

**SEPARATE OPINION ON THE ISSUES AT THE QUANTUM**

**PHASE OF:**

**CME v CZECH REPUBLIC**

**BY**

**IAN BROWNLIE, C.B.E, Q.C.**

## **I. The Applicable Law**

1. The Agreement governing this arbitration defines the applicable law as follows in Article 8(6):

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

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

2. This instrument has been incorporated in Czech law: see the Partial Award, para. 419.

3. The ‘Common Position’ on the Dutch Treaty agreed by the delegations of the Czech and Netherlands Governments, in accordance with Article 9 of the Treaty, included the following on the interpretation of Article 8(6) of the Agreement:

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

## **II. The findings on Liability**

4. The claimant requested an award, in the first place:

1. Deciding Respondent has violated the following provisions of the Treaty:
  - a) The obligation of fair and equitable treatment (Art. 3(1));
  - b) The obligation not to impair the operation, management, maintenance, use, enjoyment or disposal of investments by unreasonable or discriminatory measures (Article 3(1));
  - c) The obligation of full security and protection (Art. 3(2)); and
  - d) The obligation to treat investments at least in conformity with the rules of international law (Art. 3(5)); and
  - e) The obligation not to deprive Claimant of its investment by direct or indirect measures (Art. 5); and ...'

5. The Decision of the Tribunal was as follows:

- '1. The Respondent has violated the following provisions of the Treaty:
  - a. The obligation of fair and equitable treatment (Article 3(1));
  - b. The obligation not to impair investments by unreasonable or discriminatory measures (Article 3 (1));
  - c. The obligation of full security and protection (Article 3 (2));
  - d. The obligation to treat foreign investments in conformity with principles of international law (Article 3 (5) and Article 8 (6), and
  - e. The obligation not to deprive Claimant of its investment (Article 5); and ...'

6. In addition the claimant asked for an award:

- '2. Declaring that Respondent is obliged to remedy the injury that Claimant suffered as a result of Respondent's violations of the

Treaty by payment of the fair market value of Claimant's investment in an amount to be determined at a second phase of this arbitration ...'

7. In response the Tribunal decided as follows:
  - '2. The Respondent is obligated to remedy the injury the Claimant suffered as a result of Respondent's violations of the Treaty by payment of the fair market value of Claimant's investment as it was before consummation of the Respondent's breach of Treaty in 1999 in an amount to be determined at a second phase of this arbitration; ...' (emphasis added)
8. This member of the Tribunal does not consider that this finding can prejudice the issues of treaty interpretation which are necessary and appropriate for resolution at the quantum phase.
9. There are several considerations justifying this position. In the first place, the relevant treaty language does not refer to the fair market value but to the payment of just compensation: see Article 5(c). Secondly, the context is that of the particular treaty and not of the principles of general international law, applicable in expropriation cases.
10. It is to be presumed that the Tribunal, in formulating the Partial Award, did not intend to pre-empt issues of quantum when referring to the payment of fair market value.
11. The application of the most-favoured nation clause (see Article 3(5) of the Dutch Treaty) to the compensation provisions of the Dutch Treaty in order to incorporate the substantially different formulation in the U.S. Treaty is an unattractive hypothesis. In the first place, it involves a strange view of the intention of the parties. The express choice of a compensation clause becomes nugatory if the mfn clause applies in this form. The presumption

must be that the clause promises mfn treatment only in matters of treatment of an investment, and not to the process of dispute settlement.

12. In addition, the wording of Article 3(5) clearly indicates that the standards of treatment to which the mfn provision applies are those set forth in Article 2, and the antecedent provisions of Article 3.

### **III. The Issue of Res Judicata**

13. In the Statement of Defence on Quantum the Czech Republic invokes the principle of res judicata : see pages 5-17. In response CME rejects the application of the principle : see the Reply Respecting Quantum, pp.162-77. For a number of reasons this issue must be set aside. In the first place, the Respondent refused to consolidate the two arbitrations, and, secondly, the Respondent refused to adjourn the Stockholm proceedings in order to await the outcome of the London proceedings: see the Majority Opinion, paras [ ].

### **IV. The Locus Standi of the Claimant by Virtue of the Treaty**

14. The pertinent Treaty provides for settlement of disputes on the basis that ‘an investor’ of a Contracting Party has locus standi to submit a dispute between the investor and the other Contracting Party to arbitration: see Article 8 of the Treaty. This locus standi is conferred by the express treaty provisions and does not affect the basis of the obligations being enforced, which depend upon the treaty provisions exclusively.

### **V. The Treaty Criteria: the Principles of Interpretation**

15. The pertinent principles of treaty interpretation are those set forth in the Vienna Convention on the Law of Treaties, Articles 31 and 32:

*'Article 31*

*General rule of interpretation*

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
  - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.'

*'Article 32*

*Supplementary means of interpretation*

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

16. It will be recalled that Article 8 of the pertinent bilateral treaty defines the applicable law to include ‘the general principles of international law’, and the rules of treaty interpretation are generally accepted as forming a part of general international law: see the American Law Institute, Restatement of the Law Third: The Foreign Relations Law of the United States, St. Paul, Minn, 1987, p.196, para. 325 (Comment (a)).

**VI. The Treaty Criteria: the Context and the Object and Purpose of the Treaty : the Encouragement and Protection of Investments**

17. The title of the treaty is an ‘Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic’. The object and purpose is not the protection of foreign property as such but the encouragement and protection of ‘investments’. However, there is more to the terms of the treaty than this. One of the objects is the stimulation of the economic development of the parties, as indicated in the preamble. In this connection, the context includes the end of the Cold War (the treaty was concluded in 1991) and the promotion of a market economy in the region.
18. In the preamble the Contracting Parties take note of the Final Act of the Conference on Security and Co-operation in Europe, adopted on 1 August 1975 in Helsinki. The parties to the Final Act declared:

“... their determination to respect and put into practice, each of them in its relations with all other participating states, irrespective of their political economic or social systems, the principles laid out in the Final Act.”

And the parties undertook that they:

“will respect each other’s sovereign equality and individuality...They will also respect each other’s right freely to choose and develop its political, social, economic and cultural systems...’

Thus the Helsinki Final Act context is not confined to that of investment protection; it had a wider purpose, which was the extension and intensification of economic relations between states parties particularly with respect to investments, and that process of extension is based on the mutual respect of states.

19. The term ‘investment’ has several connotations for present purposes. In the first place the term may apply to the assets owned by the claimant at the material time: see the Partial Award, paras. 428-59. The treaty carries a detailed definition in Article 1, which provides in material part:

‘For the purposes of the present Agreement:

- a) the term “investments” shall comprise every kind of asset invested either directly or through an investor of a third State and more particularly, though not exclusively:
  - (i) movable and immovable property and all related property rights;
  - (ii) shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom;
  - (iii) title to money and other assets and to any performance having an economic value;
  - (iv) rights in the field of intellectual property, also including technical processes, goodwill and know-how;
  - (v) concessions conferred by law or under contract, including concessions to prospect, explore, extract and win natural resources.’



20. These provisions relate exclusively to assets 'invested' and, whilst the list of types of asset is extensive, the concept has certain limitations. In the first place, the genus consists of legal entitlements and does not extend to mere expectations: see Metalclad Corp. v. United Mexican States, 119 ILR 616 (2000), p.642, para.122.
21. In this context it comes as no surprise that a criterion of value is the actual investment made by the claimant (but the criterion is not necessarily exclusive). This view was adopted in the following recent awards of courts of arbitration:
- (a) Phelps Dodge Corp. v. Iran, 10 Iran – US CTR. 121 (1986), at paras. 24-31.
  - (b) Biloune v Ghana Investments Centre, 95 I.L.R. 184 (1990) at pp.228-9.
  - (c) Metalclad Corp v. United Mexican States, 119 I.L.R. 615 (2000), at pp.642-3, paras, 121-25'
22. In these cases for various reasons other methods of valuation were not appropriate. However, the key point is that these tribunals regarded the value of the claimant's investment as appropriate and reliable. The decisions also show that there is no inevitable difficulty in isolating the elements of investment from the other economic elements in the history of a business project.

## **VII. The Treaty Criteria: Just Compensation**

23. There can be no reasonable doubt that the standards of compensation in this case are set forth in Article 5 of the Czech-Netherlands Treaty 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.’

24. The formula ‘just compensation’ is significant. Other formulae in use were set aside. Thus the Netherlands Treaty stands in contrast to the U.S.-Czech Treaty which provides as follows:

‘1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (“expropriation”) except for a public purpose; in accordance with due process of law; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with the general principles of treatment provided for in Article II (2).

Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known; be paid without delay; include interest at a reasonable market rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.’

(Article III (1))

25. The criterion of ‘just compensation’ was familiar by 1991 and was the formula adopted in paragraph 712 of the Restatement : The Foreign Relations Law of the United States, Vol. 2, published in 1987.

26. In any event, the contemporary international standard was that of ‘appropriate compensation’. Thus the key provision in Resolution 1803 (XVII), adopted by the General Assembly on 14 December 1962, reads as follows:

‘4. Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognised as overriding purely individual or private interests, both domestic and foreign. In such case the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication...’

27. The resolution was adopted by 87 votes to 2, with 12 abstentions. The Netherlands voted in favour and Czechoslovakia abstained.

28. In the debate in the Second Committee of the General Assembly, Mr. Albeda, the Netherlands representative, made the following observations:

‘34. Mr. ALBEDA (Netherlands), whose country was a member of the Commission on Permanent Sovereignty over Natural Resources, said that it was evident, from the terms of the draft resolution, that its text constituted a balanced compromise between affirmation of the sovereign rights of national Governments over their natural resources and that of the desire to protect foreign interests according to the rules of international law. The draft, therefore, should be appreciated and welcomed by all the members of the Committee.

‘35. Three main elements deserved equal attention. The first was the sovereign rights of States over the natural resources within their

territories; it was the economic expression of the general principle of self-determination. That principle should be accepted by every State and by its nationals who invested their capital in another country. The time when foreign investment could be the first step to foreign domination had ended. The second principle was the need for international economic co-operation. It was based on the fact that, in many cases, full use of the existing natural resources for the benefit of all parties concerned was possible only if there was economic co-operation between sovereign nations. The third principle was that of strict adherence to the rules of international law and of the need for the consolidation and progressive development of those rules. That principle followed logically from the second one. If it was desired to eliminate the danger of foreign capital being the forerunner of foreign domination or of its being entirely at the mercy of the Government of its host country, strict adherence to the rules of international law was required.

'36. Those principles made it clear that substantial study of the draft resolution was not strictly within the competence of the Second Committee, but rather within that of the International Law Commission. It would perhaps not be wise for the Committee to start a debate and endeavour to change the text of the existing draft, since that would reopen the discussions which had been held in the Commission on Permanent Sovereignty over Natural Resources and would risk upsetting the balance of the existing text. The Committee therefore had the choice between accepting the draft resolution as it stood, without amendment, or repeating the debates that had taken place in the Commission on Permanent Sovereignty over Natural Resources. The Netherlands delegation thought that the first alternative would be the best procedure for the Committee to adopt.'

(Gen. Ass., Seventeenth Session, Second Committee, Agenda item 39, p.230)

29. On 12 December 1974 the General Assembly adopted the Charter of Economic Rights and Duties of States. The states voting against the resolution were: Belgium, Denmark, German Federal Republic, Luxembourg, the United Kingdom, and the United States.

For present purposes the leading principles of the Charter are to be found in Article 2, as follows:

- '1. Every State has and shall freely exercise full permanent sovereignty including possession, use and disposal, over all its wealth, natural resources and economic activities.
- '2. Each State has the right:
  - (c) to nationalise, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalising State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.'

30. The resolution was adopted by 120 votes to 6, with 10 abstentions. The Netherlands abstained and Czechoslovakia voted in favour.

31. Whilst caution must be exercised in evaluating these resolutions, there can be no doubt that the Cordell Hull formula no longer reflects the generally accepted international standard. As Professor Schachter observes:

'The standard of "appropriate" compensation or its near-equivalents "just" and "equitable" compensation leaves considerable latitude to the parties in negotiation or to a third-party arbiter. In many cases, especially those involving a single property or investment, appropriate or just compensation would seem to require payment of "full market value" where that can be determined. The value of the enterprise as a "going concern" capitalising income may also be an appropriate standard subject to legitimate expectations and actual conditions. As some governments have maintained, it would not be inappropriate or unjust to reduce that amount where the company had valued a project at low figures to avoid taxation. Compensation settlements have used book value, sometimes "updated" to reflect inflation. In cases where the company had by practices contrary to good standards of operation, diminished the value of a natural resource, it would not be unjust for the government to reduce its compensation to make up for the damage. Payment in bonds may not be "prompt" under the Hull formula, but in many cases such deferred compensation would be appropriate and not unjust provided that the interest on the bonds was in keeping with market rates. Large-scale expropriation such as general land reform often raises questions as to ability of the State to

pay full compensation. In such cases, a good case can be made that “less than full value would be just compensation” when the State would otherwise have “an overwhelming financial burden”. (emphasis added)

(International Law in Theory and Practice, Dordrecht, 1991, p.324).

32. The standard of appropriate or just compensation carries the strong implication that, in the case of a going concern and more generally, the compensation should be ‘subject to legitimate expectations and actual conditions’, as Schachter indicates. Schachter’s assessment coincides with the period in which the relevant treaty was concluded.

**VIII. The Treaty Criteria: a Reasonable Rate of Return and Legitimate Expectations**

33. The treaty provisions make no explicit reference to a limitation placed upon the right to compensation based upon a reasonable rate of return or the legitimate expectations of the investor. However, it is clear that such a limitation forms an inherent part of the concept of investment and the principle of the ‘protection of investments’ embodied in the treaty. The treaty is not related to the protection of ‘foreign property’, but to the protection of ‘investments’, all this in the context of the promotion of the economic development of the Contracting Parties.

34. The application of the treaty provisions necessarily involves recognition of three distinct but related elements:

First: the nature of an investment as a form of expenditure or transfer of funds for the precise purpose of obtaining a return.

Secondly: the element of reasonableness, which rules out the compensation of returns which go beyond the legitimate expectations of the investor.

Thirdly: the element which derives from the general principle that merely speculative benefits, based upon unproven economic projections, do not count as investment or as returns.

35. In his work, already quoted, Schachter refers to two decisions in which tribunals curtailed the compensation of future profits in the light of legitimate expectations: see Schachter, *op.cit.*, p. 328, fn.75. The first decision is LIAMCO v Libya, 62 I.L.R. 140 (1977) which involved the award of ‘just and equitable compensation’: see at pages 208-15. The practical effect of applying this standard was to rein in the compensation for loss of profits to cover only loss which was ‘certain and direct’ and ‘probably realisable’: see at pages 214-15.
36. The second such decision was in Government of Kuwait v Aminoil (Reuter, President, Hamed Sultan and Sir Gerald Fitzmaurice, Members), 66 I.L.R. 518 (1982). In this case the distinguished tribunal adopted certain principles governing the award of compensation. The key passages are as follows:
- ‘146. But as regards States which welcome foreign investment, and which even engage in it themselves, it could be expected that their attitude towards compensation should not be such as to render foreign investment useless, economically. In this respect it is not disputed that Kuwait is a country favouring foreign investment, and itself an important investor abroad. The Tribunal does not intend either to examine, or resolve the complex of juridical problems created by the fact that there are some States that are motivated by very different sets of conceptions about foreign investment, possibly involving within the framework of the international community what the International Court of Justice has called an “intense conflict of systems and interests” (*Barcelona Traction, etc., case, I.C.J.*

*Reports, 1970, p.47, paragraph 89).* The Tribunal will therefore confine itself to registering that in the case of the present dispute there is no room for rules of compensation that would make nonsense of foreign investment.

‘147. This is a fundamental precept. It is pertinent during the life-time of a concession; it is equally pertinent when a concession comes to an end. Compensation then, must be calculated on a basis such as to warrant the upkeep of a flow of investment in the future.

‘148. Both Parties to the present litigation have invoked the notion of “legitimate expectations” for deciding on compensation. That formula is well-advised, and justifiably brings to mind the fact that, with reference to every long-term contract, especially such as involve an important investment, there must necessarily be economic calculations, and the weighing-up of rights and obligations, of chances and risks, constituting the contractual equilibrium. This equilibrium cannot be neglected – neither when it is a question of proceeding to necessary adaptations during the course of the contract, nor when it is a question of awarding compensation. It is in this fundamental equilibrium that the very essence of the contract consists.

‘149. For assessment of that equilibrium itself, and of the legitimate expectations to which it gives rise, it is above all the text of the contract that signifies, and it is of moment that this text should be precise and exhaustive. But it is not only a question of the original text; there are also the amendments, the interpretations and the behaviour manifested along the course of its existence, that indicate (often fortuitously) how the legitimate expectations of the Parties are to be seen, and sometimes seen as becoming modified according to the circumstances.

‘150. It is on the footing of these general principles that the Tribunal will now enquire into the circumstances specific to the case of Aminoil.

[. . . .]

‘154. The two basic points on which the Tribunal differs from Aminoil’s position are as follows:

- (a) *First*, in respect of the foundation for the calculation of anticipated profits, which Aminoil takes as being exclusively the financial arrangements of 1961, the Tribunal has already found in Section IV above, both that the 1973 Agreements were valid, and that something is owing to the Government on Abu Dhabi account. Not only is no refund due of moneys paid to the Government under the 1973 arrangements, but the latter are also a component of the present “legitimate expectations” of the



Company. Even more pertinent, the negotiations between the Parties about the application of the Abu Dhabi Formula involved a recognition of the principle of a monetary obligation to the Government, and of a modification for the future of the financial relations of the Parties. It is therefore on a combination of these data, not on those of 1961, that the indemnification of the Company must be proceeded to.

- (b) *Next* – and this constitutes the second aspect of the difference between the Tribunal’s and Aminoil’s positions – the Tribunal cannot accept the projections as to the future of the petroleum industry based on the consultations of experts that the Company has relied upon. These have been criticized by the Government. If, however, the Tribunal does not accept them, this is not because they include speculative elements, since all methods of assessment, whatever they may be, will do that. It is because the Tribunal thinks that in the present case, as will be shown later, the Parties adopted a different conception in the course of their relations and negotiations, - namely that of the reasonable rate of return. This it is, therefore, that must guide the Tribunal.’ (emphasis added)

(66 ILR. at pp.602-5)

37. Sir Gerald Fitzmaurice, in a Separate Opinion, differed from the reasoning concerning the stabilisation clauses but agreed with the award of compensation : see at page 614, para. 1.
38. There are significant parallels between the circumstances of the present case and the reasoning in Aminoil. The essential legal framework is the same : in the present case the parties are relying upon a consensual instrument in the form of a treaty, and in Aminoil the parties were relying upon a consensual instrument in the form of a concession contract (together with other forms of consent). In the Aminoil case the evolution of the relations of the parties gave rise to the conception of an equilibrium and a reasonable rate of return. In the present case the equilibrium appears in the provisions of the treaty itself,

including the preamble, and the concept of 'fair and equitable treatment' to be found in Article 3.

**IX. The Application of the Treaty Criteria : the Investment Involved**

39. At this stage it is necessary to look at the investments of the claimant and its predecessor in CNTS. These investments consist of the following items.

40. **3 Million Dollars from CEDC in 1993 in relation to the setting up of CNTS**

The supporting material is as follows:

1. Klinkhammer's Suppl. Declaration on Quantum, dated 27 July 2002, para. 53.
2. Memorandum of Association and Investment Agreement, Art. 1.4(3)(b); Exh.C.60.

41. **5.7 Million Dollars Assets in Kind invested by CEDC in 1994**

1. Exh. CQ 107 (stated in Czech Crowns). Accounts by Coopers and Lybrand, Praha : Itemised list of non-monetary investments.

42. **5.2 Million Dollars by CME Media in 1996 : Price paid to CET 21 Partners for 43.3% of CET 21 and 5.2% of CNTS**

1. Exh. RQ 13, dated 1 August 1996 : Agreement on a Future Agreement to Transfer CNTS Participation Interests and CET 21 Shares.
2. Exh. RQ 18, dated 1 August 1996: Agreement on a Future Agreement to Transfer CET 21 Shares.

3. Exh. RQ 19, dated 1 August 1996: Agreement on a Future Agreement to Transfer CET 21 Participation Interests.
  
43. **37 Million Dollars by CME Media in 1996 : Price paid to the Czech Savings Bank in respect of 22% of CNTS**
  1. Klinkhammer's Suppl. Declaration on Quantum, para. 54.
  2. Agreement on Transfer of Participation Interest, 17 July 1996, Art. II : Exh. CQ. 80.
  3. Memorandum of Association and Investment Agreement, Art. 1.4.3(a); Exh.C.60.
  
44. **28.3 Million by CME Media in 1997 representing the price paid to Nova Consulting in respect of 5.8% of CNTS**

Cox to Fertig, 18 July 1997: Exh. RQ51. See also the Statement of Defence, pp.209-11, paras 816-21.
  
45. During the hearings in September, the Chairman raised the issue of retained earnings : see DAY 11, p.55, and cp. Klinkhammer, DAY 10, p.24.  
Klinkhammer confirmed that the total dividends paid by CNTS to CME from the beginning of the investment was '50 million or greater' : DAY 11, p.25.
  
46. It is to be recalled that in CME's accounts the investment was shown at a value of 52.8 million dollars approximately : see Exh. RQ 355.
  
47. In cross-examination by Mr. Stewart on DAY 12 Mr. Klinkhammer confirmed that the total dollar amount of CME's investment in CNTS was 64,159,000 :

see Transcript, DAY 12, pp.154-55. He also accepted that this figure included the money retained within CNTS and not paid out to CME.

48. On the figures given above (paras. 44-48) the investment totals 78 million dollars. However, 28.3 million dollars must be deducted in view of the fact that the sum represents shares only held conditionally : as a consequence of the ICC Award and the payment of the Award.
49. As a consequence the original investment to be reckoned with totals less than 50 million dollars. In this context it is relevant to refer to CME's published figures of the investments. In the accounts of CME the figure is 52.8 million approximately : see Exh. RQ 355. In the presentation to Newscorp on 20 October 1998 the investment is reported at 53.5 million : see Exh. RQ 470. This brochure is of such a character that it is to be presumed to be reasonably accurate.
50. A further source of evidence takes the form of the Agreement on Transfer of Participation Interest, dated 21 May 1997 : see Exh. C. 130. CME, as a party to this transaction, valued the investment it represented at 52,723,613 U.S. dollars.

**X. The Application of the Treaty Criteria : the Preamble and the Context and the Dominant Position of CNTS**

51. The treaty standards (see above) include the standard of just and equitable compensation and, in addition, the concept of investment has its own outlines of reasonableness. An investor protected by the bilateral treaty does not have

an infinite capacity to dominate the market. Particularly in the European context, the parameters of competition militate against a dominant position.

52. As a matter of fact, CNTS, by way of TV Nova, had a dominant position in the relevant market at the material time. This was the view presented in Kagan's European Television Country Profiles 2000, published in September 1999: Exh. CQ. 546. In the context of the advertising market, 'TV Nova takes the lion's share' : and see generally at pages 205-6. In the Investor Perception Survey published by Brainerd in December 1996 the following is reported :

### **COMPETITION**

'Excluding Germany, the level of competition in CME's markets is low. In addition, CME's competitive position in each market is strengthened by strong local partners and relationships. CME's solid position financially, its control of content and programming, and its relationships with advertisers is hard to beat. Supported by an enviable track record, CME is a well respected media player and a desirable partner in these markets. Still, some investors worry about how the Company will progress when faced with real competition in the future. *Comments included, "This is as close to a monopoly as you can get;" "I don't see how much longer they can get away with monopolizing the market."*'

(Exh. RQ 377, at page 14)

53. This picture was confirmed by the evidence of Mr. Howard Knight on Day 11. Mr Knight had identified TV Nova as 'a dominant player in the market' : see the Transcript, Day 11, p.214. Subsequently, the following exchange took place when he was re-examined by Mr. Kiernan :

'Q. When you use the term "dominant player", what would you describe as some of the characteristics of a dominant television company in a market place?

'A. It is really the ability to set price, because the advertiser cannot buy around you. So, that would mean that you would have to have somewhere around a 40/45 per cent commercial share in order to be a

dominant player because anything less the advertiser can buy around you.

'Q. Can you identify some of the competitive advantages of being a dominant player?

'A. Well, that is the ability – there is the ability to set price. There is the ability to conclude exclusive arrangements with advertisers where you can insist that as a condition of doing business with you they do not do business with your competitor.

You can – you are making more money so you can afford to control programming, deny smaller stations access to programming. You can buy the talent. By the talent I mean the television hosts and the newscasters that are most appealing to the audience. You can actually go out and raid the other station's talent, pick off the talent. Those would be some of the things a dominant player can and will do.'

(Transcript, Day 11, pp.233-4)

54. This position was also confirmed by Mr. Copeland in his Report, where he stated :

'The CME forecast's relatively lower operating margins in 1999 through 2002 result from an aggressive increase in operating expenses forecasted for 1999. That Monitor margins somewhat exceed CME's during portions of the forecast period is a function of Monitor's lower inflation expectations and CME's higher depreciation charges. While CNTS's projected operating margins are high, we believe they are warranted given CNTS's dominant position as the advertising medium of choice in an oligopolistic market with little competitive threat.'

(CNTS Valuation Report, p.10)

55. Similarly, in his Supplemental Report Mr. Copeland stated :

'That TV Nova's ad revenues have outpaced even Monitor's projections is particularly remarkable in light of the damage to TV Nova's audience share that is directly attributable to the termination of CNTS's involvement with TV Nova. When CET 21 terminated its contract with CNTS, TV Nova immediately lost access to CNTS's vast library of high-quality programming. The resulting drop in program quality caused an immediate loss of 10 audience share points, from which TV Nova has not recovered. As shown in Exhibit CQ2 (at 4), during the year preceding August, 1999, TV Nova's audience share remained stable in the low-to mid-fifties. In August 1999, TV Nova's

audience share dropped to 46.8 and stabilized immediately in the mid-forties. That TV Nova was able to exceed Monitor's ad revenue projections despite this substantial loss of audience share further demonstrates both the conservatism of Monitor's revenue projections and the Czech market's unique economics that have continued to confer monopolistic rewards on the dominant player even after a substantial reduction in audience share.'

(Supplemental Report, pp.17-18)

56. During cross-examination by Mr. Stewart, Mr. Copeland did not offer any significant modification of these opinions : see the Transcript, Day 16, pp.113-16.
57. Two inferences must be drawn from this evidence. In the first place, the existence of such a position of dominance cannot be easily justified on the basis of legitimate expectations.

**XI. The Application of the Treaty Criteria : Just Compensation and a Reasonable Rate of Return**

58. The treaty criteria of reasonableness and a reasonable rate of return, examined above, constitute the alter ego of the concept of legitimate expectations. Such expectations will vary from case to case but they can be understood to include the following in the case of a bilateral investment treaty:

First : that the host State is not accepting a risk which will have the consequence of paying compensation at a level which would cause catastrophic economic consequences for the host State and its population.

Second : that an investment carries the expectation that it will be profitable, but only on a basis of reasonable expectations.

Third : that explicit indications of the investor's expectation of profitability will provide a primary criterion of what is a reasonable rate of return.

59. It happens that in the present case there is a reliable guide to the business expectations of the investor. This is the Business Plan prepared on behalf of the Administrative Board of CET 21, dated 13 January 1993 : see Exh. R.50. The original Business Plan was prepared by Mr. Fertig. The roles of Mr. Fertig are described in his own declaration :

- A. 'In October 1991, I was approached by Mr. Andrew Gaspar, a partner of Mr. Ronald Lauder in Central European Development Corporation (CEDC), and engaged as a consultant to investigate and review television opportunities for CEDC in post-communist Europe. My work for CEDC was directed by Mr. Mark Palmer, its Managing Director who was based in Berlin, and was performed through The Acorn Consulting Group, Inc., a New York Corporation owned by Victoria A.L. Rogers and myself.
- B. I continued in the above consulting capacity until the inception of Central European Media Enterprises Ltd. (CME) in June 1994 when I became Vice President and Chief Financial Officer of CME.
- C. During the calendar year 1993 and the first half of 1994 I moved from New York to Europe at the behest of CEDC. I lived half-time in Prague and was involved on a day-to-day basis with the planning and launch of Nova. In June 1994, I moved to the new London headquarters of CME and my focus shifted to the seeking of television licenses in other countries and the management of CME.
- D. In August 1995 I was named President and Chief Executive Officer of CME in which position I remained until March 1998.'

(Declaration dated 7 December 2000)

60. The background of the presentation of the Business Plan to the Media Council is the memorandum from Mr. Fertig to Mr. Palmer, dated 5 January 1993 : see Exh. C. 141.

'This memo is to record what I can recall we learned at the hearing today and document what we told the Commission which we may need to remember in the future.

- '1. Other Partners: The Commission asked if we had any other partners involved in the CET 21 investment. You responded



that at this time we were doing the investment ourselves, with the exception of the Czech Savings Bank which was described by Vladimir Zelezny. You also told them that we were open to additional Czech partners, provided that we were satisfied that we knew who they represented.

Korte said that the Commission does not want to be involved in the selection of our partners and will keep their hands off; they just wanted to know who was involved in our investment.

'We expressed our concern that if there were additional partners the station have a single management, single board, etc. Mr. Korte, speaking for the committee agreed and said it was the only way the station could work.

- '2. They asked how much we were prepared to invest. We responded that our business plan showed a requirement of 500-600 million Czech crowns – or \$18-21 million – however, we recognized that sometimes additional funding is needed and we were willing to commit up to 1 billion crowns (\$36 million) of our own money plus the 300 million from the Czech bank for a total of 1.3 billion KCS. They asked whether the technical rebuild of the transmission network was included in the 600 million figure, and I said it was not since we did not have a clear picture of the technical situation with F1 and CTV.'

[.....]

- '5. The Council asked for our business plan, and we agreed to give it to them by the end of next week. They said it must be the same plan which we use for the bank and other investors (i.e. one set of numbers).'

(emphasis added)

61. The Business Plan is prefaced by the following letter:

'Dear members of the Council,

'In accordance with our promise, which was made at the last hearing, we are sending you the business plan for our television station as it was proposed by the investors and approved by our administrative board. It is an extract from a detailed breakdown of the individual technical items.

'We expect that the basic initial capital will be CZK 1 billion 300 million (as follows from sheet 1 – Financial Summary). In accordance with the international practice, the numbers in brackets stand for the planned loss, and not profit, and, therefore, a minus could be added in front of

the numbers. It is apparent that the first active income of CET 21 is expected in 1997 and redemption of the basic investments only after 2000. In the first four years of operation, the business plan anticipates a direct loss that will have to be funded by the investors.

'The business plan has already been adjusted for the licensed station F-1 (with a variant of CTV). If you have any queries, we will respond to them at any time in writing or at the next hearing.'

Yours faithfully

[signature]

In Prague, on 13 January 1993

Administrative Board of CET 21

62. The Respondent analysed the figures in the Business Plan as follows:

'If one then looks at how the numbers work out over the page, the CET 21 business plan shows first of all, as one would expect in 1993, nil anticipated revenues, expenses at 22 million Crowns and a net loss deficit, therefore, of 22 million, capital expenditure of 100 million Crowns, networking capital needs of 119 million. Therefore a net operating deficit cashflow of 241 – the amount of the investment at 250 million with available capital there. It then works through, and as you can see, one does not get to a positive cashflow in terms of net operating cashflow until in fact the year 1998, and one does not get to a cumulative cashflow which is positive until the year 2001.

'That is then supported by the figures which are set out following, which set out what they then anticipated about revenues based on the average number of homes using the TV, weighted audiences and so on and so forth. In other words the next pages really provide what they then anticipated. If one looks forward, one sees that one has anticipated expenses and so on and so forth.

'We have summarised those figures at paragraph 5 of appendix 18. What one sees there is the figures converted into million dollars set out, and one sees the equity assumptions being provided as \$28.2 million, and one sees the revenues over the ten-year period of the plan being anticipated to be 65.7.

'So you have a total net profit of \$65.7 million, compared with equity of \$28.2 million. That amounts to a total pre-tax return of 232 per cent and over the nine full years our calculation is a average annual return of 26.9, take off tax at 35 per cent and you have a post-tax average return of 16.8 per cent.'

(Transcript, Day 23, pp.214-15; and see also Respondent's Skeleton Closing Submissions, App. 18)

63. This analysis, which was challenged by Counsel for the Claimant during the hearings, relates to the period 1993 to 2002.
64. The Business Plan provides reliable evidence of the reasonable expectations of those proposing the CET 21 investment in 1993. It is now apposite to examine evidence of the policy position of the Media Council. For this purpose it is necessary to turn to the Report on the situation in Broadcasting and Activities of the Council for Radio and TV Broadcasting of the Czech Republic, for the period 1 October 1996 to 31 January 1997 : see Exh. RQ 38. The introduction to this document insists on the element of balance. The following passage is characteristic of the content :

‘In printed media in the Czech Republic complete business liberty for home and foreign subjects is guaranteed and the publishing has no administrative obstructions. Possible evaluation of the dominant position on printed media market belongs to the competency of the concerned authority (The authority for protection of economic competition).

‘In electronic media the situation is a bit different: Plurality of the broadcasting subject is to a certain extent limited physically (by frequencies). There is a limited number of terrestrially broadcasted television programs. Each businessman gets, by the granting of nation-wide terrestrial television to an exceptional position. With contemporary advertising limits for public service TV and factual impossibility of building the equal commercial competition the granting of former “federal nation-wide television channel” was in fact a warrant of almost certain profit even with average business abilities and minimum initial investments.

‘When government grants the businessman the frequency network (= an exclusive part of national possession, “the gold mine”), it should naturally want something from the businessman for that, and this is usually common all over the world.

*‘The argument, that the businessman pays profit taxes does not stand up, because it is completely extraordinary profit from completely extraordinary kind of enterprise. Besides even back in the Middle Ages wise governor established special taxes for some profitable kinds of enterprise or gave concessions to his favorites (for mining metals, changing money in good localities, etc.).’*

(Exh. RQ 38, English version, p.6; emphasis in the original).

65. In the light of the Business Plan submitted by the Administrative Board of CET 21 in 1993, what would represent a reasonable rate of return on the investment? The Czech Republic has presented the following analysis :

‘124. We know from Len Fertig’s business plan that CEDC anticipated an aggregate net profit of US\$65.7 million over the period 1993 to 2002 on an assumed equity investment of US\$28.2 million. This established an expected rate of return of 16.8%. The Czech Republic accepts this as a reasonable and fair rate of return on the investment.

‘125. Mr Lauder’s various companies invested the following amounts (not the \$140 million asserted by Mr Klinkhammer):

- (a) \$3 million by CEDC in 1993 in respect of the setting up of CNTS;
- (b) \$5.7 million of assets in-kind by CEDC in 1994;
- (c) \$5.2 million by CME Media in 1996 representing the price paid to CET 21 partners in respect of 43.3% of CET 21 and 5.2% of CNTS;
- (d) \$37 million by CME Media in 1996 representing the price paid to Czech Savings Bank in respect of 22% of CNTS; and
- (e) \$28.3 million by CME Media in 1997 representing the price paid to Nova Consulting in respect of 5.8% of CNTS.

‘126. Thus, the maximum possible investment made by CME Ltd was \$78 million. (The purchase of the 5.8% shareholding for \$28 million has now been rescinded pursuant to the ICC Award, reducing the aggregate investment to \$49.3 million.)

‘127. Applying the post-tax rate of return of 16.8% per annum to CME Ltd’s actual investments in CNTS, from the original date of investment to (say) 31 December 2002, results in the a total gross return on the investment of \$184.3 million.

‘128. From this figure, it is necessary to deduct:

- (a) the dividends received by CME (and its predecessors) of \$34.7 million;

- (b) the amount received from Dr Zelezny in payment of the ICC award of at least \$23.35 million; and
- (c) 93.2% of the residual value (of US\$57.7 million), namely US\$53.8m.

‘129. Accordingly, the maximum net further amount of compensation that would be needed to realise in full the expectations with which Mr Lauder and the Czech Republic first embarked upon the investment would be **\$72.4 million.**’

(Respondent’s Skeleton of Closing Submissions, pp.27-8).

## **XII. The Application of the Treaty Criteria : The Inadmissibility of Speculative Benefits**

66. The treaty standard, according to which the concept of an investment involves a reasonable rate of return, has a particular application in relation to speculative benefits. The principle denying recovery for speculative benefits has long been recognised in the practice of international tribunals : see Ralston, The Law and Procedure of International Tribunals, Revised ed., 1926, paras. 438-9; Chorzow Factory (Claim for Indemnity) (The Merits), Judgment No.13, PCIJ., Ser. A, No.13, pp.56-7.
67. More recent jurisprudence has confirmed the principle : see Phelps Dodge Corp. and DPIC, 25 ILM. 619 (1986), para. 30; Biloune v. Ghana Investments Centre, 95 ILR 184 (1990), p.228; and Metalclad Corp. v. United Mexican States, 119 ILR 616 (2000), p.642, para. 122. In his Award in the LIAMCO case, the Sole Arbitrator decided to apply general principles of law for the determination of compensation in a nationalization case (not involving treaty obligations). In his opinion ‘the loss of profits to be taken into consideration

must be certain and direct' : see the Award, 62 ILR 140, pp.208-15, and, in particular, at pp.214-15.

68. In the Award in Amoco Finance Corp v. Iran, the Iran-US Claims Tribunal expressed certain opinions concerning cash flow projections, and warned of the need to avoid elements of speculation. In the words of the Tribunal:

'238. As a projection into the future, any cash flow projection has an element of speculation associated with it, as recognised by the Claimant. For this very reason it is disputable whether a tribunal can use it at all for the valuation of compensation. One of the best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded. This holds true of the existence of the damage and of its effect as well. Such a rule, therefore, applies in the case of unlawful expropriation. *A fortiori*, the reasoning on which it rests must also apply in the case of compensation for a lawful expropriation. It does not permit the use of a method which yields uncertain figures for the valuation of damages, even if the existence of damages is certain.

'239. The element of speculation in a short-term projection is rather limited, although unexpected events can make it turn out to be wrong. The speculative element rapidly increases with the number of years to which a projection relates. It is well known, and certainly taken into account by investors, that if it applies to a rather distant future a projection is almost purely speculative, even if it is done by the most serious and experienced forecasting firms, especially if it relates to such a volatile factor as oil prices. Such projections can be useful indications for a prospective investor, who understands how far it can rely on them and accepts the risks associated with them; they certainly cannot be used by a tribunal as the measure of a fair compensation.

'240. The projection of the future earnings of Khemco over 18 years was made by the Claimant in order to take into account the totality of the return which could be derived from the Khemco Agreement for the remaining time of its life. Clearly, this is a consequence of the Claimant's misconception that the measure of the compensation is *restitutio in integrum*. A case of expropriation of an undertaking with no contractual limit would, under this reasoning, require a projection into the future *ad infinitum*, or, to be more precise, up to the time when the application of the discount rate would result in a return amounting to nil. The Tribunal need not express an opinion

upon the admissibility of such a projection when the reparation must wipe out all the consequences of an illegal taking, but it certainly cannot accept it for the compensation due in case of a lawful expropriation.’

(15 Iran-U.S.C.T.R.189, at pp.262-3) (and see also at page 257, para 225 in fine).

69. In the present context it is to be recalled that the Treaty provides for the payment of just compensation and that such compensation ‘shall represent the genuine value of the investments affected.’ It is reasonable to assume that the principle of ‘genuine value’ rules out uncertain and speculative future benefits.
70. On this subject, the Czech Republic has made the following submissions:
- ’13. The International Law Commission, after a careful study of the matter, asserted that “[t]ribunals have been reluctant to provide compensation for claims with inherently speculative elements.” The Czech Republic submits that the value of an element is speculative if the realisation of the value is entirely out of the control of the investor and entirely under the control of some other party.
  - ’14. In the present case, the clearest example of such a speculative element is CME’s attempt to include in the valuation of CNTS a sum corresponding to the possibility that the Czech authorities might renew, on the same terms as were applied in 1993, CET 21’s broadcasting licence when it expired in 2005.
  - ’15. Neither CET 21 nor CME had any right to any renewal of the Licence. CME failed to demonstrate that there is any presumption in Czech law, or in public international law, in favour of renewal of the Licence. CME adduced no evidence that it had been led by any official or employee of the Czech Republic to believe that the Licence would be renewed.
  - ’16. CME did not allege that it had any legitimate expectation, enforceable under the Dutch Treaty or under Czech law, to the renewal of the Licence. But if compensation were awarded for post 2005 profits expected to arise from TV Nova, that would be tantamount to a finding that the Czech Republic was under a

legal obligation to permit CNTS to collect those profits by renewing CET 21's Licence.

- '17. Even less was there any basis for a belief that the Licence would be renewed on the same terms as were applied in 1993. CNTS was well aware of the complaints that had been made concerning the manner in which TV Nova was being operated. It was aware of concerns about the *"Call the Director"* programme; of concerns relating to the down-market content of TV Nova programmes; and of concerns that CET 21 was not in fact discharging the responsibilities imposed by law upon the holder of the Licence. In those circumstances, it is difficult to see what basis CNTS might have to suppose that CET 21 would simply have its Licence renewed. The possibility of renewal on more exacting, and accordingly less profitable, terms must have been apparent to CME.
- '18. CME was well aware of the risk of non-renewal of the Licence. As senior management acknowledged in a revised peace offer made to Dr Zelezny in early March 1999:
- "Without a closer alignment of economic interests and a stronger Service Agreement, we believe that it will not be possible to 'sleep at night' ... The term sheet provides considerable cash incentives to VZ, but the biggest payout occurs after the renewal and over four years, thereby rewarding success and sharing the risk."*
- '19. The hopes of a licence renewal were not a bankable asset. There was, on the other hand, a clear possibility of renewal. It was a commercial judgment whether that possibility warranted further investment in the company or the purchase of the company. But in the submission of the Czech Republic, the fact that this possibility was worth a commercial gamble on the part of CNTS or SBS does not mean that it must be counted in the computation of the *"genuine value"* of CNTS, as explained further below in Appendix XV.'

71. These submissions have considerable merit.

### **XIII. Other Valuation Methods : the Non-treaty Commercial Approach**

72. An alternative approach to the task of valuation would be to adopt the fair market value or 'commercial' approach to produce a value at 5 August 1999. This approach is, however, in terms of the Treaty, substantially flawed. The Treaty is not a mere vehicle for an arbitration clause and for the exclusion of



the normal requirement of the prior exhaustion of local remedies. The dispute is not about the protection of foreign property, so to speak, in the passive mode, and in the context of general international law. The dispute is, in precise terms, concerned with a process of foreign investment against the background of treaty provisions. The overall legal relationship is between the Netherlands and the Czech Republic, and is concerned with investment and not 'property rights'. Moreover, it involves a complex equilibrium of interests pre-ordained by the Treaty and by its object and purpose as revealed in the preamble.

73. Any assessment of the commercial approach to compensation in these proceedings must involve an adequate appreciation of the character of a bilateral investment treaty. As indicated above, the basis analytical datum is that the mode of reparation should reflect the nature of the basis of claim, or in the common law parlance, the cause of action. Thus, the present 'quantum phase' is devoted to the provision of just compensation for breaches, as found in the first place, of the Dutch Treaty. The Dutch Treaty is not simply a vehicle for an arbitration clause. It is an Agreement on encouragement and reciprocal protection of investments. It is not a treaty for the protection of foreign property within the territory of the Czech Republic. It is expressed to be concerned with a process of investment. Article II thus defines 'investments' and not 'property'. The Treaty has purposes which the Contracting Parties indicate in the preamble, in which the Contracting Parties:

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

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

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

‘Have agreed as follows: ...’

74. In this context, it is simply unacceptable to insist that the subject-matter is exclusively ‘commercial’ in character or that the interests in issue are, more or less, only those of the investor. Such an approach involves setting aside a number of essential elements in the Treaty relation. The first element is the significance of the fact that the Respondent is a sovereign State, which is responsible for the well-being of its people. This is not to confer a privilege on the Czech Republic but only to recognise its special character and responsibilities. The Czech Republic is not a commercial entity.
75. A further element, and one closely related to the first, is that of risk, the reasonable extent of risk accepted, and the reasonable expectations involved. Is it reasonable to suppose that, when a State like the Czech Republic, with a deregulated sector of its economy, accepts foreign investment, it is accepting the risk of national economic disaster. The Claimant claims 495.2 million dollars. The Czech Republic has a gross national income of approximately 53.9 billion dollars. No doubt treaty violations are involved but was this the outcome which the Czech Republic risked in the light of the purposes outlined in the preamble of the Agreement?
76. It is, of course, a truism to point out that multinationals may be more powerful than small states. Without exploring this question fully, there is one point

which stands out. The resources of a corporation entail considerable flexibility in changing the location of assets and in changing the organisation of assets.

The resources of a country, its human and natural resources, are a given: they are necessarily fixed.

77. And there is a final point. The Czech Republic should have the benefit of civilised modern standards in the treatment of States. Even States which have been held responsible for wars of aggression and crimes against humanity are not subjected to economic ruin: see Brownlie, International Law and the Use of Force by States (1963), 142-3; Pierre d'Argent, Les Réparations de Guerre en droit international public, Bruxelles and Paris, 2002, passim. There is here an attractive analogy with the sensitivity shown in the Judgment of the Chamber of the International Court in the Gulf of Maine case. In a very significant passage in the Judgment the Chamber observed:

'It is, therefore, in the Chamber's view, evident that the respective scale of activities connected with fishing – or navigation, defence or, for that matter, petroleum exploration and exploitation – cannot be taken into account as a relevant circumstance or, if the term is preferred, as an equitable criterion to be applied in determining the delimitation line. What the Chamber would regard as a legitimate scruple lies rather in concern lest the overall result, even though achieved through the application of equitable criteria and the use of appropriate methods for giving them concrete effect, should unexpectedly be revealed as radically inequitable, that is to say, as likely to entail catastrophic repercussions for the livelihood and economic well-being of the population of the countries concerned.'

(I.C.J. Reports, 1984, p.342, para. 237).

78. It would be strange indeed, if the outcome of acceptance of a bilateral investment treaty took the form of liabilities 'likely to entail catastrophic

repercussions for the livelihood and economic well-being of the population' of the Czech Republic.

79. It may be recalled that in the Japanese Peace Treaty, signed on 8 September 1951, Article 14 reads in part:

'(a) It is recognised that Japan should pay reparations to the Allied Powers for the damage and suffering caused by it during the war. Nevertheless it is also recognised that the resources of Japan are not presently sufficient if it is to maintain a viable economy, to make complete reparation for all such damage and suffering and at the same time meet its obligations.'

80. Historically, and in sharp contrast, the Czech Republic has been the victim of aggression (1938, 1939 and 1968) and it is against the background of the consideration shown to Japan that Mr. Stewart's submissions should be considered. In his words:

'You also know, because you have been told on several occasions, that the Czech Republic has a population of 10 million, and in our closing submissions we give the gross national income of the Czech Republic of \$5,270 per head. What we have done there is simply set out what the equivalent claims would be against each of the countries represented by the distinguished members of this arbitral tribunal. What we have done -- so that there is no dispute about it -- is multiplied first of all to take account of the population. So that in the case of United Kingdom, we multiply by 6 to take account of the fact that the United Kingdom is 6 times the size of the Czech Republic. We have then taken account of the differential in gross national income per head by dividing by 5,270 and multiplying by 24,230. I should make it plain that these are figures in dollars, of course.

So that you get a claim equivalent to that brought against the Czech Republic against the United Kingdom of 19.3 billion dollars.

In Germany's case, of course, it has a larger population. It has a slightly lower gross national income per head which, of course, followed the reunification and the accretion of what used to be East Germany. But it amounts to an equivalent claim against Germany of just under \$26 billion.

And the figures for the USA, which of course has a substantially larger population, and a substantially larger gross national income per head, would mean a claim of 131 billion dollars, if this were being brought against the United States.

That is how important this case is to the Czech Republic and I am sure each of you can well imagine the sort of political, economic and decision-making difficulties which would be faced when that sort of claim was brought under one of these treaties against your states.'

(DAY 23, p.62)

81. These considerations, significant as they are, do not necessarily render the commercial approach in all respects legally redundant, and it is relevant to examine this approach on its own terms.
  
82. The DCF analysis employed by both Monitor and Rothschild does not take the 'peace premium' or Zelesny factor into account. The Monitor assessments make no reference to the Zelesny factor : see the CNTS Valuation Report, 14 December 2001, p.28; the Monitor Supplementary Report, 28 July 2002, p.60; and the Monitor Valuation of CNTS, 9 September 2002, p.4. The Rothschild CNTS Valuation Report, 1 July 2002, expressly excludes the Zelesny factor : see at pages 8 to 10, and 72.
  
83. The Rothschild DCF valuation was 335 million dollars : see the CNTS Valuation Report, 1 July 2002, p.10.
  
84. The multiples analysis carried out by Rothschild produced a figure of 324 million dollars : see the Report, pp.43-53. This result involved the application of a 20% discount. The Report observes (pp.52-3):

'Rothschild's approach appears to be consistent with that adopted by SBS Broadcasting and CME Ltd. SBS also used a discount of 20% in its valuation of CNTS. David Stogel uses a 20% discount (in Declarations Representing Quantum of Claimant CME Czech Republic BV, tab 4, no. 10). Woody Knight likewise, states in a memo:

“we assumed that a higher risk, Eastern European operator, CME Ltd’s private market multiple would be at a 15-25% discount to the corresponding SBS multiples.” ‘

85. If this discount is returned, the valuation becomes 400 million dollars.
86. It is also relevant to note the CME Ltd. market valuation at 5 August 1999 : see the Rothschild CNTS Valuation Report, 1 July 2002, pp.20 and 54. The conclusion of the Report is that the trading value at that date was 341.1 million dollars.
87. Of particular probative value is the assessment made by SBS, as a willing buyer in the market. The SBS internal valuation had a starting point at 400 million dollars. The key evidence here derives from the SBS Board Meeting Presentations by Knight and Stogel. The first Board Presentation took place on 19 February 1999 : see Exh. CQ 145 (prepared by Mr. Howard Knight); and Exh. CQ 149, p.3025201, Exhibit A, Box 1 (400 million dollars).
88. Also in evidence is an undated SBS Board Presentation by Sloan, Knight and Bear Stearns : see Exh. CQ 146.
89. The figure given in the presentation of 19 February is confirmed in the Board Presentation dated 29 March 1999 : see Exh. CQ 149, p.3025201, Exhibit A, Box 2. This Board Presentation was prepared by Knight and Stogel. At p.3025203 of this document the asset value of CME is given as 332,048 million dollars (Exhibit C).
90. These Board Presentations also establish that the SBS people considered that the discount representing the Zelesny factor (the price of peace) was 100

million : see the Board presentation of 19 February 1999, CQ 149, Exhibit A, p.3025201, Box 1. This refers to 'assumptions' and these include:

'c. Price of peace in Czech Republic equal to approximately USD 100 million...'

91. At the Board Meeting Presentation on 29 March 1999 (ibid., Exhibit A, Box 2), the 'assumptions include an increased price of peace:

'c. Price of peace in Czech Republic equal to approximately **USD 125 million**, comprised of:

18% of CNTS (estimated value USD 400 million) = USD 72 million

Zelezny annuity for license renewal = USD 27 million

4% fee for CET21 of which approximately USD 3.2 million per year is unrecoverable, using 8x multiple value equal to approximately USD 25 million'

92. In the context of these Board Meeting Presentations it is clear that, if the price of peace (the discount for Zelesny) is replaced, the valuation of CNTS emerges as 400 million dollars.

93. On the basis of the Rothschild Report, the multiples analysis produces a valuation range of 181 to 324 million dollars. based on 2000E multiples : see the Report, pp.43-53, at page 53. The figure of 324 million involves a 20 per cent discount.

94. According to the same Report, the value ascribed to CNTS by SBS, as a willing seller, was 226 to 296 million dollars : see the Report, pp.61-8. The enterprise value of CME was calculated at 452 million, and the Report then states the following:

### 3.4 IMPLIED CNTS VALUE

Applying a 15% liquidity discount to the nominal value of the Final SBS Offer, CNTS' implied value is derived in the following table:

Table 3.3.3 – CNTS value implied by SBS Final Offer

	<u>US\$m</u>
Offer value (nominal)	374
15% Discount	<u>(56)</u>
Net value of CME	318
Add: net debt	<u>134</u>
Enterprise value of CME	452
<u>Comprising:</u>	
Corporate expenses	(51) – (33)
Value of non-CNTS assets	207-259
Implied value of CNTS	296-226

On this basis, the implicit value of CNTS represents between 50% and 65% of CME Ltd.'s enterprise value before adjusting for the value of corporate expenses. This is consistent with statements that we understand were made to investors by SBS management in connection with the Final SBS Offer.'

(Report, page 68)

95. In conclusion, the internal SBS valuation was of the order of 300 million dollars, excluding the price of peace.

#### **XIV. The Commercial Valuation Methods are incompatible with the Treaty Provisions**

96. The commercial valuation methods examined before have their own significance and the Rothschild and Monitor Reports constitute important



elements of the evidence available. The commercial valuations show that, leaving aside the peace premium, the commercial or business valuation comes out at 400 million, less 100 million for the peace premium. These results have the particular effect of placing the claimant's submissions within a certain perspective.

97. This having been said, the commercial methods have a substantial defect. The commercial methods have no relation to the Treaty provisions and thus float in the ether unconnected with the actual subject of compensation, which is the specific violations of the Treaty provisions determined at the first phase of these proceedings.

98. Thus, in the Rothschild Report the DCF method is described as follows:

'The DCF method estimates a company's value based on the current value of its forecasted cashflows. As Monitor correctly notes, DCF is generally accepted by mergers and acquisitions practitioners as a leading method to value a company as a going concern. Any company is said to be "worth" the net present value of its future cash earnings stream taken out to infinity and discounted at a rate that approximates the risk.' (at page 18).

99. This approach is totally unrelated to the task in hand, which is the calculation of the compensation relating to breaches of the specific Treaty provisions. The DCF locutions simply do not overlap with the language of the Treaty.

100. It is also the case that the DCF analysis ignores the principles of general international law which are applicable. Thus the paragraph quoted above is incompatible with applicable Treaty and other legal standards because it does not exclude compensation for purely speculative benefits.

101. The Rothschild Report also relies upon multiples analysis : see pages 43-53. As a perusal of the relevant part of the Report will demonstrate, the language and concepts attached to the comparable company analysis are completely divorced from the relevant legal principles and governing Treaty provisions.
102. The next source of evidence adverted to in the Rothschild Report is the market valuation of CME Ltd. as of 5 August 1999 : see the Report, pages 20 and 54. Once again the approach is that of property or asset valuation and is divorced from the pertinent legal principles.
103. The other element referred to in the Rothschild Report was the August 1995 value implied by the value ascribed to CNTS by SBS as a willing buyer : see the Report, pages 61-68; and see also paras. 87-95 above. The SBS internal valuation is of evidential value but it is very clear that the valuation process was totally unrelated to the Treaty provisions and other relevant legal principles. In any case as the Rothschild Report makes clear (at pages 61-62) the final SBS offer had various special features and did not involve a cash purchase.
104. In conclusion, it must be stated once more that the Rothschild Report concept of enterprise value takes the valuation beyond 2005 and therefore includes non-compensable speculative benefits.

## **XVI. The Treaty-based Valuation : Conclusions**

105. As already indicated in the present Opinion, the basis of the valuation must be the Treaty provisions. The difficulty which then appears is the fact that the expert reports submitted by the parties make no reference to the Treaty

criteria and are based principally upon the currently fashionable DCF method. There is no basis for thinking that the DCF method is to be applied independently of legal criteria and its application cannot be superimposed on the legal criteria but must be compatible therewith.

106. The provisions of the Treaty produce certain cumulatively applicable criteria, which flow from the requirement that the Tribunal shall award 'just compensation' which 'shall represent the genuine value of the investment affected'. Thus compensation must be both 'just' and 'reflect the genuine value of the investments affected'
107. As a first step, it must be assumed that the 'genuine value' does not include speculative benefits and that, in any event, such benefits would not be compatible with the governing principle of 'just compensation'. In the present case, the post-2005 projections of profits do not constitute direct and foreseeable benefits. Moreover, as has been demonstrated, the post-2005 profits envisaged by the Claimants do not comply with the standard of a reasonable rate of return.
108. In relation to the issue of speculative benefits it is relevant to note that, in case the treaty provisions are not in themselves clear, the Vienna Convention justifies reference to the position in general international law. The long-established principle is that speculative benefits should not be the subject of appropriate compensation : see above, paras. 66-71.
109. Leaving aside the question of speculative benefits, the principal Treaty criterion is that the just compensation shall represent 'the genuine value of the investments affected' : see Article 5(c) of the Treaty. Here also it is to be

recalled that there are modern precedents for reliance upon the value of the investment : see above, paras. 20-22.

110. The value of the actual investments is 49.3 million dollars : Resp. Skeleton, paras.124-6; and see above, paras. 39-50. To this should be added the retained profits: the dividends received by CME, and its predecessors. Whilst there is a margin of doubt, for the purposes of the Treaty it is appropriate to treat retained profits as investment. This position sits reasonably well with the language of Article 4 of the Treaty. According to the TV Nova Budget 1999 submission (CQ 142) on page 1004183, the paid-in capital was CZK 400.100.000 and the retained earnings at the end of 1998 CZK 662.621.000. According to page 1004185, the retained earnings at the end of September 1999 was projected in the amount of 1.100.365.000 (after profit distribution April/May 1999 in the projected amount of roughly CZK 400.000.000). This seems to be in compliance with the capital contribution (negative) in the amount of CZK 428.101.000 in the table on page 1004186.
111. In US dollars the amounts are printed out on page 1004190 showing paid-in capital in the amount of US dollars 12 million for December 1998 and retained earnings of US dollars 32,847 million for December 1999 (budget). The amount of retained earnings after the profit distribution in May 1999 remains stable until the end of the year.
112. The retained earnings, therefore, must be assessed at US dollars 32,8 million as of August 5, 1999. This is according to page 1004190 **without** the net income of the current period January 1 – September 30, 1999, which was US dollars 19,383 million. These figures seem to be in compliance with the

Czech language balance sheet in Czech language balance sheet in Czech Crowns, page 1004232.

113. It is assumed that the genuine value of the investments affected should include foreseeable profits, and the Respondent State has accepted the principle that such profits are recoverable provided they satisfy the standard of a reasonable rate of return : see the Skeleton Argument of the Respondent State, p.27, para.124.
114. The Rothschild Report produces a valuation of 113 million dollars on the basis that the DCF method, applied up to 2005, results in an enterprise value of 113 million dollars: see the CNTS Valuation Report, 1 July 2002, 69-71; and App. Q. This methodology is acceptable, but only as a provisional reflection of compensable profits for Treaty purposes. It must be borne in mind that the Rothschild Report does not take the Treaty provisions into account.
115. At this stage it is necessary to refer to the other main Treaty-based criterion, that is, that the concept of 'genuine' value requires that profits compensated be compatible with a reasonable rate of return. Any element of value which does not constitute a reasonable rate of return would not be compatible either with the concept of just compensation or with the principle of the genuine value of the investments affected, as prescribed by the Treaty.
116. The concept of a reasonable rate of return has several connotations. Probably its most important role is to supplement the concept of 'investments affected' to include foreseeable profits and to exclude speculative benefits. In the present case the foreseeable profits can be computed on the basis of Mr. Fertig's Business Plan. The gross return which emerges is 184.3 million

dollars for the period 1993 to 2002. Total net profits of 65.7 million dollars were anticipated. If this figure is extrapolated to reach the end of 2005, that is, the full period of the licence, a further 19.71 million is added, producing a total net profit of 85.41 million.

117. Before the question of necessary deductions is approached, it is appropriate to refer to the dominant position factor. There is substantial evidence on the record of the dominant position of CNTS and TV Nova in the relevant market : see above, paras. 51-57. There are also questions relating to the legality of the situation in Czech law. However, for present purposes, that is, the compensation phase of these proceedings, the applicable standards are those of Article 5 of the Treaty. 'Just Compensation', it is to be presumed, is incompatible with profit levels derived from a dominant position in the media market. In the circumstances a treaty-based discount factor of ten per cent of the total net profit will provide the necessary assurance of compatibility with the concept of just compensation. Applying this discount, the net profits fit for compensation total 76.87 million dollars.

118. The outcomes are as follows:

- (1) Investments, including retained profits: 84 million dollars.
- (2) Foreseeable profits (Len Fertig's Business Plan): Period 1993-2002: profits of 65.7 million dollars + extrapolated to the end of 2005: add 19.71 million: total is 85.41 million + subject to (3) below.
- (3) Dominant position: treaty-based discount factor of ten per cent of the total profit equals 76.87 million dollars.

119. Total thus far:

49.3 million (investments)  
34.7 million (retained profits)  
76.87 million (foreseeable profits)  
160.87

120. This final figure more effectively reflects the provisions of the Treaty than the methodology adopted in the Final Award.
121. In view of the methodological drawbacks attaching to the Final Award, it has been necessary to present this Separate Opinion. However, in view of the assessment of compensation as such in the Final Award, a dissenting vote would not have been justified. The compensation figure supported in this Separate Opinion is considerably less than that offered in the Final Award, but nonetheless the mode of application of the 'commercial' method adopted in the Final Award is, on its own terms, moderate. The calculations derive to a considerable extent from the expert Report produced on behalf of the Respondent. Moreover, a similarly moderate approach has been adopted in relation to both interest and costs.
122. With respect to the Zelezny factor the discount of 72 million adopted in the Final Award is defensible, in spite of the fact that there are a number of references to the figure of 100 million in the documents: see above, paras. 87-92.

London, March 14<sup>th</sup>, 2003

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