from transactions not from year-end accounting performances for the company as a whole. When money is received from a transaction, it is invested in a similar transaction. The money received by CSOB from lending to SI would have been used to provide loans to other clients.

324. The Tribunal agrees that the abstract profit has to be based upon the specific type of transaction involved, *i.e.* loans. However, should the profitability of the loan be assessed on the basis of the market in the Slovak or in the Czech Republic ?

325. For the Slovak Republic, only the profit on banking business in the Czech Republic should be considered, as the Czech Republic is the proper venue to assess the profits.

326. For CSOB, the potential profit made on re-lending the money from the SI loan to other customers has to be based upon the profit on loans in the Slovak Republic as this is the most appropriate country of reference. The loan was extended by CSOB's Slovak branch to a Slovak entity, was denominated in Slovak Crowns and was governed by Slovak law. The proceeds were intended to remain in the Slovak Republic and to be part of the Slovak CSOB spin-off. Under Section 737(1) Commercial Code, the abstract profit shall take account of "the rate of profits usually attained in the country where the entitled person has his registered seat, place of business or residence." For CSOB, this provision thus allowed CSOB to opt for the profit in the Slovak market. Through its Slovak branch, it was doing business in that country. Moreover, that Slovak branch had its registered office in the Slovak Republic.[184]

327. On the basis of this provision and the CA's goal to promote CSOB business activity within the Slovak Republic, the Tribunal accepts that the profitability within the Slovak market is relevant. The conversion by CSOB and SI of part of the loan in a Czech Crown portion does not affect the fact that the losses the Slovak Republic had to cover remained in Slovak currency and were considered as such by the Parties.

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[184] TR, November 11, 2002, 91:11-16 (Dědič).

3. *The issue of evidence of CSOB's lost profits*

328. Under Czech law, as in other legal systems, lost profits can only be awarded when evidence has been submitted that it is not a mere speculation that profits would have been made if the breach had not occurred. For CSOB's legal expert, it had to be "highly probable" that profits would have been earned.[185] For the Slovak Republic, CSOB has to prove that the amount of profits lost would *undoubtedly* have been achieved if the contract had been performed.[186] The Czech Supreme Court has held that it should be proven "with probability reasonably considered certainty that in the usual course of events" the profit would have been made.[187]

329. CSOB alleges that, as a commercial bank, it undoubtedly would have reinvested the proceeds in other lending activities at a higher profit level than SI's loan that was designed to be not more than cost neutral. CSOB has, however, not substantiated its lost profit claim with an analysis of the profits banks operating in the Slovak Republic would actually have made on loans.

330. For the Slovak Republic, the profitability of the Slovak equity market was very low and even negative during certain periods of time.[188]

331. CSOB did find support for its lost profits on the basis of six very different approximate market indicators, with a wide range of results. It claims on the basis of the highest indicator, *i.e.* on the basis of the Slovak Government Bond Yield.

332. However, CSOB did not establish that this indicator, or any other indicator, would have been the basis for actual profits. It did not present evidence that it would actually have been able to make loans on the basis of such interest rate and for such amounts had payments under the LA been made on time. It only established that CSOB and other banks purchased some Slovak state bonds at different times.[189] However, it has not been

[185] Opinion of Professor J. Bejček, No. 116; see also TR, November 10, 2002, 155:10-156:16 (Dědič).
[186] Opinion of Professor J. Bejček, No. 114.
[187] Opinion of Professors Pohunek, Stuna, Švestka, No. 130.
[188] Opinion of D. Berrey (Deloitte & Touche), No. 148-155.
[189] Statement of S. Majlingová, No. 5; Reply Statement of S. Majlingová, No. 31-35.

proven that CSOB would have invested the whole amount from the SI loan in Slovak Government Bonds, *e.g.* in 1996, when their interest rate was at 42,53 %, probably reflecting not only a high inflation of the SKK, but also a higher risk of default. In fact, CSOB seemed to have a more prudent general investment policy, under which it held only a small portion in debt securities and an even much smaller portion in Slovak bonds.[190]

333. CSOB has argued that the interest rate of Slovak Government Bonds was a proper criterion to assess the profits lost, because Articles 9 and 10 LA provided for the possibility that the reimbursement of the SI loan would be financed with Slovak Government Bonds, which would probably to a large extent be purchased by CSOB whenever it had money to invest. The interest on these bonds, that have never been issued, constitutes the amount SI - and thus also the Slovak Republic - saved by not paying and thus by not having to issue bonds. Therefore, in CSOB's view, Slovak Government Bonds interest rates are a proper criterion to assess CSOB's lost profits.

334. For the Tribunal, however, the alleged evidence on CSOB's lost profits is unrelated to the costs SI and/or the Slovak Republic allegedly saved. Moreover, CSOB's argument is a mere hypothesis of which the constituent elements (*i.e.* issuance of bonds by SI or the Slovak Republic and purchase of those bonds by CSOB) remain uncertain.

335. Under Section 379 Commercial Code, the amount of lost profits must have been foreseeable when the CA was concluded. The Slovak Republic has argued that it would have been impossible to foresee the actual scope of its obligation to "cover losses" when the CA was signed in December 1993, as the actual amount of the loan was not known at that time.

336. However, as the Tribunal has already noted above, the Slovak Republic had full knowledge of its obligation to cover SI's losses and of the scope of its exposure and the need to provide for the necessary budget. In particular, it accepted to provide for a net expenditure of the state budget in an amount of approximately SKK 13.3 billion until 2003.

[190] Rejoinder Opinion of D. Frishberg, No. 141.

The Slovak Republic could thus foresee the maximum amount of its cover losses obligation and of its potential liability to cover CSOB's actual damages. When the Slovak Republic concluded the CA, it could have foreseen that CSOB would use the revenues from the loan to generate other loans and make profit. However, it could not have foreseen that CSOB would claim as lost profits an average of 18.98% per year for nearly 6 years. CSOB did not submit evidence to prove that the Slovak Republic could have foreseen such high lost profits margin.

337. For the reasons given above, the Tribunal dismisses CSOB's claim for lost profit in so far that this claim requests the Slovak Republic's to compensate CSOB for an alleged loss of a potential investment in Slovak Government Bonds.

4. Interest on CSOB's damage claim

338. CSOB recognized that providing interest on its damage claim is yet another solution to compensate for "lost profits" occurred and still occurring in respect of its damages accruing as from the time it formally requested the Slovak Republic, on April 10, 1997, to compensate CSOB for damages arising from the Slovak Republic's failure to cover SI's losses as provided for under Article 3(II)(5) CA.[191] Such interest serve the purpose to let the damage claim accrue in such a way that full compensation is granted to the party entitled to it at the date of effective payment. Within this meaning, such interest can be considered, depending on the circumstances, as compensation for actual damage or for lost profits. However, as stated above, the Tribunal has not received evidence demonstrating that CSOB would have been in a position, had it received the Slovak Republic's payment promptly upon request (on April 10, 1997), to invest the respective amounts of money in a way to recover substantially more than the Bank was able to receive for credits extended on the relevant market. It is also to be noted that under Section 369(2) Commercial Code, the creditor is entitled to be compensated for damage caused by de-

191 The Tribunal understands that when CSOB presented its final submission on June 20, 2003 (*supra*, paragraph 39), stating that it claimed the sum referred to "as of March 31, 2003", it assumed that interest on "actual damages" is to be further carried forward from that date until the date of this Award. In other words, this final submission was not meant to withdraw the claim made in this respect in CSOB's preceding submissions.

lay in the rendering of performance on monetary obligation "only if such damage is not covered by the interest paid on the amount in arrears". This provision indicates that interest is the ordinary remedy in case of default on a monetary obligation.

339. The Tribunal is satisfied with the advise that the fact that under Slovak law, interest accrued since SI's declaration of bankruptcy is excluded from SI's bankruptcy does not prejudice its existence and ability to be claimed.[192]

340. In respect of interest accruing on its damage claim, CSOB offered as an alternative to apply Section 735 Commercial Code that provides for the following –

> Delay in Fulfilling a Monetary Obligation
> On delay in fulfilling a monetary obligation, interest on the amount in arrears is payable in the same currency as the monetary obligation. The debtor is obliged to pay interest on the sum in arrears at a rate one per cent higher than the interest set under section 502, with the decisive rate of interest being the rate fixed or offered by banks on credits granted for a period corresponding to the debtor's default in the country where the debtor has his seat, place of business or home address.[193]

The quoted provision is part of a chapter on "Special provisions on contractual relations in international trade" that is applicable to the CA, as one of the parties has its seat, place of business or his home address on the territory of a country different from that of the other party and, further, as their relationship is governed by Czech law. CSOB did not explain for what reason such "interest on the amount in arrears" would be applicable to the instant case where interest has to be determined by the Tribunal in respect of damage resulting from the non payment by the Slovak Republic of the amounts that would have permitted to cover SI's losses. The Slovak Republic objected to the application of this provision to the determination of interest on CSOB's damage claim (except

[192] Opinion of Professor O. Ovečková, No. 59.

[193] Section 502 Commercial Code, referred to in Section 735 of the same Code, reads as follows –
(1) As of the day when the debtor is provided with the monetary resources, he shall pay interest on them at the agreed rate, or else at the maximum rate set by law or on the basis of law. If an interest rate is not fixed in this manner, the debtor must pay the usual rate of interest demanded on credits by banks at the place of the debtor's seat at the time of the conclusion of the contract. If the parties agree on a higher interest rate than the rate permitted by law or on the basis of law, the debtor is bound to pay the interest at the maximum permissible rate.
(2) In case of doubt, it is presumed that the agreed interest rate is interest per annum.

for post-award interest) and it argued that it had not had full opportunity to address this issue that was raised by CSOB as an alternative only.

341. The Tribunal is of the view that Section 735 Commercial Code concerns a monetary obligation that has already been fixed as to its amount and terms of payment and regulates the payment of interest as from the day of default. This provision does not cover the issue of interest determination as from April 10, 1997 as part of the compensation to be established by this Award. The Tribunal refers in this respect to the legal expert on which CSOB relied and who accepted interest to be determined on this legal basis only for the period after the date for the payment of compensation of damages as assessed by this Tribunal.[194]

342. The CA does not provide for an interest rate to be applied to a damage claim resulting from a breach of an obligation contained therein.

343. In the Tribunal's view, the actual rate on April 1997 should not be retained for the whole period for which the Slovak Republic's payment was outstanding, as this has been argued by CSOB.[195] Such a rate, fixed over years, would alter significantly the purpose of the interest allocation on a market with considerable changes in interest rates over the years, and, in particular, with notably lower rates in more recent years.

344. Therefore, the Tribunal decides to retain the BRIBOR rate as determined by the National Bank of Slovakia for lending money on a three months basis. In the Tribunal's view, the 3-months BRIBOR rate can be considered under the particular circumstances of the Slovak Republic's obligation to cover SI's losses as a solution most closely based on the trade usages to which the Czech Commercial Code refers (Sections 264 and 730). This rate is thus applied to the damage amount retained at April 10, 1997.

345. The Parties have provided the Tribunal with a chart of the quotations for the three-months BRIBOR rate as from the first quarter of 1994 until the last quarter of 2004. The Tribunal notes that it had indicated that it was considering this rate at the April 2003

194 Additional Expert Opinion of Professor J. Dědič, No. 159, page 78.
195 TR, April 18, 2003, 74:7-15.

hearing when it invited the Parties to submit an update of the relevant quotations.[196] None of the Parties has raised objections against this question or argued that it was irrelevant.

346. The Tribunal relies on the quotations cited by both Parties. In respect of the quotations for the third and fourth quarter of 1997, that CSOB alleges that it was not quoted, whereas the Slovak Republic asserts that it was quoted, the Tribunal observes that the tables copied from the Slovak National Bank's website indicate that the quotation of the BRIBOR rate was temporarily stopped;[197] on the other hand, the Slovak Republic's accounting expert indicates that the quotations he refers to were obtained by comparison or as a "substitute".[198] Therefore, the Tribunal deems appropriate to bridge the gap by using the average between the two closest rates, *i.e.* the second quarter of 1997 and the first quarter of 1998. For the fourth quarter of 1998, for which both Parties state that no quotation was available, the Tribunal applies the same method.

347. For some quarters, the Parties' figures differ to a minimal extent as they disagree on the precise date to be considered for the fixation of the rate applicable to the following quarter. Article 4(1) LA, on which the Parties rely, stipulates that the interest rate shall be "fixed" at the last day of the previous quarter or, pursuant to the wording of the modified version adopted in Amendment No. 7, "adjusted" at the first business day of the subsequent new quarter or, if this is a non-banking day, at the next banking day. Article 4(2) LA provides for the use of method (a) that the rate published two business days prior to the fixation date is to be used. The Parties are in dispute about the operation of these provisions.

348. As the Tribunal has explained above, the determination of the interest to be awarded on CSOB's claim for damages as from April 10, 1997 is not based on the Loan Agreement. The Tribunal notes that fixation date of the rates quoted by CSOB is closer to the end of the previous quarter. In addition, the rates so determined by CSOB are, taken as an average, lower than the rates quoted by the Slovak Republic. The Tribunal retains the rates

[196] TR, April 16, 2003, 123:25-124:4, April 17, 2003, 170:15-25
[197] Cf. Expert Reply of T.H. Hart, Exh. 29.
[198] Cf. Expert Opinion of D. Frishberg, No. 72; Rejoinder of D. Frishberg, No. 120.

provided by CSOB; there is no reason to retain interest rates higher than those invoked in support of CSOB's claim.

349. To the Tribunal's knowledge, Czech law does not prohibit an award for compound interest on a damage claim. Full compensation for damage may include such interest if the damage includes claimant's costs of refinancing that imply payments on the basis of compound interest, *e.g.* in case a bank has to refinance an outstanding loan on a short-term basis. However, CSOB has chosen to claim "abstract" lost profit, *i.e.* profit made in transactions similar to the one at issue. In this respect, the Tribunal has not received evidence demonstrating that such transactions would imply compound interest, in full or in part. In particular, it has not been shown convincingly that "common business practice" in the Slovak Republic supported capitalization of interest. Under these circumstances, awarding compound interest as part of the compensation for CSOB's damage would amount to pure speculation. Therefore, the Tribunal's interest computation does not retain compound interest.

350. The Tribunal's computation takes account of the repayments made by the FTOs in a total amount of SKK 186,389,159 since April 10, 1997, as evidenced during this proceeding.[199]

351. In respect of the amount of principal and interest of SKK 13,364,616,692 owed to CSOB as of April 10, 1997, the accumulation of interest on the basis of the three months BRIBOR, taking into account the repayments (reducing the principal to SKK 13,178,227,533), results in an amount of SKK 11,618,154,309. Therefore, the Tribunal concludes that on November 30, 2004, the total amount to be awarded to CSOB is SKK 24,796,381,842.

352. Pursuant to Section 735 Commercial Code, the Tribunal retains the rate of 4%, plus 1%, as applicable to interest running on the principal amount awarded as from the date of payment fixed in the Award, until full payment.

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199 Cf. Expert Opinion of T.H. Hart, Exh. 39, amending Exh. 4.

E. Operating Costs and Other Fees

353. CSOB has claimed management fees from SI under the SI Security Agreement for an amount of SKK 20,934,665, representing the management fees for 14 quarters and charged through either the SI current account or the SI current sub-account related to Technopol.

354. Relying on its accounting expert, the Slovak Republic claims as of December 31, 2002, a reduction of SKK 20,935,976 because CSOB allegedly mismanaged SI and did not perform with the expert care and in accordance with the interests of SI, as required under Section II.3 of the Operation Agreement.[200]

355. The Tribunal will not inquire whether CSOB has managed SI correctly and it will not make any ruling based on the Operation Agreement that is not within the Tribunal's jurisdiction. As a matter of fact, the Tribunal was informed that the SI management, while carried out by CSOB, collected more than SKK 1.7 billion on receivables and negotiated favorable agreements on future collections.

356. The Tribunal also noted that the SI Supervisory Board had to supervise SI managers and it actually did so, until the Supervisory Board chose not to hold formal meetings. This Board did not object to the way SI was being managed. The Operation Agreement authorized SI to terminate the Agreement without cause and with six months notice (Section V). SI did not do so until the contract was cancelled in April 1997.

357. As the Tribunal has stated above, what matters from the perspective of Article 3(II) CA and the Slovak Republic's cover losses obligation is the actual state of SI's losses in respect of SI's assets and liabilities. Merely potential claims based on agreements other than the CA are not to be taken into account for the determination of SI's losses and the Slovak Republic's cover losses obligation.

[200] The Slovak Republic's Rejoinder, p. 60; the Slovak Republic's Counter Memorial, p. 83; Expert Opinion of D. Frishberg, No. 38-40; Rejoinder of D. Frishberg, No. 75-78.

358. The Slovak Republic also argues that CSOB has incorrectly charged SKK 14,011,934 maintenance fees and SKK 12,622,267 for foreign bank charges related to its payment of the OBS guarantees, whose creation and payment was insufficiently documented.[201] CSOB's accounting expert has indicated that these maintenance fees were charged for the OBS guarantees independently of whether the guarantees were paid or not, and that the other fees were properly charged as the related guarantees had effectively been paid.[202]

359. However, as the Tribunal has already stated, such alleged deficiencies could not offer any reason to consider that the assignment of the receivables would not have been binding for SI. These assignments had been accepted by SI, with the full knowledge of the Slovak Republic. There is no reason either to refuse payment of the bank costs related to these receivables. This is all what matters under Article 3(II) CA. Therefore, the amounts referred to above are not relevant for the determination of the Slovak Republic's cover losses obligation.

F. Taxes

360. The Slovak Republic has argued that the amount CSOB claims should be reduced because of a "tax windfall". In its view, CSOB would have owed taxes on interest income in an amount greater *if* SI had made timely payments on the loan than the respective taxes CSOB would owe today on that portion of the claim, and on the amounts that might be awarded to CSOB.

361. A first alleged reason for a "tax windfall" is the interest capitalization. In the hypothesis of interest capitalization, the capitalized amount would also have been smaller if account is taken of the taxes to be paid on the interest due. However, as indicated above, the Tribunal does not accept such interest capitalization. Consequently, the impact of earlier tax payments on the amount of interest needs not to be examined from this perspective.

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201. Cf. Rejoinder of D. Frishberg, No. 75-78.
202 Expert Reply of T.H. Hart, No. 98.

362. A second alleged reason for a "tax windfall" is the fact that tax rates in the Slovak Republic were 40% until the year 2000, when they were reduced to 29%. The Slovak Republic has argued that CSOB would obtain a windfall profit when its income out of the award would now be taxed at 29% while the compensation had it been paid on time, would have been taxed at 40%. Consequently, as of December 31, 2002, because of the present tax rate, CSOB would save an amount of SKK 3,403,227,165 (not taking the interest capitalization into account).

363. The Slovak Republic has relied on a study in a US accounting journal to sustain that compensation should take into account changes in a tax regime.[203] However, it has not submitted any evidence that under Czech law compensation is reduced proportionally when the tax rate has decreased between the moment the compensation became due (*i.e.* in April 1997) and the moment of actual payment.

364. The court decisions submitted by the Slovak Republic are unconvincing. The decisions concerning whether the repair costs to be compensated include VAT or not do not rule that the amount of compensation depends on the later actual impact of income tax rates on the compensation to be received.[204]

365. The decision of the Czech Supreme Court that compensation due for renting a car consists of the renting expenses minus the saved costs of using one's own car, in other words that the "actual damage" is granted, is irrelevant for the issue whether compensation is affected by later changes in an income tax rate.[205] The Slovak Republic incorrectly alleges that such reduced income tax rate is an "advantage brought about by the harmful event"; on the contrary, there is no link between the harmful event and the rate at which the injured party's compensation is taxed as income.

366. Similarly, the decisions from the US-Iran Claims Tribunal to which the Slovak Republic referred are also irrelevant. In one case, the 5.5% tax on contract payments was not in-

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203 Fisher & Romaine, Janis Joplin's Yearbook and the Theory of Damages, *Journal of Accounting*, 145, 148 (1990).

204 Judgements 3C 258/98-20, District Court in Semily, and 25 Co 558/98-36, Regional Court in Hradec Králové.

205 Czech Supreme Court, 1 Cz 86/90, November 30, 1990.

cluded in the compensation, because it did not have to be paid on amounts received as compensation; only on amounts received as contract payments. In another case the fact that the investor was entitled to half of the proceeds after taxes from the compensation due to its joint venture with Guinea, was a mere consequence of the fact that it was the shareholder and not the injured company itself that claimed compensation.

367. Income taxes are an act of government (*"fait du prince"*) that are out of the parties' control and are unrelated to the obligation of one party to fully compensate the other party for the harm done. Moreover, they are consequential to the compensation and do not affect its determination. Compensation will not increase or decrease according to whether the amount of income tax rates is increased or decreased. Anyhow, the evidence before the Tribunal does not permit it to make any assessment on CSOB's tax duties, past and present.

368. For the reasons given above, the Tribunal cannot examine CSOB's objections that, to assess the impact of a difference in tax rate, not the specific amounts due to CSOB under the CA, but CSOB's complete tax situation and its global year end taxable income - or at least the tax situation and income of CSOB's Slovak branch - should be considered. The Tribunal does equally not examine CSOB's argument that the interest actually generated by the LA were set "at cost" and thus did not generate profit for CSOB and that it allegedly has paid taxes on the amounts due but unpaid till April 1998.

VII. THE DIVISION OF COSTS

369. CSOB requests that the Slovak Republic be ordered to pay all of CSOB's costs including all the costs and expenses of this arbitration proceeding, in the total amount of US$ 16,351,846.[206]

206 This amount includes a correction in respect of the advances paid to the Centre.

370. The Slovak Republic requests that CSOB be ordered to pay all the Slovak Republic's costs associated with this proceeding, including attorney's fees and expenses, in the total amount of US$ 14,314,236.17.[207]

371. In the Tribunal's view, there was not, in the instant case, a situation as argued by the Slovak Republic, where one party only was clearly advocating arguments that compelled the other Party to reply with extensive and unnecessary arguments. Both Parties have argued their case to the best of their knowledge; there is no reason to determine the distribution of costs on the basis of the cost effectiveness of each argument put forward by a Party, all the more so as the statements submitted by the Parties would not allow the identification of the pertinent amounts in such respect. Further, the Tribunal understands that, as a general rule, the party's employee costs are not recoverable to the extent that such costs are part of a party's normal operating expenses and do not represent special costs incurred for the purposes of the arbitration. However, in the instant case, the record shows that CSOB's employees had prepared specific contributions that were caused by this proceeding, including several statements filed with the Tribunal, which justify the request for recovery of the associated costs, not to mention that the same are in an amount of not more than 1.54% of CSOB's total costs.

372. The Tribunal takes into account that the Slovak Republic did oppose without success the Tribunal's jurisdiction; that the proceedings related to SI's bankruptcy caused CSOB to request from the Tribunal provisional measures that were granted; and that its objections to the merits in respect of the existence of its cover losses obligation under the CA have been rejected by the Tribunal, whereas CSOB's claim for compensation has been granted in its prevailing part. Therefore, the Tribunal finds appropriate that the Slovak Republic bear its own costs, expenses and counsel fees and that it shall contribute to CSOB's costs by the amount of US$ 10,000,000. CSOB shall bear its own costs, expenses and counsel fees above this amount of US$ 10,000,000.

373. Finally, the Tribunal rejects the Slovak Republic's request that it be granted "any further relief that the Tribunal deems appropriate". This request lacks any substantiation. Moreover, the Tribunal has no power to provide for any relief on its own initiative.

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[207] This amount includes a correction in respect of the advances paid to the Centre.

VIII. DECISION

374. On the basis of the reasons given above, the Tribunal unanimously decides as follows -

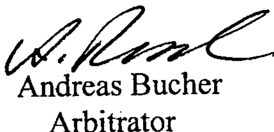
1. The Slovak Republic shall pay to Československá Obchodní Banka A.S. the amount of Slovak Crowns 24,796,381,842.00 as compensation, including principal and interest until November 30, 2004, for Československá Obchodní Banka's damage.

2. The Slovak Republic shall pay to Československá Obchodní Banka A.S. on the amount of Slovak Crowns 24,796,381,842.00 interest at a rate of 4.19% between December 1, 2004 and the date of this Award.

3. The amounts awarded under No. 1 and 2 shall be paid by the Slovak Republic to Československá Obchodní Banka A.S. within 30 days from the date of this Award. Thereafter, the amounts awarded under No. 1 and 2 will accumulate interest at an annual rate of 5%, until paid.

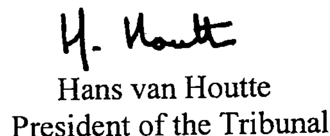
4. The Slovak Republic shall bear its own costs, expenses and counsel fees, including its share of the costs incurred by the Arbitral Tribunal and ICSID.

5. The Slovak Republic shall pay to Československá Obchodní Banka A.S. the amount of US$ 10,000,000 within 30 days from the date of this Award, together with interest running thereafter at an annual rate of 5%, as a contribution to Československá Obchodní Banka's costs, expenses and counsel fees, including its share of the costs incurred by the Arbitral Tribunal and ICSID. Československá Obchodní Banka A.S. shall bear its costs, expenses and counsel fees, including its share of the costs incurred by the Arbitral Tribunal and ICSID, in any amount higher than US$ 10,000,000.



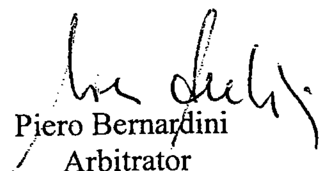
Andreas Bucher
Arbitrator

December 7, 2004



Hans van Houtte
President of the Tribunal

December 14, 2004



Piero Bernardini
Arbitrator

December 13, 2004