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March 27, 2007

Partial Award

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in the matter of
UNCITRAL ad hoc arbitration
in Paris
SCC No. 088/2004

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concerning

Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic of April 29, 1991 (the BIT)

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Abbreviations

BIT	Bilateral Investment Treaty
CSSR	Czechoslovak Socialist Republic
EC	European Community
ECJ	European Court of Justice
ECT	Treaty Establishing the European Community
EU	European Union
EUR	Euro
IBA	International Bar Association
UNCITRAL	United Nations Commission on International Trade Law
REIO	Regional Economic Integration Organization
SZIF	State Agricultural Intervention Fund

A.**Introduction**

1.

In late 1989, Czechoslovakia by its Velvet Revolution overthrew the communist regime. The CSSR was replaced by the Czechoslovak Federal Republic which in 1990 was succeeded by the Czech and Slovak Federal Republic.

2.

The centralized state economy oriented towards the Soviet Union was replaced by a generally free market economy open towards the world. Businesses were privatized by the coupon method. Foreign investment was encouraged. Until 2002, Bilateral Investment Treaties were concluded with all countries that are today member states of the European Union (EU).

3.

On April 29, 1991, an Agreement on encouragement and protection of investments was made between the Kingdom of the Netherlands (the Netherlands) and the Czech and Slovak Federal Republic (the BIT).

4.

Art. 8 of the BIT reads as follows:

1. *All disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter shall if possible, be settled amicably.*
2. *Each Contracting Party hereby consents to submit a dispute referred to in paragraph (1) of this Article, to an arbitral tribunal. If the dispute has not been settled amicably within a period of six months from the date either party to the dispute requested amicable settlement.*
3. *The arbitral tribunal referred to in paragraph (2) of this Article will be constituted for each individual case in the following way: each party to the dispute appoints one member of the tribunal and the two members thus appointed shall select a national of a third State as Chairman of the tribunal. Each party to the dispute shall appoint its member of the tribunal within two months and the Chairman shall be appointed within three months from the date on which the investor has notified the other Contracting Party of his decision to submit the dispute to the arbitral tribunal.*
4. *If the appointments have not been made in the above mentioned periods, either party to the dispute may invite the President of the Arbitration Institute of the Chamber of Commerce of Stockholm to make the necessary appointments. If the President is a national of either Contracting Party or if he is otherwise prevented from discharging the said function, the Vice-President shall be invited to make the necessary appointments. If the Vice-President is a national of either Contracting Party or if he too is prevented from dis-*

charging the said function, the most senior member of the Arbitration Institute who is not a national of either Contracting Party shall be invited to make the necessary appointments.

5. *The arbitration tribunal shall determine its own procedure applying the arbitration rules of the United Nations Commission for International Trade Law (UNCITRAL).*
6. *The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively:
 - the law in force of the Contracting Party concerned;
 - the provisions of this Agreement, and other relevant Agreements between the Contracting Parties;
 - the general principles of international law
 - the provisions of special agreements relating to the investment.*
7. *The tribunal takes its decision by majority of votes: such decision shall be final and binding upon the parties to the dispute.*

5. Effective January 1, 1993, the Czech and Slovak Federal Republic separated into its two constituent parts which became sovereign states. The Czech Republic succeeded into the former entity's international obligations, including those arising from the BIT.

6. From December 1994 onwards, Eastern Sugar BV which is jointly owned by the large British and French sugar producers, Tate & Lyle Plc. and St. Louis Sucre, the majority of which is by now owned by Südzucker of Germany, acquired interests in Czech sugar producing facilities.

7. On December 31, 1994, with the Europe Agreement, the Czech Republic became a candidate for membership in the European Union as it is now called. The Kingdom of the Netherlands was already a member.

8. The Europe Agreement required the Czech Republic to adapt its legislation to EU standards.

9. The European Union always had a protectionist agrarian system, especially to ensure that its sugar beet growers receive minimum prices. The price of white sugar produced locally from artificially expensive local sugar beet is far higher than the world market price of white sugar produced overseas from sugar cane.

10. The Parties agree that some form of regulatory control is the only way in which a European

sugar beet industry can survive at all in face of much cheaper imported sugar from sugar cane.

11.

The present arbitration centers on the various regulatory sugar regimes that the Czech Republic put in place from 2000 onwards, particularly the Third Sugar Decree of 2003, and their effect on Eastern Sugar to this day.

12.

Eastern Sugar claims that it was not properly treated as an investor into sugar factories in the Czech Republic through Czech subsidiaries that it had acquired (point 6). These subsidiaries are now all merged into Eastern Sugar BV's almost wholly-owned Czech subsidiary, Eastern Sugar Ceska Republika a.s.

13.

On December 12, 2003, Eastern Sugar initiated the amicable settlement process under Article 8(1) of the BIT.

14.

On May 1, 2004, pursuant to the Accession Treaty of April 16, 2003, the Czech Republic acceded to the EU.

15.

On June 22, 2004, Eastern Sugar filed its Notice of Arbitration.

16.

It appointed Mr. Robert Volterra as its party-appointed arbitrator.

17.

On August 9, 2004, the Czech Republic appointed Prof. Emmanuel Gaillard as its party-appointed arbitrator.

18.

On November 10, 2004, the Stockholm Chamber of Commerce as the Appointing Authority appointed Dr. Pierre A. Karrer as Chairman.

19.

The Arbitral Tribunal received the file on December 6, 2004, from the Appointing Authority.

B. Prayers for Relief

(a) *Eastern Sugar's Prayers for Relief on the merits*

20.

In its submission of July 1, 2005, Eastern Sugar presented originally the following Prayers for Relief:

(a) *DECLARE that the Czech Republic has breached Article 3(1) of the Treaty by failing to accord Eastern Sugar's investment fair and equitable treatment;*

(b) *DECLARE that the Czech Republic has breached Article 3(1) of the Treaty by impairing, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal of Eastern Sugar's investment;*

(c) *DECLARE that the Czech Republic has breached Article 3(2) of the Treaty by failing to accord Eastern Sugar's investment full security and protection;*

(d) *ORDER the Czech Republic to pay Eastern Sugar an amount of EUR 95,858,000;*

(e) *ORDER the Czech Republic to compensate Eastern Sugar fully for any other losses suffered as a result of the Czech Republic's breaches of the Treaty;*

(f) *ORDER the Czech Republic to pay interest on the compensation to be awarded to Eastern Sugar at a rate 100 basis points above the 6-month applicable EURIBOR rate to be compounded bi-annually;*

(g) *ORDER the Czech Republic to pay all of the costs and expenses of this arbitration, including the fees and expenses of the Tribunal, the fees and expenses of any experts appointed by the Tribunal and Eastern Sugar, and the fees and expenses of Eastern Sugar's legal representation, on a full indemnity basis; and*

(h) *AWARD such other relief as the Tribunal considers appropriate.*

21.

On March 15, 2006, Eastern Sugar's Request for Relief was the same, with the following differences:

(d) *ORDER the Czech Republic to pay Eastern Sugar an amount of EUR 109,078,000;*

(f) *ORDER the Czech Republic to pay interest on the compensation to be awarded to Eastern Sugar at a rate of 12%, representing Eastern Sugar's internal cost of capital, failing which, 100 basis points above the six-month applicable EURIBOR rate, to be compounded bi-annually.*

22.

On September 8, 2006, the same parts of Eastern Sugar's Request for Relief were amended once again to read as follows:

(d) ORDER the Czech Republic to pay Eastern Sugar an amount of EUR 88,537,000 plus interest;

(f) ORDER the Czech Republic to pay interest on the compensation to be awarded to Eastern Sugar at a rate of 12%, representing Eastern Sugar's weighted average cost of capital, failing which, 100 basis points above the six-month applicable EURIBOR rate, to be compounded bi-annually, in either case as calculated above.

23.

The Arbitral Tribunal takes Eastern Sugar's Prayers for Relief of September 8, 2006, to be Eastern Sugar's final Prayers for Relief for the purposes of Art. 20 of the UNCITRAL Arbitration Rules.

(b)

Czech Republic's Prayers for Relief on procedure and the merits

24.

The Czech Republic's Prayers for Relief were originally stated in its Answer of December 31, 2005, as follows:

(a) Declare that it has no jurisdiction to rule over the dispute;

(b) On a subsidiary basis, dismiss Eastern Sugar's claim pursuant to articles 3 (1) and 3 (2) of the bilateral investment treaty;

(c) In all cases, order Eastern Sugar to pay all the costs and expenses of this arbitration, including the fees and expenses of the Tribunal, the fees and expenses of all experts appointed by the Czech Republic and the fees and expenses of the Czech Republic's legal representation, on a fully indemnity basis;

(d) Award such other relief as the Tribunal considers appropriate.

25.

In its submission of May 31, 2006, the Prayers for Relief of the Czech Republic read as follows:

(a) For all the reasons exposed in Part I (Chapters 1 and 2) of the present Rejoinder, declare that it has no jurisdiction to rule over the dispute;

(b) On a subsidiary basis, lodge a request for preliminary ruling before the European Court of Justice pursuant to article 234 ECT and refer the following questions to the ECJ:

1. At what date did the Bilateral agreement on encouragement and reciprocal protection of investments signed on 29 April 1991 between the Kingdom of the

Netherlands and the Czech and Slovak Republic, to the rights and obligations of which the Czech Republic succeeded on 1 January 1993, (the "BIT") stop being applicable (e.g. date of the Accession Treaty signature, i.e. 16 April 2003, date of the accession Treaty ratification by the two contracting States to the BIT, i.e. 14 June 2003 or date of the Accession Treaty entry into force, i.e. May 2004);

2. If any form is necessary to render effective the substitution of the BIT by EC law and if contracting States have to formally terminate the BIT;

3. If such formal termination, assuming it is necessary, is effective immediately, with a retroactive effect, or after expiration of the notice period;

And stay the present proceedings until judgement has been rendered by this court;

(c) On a very subsidiary basis, dismiss all Eastern Sugar's claims pursuant to articles 3 (1) and 3 (2) of the BIT;

(d) In all cases, order Eastern Sugar to pay all the costs and expenses of this arbitration, including the fees and expenses of the Tribunal, the fees and expenses of all experts appointed by the Czech Republic and the fees and expenses of the Czech Republic's legal representation, on a full indemnity basis;

(e) Award such other relief as the Tribunal considers appropriate.

26.

On September 8, 2006, the Czech Republic repeated these Prayers for Relief verbatim, except for the first line of (a) which now read as follows:

(a) for all the reasons expressed in the Czech Republic's written submissions...

27.

The Arbitral Tribunal takes the Czech Republic's Prayers for Relief of September 8, 2006, to be the Czech Republic's final Prayers for Relief.

C. Confidentiality

28.

Unlike many other investment arbitrations, the present arbitration is subject to confidentially undertakings.

D. Proceedings

(a) *Preliminary matters*

29.

On March 24, 2005, Eastern Sugar filed a request for production of documents.

30.

On March 30, 2005, a preliminary hearing was conducted in Paris. The Parties argued about the seat of the arbitration. The further proceedings were also discussed.

31.

On May 3, 2005, the Arbitral Tribunal issued a *Preliminary Award and Order for Directions*. It ruled as follows:

1. *The Arbitral Tribunal shall have its seat in Paris, France, but may meet and conduct hearings wherever convenient.*

2. *The costs in connection with this Award shall be assessed and allocated later.*

This award remained unchallenged.

32.

The *Directions* provided *inter alia* as follows:

The Arbitral Tribunal shall seek guidance from, but not be bound by, the (1999) IBA Rules of Evidence.

[...]

In the written submissions, the Parties shall present their allegations and denials with reasonable particularity, offering immediate specific proof for each allegation and denial.

[...]

On production of documents Art. 3 IBA Rules of Evidence applies.

[...]

Party-appointed experts' reports shall be submitted as prescribed in the IBA Rules of Evidence (article 5.2).

[...]

At the hearings, any testimony submitted in a language other than English shall be translated consecutively (or if the Arbitral Tribunal so directs, simultaneously). The necessary arrangements shall be made by, and at the expense

and risk of, the submitting Party.

[...]

The hearings will be conducted generally as described in Art. 4 of the IBA Rules of Evidence.

There will be oral opening statements of no longer than 30 min. each.

If witnesses are heard individually, the following provisions will apply.

[...]

Witnesses will be admonished to tell the truth, and will affirm their testimony.

The Witnesses will be primarily questioned by the Parties. The Arbitral Tribunal will have the right to interject questions at any time.

The Witnesses will not provide any direct testimony (sometimes also called evidence-in-chief) beyond confirming their witness statements.

The Witness may then be cross-questioned forthwith without restriction to the scope of the witness' previous testimony (Scope Restriction).

[...]

A witness after cross-questioning may be re-direct-questioned by the presenting Party without Scope Restriction.

The Arbitral Tribunal may allow re-cross-questioning, with or without Scope Restriction.

[...]

Time management at the hearing, grouping of testimony and availability of witnesses (physically or by telephone) will be discussed at pre-hearing telephone conferences before each stretch of hearings. It is likely that the Arbitral Tribunal will apply a chess-clock system as follows: Each Party will have a pre-determined amount of time for the whole stretch (working out to no more than two hours in the average per day) available for its examination of all the witnesses and experts. Time used by a Party to ask questions of any witness or expert, and the time used by them answering such questions will go against that Party's time. Interpretation time will also be deducted. When the Arbitral Tribunal asks questions, these questions and the answers to them will not be deducted, but questions interjected for better understanding or to speed up, and answers to such questions, will not stop the clock. If procedural incidents, including interpretation incidents, arise, the clock will be stopped. Opening statements and oral summations, if any, will be on an equal time basis, but outside the chess-clock system. The Arbitral Tribunal will have no float-time to distribute.

Oral summation, if any, will be on an equal-time basis. The Parties may present their oral summation in French, provided that they arrange and pay for full simultaneous interpretation into English which will be the only basis for the transcript.

If additionally to or instead of oral summation post-hearing briefs are re-

quested, this will be covered in a separate order.

The Parties will agree on the confidentiality aspects of the present arbitration.

33.

A procedural *Time-table* was issued.

(b)

Written submissions and production of documents

34.

In conformity with the procedural *Time-table*, Eastern Sugar which had given its Notice of Arbitration on June 22, 2004 (see above, point 15) filed its full memorial on July 1, 2005, together with witness statements from the following:

Mr. John Walker

Mr. Jeff Hatt

Mr. Anthony Evans

Mr. John Ellison FCA (Expert).

35.

The Czech Republic filed its full answer and a plea of lack of jurisdiction on December 30, 2005, together with witness statements from the following:

Mr. Jaroslav Palas

Mr. Jan Höck

Mr. Philip Haberman MA FCA (Expert).

36.

The production of documents requested at the outset by Eastern Sugar on March 24, 2005 (see above, point 29), was discussed in correspondence by Eastern Sugar on January 23, 2006, and January 26, 2006, by the Czech Republic, on January 25, 2006, and February 7, 2006, again by Eastern Sugar on February 16, 2006, and finally by the Czech Republic on February 24, 2006.

37.

On March 15, 2006, Eastern Sugar filed its reply on the merits, and its answer on jurisdiction, together with second witness statements from the following:

Mr. John Walker

Mr. Jeff Hatt

Mr. Anthony Evans

Mr. John Ellison FCA (Expert).

38.

On March 28, 2006, the Arbitral Tribunal issued its decision on the production of documents, in form of a letter.

39.

On April 18, 2006, the Czech Republic sent a bundle of documents in Czech in answer to Eastern Sugar's request for production of documents (the April 18, 2006, bundle). The Arbitral Tribunal was copied. On May 22, 2006, Eastern Sugar complained about the alleged paucity and insufficiency of the documents produced in the April 18, 2006, bundle. Subsequently, some of the documents became part of the record, see below, point 46 et seq.

40.

On May 31, 2006, the Czech Republic filed its rejoinder and its reply on jurisdiction. It attached a witness statement from

Mr. David Froněk.

41.

The Czech Republic also filed a second expert's report from

Mr. Philip Haberman MA FCA (Expert).

(c)

Sundry procedural disputes

42.

In June, 2006, various procedural disagreements arose between the Parties, many centering on documents in the April 18, 2006, bundle (see above, point 39). With one exception (see, for that, point 55 et seq.), they were all resolved in early July 2006.

43.

Most of the pending disagreements were already resolved on July 3, 2006, by a telephone conference led by the Arbitral Tribunal. The agreements reached at the telephone conference was reflected in the Arbitral Tribunal's letter to the Parties, dated July 4, 2006, which also decided a few of the issues that were still open.

44.

With one exception (for the exception, see below, point 55 et seq.), the remainder of the disagreements were amicably resolved by July 10, 2006, or then decided by the Arbitral Tribunal's letter of July 10, 2006. The details of these matters are as follows:

45.

On June 9, 2006, the Czech Republic had submitted three new documents, namely an English translation of Art. 17 of the Czech Commercial Code, a decision by the Czech Anti-

trust Office of February 6, 2006, and a Summary of price controls (undated, terminus post quem 2004). These three documents were admitted on July 10, 2006.

46.

On June 28, 2006, the Czech Republic had filed a second witness statement from
Mr. Daniel Fronek.

This was accompanied by new documents R-71 to R-74 to which it referred.

47.

On June 28, 2006, the Arbitral Tribunal was also given new documents R-75 to R-81.

48.

All these new documents (R-71 to R-81) were from the April 18, 2006, bundle. Eastern Sugar had no objection to these documents "as such", but on June 29, 2006, Eastern Sugar asked the Arbitral Tribunal to exclude, as belated, Mr. Fronek's second witness statement and all the new documents R-71 to R-81 from the April 18, 2006, bundle (see above, point 46 and 47).

49.

On July 10, 2006, the Arbitral Tribunal however accepted Mr. Fronek's second witness statement with its exhibits R-71 to R-74 from the April 18, 2006, bundle (see above, point 46). In its provisional Time-table, the Arbitral Tribunal had foreseen a second round of witness statements from the Czech Republic for June 28, 2006, but with a question mark. The Czech Republic should have requested leave to file Mr. Fronek's second witness statement, but leave would have been granted.

50.

On July 10, 2006, the Arbitral Tribunal also accepted the new documents R-75 to R-81 that also had been provided by the Czech Republic in the April 18, 2006, bundle (see above, point 47) in view of Eastern Sugar's position concerning further documents in the April 18, 2006, bundle (see below, point 51).

51.

The Order for Directions (see above, point 32) had said that "new documents may not be submitted after a deadline set well ahead of the hearing. However, a new document may be offered as a *novum* if that document could not have been reasonably presented earlier". The cutoff date was set at the telephone conference of July 3, 2006, with the exception of the documents in the April 18, 2006, bundle that Eastern Sugar on July 3, 2006, still *reserved* to identify and introduce into the record.

52.

By July 10, 2006, Eastern Sugar identified, as exhibits C-183 to C-188, the further documents from the April 18, 2006, bundle that it wished to include into the record.

53.

Of the other documents in the April 18, 2006, bundle, at the Czech Republic's request, document n(2) was admitted by the Arbitral Tribunal on July 4, 2006, as exhibit R-76. This was the minutes of the extraordinary meeting of the Commodity council for sugar beets and sugar of December 3, 2002, four pages of which the first two were already on record.

54.

The July 3, 2006, telephone conference also dealt with the matter of the numerous documents in original language filed without translation and of the numerous translations filed without original text. This matter was likewise resolved in due course by July 10, 2006.

55.

The one matter that remained unresolved was as follows:

56.

Eastern Sugar had criticized that its request for the production of all inspection reports had been answered by a mere list of alleged inspections conducted at competitor's plants. The Czech Republic argued that for reasons of confidentiality it could not provide the inspection reports themselves.

57.

At the outset of the main hearing of July 17, 2006, the Czech Republic said that it had brought along the inspection reports. It offered that Eastern Sugar's lawyers (but only the lawyers) could inspect the reports. The Arbitral Tribunal invited the Parties to discuss the matter and report about the outcome (See transcript of July 17, 2006, p. 2 et seq.). This did not happen, however.

58.

On July 27, 2006, after the main hearing, the Czech Republic renewed its offer for an inspection either in Paris or Prague.

59.

This one point was briefly discussed at the pleading session of September 27, 2006.

(d)

Main hearing

60.

On July 17 to 20, 2006, the main hearing was conducted in Paris.

61.

Mr. P. Turner and Mr. M. Mangan of Freshfields Bruckhaus Deringer, Paris, appeared on behalf of Eastern Sugar. Mr. E. Teynier and Mr. P. Pic of Teynier, Pic & Associés, Paris, and Mr. D. Weinhold and Mr. O. Havranec of Weinhold Legal, Prague, appeared on behalf of the Czech Republic.

62.

An arbitration of this magnitude involves of course the work of many who do not speak at hearings. Some of their names appear in the written submissions, some do not. It is appropriate at this juncture to record the Arbitral Tribunal's appreciation of the extremely helpful way the arbitration was conducted on behalf of both Parties.

63.

The Parties presented opening statements of 30 minutes each.

64.

During the whole hearing, a chess-clock system was applied as described in the Order for Directions (see above, point 32).

65.

The following witnesses were heard :

Mr. John Walker

Mr. Daniel Fronek

Mr. Jeff Hatt

Mr. Jaroslav Palas

Mr. Anthony Evans

Mr. Jan Höck

Mr. John Ellison FCA (Expert)

Mr. Philip Haberman MA FCA (Expert).

66.

The Czech witnesses testified with the help of a Czech-English interpreter.

67.

Eastern Sugar had, during the telephone conference of July 3, 2006, filed a protest against equal time being applied despite the fact that the Czech Republic's factual witnesses were going to testify through an interpreter. However, at the close of the hearing, Eastern Sugar had 60 minutes left of its chess-clock time, and the Czech Republic 256 minutes.

68.

At the close of the hearing, the Arbitral Tribunal gave the Parties an opportunity to voice any complaint about the way the hearing had been conducted. No complaint was voiced.

69.

The hearing was transcribed by live notes. The transcript is 485 pages long.

70.

On July 31, 2006, the Parties presented agreed errata sheets for the transcript of the July 17 to 20, 2006, main hearing.

(e)

Final phase

71.

On July 24, 2006, the Arbitral Tribunal issued its instructions on Post-hearing submissions.

72.

On September 8, 2006, the Parties presented their Post-hearing briefs. Eastern Sugar attached a new factual document. The Arbitral Tribunal sealed this document unread.

73.

A pleading session was then conducted on September 27, 2006, in Paris.

74.

Mr. P. Turner and Mr. M. Mangan of Freshfields Bruckhaus Deringer, Paris, appeared on behalf of Eastern Sugar. Mr. E. Teynier and Mr. P. Pic of Teynier, Pic & Associés, Paris, and Mr. D. Weinhold and Mr. O. Havranec of Weinhold Legal, Prague, appeared on behalf of the Czech Republic.

75.

Each party presented conclusive pleadings of three hours each (the Czech Republic in French, see above, point 32).

76.

At the close of the hearing, the Arbitral Tribunal gave the Parties an opportunity to voice any complaint about the way the hearing had been conducted. No complaint was voiced.

77.

The pleading session was transcribed in English, but as arranged by the Parties, only on the basis of a tape recording. This was not satisfactory.

78.

On October 20, 2006, Eastern Sugar presented together with its errata sheets a marked-up version of the Transcript of September 27, 2006.

79.

On December 7, 2006, the Czech Republic presented a full redraft of the entire transcript of the English translation of its conclusive pleadings that had been presented in French (see above, point 75). On January 8, 2007, Eastern Sugar claimed that the Czech Republic had not only improved the transcript but had also given in to the temptation to improve on what it had said.

80.

Statements of costs were presented by the Parties on October 13, 2006.

81.

By October 27, 2006, the Parties could have commented on the Statements of costs, but did not do so.

82.

On January 8, 2007, the Parties submitted at the Arbitral Tribunal's request, documents and comments on two subjects: The first was the European Commission's Note (of November 2006) on the Free Movement of Capital, and the Czech Government's reaction to it. The second was Eastern Sugar's application to relinquish its quota and its relevance, if any, to calculation of damages, if any.

83.

The Czech Republic also requested disclosure by Eastern Sugar of further documents on the second subject. But, on January 12, 2007, the Arbitral Tribunal decided not to issue an Order for Production of further documents.

84.

On January 11, 2007, the Czech Republic submitted, with comment, two further documents.

85.

On January 12, 2007, the Arbitral Tribunal decided to unseal the documents submitted by Eastern Sugar on September 8, 2006 (see above, point 72) since this was related to the documents requested by the Arbitral Tribunal that had been provided by the Parties on January 8, 2007 (see above, point 82) and on January 11, 2007, see above point 84.

86.

The Parties were given an opportunity for further comment on the documents newly admitted on January 12, 2007, by January 26, 2007.

87.

Both Parties commented. The Czech Republic sought to introduce a new document, as a *novum*. The Arbitral Tribunal sealed this document.

88.

The proceedings were closed on February 5, 2007, on all matters. The file occupies about five meters of shelf length.

89.

The Arbitral Tribunal deliberated in person on all hearing days and on September 28, 2006, always in Paris, on January 12, 2007, in Zurich, without changing the place of arbitration which was and remained Paris, and through numerous e-mails and telephone conferences.

90.

The Arbitral Tribunal will first discuss some *procedural* issues, particularly those raised by the Czech Republic's prayers for relief (a) and (b).

*

E. Constitution

91.

This is an ad hoc UNCITRAL arbitration under Art. 8 of the BIT (see above, point 4).

92.

Its seat is in Paris (see above, point 31).

93.

There were no objections to the proper constitution of the Arbitral Tribunal as an arbitral tribunal under Art. 8 of the BIT.

94.

However, the Czech Republic claimed that by its accession to the EU, Art. 8 of the BIT was superseded pursuant to Art. 59 of the Vienna Convention. The alleged implied termination of the BIT arbitration agreement and its effect on the jurisdiction of the Arbitral Tribunal and on arbitrability will be discussed forthwith, see below, point 95 et seq.

F. Jurisdiction and Arbitrability

(a)

Czech Republic's Plea of Lack of Jurisdiction

95.

The Czech Republic's Plea of Lack of Jurisdiction was raised timely (Art. 21.3. of the UNCITRAL Arbitration Rules) in its submission of December 30, 2005, and in its full answer of May 31, 2006.

96.

There is no dispute that Eastern Sugar BV is an investor under the BIT.

97.

The Czech Republic did not argue that the BIT had been expressly terminated. However it argued that the BIT is not applicable beyond the Czech Republic's EU accession, that is, beyond May 1, 2004.

98.

The Czech Republic points out that no BITs have ever been concluded between EU member states after their accession to the EU.

99.

The Czech Republic also argues that a letter attached to a French-German Convention of 1956 expressed the view that the Convention could not apply to products originating in the then European Coal and Steel Community. The EU since extended its field and set up a common agricultural policy and a specific regime for the freedom of investments. The Czech Republic argues that, as originally for the limited field of coal and steel, no room is by now left for bilateral treaties in these much wider fields.

100.

The Czech Republic further invokes the 1969 Vienna Convention on the Law of Treaties. Under that convention, a treaty shall be deemed terminated if all parties conclude a later treaty relating to the *same subject-matter* and (1) it appears that the parties intended that the subject-matter should be governed by the later treaty or (2) the provisions of the later treaty are so far incompatible with those of the earlier one that both treaties cannot be simultaneously applied (Article 59).

101.

The Czech Republic is of the view that the BIT and the EU rules are competing legal frameworks addressing the same subject-matter (i.e. the faculty of a party to invest assets on the territory of another state, and to freely dispose of the revenues).

102.

The Czech Republic argues that it was the Netherlands' and the Czech and Slovak Federal Republic's subjective intention that Dutch investments be governed by EU law. According to Article 118 of the Czech Association Agreement, this agreement shall not affect rights created by earlier agreements "until equivalent rights [...] have been achieved under this Agreement".

103.

The Czech Republic also points out that the European Court of Justice ruled in *Commission v Italy* that a member state may not exercise rights granted under an earlier agreement to the extent that such exercise *conflicts with obligations* under the EEC treaty.

104.

According to the Czech Republic, the intra-EU investment regime, as of the date of the

Czech Republic's EU accession, indeed gives equivalent rights to those under the Treaty, which is therefore superseded by the intra-EU regime.

105.

Moreover, always according to the Czech Republic, if earlier agreements survived, this might distort the principle of *equality of treatment*. This principle was confirmed in later cases (Matteucci). The principle was confirmed with reference to situations in which one of the parties (i.e. Spain) to a bilateral agreement became part of the EU (Exportur v LOR SA and Confiserie du Tech SA).

106.

The Czech Republic also argues that it is impossible to simultaneously apply the BIT and the intra-EU investment regime. The application of the BIT would breach the principle of non-discrimination/equality of treatment (Article 12 of the European Consolidated Treaties); it would affect the uniformity of the legal regime within the EU.

107.

The application of the BIT would also breach the EU principle of mutual trust. This principle would imply that Eastern Sugar brings its claim before a Czech national court. There would be no room for international arbitration in this area.

108.

It follows, the Czech Republic concludes, that the BIT is not applicable, and that the Arbitral Tribunal does not have jurisdiction.

109.

Subsidiarily, according to the Czech Republic the Arbitral Tribunal should refer the matter to the ECJ.

110.

The Czech Republic points out that to address the European Commission is not uncommon. In the Mox Plant case, a dispute under an agreement to which the EU member states as well as the EU itself were parties was stayed by an arbitral tribunal until the European Commission had rendered a decision on the interpretation of the agreement.

(b)

Czech Republic's Argument on Lack of Arbitrability

111.

According to the Czech Republic, Eastern Sugar brings two heads of claim. The first relates to the Czech Republic's alleged failure to enact and enforce a workable sugar regime, and admittedly does not raise issues of arbitrability.

112.

The second head of claim however is based on *legitimate expectations* that allegedly have been frustrated by the Czech Republic's adopting rules that differ from the EU sugar re-

gime. This claim, the Czech Republic argues, cannot be heard by an arbitral tribunal to the extent that it relates to a time *after 1 May 2004*, the Czech Republic's EU accession. From this time forth, only the European Commission would be competent to deal with such issues.

113.

In an earlier dispute between Eastern Sugar and the Czech Republic, Eastern Sugar had itself approached the EU Commission for assistance under the Association Agreement. Ever since the Czech Republic acceded the EU, Eastern Sugar would henceforth be obliged to bring its claim before the EU Commission.

(c)

Eastern Sugar's Defence on Jurisdiction

114.

Eastern Sugar answered the plea of lack of jurisdiction on March 15, 2006, and presented its rejoinder on jurisdiction on June 28, 2006. Since the Arbitral Tribunal accepts jurisdiction (below, point 181) there is no need to summarize Eastern Sugar's arguments, many of which the Arbitral Tribunal accepts.

(d)

Arbitral Tribunal's Discussion of Jurisdiction

115.

The Czech Republic raised its plea of lack of jurisdiction timely, Art. 21.3. of the UNCITRAL Arbitration Rules.

116.

Pursuant Art. 21.1 and 21.2. of the UNCITRAL Arbitration Rules, it is for the Arbitral Tribunal itself to decide on its own jurisdiction on the basis of the arbitration agreement.

117.

The Czech Republic's plea of lack of jurisdiction and its lack of arbitrability defence are based on the premise that when the Czech Republic became a member of the EU of which the Netherlands was already a member, this changed the relationship that it had had with the Netherlands sufficiently to terminate or limit the application of the BIT implicitly, and as a result, to put an end to the benefits and protection enjoyed under the BIT by a Dutch investor such as Eastern Sugar.

118.

Before the Arbitral Tribunal addresses the central issue of the effect of the Czech Republic's accession to the EU on the BIT, it will discuss the Czech Republic's arguments that because of the supremacy of EU law, the Arbitral Tribunal should *defer* or refer to the opinion of EU authorities when deciding about its own jurisdiction (see below, point 119 et

seq., point 130 et seq.) and that Eastern Sugar is *estopped* from bringing up certain matters that it failed to raise earlier (see below, point 140 et seq.).

(aa)

EC Letter of January 13, 2006

119.

Many aspects relevant to the Arbitral Tribunal's jurisdiction were discussed in the letter that Mr. Schaub of EC Internal Market and Services wrote on January 13, 2006, to Mr. Ze-linka, the Czech Deputy Minister of Finance. The letter reads as follows:

Firstly I would like to apologize for the delayed reply to your letter of 13 June 2005 to Mr. O'Sullivan concerning the effect of Bilateral Investment Treaties (BITs) concluded between Member States. The complexity of the questions raised has required the input and analysis by various Commission services.

I might, however, recall that the concern of the Commission services on BITs in general was raised with the Czech Republic in very early contacts with DG ECFIN, in the Chapter 4 screening process in 1998, at a specific TAIEX seminar on the subject with all candidate countries, including the Czech Republic, on 17 January 2000, and subsequently in the external relations chapter of the negotiation process. As you are undoubtedly aware, the Commission services were primarily concerned with conflicting provisions in pre-accession BITs with third countries that could prevail over EU measures, concerns that still remain.

The general question you raised concerns the compatibility of BITs concluded between Member States, thus, as you point out, almost exclusively (apart from agreements between Germany and Portugal and Germany and Greece) BITs concluded by the 10 new Member States. Following from there, you enquire about (i) the date at which the BITs ceased to apply, and (ii) if any form is necessary to render effective the substitution of BITs by EC law and if contracting states have to formally terminate BITs as well as, (iii) should such termination be required, when it would take effect.

Please find below the view of the Commission's services, without prejudice to any interpretation by judicial instances.

a) EC law prevails in a Community context as of accession

Given that the rights and obligations of membership come into force on accession rather than on signature or ratification, the applicable date can be considered as 1 May 2004.

Based on ECJ jurisprudence. Article 307 EC is not applicable once all parties of an agreement have become Member States. Consequently, such agreements cannot prevail over Community law.

For facts occurring after accession, the BIT is not applicable to matters falling under Community competence. Only certain residual matters, such as diplomatic representation, expropriation and eventually investment promotion, would appear to remain in question.

Therefore, where the EC Treaty or secondary legislation are in conflict with some of these BITs' provisions – or should the EU adopt such rules in the future – Community law will automatically prevail over the non-conforming BIT provisions.

As you mention correctly, the application of intra-EU BITs could lead to a more favourable treatment of investors and investments between the parties covered by the BITs and consequently discriminate against other Member States, a situation which would not be in accordance with the relevant Treaty provisions.

The commission therefore takes the view that intra-EU BITs should be terminated in so far as the matters under the agreements fall under Community competence.

b) Effect on existing BITs

However, the effective prevalence of the EU acquis does not entail, at the same time, the automatic termination of the concerned BITs or, necessarily, the non-application of all their provisions.

Without prejudice to the primacy of Community law, to terminate these agreements, Member States would have to strictly follow the relevant procedure provided for this in regard in the agreements themselves. Such termination cannot have a retroactive effect.

c) Dispute settlement procedures

As mentioned above, Community law, including the jurisdiction of the Court of Justice, in principle prevails from the date of accession. However, the transitional situation until the BITs are formally terminated may result in complex questions of interpretation with regard to jurisdiction in particularly with regard to pending arbitration procedures but also in relation to rules such as Article 13 in the BIT between the Czech Republic and the Netherlands, which provides for an extended application of the agreement in a certain period after termination.

In so far as conflicts between Member States are concerned, it follows from Article 292 EC that the Member States cannot apply the settlement procedures provided for in the BITs in so far as the dispute concerns a matter falling under Community competence.

On the other hand, if the dispute concerns an investor-to-state claim under a BIT, the legal situation is more complex. Since Community law prevails from the time of accession, the dispute should be decided on basis of Community law (which indirectly also follows from Article 8(6) first bullet point in the agreement between the Czech Republic and the Netherlands). However, it may be argued that the private investor could continue to rely on the settlement procedures provided for in the agreement until formal termination of the BIT if the dispute concerns facts which occurred before accession. The primacy of Community law should in such instance be considered by the arbitration instance.

The primacy of EU law and its definite interpretation by the European Court of Justice would not necessarily preclude a legal instance (arbitration) in another jurisdiction arriving at a different conclusion, even in an international agreement between two Member States.

In particular, in order to avoid any legal problem with regard to an arbitration procedure, existing BITs between member States should, as mentioned above, therefore be terminated. The formal termination can only be done according to the provisions of the agreement in question. I would note that this principle would not only apply to the Czech BIT with the Netherlands, which would seem to have given rise to a significant amount of litigation, but also those of the Czech Republic with 21 other Member States. Without prejudice to the primacy of Community law, termination of the BIT would take effect according to the respective provisions of each such BIT.

120.

The Arbitral Tribunal notes that *both* Parties claim that in the January 13, 2006, letter, the European Commission agreed with their views. The Arbitral Tribunal however finds the letter of January 13, 2006, for the most part diplomatic or ambiguous, and in any event, by its terms, without prejudice to any interpretation by a "judicial authority" which in the Arbitral Tribunal's understanding, includes the present Arbitral Tribunal.

121.

It also notes that the European Commission did not start infringement proceedings against the Netherlands and the Czech Republic and other members in similar position, for failing to terminate their BITs as one would expect if it agreed with the Czech Republic's views.

122.

To the Arbitral Tribunal's knowledge, neither the Czech Republic nor the Netherlands, nor anybody else, did file a complaint to the European Commission against the Netherlands and the Czech Republic and other members in similar position, concerning their failure to comply with EU Law by leaving their BITs in place.

123.

Even if one had to read the letter in a way favorable to the Czech Republic (in the sense that the BIT is automatically superseded by EU law), the Arbitral Tribunal is of the view that as a matter of EU law the European Commission's opinion on the questions raised by the Czech Republic's letter of June 13, 2005, cannot be binding for the Arbitral Tribunal.

124.

As the European Commission correctly points out, the answer to the questions raised must be given by judicial authorities, which clearly *excludes* the European Commission, and, admittedly less clearly, includes an arbitral tribunal such as the Arbitral Tribunal in the present arbitration.

125.

It follows that the views of the European Commission in its letter *are not binding* on this Arbitral Tribunal but, if clear, which they are not, would at best have persuasive force.

(bb)

EC Note of November 2006 on the Free Movement of Capital

126.

In November 2006 the European Commission, Internal Market and Services DG, sent a Note to the Economic and Financial Committee. *Inter alia* it wrote the following (foot-notes omitted):

There are still around 150 BITs between Member States in force (Annex IV). There appears to be no need for agreements of this kind in the single market and their legal character after accession is not entirely clear. It would appear that most of their content is superseded by Community law upon accession of the respective Member State. However the risk remains that arbitration instances, possibly located outside the EU, proceed with investor-to-state dispute settlement procedures without taking into account that most of the provisions of such BITs have been replaced by provisions of Community law. Investors could try to practice "forum shopping" by submitting claims to BIT arbitration instead of - or additionally to - national courts. This could lead to arbitration taking place without relevant questions of EC law being submitted to the ECJ, with unequal treatment of investors among Member States as a possible outcome.

In order to avoid such legal uncertainties and unnecessary risks for Member States, it is strongly recommended that Member States exchange notes to the effect that such BITs are no longer applicable, and also formally rescind such agreements. The Committee is invited to endorse this approach and Member States are asked to communicate to the Commission by 30 June 2007 which actions have been taken in that regard and which of their intra-EU investment agreements still remain to be terminated.

127.

The Czech Ministry of Finance thereupon proposed to the Czech Government to terminate the validity of the Czech intra-EU BITs by mutual agreement. It wrote, *inter alia*, the following:

With respect to the delay in the ratification process for the European Constitution and the fact that a decision on further steps by the EU will not be adopted until 2008, the Czech Government is again submitting for approval a proposal for actions by the Czech Republic in terminating the validity of treaties for the protection and encouragement of investments which the Czech Republic concluded with European Union Member States. In addition to the circumstances already expounded, an additional reason for submitting this proposal is the fact that the concurrent existence of these treaties for the protection of investments and Community law can create a confused legal situation in the inter-

pretation and use of these treaties. The termination of the validity of the investment treaties likewise significantly improves the situation of the Czech Republic in the sphere of international arbitration processes, as the majority of processes being pursued by foreign investors against the Czech Republic were instigated according to treaties on the protection of investments concluded with EU Member States.

The termination of the validity of treaties for the protection and encouragement of investments concluded between the Czech Republic and EU Member States will not have a negative impact on Czech business making investments in European Union countries and does not even impact the protection of investments made in the Czech Republic by businesses based in EU Member States. As indicated above, the single exception will be that foreign investors will not be able to instigate international arbitration cases against the Czech Republic. The potential claims of these investors will have to be asserted, based on their own choice, either before domestic courts or before the European Court of Justice.

The documents submitted contain a proposal for the approach by the Czech Republic in terminating the validity of treaties for the protection and encouragement of investments concluded between the Czech Republic and European Union Member States.

In the interest of ensuring the maximum protection of mutual bilateral relationships it is recommended that the Czech Republic submit a proposal to the second contractual state to terminate the validity of a treaty for the protection of investments by means of an agreement. In this context the Czech Republic proposes that these agreements eliminate the application of transitional investment treaty provisions that enable the application of investment treaties for additional, typically ten-year, periods.

[...]

A more complicated situation arises in the case of a dispute between an investor and a host contractual country. In this case, from the date of Czech accession the EU arbitration tribunal should consider, with respect to the precedence of Community law over a treaty for the protection investments, whether the submitted dispute falls under its jurisdiction. However, without regard to the precedence of Community law it is nevertheless impossible to rule out ahead of time that the arbitral tribunal will decide the matter of jurisdiction differently and rule that the tribunal is authorized to hear the claims of the investor. In the interest of ensuring the transparency of the legal environment it is therefore necessary to guard against a situation which could lead to duplicity of jurisdiction - an arbitration proceeding according to the treaty for the protection of investments and a case before the courts of the host contractual country, with the use of the authority of the European court of Justice in questions falling exclusively under the jurisdiction of the EU. **The European Commission recommended that this undesirable condition be resolved through the termination of the validity of treaties for the protection and encouragement of investments concluded between the European Union Member States**

With the exception of the possibility to file a complaint against a host country in an international arbitration proceeding, the protection of investments within the EU is on a comparative level with the protection that is provided to investors according to bilateral treaties for the protection of investments.

[...]

There has been significant economic and social development in the Czech Republic since the beginning of the 1990's, thanks in large part to the stability of the legal environment. This progress resulted first in Czech entrance to the OECD and was followed by the acceptance of the Czech Republic in the European Union. In light of these positive circumstances the treaties for the protection of investments that were signed with EU Member States cease to fulfil the original function intended in the 1990's which was based primarily on the protection of investments by foreign investors against risks arising from the undeveloped legal climate in the Czech Republic.

With a single exception the legal code of the Czech Republic incorporates all the obligations and responsibilities the country undertook in the treaties for the protection of investments. This concerns, for example, a commitment to non-discriminatory treatment of foreign investors and their investments, a prohibition on expropriation, with the exception of eminent domain on the basis of the law and with compensation. As indicated above, the only difference is in the method for resolving disputes between investors and the host contractual country; this method authorizes investors to file claims against the host country in an international arbitration case in the event that a commitment arising from this treaty is violated. The existence of bilateral treaties for the protection of investments signed between EU Member States is therefore superfluous and in the case of disputes between an investor and a host country these treaties in fact cause an undesirable condition of potential jurisdictional duplicity.

[...]

For illustration purposes, we can point out that there are currently fourteen arbitration processes underway against the Czech Republic, twelve of which are on the basis of treaties for the protection of investments that the Czech Republic signed with EU Member States. The high number of arbitration disputes brought by investors from European Union Member States is caused by the fact that the majority of investments in the Czech Republic come from EU Member States and this creates the greatest risk of potential international arbitration cases. The termination of the validity of the treaties mentioned would substantially reduce this risk.

[...]

The majority of these treaties have actually already been extended for an additional (typically ten-year) period and it is only possible to terminate the validity of these treaties at the end of this period, usually with a one-year withdrawal term. Therefore, it wouldn't be possible to withdraw from many of these treaties until the following decade. Due to the fact that after the termination of the validity of a treaty there is still a so-called safety period during which existing investments will continue to be protected by the relevant treaty

for the protection of investments, it can be stated that in many cases the investments of foreign investors in the event of a withdrawal from the treaty would still be protected beyond the year 2020 (according to the terms of individual treaties).

128.

The Arbitral Tribunal does not find that the Note of the European Commission supports the view that the intra-EU BITs are all *automatically* superseded.

129.

Even if the European Commission's view was clearly in the Czech Republic's favor, it could only have persuasive force for the Arbitral Tribunal.

(cc)

Refer to the ECJ the question of the effect of the EU accession on the BIT?

130.

Subsidiarily, the Czech Republic requests the Arbitral Tribunal to make a referral to the European Court of Justice under Art. 234 (formerly Art. 177) of the Rome Convention for a preliminary ruling on the question of the BIT's termination.

131.

As it understands the possibility of a referral to the European Court of Justice, this is a route not open to an arbitral tribunal even if it has its seat in the European Union, see *Nordsee v. Reederei Mond* [1982] ECR 1095, 1110; *Denuit v. Transorient*, ECJ Jan. 27, 2005.

132.

The Czech Republic argues that a *dictum* in the latter decision reads as follows:

Under the Court's case law, an arbitration tribunal is not a „court of a member State“ within the meaning of Article 234 EC where the parties are under no obligation, in law or in fact, to refer their disputes to arbitration...

133.

This, the Czech Republic claims, must be understood to mean that *only* where the two Parties are under no obligation to refer their dispute to arbitration is an arbitral tribunal not “a court of a member state”, and by contrast, where the Parties *are* under the obligation to refer their dispute to arbitration, the arbitral tribunal *may* file a request for a preliminary ruling by the ECJ. Here, the Czech Republic argues, the BIT *requires* the Parties to go to arbitration, hence the Arbitral Tribunal *may* request a preliminary ruling by the ECJ.

134.

The Arbitral Tribunal finds this interpretation even harder to understand than the *dictum* itself. There is no such thing as compulsory arbitration even though occasionally some

state courts go by the name of arbitral tribunal. Normally, parties are free to agree to arbitration or not. Once they have agreed to arbitration, they are of course bound.

135.

The ECJ's dictum simply is to the effect that the meaning of "court of a member state" in Art. 234 EC excludes voluntary arbitration in the normal sense.

136.

The present BIT arbitration is such a voluntary arbitration in the normal sense, binding only once agreed, and here agreed in the BIT and the Notice of Arbitration respectively, unless the Czech Republic's offer in the BIT lapsed with its accession to the EU and therefore could no longer be accepted by the Notice of Arbitration (see below, point 142 et seq.).

137.

Even if the Arbitral Tribunal *had discretion* to refer (and this is as high as the Czech Republic puts its case), the Arbitral Tribunal sees in any event no reason to make a referral in a case where the answer is not difficult.

138.

Accordingly, the Arbitral Tribunal *will not refer* the matter to the European Court of Justice. The Czech Republic's Prayer for Relief (b) to that effect (see above, point 25) is *rejected*.

139.

To the Arbitral Tribunal's knowledge, nobody else has referred the matter to the ECJ. In any event, the Arbitral Tribunal *will not stay* the arbitration. The Czech Republic's Request for Relief (b) to that effect is *rejected*.

(dd)

Estoppel?

140.

On various occasions, the Czech Republic – using the word or not – argues that Eastern Sugar is *estopped* from challenging administrative decisions that it failed to attack through internal Czech remedies. This applies to the following:

(aa) The Czech Republic argues that the *unitary beet pricing mechanism* – not establishing different minimum sugar beet buying prices depending on whether the white sugar produced from the sugar beet purchased would be exported or not – in the various sugar decrees had been submitted for consultation to interested circles, including Eastern Sugar, and had not been criticized, so Eastern Sugar is now estopped from complaining about this lack of differentiation in the present arbitration.

(bb) The Czech Republic argues that Eastern Sugar's alleged failure to criticize in the consultation process that the Czech Republic was *not obligated to intervention*

purchases and had discretion on whether to intervene, so Eastern Sugar is now estopped from complaining about that discretion in the present arbitration.

(cc) The Czech Republic argues that under the Third Sugar Decree, Eastern Sugar failed to challenge formally the allegedly wrong application by the SZIF decision of May 15, 2003, of the criteria to establish Eastern Sugar's quota. The SZIF had taken as the basis the daily production in October 2002 rather than the allegedly higher production that Eastern Sugar claims to have had in November 2001. The failure to challenge this, Eastern Sugar claims, was due to the Czech Republic's representations that led Eastern Sugar to expect a substantial reserve allocation. The Czech Republic argues that Eastern Sugar itself asked that the October 2002 figures be used, and that no representations were made by the Czech Republic on the occasion of a dinner. Now, the Czech Republic argues that Eastern Sugar is estopped from complaining that it received too small a quota.

141.

Since the BIT does not provide for the exhaustion of local remedies as a pre-condition to a claim under the BIT, the Arbitral Tribunal does not find it possible to accept the Czech Republic's estoppel argument. It follows that the Arbitral Tribunal does not lack jurisdiction over the matters just mentioned on grounds of *estoppel*.

(ee)

Does the Arbitral Tribunal have jurisdiction?

142.

The Arbitral Tribunal accordingly must now decide by itself whether the Czech Republic's accession to the EU excluded its jurisdiction under the BIT by a *contrarius actus* (even if not in the same form as the original act) .

143.

Neither the Europe Agreement nor the Accession Treaty provide *expressly* that the BIT is terminated. The Arbitral Tribunal would find it odd if a matter as important as investment protection had been overlooked in the negotiations of the old EU countries with the Czech Republic and the other new EU countries.

144.

Indeed, the Europe Agreement provides expressly as follows in Art. 74 (1) and (2):

1. *Cooperation shall aim to establish a favourable climate for private investment, both domestic and foreign, which is essential to economic and industrial reconstruction in the Czech Republic.*
2. *The particular aims of cooperation shall be:*
 - *to improve the institutional framework for investments in the Czech Republic,*
 - *the extension by the Member States and the Czech Republic of agreements for the promotion and protection of investment,*

- to implement suitable arrangements for the transfer of capital,

...

145.

Art. 118 of the Europe Agreement reads as follows:

This Agreement shall not, until equivalent rights for individuals and economic operators have been achieved under this Agreement, affect rights assured to them through existing agreements binding one or more Member States, on the one hand, and the Czech Republic, on the other.

146.

The Accession Treaty says nothing at all.

147.

Thus one cannot say that the Europe Agreement or Accession Treaty by their terms expressly superseded the BIT.

148.

Neither does the BIT itself expressly provide that it might be replaced if both its parties became members of the same REIO.

149.

Indeed, Art. 3.3 of the BIT reads as follows:

The provisions of this Article shall not be construed so as to oblige either Contracting Party to accord preferences and advantages to investors of the other Contracting Party similar to those accorded to investors of a third State

a) by virtue of membership of the former of any existing or future customs union or economic union, or similar institutions: or

b) on the basis of an agreement for the avoidance of double taxation, or on the basis of reciprocity with a third State.

150.

The second paragraph of Mr. Schaub's letter of January 13, 2006 (see above, point 119) mentions early contacts about BITs in general. These took place in 1998 and again in 2000. It is not clear what was said in those early contacts.

151.

In 2002, after the award in the CME v. Czech Republic arbitration, there were some later contacts. The Czech Republic started *consultations* with the Netherlands specifically under Art. 9 of the Dutch/Czech BIT. However, the subject of the EU accession possibly superseding the BIT was not raised in this consultation nor in any other such consultation. What was discussed in the 2002 consultations will be discussed in below, point 194 et seq.

152.

Art. 13 of the BIT reads as follows:

1. *The present Agreement shall enter into force on the first day of the second month following the date on which the Contracting Parties have notified each other in writing that the procedures constitutionally required therefore have been complied with, and shall remain in force for a period of ten years.*

2. *Unless notice of termination has been given by either Contracting party at least six months before the date of the expiry of its validity, the present Agreement shall be extended tacitly for periods of ten years, each Contracting Party reserving the right to terminate the Agreement upon notice of at least six months before the date of expiry of the current period of validity.*

153.

To this day, no notice of termination of the BIT was given by either the Czech Republic or the Kingdom of the Netherlands.

154.

Thus, neither the BIT nor the Europe Agreement nor the Accession Treaty deal expressly with the question whether the BIT is still valid today.

155.

The argument by the Czech Republic that the BIT was *implicitly superseded* by the *acquis communautaire* when the Czech Republic acceded to the European Union of which the Netherlands was already a member appears novel. Both the Netherlands and the Czech Republic still list their BIT as one of the international treaties to which they are a Party. As is well known, the BIT between the Netherlands and the Czech Republic was invoked in more than one recent arbitration. The argument does not appear to have been made by the Czech Republic in those other arbitrations. Nor does it appear that the argument was made in respect to other BITs between countries that, thanks to the EU's enlargement, are now members of the European Union, and older members. The Arbitral Tribunal does not know whether it was recently raised in other BIT arbitrations possibly still pending.

156.

The Arbitral Tribunal is of the view that in the absence of more specific legal provisions, the effect of the Czech Republic's accession to the European Union, a regional multilateral treaty, on the BIT must be judged according to the law of Nations, and in particular the Vienna Convention on the Law of Treaties dated 1969, of which the Netherlands and the Czech Republic are parties. The applicable law according to Art. 8.6 of the BIT (which will be discussed below, point 191) is not relevant in this connection.

157.

Indeed, as a matter of public international law, a treaty can only end in accordance with its own terms or the Vienna Convention. Art. 42 of the Vienna Convention reads as follows:

1. *The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the present Convention.*

2. *The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty*

or of the present Convention. The same rule applies to suspension of the operation of a treaty.

The discussion of the Europe Agreement and of the BIT itself which showed that the BIT was not terminated in accordance with their own terms (see above, points 143 to 154) presupposed the applicability of Art. 42.2. of the Vienna Convention.

158.

Art. 59 of the Vienna Convention on International Treaties reads as follows:

1. A treaty shall be considered as terminated if all the parties to it conclude a later treaty relating to the same subject-matter and:

(a) it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty; or

(b) the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time.

2. The earlier treaty shall be considered as only suspended in operation if it appears from the later treaty or is otherwise established that such was the intention of the parties.

159.

First, the Arbitral Tribunal does not accept the Czech Republic's argument that the EU treaty as the later treaty (as between the Czech Republic and the Netherlands) covers the *same subject matter* as the BIT, the earlier treaty.

160.

While it is true that European Union law deals with intra-EU crossborder investment, say between the Netherlands and the Czech Republic, as does the BIT, the two regulations do not cover the same precise subject-matter.

161.

The European Union guarantees the free movement of capital. Thus, it guarantees to non-Czech investors from other EU member countries the right to invest in the Czech Republic on a par with any Czech investor.

162.

The precedents cited by the Czech Republic concern impediments to the free movement of capital such as cases where one EU Member country – France – retained a "golden share" which allows the host state to assume, when it suits it, control over the company, thereby making it unattractive for investors from fellow EU Countries to invest in such companies in the host state.

163.

Similarly, the European Union guarantees the free movement of capital outwards, thus, the investor may take out profits and even the investment as such out of the host country.

164.

By contrast, the BIT provides for fair and equitable treatment of the investor *during* the investor's investment in the host country, prohibits expropriation, and guarantees full protection and security and the like. The BIT also provides for a special procedural protection in the form of arbitration between the investor state and the host state and, especially arbitration of a "mixed" or "diagonal" type between the investor and the host state, as in the present case.

165.

From the point of view of the promotion and protection of investments, the arbitration clause is in practice the most essential provision of Bilateral Investment Treaties. Whereas general principles such as fair and equitable treatment or full security and protection of the investment are found in many international, regional or national legal systems, the investor's right arising from the BIT's dispute settlement clause to address an international arbitral tribunal independent from the host state is the best guarantee that the investment will be protected against potential undue infringements by the host state. EU law does not provide such a guarantee.

166.

The importance of dispute settlement provisions was underlined by Arbitral Tribunals in such cases as ICSID Case No. ARB/97/7, *Emilio Agustín Maffezini v. Kingdom of Spain*, Decision on Objections to Jurisdiction dated January 25, 2000, point 54; ICSID Case No. ARB/03/10, *Gas Natural SDG, S.A. v. Argentine Republic*, Decision of the Tribunal on Preliminary Questions on Jurisdiction dated June 17, 2005, point 31; ICSID Case No. ARB/03/17, *Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentine Republic*, Decision on Jurisdiction dated May 16, 2006, point 57.

167.

Second, the Czech Republic has not established that the common *intention* of the Czech Republic and the Kingdom of the Netherlands was that the EU Treaty should supersede the BIT.

168.

Third, the Arbitral Tribunal is of the view that the BIT and the EU Treaty are not *incompatible*.

169.

Free movement of capital and protection of the investment are different, but complementary things.

170.

If the EU Treaty gives more rights than does the BIT, then all EU parties, including the Netherlands and Dutch investors, may claim those rights. If the BIT gives rights to the Netherlands and to Dutch investors that it does not give other EU countries and investors,

it will be for those other countries and investors to claim their *equal rights*. But the fact that these rights are unequal does not make them incompatible.

171.

Nor does the fact that the BIT provides for arbitration violate the principle of *mutual trust* between EU Countries. Arbitration is not contrary to mutual trust into State Court systems. As is well known, the "Brussels Regulation" 2000, which is the successor of the Brussels Convention, excludes arbitration from its ambit.

172.

The Arbitral Tribunal is of the view that EU law has not *automatically* superseded the BIT as a result of the accession of the Czech Republic to the EU. It follows that the BIT, including its arbitration clause, is still in force.

173.

Several *additional* reasons, each of which is sufficient by itself, lead to the result that the Arbitral Tribunal has jurisdiction in any event.

174.

Art. 13 (3) of the BIT guarantees an investor's rights for a further 15 years from the date of any termination. Art. 13 (3) reads as follows (for Art. 13 (1) and 13 (2) (see above, point 152)).

In respect of investments made before the date of termination of the present Agreement the foregoing Articles thereof shall continue to be effective for a further period of fifteen years from that date.

175.

The Arbitral Tribunal can only reject the Czech Republic's argument that the implied termination of the BIT through accession also terminated the continuing effect expressly guaranteed by Art. 13 (3) of the BIT.

176.

In any event, the dispute before the Arbitral Tribunal arose before the Czech Republic's accession to the European Union and could not have been affected if the BIT had been terminated after that.

177.

This is in harmony with Art. 70 Subs. 1 of the Vienna Convention which reads as follows.

1. Unless the treaty otherwise provides or the parties otherwise agree, the termination of a treaty under its provisions or in accordance with the present Convention:

(a) releases the parties from any obligation further to perform the treaty;

(b) does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination.

2. If a State denounces or withdraws from a multilateral treaty, paragraph 1 applies in the relations between that State and each of the other parties to the treaty from the date when such denunciation or withdrawal takes effect.

178.

The Arbitral Tribunal moreover does not believe that it can accept the Czech Republic's argument that the treaty can end partially and remain in force otherwise. This situation would be governed by Art. 30 of the Vienna Convention.

179.

Art. 30 of the Vienna Convention applies in cases where the strict conditions of Art. 59 are not fulfilled. It reads as follows:

1. Subject to Article 103 of the Charter of the United Nations, the rights and obligations of States parties to successive treaties relating to the same subject-matter shall be determined in accordance with the following paragraphs.

2. When a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail.

3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the latter treaty.

4. When the parties to the later treaty do not include all the parties to the earlier one:

(a) as between States parties to both treaties the same rule applies as in paragraph 3;

(b) as between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations.

5. Paragraph 4 is without prejudice to article 41, or to any question of the termination or suspension of the operation of a treaty under article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty the provisions of which are incompatible with its obligations towards another State under another treaty.

180.

On the merits, the fact that the European Union does not provide for a possibility for an investor to sue a host state directly, and that in international BIT arbitration this is an essential feature of most bilateral investment treaties, is in itself sufficient to reject the Czech Republic's equivalence argument. The Arbitral Tribunal notes that the Netherlands Ministry of Foreign Affairs expressly mentioned BIT arbitration at the outset of its report on the BIT. The Czech Ministry of Finance's report (see above, point 127) is precisely aimed at abolishing intra-EU BIT arbitration as quickly as possible by securing the mutual consent of the States involved.

(ff)

Conclusion on Jurisdiction

181.

The Arbitral Tribunal *accepts jurisdiction*. The Czech Republic's Prayer for Relief (a) to the contrary (see above, point 25) is *rejected*.

(e)

Arbitral Tribunal's Discussion of Arbitrability

182.

The Czech Republic's lack of arbitrability defence concerns damages claimed by Eastern Sugar in what came to be called Claim B, but only those damages arising from the period *after* the Czech Republic's accession to the EU.

183.

Eastern Sugar bases itself on the BIT, not EU law, also for that portion of Claim B.

184.

The Czech Republic claims that the post-accession damages claimed by Eastern Sugar are not arbitrable.

185.

The Czech Republic's argument is that with accession the BIT was superseded so that Eastern Sugar could at best have claims under EU law, no longer the BIT. The Arbitral Tribunal has discussed and rejected this contention (see above, point 172).

186.

The Czech Republic also seems to argue that any claim, possibly even under the BIT, arising after accession to the EU would no longer be arbitrable, or the Arbitral Tribunal would lack jurisdiction because, from accession onwards, exclusive jurisdiction allegedly lies with the ECJ. The Arbitral Tribunal has already discussed and rejected this argument (see above, point 180).

187.

The post-accession damages claimed under the BIT are *arbitrable*. The Czech Republic's Prayer for Relief (a) to the contrary is *rejected*.

*

188.

Having rejected the Czech Republic's procedural prayers for relief (a) and (b), the Arbitral Tribunal now turns to the *merits*.

189.

On the merits, Eastern Sugar requests as its prayers for relief (a) to (c) various declarations

plus orders for monetary relief as its prayers for relief (d) to (f) (see above, point 22), while the Czech Republic requests as its prayers for relief (c) that all of Eastern Sugar's claims be dismissed "pursuant to articles 3 (1) and 3 (2) of the BIT" (see above, point 25).

190.

Since prayers for declaratory relief often become moot once monetary relief is granted or rejected, the Arbitral Tribunal will first discuss Eastern Sugar's requests for monetary relief (d) to (f).

*

G. Applicable Law

191.

Art. 33 UNCITRAL Arbitration Rules provides as follows:

1. *The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.*
2. *The arbitral tribunal shall decide as amiable compositeur or ex aequo et bono only if the parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.*
3. *In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.*

192.

Art. 8 subs. 6 of the BIT provides as follows:

- The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively:*
- the law in force of the Contracting Party concerned;*
 - the provisions of this Agreement, and other relevant Agreements between the Contracting Parties;*
 - the provisions of special agreements relating to the investment;*
 - the general principles of international law.*

193.

Art. 9 of the BIT provides as follows:

Either Contracting party may propose the other Party to consult on any matter concerning the interpretation or application of the Agreement. The other Party

shall accord sympathetic consideration to and shall afford adequate opportunity for such consultation.

194.

The meaning of article 8 of the BIT was addressed at the occasion of a meeting held on April 4 and 5, 2002, between the Czech Republic and the Netherlands.

195.

The agreed minutes read as follows:

The delegations agree that the arbitral tribunal shall decide on the basis of the law. When making its decision, the arbitral tribunal shall take into account, in particular, though not exclusively, the four sources of law set out in article 8.6. The arbitral tribunal must therefore take into account as far as they are relevant to the dispute the law in force of the Contracting Party concerned and the other sources of law set out in article 8.6. To the extent that there is a conflict between national law and international law, the arbitral tribunal shall apply international law.

196.

This does not mean that international law applies only when it is in conflict with national law. On the contrary, it means that international law generally applies. It is not just a gap-filling law. It is only where international law is silent that the Arbitral Tribunal should consider before reaching any decision how non conflicting provisions of Czech law might be relevant, and if so, could be taken into account.

197.

In other words, the agreed minutes explain in a contorted way what Art. 8 subs. 6 of the BIT means. It means that beyond the wording of the BIT, international law applies, but that the Arbitral Tribunal should consider, before reaching any decision, how non-conflicting provisions of Czech law might be relevant and, if so, could be taken into account.

H. Law - Fair and equitable treatment

198.

Art. 3 (1) of the BIT reads as follows:

Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.

199.

Eastern Sugar claims that the Czech Republic failed to treat it fairly and equitably and in accordance with its legitimate expectations already with the First and Second Sugar Decree, and particularly with the Third Sugar Decree which, Eastern Sugar contends, was specifically designed to *target* Eastern Sugar and was *intended* to be discriminatory, thus *per se* an unreasonable or discriminatory measure.

200.

The Czech Republic is of course responsible for all acts and submissions of all its officers, including the Government and the Constitutional Court. It contests that it breached Art. 3(1) of the BIT.

I. Law - Full security and protection

201.

Art. 3 (2) of the BIT reads as follows:

More particularly, each Contracting Party shall accord to such investments full security and protection which in any case shall not be less than that accorded either to investments of its own investors or to investments of investors of any third State, whichever is more favorable to the investor concerned.

202.

Eastern Sugar claims that the Czech Republic violated its obligation to provide Eastern Sugar with full security and protection of its investments.

203.

As the Arbitral Tribunal understands it, the criterion in Art. 3(2) of the BIT concerns the obligation of the host state to protect the investor from *third* parties, in the cases cited by the Parties, mobs, insurgents, rented thugs and others engaged in physical violence against the investor in violation of the state monopoly of physical force. Thus, where a host state

fails to grant full protection and security, it fails to act to *prevent* actions by third parties that it is required to prevent.

204.

In the present case, for the most part, Eastern Sugar complains about acts committed by the Czech Republic itself, not acts of third parties. Eastern Sugar does not claim that disgruntled sugar beet growers were dumping sugar beet on the entrance stairs of Eastern Sugar, and policemen were looking on with a grin on their face. Sugar beet was dumped on the stairs of the Ministry of Agriculture, and the Ministry of Agriculture then allegedly reacted with the Third Sugar Decree, targeting Eastern Sugar.

205.

The only third parties about whose behaviour Eastern Sugar complains were its Czech "newcomer" competitors who, once awarded sugar quota to sell, allegedly sold beyond their quota. The Czech Republic allegedly did not prevent this, and on the contrary rewarded the Czech newcomers by granting them a still larger quota in the subsequent decrees, particularly the Third Sugar Decree.

206.

The Czech Republic contests that it breached Art. 3(2) of the BIT.

207.

The Arbitral Tribunal will concentrate on the actions of the *Czech Republic* and on the question whether these actions were within legitimate expectations of an investor or violated the standard of their equitable treatment under Art. 3(1) of the BIT.

J.

Law – Measures depriving investor of the investment

208.

Art. 5 of the BIT reads as follows:

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

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

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

209.

The Czech Republic argues that the Sugar Decrees were a measure taken in the public interest and under due process of law, and that they were not discriminatory.

210.

The Arbitral Tribunal is in any event of the view that Art. 5 of the BIT is applicable only if there was a substantial deprivation of the entire investment or a substantial part of the investment. This is not what Eastern Sugar is alleging in the instant case.

K.

Law - Intertemporal Aspects, Vested Rights, Estoppel

211.

As one will see, the Czech Republic first came close to the European Union model, but then moved away from it.

212.

The Arbitral Tribunal must decide whether, as the legislation changed almost from year to year, the Czech Republic punished behavior by Eastern Sugar that it had initially permitted and even encouraged, and on the contrary later rewarded behavior by others that it had initially forbidden, and whether, if it did that, the Czech Republic violated the BIT, particularly its Art. 3(1).

213.

The Czech Republic argues against this that each step that it took was pre-discussed with all interested circles, including Eastern Sugar and the Bohemian-Moravian sugar producers association of which Eastern Sugar was a member, and Eastern Sugar failed to alert the Czech Republic to the matters that it is now complaining about.

214.

The Arbitral Tribunal does however not believe that the Czech Republic wishes to say that Eastern Sugar is estopped from complaining about the sugar regimes that the Czech Republic set into place simply because it failed to resist them early on.

215.

Besides, it is factually incorrect that Eastern Sugar failed to complain about the Czech Republic's plans. In particular, this is true of the Third Sugar Decree to which the Arbitral Tribunal will revert.

216.

Similarly, the Czech Republic points out that Eastern Sugar failed to resist some of its moves internally through the administrative process.

217.

This is in part true. In particular, it appears that Eastern Sugar at one time believed, with or without good reason, that the adverse effect that the Third Sugar Decree would have on Eastern Sugar would be mitigated through Eastern Sugar being awarded additional quota from the reserve.

218.

However, since the BIT does not provide for the exhaustion of the local remedies before an investor may complain about a violation of the BIT, the point is without relevance to the Arbitral Tribunal's decision.

219.

The Czech Republic also makes much of the regular inspection reports from the European Union stating that the various sugar decrees were put into place without criticizing them. In particular, one such report describes the Third Sugar Decree as "adequate" regulation.

220.

On its face, the Czech legislation may have appeared "adequate", if that word is used properly by the European Commission, which is doubtful.

221.

The Arbitral Tribunal is in any event not persuaded that the European Union analyzed the Czech legislation in a depth sufficient to identify whether legislation was targeted against a particular company such as Eastern Sugar to punish it for having closed a factory in a previous year.

L.

1989 to 2000: Free Market and EU Sugar Regime

222.

Growing sugar cane is cheap, particularly in tropical climates, for instance in the Caribbean.

223.

Producing sugar from sugar cane is cheap, particularly in the low wage sugar cane producing countries.

224.

Sugar transportation costs to Europe are relatively low.

225.

European Sugar beet growers expect to make a far better living than farmers in the Caribbean, and producing sugar from beet is comparatively expensive.

226.

The world price of sugar landed in Europe is accordingly low, far lower than the price of sugar produced in Europe from sugar beet.

227.

For protectionist reasons, at all times, European countries, including the Czech Republic, put heavy import duties on sugar and related products.

228.

Sugar beet is expensive to transport since the sugar content of beet is low and beet is bulky.

229.

White sugar is stable, concentrated, and rather easy to transport.

230.

This means that within a country a sugar factory will normally process sugar beet from nearby growers. Sugar factories need not be close to large users of sugar, such as chocolate factories.

231.

Sugar and sugar products are distributed to consumers and sold at retail everywhere. The retail distribution costs of sugar and sugar products are significant.

232.

At the time of the investment, that is 1994 to 2000, what could Eastern Sugar legitimately expect?

233.

Before the Velvet Revolution, there was no free cross-border movement of agricultural goods such as sugar beet. In Czechoslovakia various beet sugar factories in Bohemia and Moravia, many small and old, were producing locally sugar from local sugar beet. Czechoslovakia exported sugar to other COMECON countries.

234.

But now large-scale export to other countries, soon including Slovakia, was no longer feasible.

235.

A liberal regime was in place in the Czech Republic. On the sugar market, this led to a drastic reduction of the number of market players. Three major foreign-owned domestic sugar producers (graced with the term, "strategic") had bought themselves into the Czech sugar market and were competing with each other. In 2000, before the First Sugar Decree, Eastern Sugar had a market share of 31.03 percent of the white sugar tonnage produced in the Czech Republic.

236.

That the market would remain free or would become even more free could not be within the expectations of an investor such as Eastern Sugar. The wish within the Czech population to join the European Union was obvious. So was the wish within the then European Union to accept Eastern Central European Countries in its midst, after an adaptation period during which the candidates would adapt their countries to European Union standards, particularly their legal system. The Europe Agreement 1993 provided for this.

237.

In 2000, an investor such as Eastern Sugar accordingly had to expect that the regulation of the sugar market would, as accession neared, become roughly the protectionist regime prevailing in European Union countries.

238.

The future was thus in the past of the European Union.

239.

In what became the European Union, regulation of the sugar market started in 1967. Already the European Communities Regulation no 1009/67 of the then Council of the European Communities of December 18, 1967, provided for quotas of white sugar to be produced annually in each member country and sold there. It provided that the basic annual country quota would be set on the basis of the average production over the five previous marketing years on the basis of their historical production.

240.

The various member states similarly distributed their quota internally to each factory or each undertaking. An internal quota system based on historical production was also mandated by the European Regulation. It further provided for intervention purchases of sugar (to sustain a high ex-factory white sugar price), minimum prices for sugar beet, a high price for beet for sugar for the domestic market and a low price for beet for sugar for export, and limiting sugar imports (by requiring an import license and imposing high customs duties).

241.

Council Regulation no. 1705/81 was amended several times. The subsequent Regulations continued the historical quota system.

242.

Eastern Sugar could therefore expect in 2000 that its historical quota acquired from December 1994 onwards (see above, point 6) would be maintained.

M.

First Sugar Decree of February 21, 2000, cancelled on February 14, 2001

(aa)

Philosophy of First Sugar Decree

243.

From 1994 to 2000, as the Czech Republic was readying itself to enter the EU, the Czech political pronouncements were emphatically in favor of a free market economy and in favor of rationalization to make the Czech Republic fit for competition within the framework of the European Union.

244.

Eastern Sugar points to various newspaper interviews of government officials and to a statement by the agriculture ministry before the time of Mr. Palas. These documents, the

Czech Republic objects, are neither attributed nor signed. It seeks to discredit these sources as mere political pronouncements, but in the Arbitral Tribunal's view, not properly so. It does happen that the views and the pronouncements of governments are on occasion distorted. However, governments then invariably set the record straight. The Czech Republic did not point to any correction by anybody of political pronouncements, both the earlier governments and the more recent governments down to those of today's Czech government. Under these circumstances, the Arbitral Tribunal must accept this allegations by Eastern Sugar as to the position taken by the then government to be correct.

245.

When the Czech Republic issued its First Sugar Decree in 2000, after a first proposal had been made in 1997, the overall goal was to slowly reduce use of domestic and foreign beet, and to continue increasing efficiency of sugar manufacturing by closing down facilities and modernizing the others. Accordingly the Czech Republic

- continued to close borders to foreign white sugar, foreign raw beet or
- imposed prohibitively import duties
- imposed a minimum purchase price for domestic sugar beet to be converted to domestic sugar
- imposed a maximum domestic sugar sales price
- imposed domestic sugar sales quotas
- imposed, beyond the quotas, an obligation to export excess sugar.

246.

The idea behind the First Sugar Decree was primarily to introduce a sugar regime similar to those in the EU member states operating under the EU Sugar Regime (see above, point 239 et seq.).

247.

Accordingly, quota was allocated on the basis of production during the previous five years which were, in the Czech Republic, 1994 to 1999, years characterized by a market economy. This was as could reasonably be expected.

248.

Eastern Sugar tried to persuade the Arbitral Tribunal that any internal sugar regime must comply with certain specific requirements.

249.

The Arbitral Tribunal does not follow this entirely. Once the state starts regulating the internal sugar market, there are indeed elements that are necessary: First and foremost, the internal market must be ring-fenced against imports of cheap sugar normally produced overseas from sugar cane, including near-sugar products such as sugar cocoa powder, soft drinks, syrup and sugar substitutes.

250.

How the internal sugar market is regulated in detail depends however on the political goals pursued. In the First Sugar Decree, the beet growers were guaranteed minimal prices at which the sugar producers had to purchase beet. The quantity that could be purchased was left open, and the sugar producer could buy beet wherever in the country they wished. The sugar producers could not sell more than their quota of white sugar into the Czech sugar market. They were guaranteed a minimum domestic sugar price which ensured that they would make a profit despite having bought beet at prices not below the minimum beet price. They could sell to whoever they chose within the country.

251.

If they produced more sugar than their quota, they could sell the excess sugar only for export, but the price on the world market was far lower than the internal Czech sugar price. Since however the beet price to produce sugar for export was the same high minimum price, in effect, producing more than the domestic quota was discouraged because it would lead to a loss. Thus the amount of sugar that could be produced was practically fixed.

252.

Under a regime as just described, with the price of raw material (beet) and of end product (sugar) fixed, and the volume practically fixed as well, a sugar producer was encouraged to optimize its operations by making better use of its production facilities.

253.

It could be advantageous to realize economies of scale by continuing to close down small old-fashioned factories and switch their production to other, larger and more modern factories.

254.

In this connection, last minute investors were discouraged from buying up old sugar factories that already had been closed. In a 1999 memorandum, the then Minister of Agriculture, Mr. Jan Fencl, commented as follows:

... such efforts will inevitably fail in the long term due to the commitments of the Czech Republic to the European Union.

255.

A producer could increase its production in a factory by making use of its daily production capacity for more days, that is by prolonging its production campaign. To this end, instead of producing sugar directly from sugar beet it could be advantageous to produce thick sugar juice first, store it temporarily, and use it to produce white sugar later.

256.

Finally, one could wish to use a beet-saving technique, producing more sugar from less beet, for instance by processing sugar molasses and producing white sugar also from those rather than only from beet.

257.

All these techniques involved some initial investment, but could over time be advantageous.

258.

Eastern Sugar used these techniques perhaps more than its competitors, by closing down factories, producing thick sugar juice first, and using a technology known as SSMB to produce sugar from molasses.

(bb)

Political Flexibilization

259.

The First Sugar Decree had however a further feature that was disturbing.

260.

After the February 8, 2000, draft, the First Sugar Decree, of February 21, 2000, "flexibilized" the quota allocation by giving the state a "reserve" quota.

261.

The Czech Republic argues that this reserve quota was an element of the European Union regulation itself. Not quite. What was different, was that the Czech Government had full discretion.

262.

The Czech Republic also claims that it was *required* to open its markets to newcomers. Mr. Froněk even said that this was required by the WTO. Where the WTO can come in a purely internal Czech matter is not clear at all.

263.

The reserve quota was said by Mr. Fencel to have been "politically established".

264.

Eastern Sugar claims that this is exactly what it was.

265.

The Arbitral Tribunal agrees. It finds the opening up of the cartel of sugar producers to newcomers illogical. If indeed the policy is that closure of sugar factories should be encouraged, and generally the sugar production should be shrunk rather than expanded, it makes no sense to reward purchasers of closed factories with quota out of the blue. This is however exactly what the Czech Republic did. It favored newcomers who had no record and had no market share to the detriment of those who had bought into or fought for their market share and had earned their quota.

266.

Thus, the First Sugar Decree had an element of internal inconsistency: It was designed to do one thing, but for political reasons was also doing a bit of the opposite.

(cc)

Ineffective Implementation

267.

Eastern Sugar also faults the Czech Republic with having failed to implement the First Sugar Decree effectively. Indeed, it let in sugar imports which competed with Czech-produced beet sugar.

268.

Moreover, it is undisputed that the newcomers oversold their domestic quota instead of exporting the excess sugar produced.

269.

How this happened, and how often and how well the various sugar factories were inspected by the Czech Republic under the various sugar decrees, has no impact on the Arbitral Tribunal's decision. Accordingly the issue of the inspection reports (see above, point 55 et seq.) need not be resolved.

(dd)

Cancellation by the Czech Constitutional Court

270.

The First Sugar Decree was set aside by the Czech Constitutional Court because it lacked proper legislative basis. The proposed enabling statute had not been passed by the Czech Parliament in early 2000, but the Government had gone ahead with the First Sugar Decree anyway in February 2000.

(ee)

Overall Assessment

271.

The Arbitral Tribunal must assess whether the various imperfections of the First Sugar Decree just mentioned must be seen as a violation of the BIT.

272.

This raises an interesting aspect: A violation of a BIT does not only occur through blatant and outrageous interference. However, a BIT may also not be invoked each time the law is flawed or not fully and properly implemented by a state. Some attempt to balance the interests of the various constituents within a country, some measure of inefficiency, a degree of trial and error, a modicum of human imperfection must be overstepped before a party may complain of a violation of a BIT. Otherwise, every aspect of any legislation of a host

state or its implementation could be brought before an international arbitral tribunal under the guise of a violation of the BIT. This is obviously not what BITs are for.

273.

The Arbitral Tribunal does not believe that for historical reasons the Czech Republic should be held to a less stringent standard than other countries, say the Netherlands.

274.

Even though the First Sugar Decree was rashly introduced on an insufficient legislative basis (see above, point 270), ineffectively implemented (see above, point 267 et seq.), and had a disturbing feature, the discretionary reserve quota (see above, point 259 et seq.), the Arbitral Tribunal does not find this to amount to a violation of the BIT requirement to treat investors fairly and equitably.

N.

Second Sugar Decree of March 7, 2001, cancelled on October 30, 2002

275.

The Second Sugar Decree was in most respects the same as the First Sugar Decree. It is sufficient to discuss the differences that it introduced.

(aa)

Philosophy of Second Sugar Decree

276.

The Second Sugar Decree again allocated quota on the historical basis of the previous five years, now 1995 to 2000.

277.

The Second Sugar Decree corrected the previous mistake (see above, point 270) and was now based on a proper legislative basis, the SZIF Statute.

(bb)

Further Political Flexibilization

278.

The Second Sugar Decree provided for a reduction of quota if a historical quota went unused. This was a new feature contrary to the policy of furthering rationalization.

279.

The reserve was now increased and made expressly available to new entrants only, again against rationalization.

(cc)

Continued Ineffective Implementation

280.

It is undisputed that the new local entrants continued to produce in excess of their quotas, and oversold into the domestic market (see above, point 267 et seq.). The SZIF planned to fine them for this.

(dd)

Cancellation by the Czech Constitutional Court

281.

The Second Sugar Decree was struck down by the Czech Constitutional Court because it allocated quota on the basis of a historical period that had been affected by the First Sugar Decree since it included the year 2000 (see above, point 278).

282.

The effect of the cancellation was that no fines were imposed on the new local entrants for having produced in excess of their quota and oversold on the domestic market (see above, point 280).

283.

The cancellation also had another effect (see above, point 278). As the Czech Republic puts it:

Eastern Sugar, the Czech Republic claims due to insufficient production capacity and poor commercial strategy, failed to produce sugar up to the production quota that it had been allocated by the Czech Republic in 2001/2002. Eastern Sugar thus risked the sanctions enshrined in the Second Sugar Decree then applicable, namely a reduction of its sugar quota by an amount exceeding its insufficient production. Only the cancellation of the Second Sugar Decree by the Constitutional Court permitted, the Czech Republic argues, Eastern Sugar to evade a substantive reduction of its quota, which finally occurred under the Third Sugar Decree.

(ee)

Overall Assessment

284.

Overall, the Second Sugar Decree had flaws similar to those of the First Sugar Decree (see above, point 271 et seq.).

285.

The disturbing feature of a reserve was now increased, and, moreover, made available to newcomers (see above, point 279).

286.

That Eastern Sugar produced less sugar than permitted by its quota (this was due, as Eastern Sugar claimed, to excessive production and imports by others) would have under the Second Sugar Decree led to a reduction of Eastern Sugar's quota by the SZIF which was administering the Second Sugar Decree (but had not administered the First Sugar Decree). This might have led the Arbitral Tribunal to a discussion that would have been similar to what will follow in connection with the Third Sugar Decree. However, the Second Sugar Decree did not last enough for this to happen.

287.

The Arbitral Tribunal, with more hesitation than for the First Sugar Decree (see above, point 274), still does not find the Second Sugar Decree to have been in violation of the BIT.

O.

Third Sugar Decree of March 19, 2003

(aa)

Philosophy of Third Sugar Decree

288.

In July 2002, thus during the time of the Second Sugar Decree, the Government changed. This is of course legally irrelevant, but it explains what then happened.

289.

The new Government made no statements about a change in policy.

290.

But as one will see, the policy changed from encouraging rationalization (as generally in the First and Second Sugar Decree) to protecting and appeasing beet growers at the expense of foreign-owned producers and to leaving things as much as possible as they were (the code word for this was "stabilization of the market") or even increase sugar production in the interest of beet growers and to improve the Czech Republic's bargaining position towards the EU.

291.

By 2003, the European Union reduced the country quota allocated to the Czech Republic. One could have imagined that the quotas of the individual manufacturers might have been reduced *pari passu*, but this is not what happened. Earlier Sugar was made to bear the biggest reduction by itself since its quota was reduced by more than the entire country quota reduction.

292.

This was achieved by abandoning the historical quota basis altogether.

293.

Now the quota was set on the basis of the production achieved on two particular days in factories still operating.

294.

The effect of this was that a producer which had closed a factory and shifted production to other factories in the meantime was penalized by a reduction of its quota.

295.

Similarly, a producer which had used modern technology to spread sugar production over the year and use less beet was also penalized by a reduction of its quota.

296.

Now newcomers were encouraged even more than before. The reserve was again increased.

(bb)

Eastern Sugar targeted?

297.

Eastern Sugar claims that it was now being targeted by the Czech Republic as a revenge for the closure of the Modrany factory which had occurred in January 2002, thus under the Second Sugar Decree. The Czech Republic denies this.

298.

The Arbitral Tribunal *did* receive testimony from the Czech Republic's witnesses, Mr. Palas, Mr. Höck and Mr. Fronek, about the reasons that led to the enactment of the Third Sugar Decree, and in particular, to the adoption of the internationally unusual one-day production basis to allocate quota.

299.

The only document that the Arbitral Tribunal received was a report by Mr. Fronek to the Minister of Agriculture. It read as follows:

Annex No. r-77

Reference No. 1105/03-8001

Date: 14 January 2003

Memorandum for the Minister of Agriculture

<i>Assigned by: Deputy Minister of Agriculture Ing. Rudolf Jánský</i>	<i>Department 8001</i>	<i>Prepared by: Ing. Daniel Fronek</i>
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<i>Task: to develop production quota allocation alternatives - pros and cons, opinions</i>		<i>Head of the Sugar Dept. Ing. Eva Divišová</i>
<i>Deadline: immediate</i>		<i>Deputy Minister: Ing. Rudolf Jánský</i>
<i>Re: Sugar production quota allocation system</i>		
<i>Negotiated with the trade unions:</i>		
<i>Related reference numbers:</i>		

Dear Sir,

Below find a draft of the sugar production quota allocation system to be included in the planned amendment of Government Decree No. 114/2001 Coll.

Three alternatives of the sugar production quota allocation system have been drafted after extensive negotiations. These alternatives have been discussed and reviewed mainly in terms of system functionality, legal viability and the level of consent of system participants. Based on the assessment of the risks and pros and cons of the three alternatives we have set up a ranking reflecting their overall acceptance, i.e. from the most acceptable to the least acceptable one. All the three alternatives are based on the negotiated national production quota of 454 862 tonnes of sugar (i.e. on the reduced level from the original amount of 505,000 tonnes) and apply to the quota year of 2003/2004. The results for each alternative are as follows:

1) "Production quantities with the choice of a reference period"

Basic principle: A sugar production quota allocation system which is based on production quantities expressed as an average quantity of sugar produced in 24 hours; the applicant will be able to choose a reference period (either November 2001 or October 2002), depending on whichever is more favorable to him.

Pros: a) Relative transparency and fairness of quota allocation; the system reflects the current levels of domestic sugar producers.

b) Sugar production figures for each producer are available as sugar movements are being monitored pursuant to Government Decree No. 114/2001 Coll. (hereinafter "NV 114"). These figures are not influenced by the sugar producers knowing in advance that the figures will be used as a basis for quota allocation.

c) Only limited changes in the current NV 114 required - a minor amendment from a legal point of view - this would be in compliance with the requirements of the Government Legislative Council.

d) All sugar producers will be allocated the quota at a time; sugar beet growers will know the quota levels before they start seeding.

e) This alternative provides for a timely application of the NV 114 requirement to prove that sugar beet supplies covering at least 90% of the allocated quota have been contracted.

Cons: The system does not impose the obligation to export sugar produced in 2002/2003.

Opinions: a) Sugar producers from the Eastern Sugar and Agrana groups (51% of the sugar market) are against this alternative; the position of the Moravian Sugar Beet Growers Union is reserved; other sugar producers support this alternative.

The draft amendment of NV 114 for this alternative has been prepared in cooperation with the legal department and may be submitted to the Minister's Council after certain formal adjustments are made.

2) "Combination of production quantities and exports"

Basic principle: A portion of the national production quota (approximately 320,000–360,000 tonnes) would be allocated based on production quantities, the rest of the national quota would be allocated according to each producer's exports during the 2002/2003 campaign.

[...]

3) "1995–1999 reference period"

Basic principle: The whole national production quota would be allocated at a time, based on production quantities of applicants and their average daily production during the 1995–1999 reference period.

*Pros: a) A "clean" reference period free of any regulation interventions.
b) The period not challenged by any decision of the Constitutional Court of the Czech Republic.
c) Sugar producers will be allocated the whole quota at a time; sugar beet growers will know the quota levels before they start seeding.*

Cons: a) The system does not reflect the current status of the sugar sector—the capital structure of sugar producers went through significant changes in those eight years, the sector was restructured and production equipment upgraded.

Opinions: a) Supported by the Eastern Sugar and Agrana groups; Cukrovary TTD disagrees.

300.

Mr. Fronek stated in his memorandum that based on an assessment of system functionality, legal viability, and the level of consent of system participants and of risks and pros and cons, the system later used in the Third Sugar Decree (alternative 1) ranked first. He did not explain why this was his opinion, nor could he explain this at the hearing.

301.

Mr. Fronek's immediate superior and other higher officials in the ministry of agriculture did not testify, but the minister of agriculture at the time and recipient of the memorandum, Mr. Palas, did.

302.

Mr. Palas was unable to explain why he had preferred the method used in the Third Sugar Decree.

303.

His testimony was that the decision had been taken on the basis of Mr. Fronek's memorandum (which had simply stated that using daily production as a basis ranked first), and on "other information" as well. What that "other information" was and what it said, Mr. Palas was unable to say.

304.

If the decision was not taken by preferring the first alternative as the best but rather *per exclusionem* of the others as worse, it is still unclear why the third alternative was ranked only third.

305.

Mr. Fronek in his memorandum wrote that the 1995 to 1999 historical basis (alternative 3) was clean of any regulation interventions. Nevertheless the Czech Republic witnesses loosely doubted the constitutionality of using the 1995 to 1999 historical basis.

306.

In his testimony Mr. Fronek claimed that to exclude the new sugar market players would have been in violation of the constitution. He did not explain why.

307.

He also testified as follows:

A. As far as I remember, this was the result of meetings of public administration bodies, meaning the ministries, and the result of these meetings was that, based on the decision of the Constitutional Court, the quota allocation system was found in preparing -- also the period prior to this decision was influenced by this unconstitutional decision, meaning that if we continued with the same method for quota allocation, it could lead to further constitutional complaints and the quota allocation system would be abolished again.

THE CHAIRMAN: This is advice that you received in the Ministry; correct?

A. This was the opinion of legal authorities of the Ministry, and the opinion was that continuing the old quota allocation system would lead to additional constitutional complaints.

308.

The then Minister of Agriculture, Mr. Palas, testified as follows:

Well, the situation was that, if we used this period, there was the possibility that the Constitutional Court could strike out the decree because it was the case relating the previous two decrees. So this is why we chose a different principle.

[...]

A. As I have already stated -- well, this principle was struck out by the Constitutional Court twice and there was a danger that it would happen in the future, that this method would be struck out again by the Constitutional Court.

309.

The Arbitral Tribunal does not find the decisions by the Constitutional Court difficult to understand. It is clear that the only reason why the Second Sugar Decree was struck down was that it included in the historical basis that it used a period that had been affected by the struck-down First Sugar Decree. Beyond this aspect, the Constitutional Court said nothing about the basis that should be used to set the quota. It did not criticize using a historical basis as such.

310.

In any event, the Arbitral Tribunal has the Czech Republic in front of it, not its government nor its constitutional court. As far as the Arbitral Tribunal is concerned, these are both state organs which determine the Czech Republic's actions.

311.

What, then, had been Mr. Fronek's task? Mr. Palas testified as follows:

A. I gave the instruction to the employees to prepare a draft of a new regulation that could not be challenged by the Constitutional Court.

312.

Mr. Fronek testified as follows:

A. It was my task to find verifiable, measurable, relevant new method for quota allocation.

THE CHAIRMAN: Did he say "new"?

THE INTERPRETER: Yes.

A. It was my task to find verifiable, measurable, relevant, new quota allocation key, other than this reference production period, and we were talking about sugar production, sugar marketing. Everything was about sugar. So we were trying to find a method that would take this fact into account.

[...]

A. Well, this was an assignment given by my managers, my bosses.

313.

The explanations given by the Czech Republic's witnesses for giving up setting quota on a historical reference basis are not persuasive. Moving to an entirely new basis just for the sake of doing something different simply makes no sense to the Arbitral Tribunal.

314.

The only rational explanation is that the Government wished to appease the beet growers in connection with the Modrany closure and the use of SSMB.

315.

It is striking that in the Arbitration, the Czech Republic raised the subject of Modrany time and again and reverted to it again and again. For example, its first line of questioning in Mr. Evan's cross-examination concerned the closure of Modrany. See Transcript of July 17, 2006, page 40, line 3.

316.

Mr. Fronek testified that following the closure of Modrany the Czech Republic was under enormous pressure from the beet growers. He testified as follows:

From the point of view of the Ministry of Agriculture, the reactions to the first closure of the factory of Eastern Sugar was unprecedented. There was a very strong opposition from beet growers, not just in the Modrany region but also from the representatives nationwide. The disapproval and the opposition was very strong and the sugar-beet growers started pressing, started pushing, on the Ministry of Agriculture to make sure that something similar would not be possible in the future. As a result, there was an agreement between Eastern Sugar and TTD about the transfer of the quota.

I can tell you that there were numerous calls received from beet growers, also from civil servants, members of the Parliament, so this is the reality that I experienced, and I can also confirm that, all of this was happening.

317.

Mr. Höck confirmed this.

318.

Mr. Palas' contrary testimony that there was no strong pressure on the ministry of agriculture is surprising.

319.

Mr. Fronek in a memorandum that he compiled on January 9, 2002, was concerned that the closure of Modrany would shift the balance of beet cultivation from Bohemia to Moravia.

320.

Beet growers wrote Mr. Palas in September 2002 to ask him to retaliate against Eastern Sugar for its closure of Modrany.

321.

The Czech Republic wrote the following in its submission of December 31, 2005:

The closure of Modrany was never used as an argument for introducing the daily production formula, neither was the idea behind to punish Eastern Sugar. The only concern of the Czech Republic at this time was to settle the upheaval

among the growers.

322.

The three witnesses of the Czech Republic, Mr. Palas, Mr. Höck and Mr. Fronek, emphatically denied that the Third Sugar Decree had anything to do with the *Modrany* closure which they all agreed had been perfectly legitimate, but they still appeared upset about the closure.

323.

Mr. Fronek testified as follows (Transcript of July 18, 2006, page 52, line 19 et seq.):

I absolutely disagree with this statement. I believe that the primary cause, the primary source of difficulties, as I see it, was the fact that foreign investors make certain unusual extraordinary decisions. They let certain sugar factories go bankrupt, even though these sugar factories were operational, they were able to function. As a result, there were bankruptcy proceedings in the 1990s. So it was in the 1990s. These sugar factories were later on purchased by other entities, as was allowed by our legal system.

As far as I am aware, this development was very specific to the Czech Republic. It did not happen anywhere else outside of the Czech Republic. Our sugar factories that were controlled by foreign investors, it was actually 100 per cent of the production quota, made this decision.

I must emphasise that the Czech Republic, in the scope of its loss, did not have any opportunity to prevent any new entrants to come to the Czech market and to start operating these sugar factories. In the year 2000 it was new entrants in the Czech Republic's sugar market, two new players, the sugar factory in Prosenice and the sugar factory in Vrdy. At Prosenice there was a former sugar factory controlled by Eastern Sugar.

So previously the total national quota was occupied by foreign investors, 95 to 100 per cent, but as of January 1st 2000, there were new players on the market and the Czech Republic could not exclude them from the sugar market. It had to take the situation into account.

324.

See also the witness statement of Mr. Palas of 15 December 2005:

In his witness statement quoted in paragraph 280 of the Claimant's Memorial, Mr. Evans directly claims that by setting up a method based on daily production I "sought retribution for the damages EAS caused by closing the refinery in Modrany." I absolutely deny this. The ministry could have reacted to the closing of Modrany sooner by amendment to the existing decree, but no steps were taken in this direction, the ministry only (still in the time of my predecessor Mr. Fencl) assisted in drafting a contract between TTD and EAS transferring part of the quota, which supports my claim that EAS was aware of the unfairness of its closure of the refinery in Modrany as well as the fact that by this act they would markedly reduce their production capacity.

The reduction in the quota by the new [3rd] decree was therefore connected

with the closing of the Modrany refinery, but for purely technical reasons, as the quota was derived from the amount of sugar produced for a certain period of time, and the closure of the refinery is logically reflected in this amount without respect to what reference period was chosen for the quota. That it was not the intention of the Czech government is supported by what really happened, that the new decree was in reaction to the preceding [2nd] decree being repealed [on October 3, 2002] by the Constitutional court, which if it hadn't been repealed, the previous decree would have remained valid and the ministry would not have planned any interference into the sugar industry motivated by the unplanned closure of the Modrany refinery and the production quota allocated to EAS would have remained unchanged.

325.

Mr. Höck testified as follows:

A. I do not think that there is a connection between the allocation of the reserve and the closure of the Modrany sugar factory, but what was important was the assessment of one of the conditions that were stipulated in the decree and the definition or the formulation was very precise. This condition was that it is necessary to assess to what extent the sugar factories accepted obligations towards sugar-beet growers in areas where sugar factories were closed.

Q. And that would not, in your view, be an indirect reference to Modrany?

A. No.

326.

Reserve distribution was made in application of the Third Sugar Decree to benefit producers which contributed to the "stabilization of the sugar sector". "Stabilization of the sugar market" is of course a code word for keeping things as they are, and the connection with the Modrany closure is once again obvious.

327.

The Czech Republic asserts the following:

It is a fact, that the two successive closures of Zvoleněves and Modřany, performed by Eastern Sugar in 2001 and 2002, caused a brutal and sudden destabilization of the Czech market, in particular in the sugar beet production sector. The subsidiary of French – not Czech – sugar producer, TTD, which took over the beets formerly supplied to these two closed factories, was the company that most contributed to the stabilization of the sugar market.

328.

On May 31, 2006, the Czech Republic wrote the following:

Effectively, the sudden and brutal closure of the Modrany plant in January 2002 led the Czech authorities to allocate TTD with a substantial part of the reserve in order to maintain the growers' activities in the area of the Modrany factory.

329.

Eastern Sugar's use of the SSMB beet-saving technique also obviously displeased the Czech Republic under its new government.

330.

Mr. Fronek's argued that if SSMB had been taken into account in setting Eastern Sugar's quota, this would have been in favour of one sugar producer - Eastern Sugar - to the detriment of other sugar producers in the Czech Republic. This is disingenuous. It is obvious that favoring one producer over the others disadvantages the others. The question simply is whether there is good reason to favour the one producer using SSMB, and whether it is discrimination if such a producer is not favored, or whether the use of SSMB is irrelevant, in which case the producer using that technology should not be put in a more advantageous position than others.

331.

Mr. Fronek added the following remark:

Also, I must say that as far as I am aware this sugar production method is not common in Europe. I just know there is one plant, I believe in Austria, that uses this method, but it is not just for sugar production; they produce other partial products. I am not aware of any other countries where this method would be used, apart from some laboratory experiments or laboratory production.

332.

It is obvious to the Arbitral Tribunal that Eastern Sugar's earlier investment into the SSMB technique was an investment into rationalization, which had heretofore been encouraged by the then Government but now displeased the present Government.

(cc)

Overall Assessment

333.

From an objective point of view, the Arbitral Tribunal agrees with Eastern Sugar that the Third Sugar Decree had as its effect that Eastern Sugar lost out at every corner.

334.

Eastern Sugar also complains that the quota that it received under the Third Sugar Decree on the basis of daily production was on top of everything wrongly calculated. The Arbitral Tribunal needs not go into this since it considers that the switch to the daily production basis was as such in violation of Art. 3 (1) of the BIT.

335.

The Arbitral Tribunal agrees that Eastern Sugar was unfairly and inequitably *targeted* by the Third Sugar Decree in violation of Art. 3 (1) of the BIT.

336.

This is the sole rational explanation offered to the Arbitral Tribunal.

337.

In sum, with the Third Sugar Decree the Czech Republic penalized a foreign company that had done nothing illegal in the previous years, while Czech newcomers who had exceeded their quota within the previous years were now rewarded for having done so.

338.

Even if the intent was not to punish Eastern Sugar specifically but more generally to favor newcomers and to preserve the jobs of sugar beet growers, the result is still that a violation of the BIT occurred. Accordingly, the Arbitral Tribunal is of the view that the effect of the Third Sugar Decree was a discriminatory and unreasonable measure in the sense of Art. 3 (1) of the BIT.

P.

From May 2004 to date

339.

The Fourth Sugar Decree dated May 26, 2004, replaced the Third Sugar Decree. It essentially continued the Third Sugar Decree.

340.

It was upheld by Constitutional Court on March 8, 2006.

341.

From March 2003, onwards, Eastern Sugar did not fill the reduced quota allocated to it.

342.

In 2006, the European Union was forced by the WTO to liberalize its protectionist sugar regime.

343.

Briefly after the pleading session of September 27, 2006, Eastern Sugar announced its intention to abandon sugar production in the Czech Republic and two other new EU countries, and to relinquish its Czech quota.

Q.**Conclusion on principle**

344.

With the introduction of the First Sugar Decree, the Czech Republic did *not* violate the BIT.

345.

With the introduction of the Second Sugar Decree, the Czech Republic did *not* violate the BIT.

346.

With the introduction of the Third Sugar Decree, the Czech Republic *did* violate the BIT.

347.

It follows that Eastern Sugar must now be put in the condition in which it would have been today had the Czech Republic not committed the above violation by issuing the Third Sugar Decree on March 19, 2003.

R.**Quantum: Claim A**

348.

In its post-hearing brief, Eastern Sugar claimed *Damages* of EUR 40,806,000 for failure to enact and enforce a workable sugar regime.

349.

This concerns the period from the First Sugar Decree to the accession to the EU on May 1, 2004.

350.

The Arbitral Tribunal cannot award any damages accrued before the Third Sugar Decree of March 19, 2003, which is the one sugar decree that it finds to have violated the BIT.

351.

For the period after that, the complaint is not justified. What the Czech Republic enacted in the Third Sugar Decree and enforced was workable – it was just unfair and unequitable.

352.

This claim is *rejected*.

S.**Quantum: Claim B – 1**

353.

On March 15, 2006 (see above, point 21), Eastern Sugar claimed as per the Second Ellison Report, lost profits from March 19, 2003, (the Third Sugar Decree) to July 31, 2006, of EUR 19,501,000.

354.

The Czech Republic claims that from its EU accession on May 1, 2004, onwards, this claim is not arbitrable. This aspect was discussed in above, point 182 et seq.

355.

It is always difficult to assess lost profits. One cannot simply rely on a business plan.

356.

The lost profits claim under the Third Sugar Decree presupposes that profits would have been made from March 19, 2003, onwards. The Arbitral Tribunal is not persuaded that this is so. Had sugar production been sufficiently profitable, Eastern Sugar would have filled the reduced quota available to it. It produced even less sugar. It is difficult to believe that it would have produced more sugar, and then made substantial profits, if only it had had a larger quota. That it now is seeking to abandon production in the Czech Republic altogether (see above, point 343) confirms that the lost profits claimed are overly speculative.

357.

This claim is *rejected*.

T.**Quantum: Claim B – 2**

358.

On March 15, 2006 (see above, point 21) as per the Second Ellison Report, Eastern Sugar claimed unfair and inequitable allocation of quota - *Loss of share value* from July 31, 2006, onwards, of EUR 28,230,000.

359.

This is based on an average market value of a quota of EUR 730 per ton and the assumption that Eastern Sugar's quota would have remained as in the Second Sugar Decree rather than reduced by 38,671 tonnes, as it was by the Third Sugar Decree.

360.

The Czech Republic claims that from its EU accession on May 1, 2004, this claim is not arbitrable. This aspect was discussed in above, point 182 et seq.

361.

The Arbitral Tribunal agrees that by being denied a higher quota, Eastern Sugar was denied the value associated with it, a value that it had acquired in earlier years by investing into the Czech sugar market under the encouragement of the Czech Republic.

362.

The Arbitral Tribunal has some doubts about the ability of Eastern Sugar to sell quota for EUR 730 per ton to other sugar manufacturers since no such sale occurred.

363.

For the Arbitral Tribunal the no doubt complex negotiations now underway between the Parties on Eastern Sugar's possible exit from the Czech Republic sugar market in 2007 are not relevant to determine the value of the quota that was denied to Eastern Sugar by the Third Sugar Decree in 2003. The information about the possible exit that was provided to the Arbitral Tribunal in January 2007 is sufficient (and no further information is required, see above, point 87) for the Arbitral Tribunal to conclude that in 2003 the quota had a value equivalent to its potential of being bought back.

364.

It accepts as its yardstick the EUR 730 per ton figure which is the amount for which quota may be purchased from the European Union from July 1, 2006, onwards under the EU Council Regulation in force.

365.

If however a manufacturer is compensated for quota that it no longer uses, it is required to pass on 10% at least of the price, thus EUR 73 per ton, to beet growers and machinery manufacturers adversely affected by the reduction of the sugar production, see Art. 3(6) of EU Regulation 320/2006. This 10% must accordingly be deducted from the damages claimed under this heading.

366.

This leads the Arbitral Tribunal to assess the damages at *EUR 25,400,000*. In this amount, the claim is *granted*.

U.**Parent Company Claim for Loss by Subsidiary?**

367.

The Arbitral Tribunal is aware that the loss of quota was suffered primarily by Eastern Sugar Ceska Republika a.s. However, this is a practically wholly-owned subsidiary of the Claimant Eastern Sugar B.V, and the value of the subsidiary is in the present circumstances in practical terms determined by the value of the quota allocated to it. The Arbitral Tribunal deems it correct to award to the Claimant full damages for Eastern Sugar Ceska Republika a.s.' loss of quota attributable to the Third Sugar Decree.

V.**Summary**

368.

The Claimant Eastern Sugar is awarded *EUR 25,400,000* in principal.

W.**Interest**

369.

Interest is claimed by Eastern Sugar at the rate of 12% per annum compounded annually, subsidiarily at EURIBOR plus 1% compounded by-annually (see above, point 23).

370.

There was little discussion between the Parties on the interest question.

371.

Eastern Sugar did not discuss the applied rates nor did it discuss why interest should be compounded yearly or half-yearly.

372.

On September 8, 2006, the Czech Republic wrote the following:

The Czech Republic contends that the 12% WACC applied for by Eastern sugar is not an interest rate.

In the absence of Eastern Sugar's demonstrating how a bi-annual compound of interests may "adequately compensate" it for the damage it adequately suf-

ferred, there is no room for interest being compounded bi-annually.

373.

The Arbitral Tribunal believes that it should apply the statutory interest provided by the applicable law, which is Czech law, which on this point does not conflict with International Law (see above, point 197).

374.

This is simple annual interest at 7 percentage points above the repo rate as published from time to time by the Czech National Bank.

375.

The Arbitral Tribunal is aware that this is statutory interest on the Czech Crown, not on the Euro, but the difference is not spectacular as the Czech Republic is striving to adopt the Euro.

376.

Interest runs from July 31, 2006, the reference date under Claim B – 2 granted by the Arbitral Tribunal as described above (see point 359).

*

377.

Now that the Arbitral Tribunal has decided Eastern Sugar's claims (d) to (f) for monetary relief, Eastern Sugar has no interest worthy of protection that the Arbitral Tribunal decide its claims (a) to (c) for various declarations. These are *rejected*.

378.

The only matter that remains to be decided is costs.

*

X.

Costs

(a)

Costs Follow the Outcome

379.

The Arbitral Tribunal adopts a "broad brush" costs-follow-the-outcome approach, which is what many arbitral tribunals do, no matter where they sit. This does not mean that the winner on balance takes all. On the contrary, it means that the costs must be borne in proportion to the outcome.

380.

The Arbitral Tribunal using a broad brush and taking into account that the "high mark" of Eastern Sugar's claims, principal only, was EUR 109,078,000 (see above, point 21), and that the Czech Republic fails with its plea of lack of jurisdiction and its lack of its arbitral defence allocates 30% of the costs to the Czech Republic and 70% to Eastern Sugar.

(b)

Party Representation Costs

381.

The Arbitral Tribunal finds that the party representations costs claimed by the Parties (Eastern Sugar: EUR 3,366,120.35, plus EUR 1,500 for the Stockholm Institute. The Czech Republic: EUR 1,242,486.90 plus EUR 1,500 for the Stockholm Institute) to be generally reasonable.

382.

The Arbitral Tribunal is comforted by the fact that neither Party objected to the Party Representation costs claimed by the other.

383.

Accordingly, the Czech Republic shall pay Eastern Sugar 30% of Eastern Sugar's party representation costs, that is EUR 1,010,786, and shall receive reimbursement of 70% of its own, that is EUR 870,791. On balance, the Czech Republic shall pay Eastern Sugar EUR 139,995 towards its party representation costs.

(c)

Arbitration Costs

384.

The arbitration costs will be fixed and allocated at a later date.

Based on the foregoing, the Arbitral Tribunal issues the following

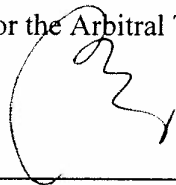
Partial Award

1. The Arbitral Tribunal accepts jurisdiction.
2. All claims are arbitrable.
3. The Czech Republic shall pay Eastern Sugar BV EUR 25,400,000, plus, from July 31, 2006, to the date of payment, simple annual interest thereon at 7 percentage points above the repo rate as published from time to time by the Czech National Bank.
4. The Czech Republic shall pay Eastern Sugar EUR 139,995 towards its party representation costs.
5. The arbitration costs will be fixed and allocated at a later date.
6. All other and furthergoing claims are rejected.

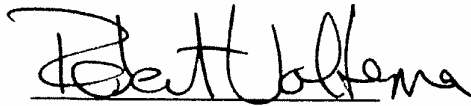
Seat of arbitration: Paris

Dated, 27. MRZ. 2007

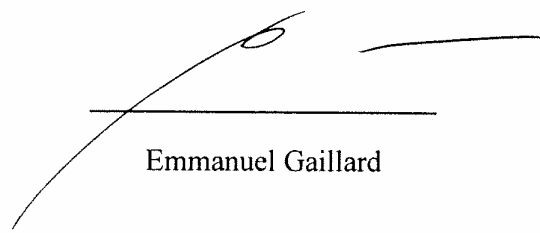
For the Arbitral Tribunal:



Pierre A. Karrer



Robert Volterra



Emmanuel Gaillard