

**IN THE MATTER OF AN INDEPENDENT REVIEW PROCESS  
BEFORE THE INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION**

<p>AMAZON EU S.À.R.L.,</p> <p style="text-align: right;">Claimant,</p> <p style="text-align: center;">v.</p> <p>INTERNET CORPORATION FOR ASSIGNED NAMES AND NUMBERS,</p> <p style="text-align: right;">Respondent.</p>
----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

ICDR Case No. \_\_\_\_\_

**REQUEST BY AMAZON EU S.À.R.L. FOR INDEPENDENT REVIEW**

**List of Legal Authorities**

Ex. No.	Description
<b>CLA-001</b>	<i>Booking.com B.V. v. ICANN</i> , ICDR Case No. 50-20-1400-0247, Final Declaration (3 Mar. 2015)
<b>CLA-002</b>	<i>DotConnectAfrica Trust v. ICANN</i> , ICDR Case No. 50-2013-001083, Final Declaration, (9 July 2015)
<b>CLA-003</b>	<i>ICM Registry, LLC v. ICANN</i> , ICDR Case No. 20 117 T 00224 08, Declaration of the Independent Review Panel (19 Feb. 2010)
<b>CLA-004</b>	<i>Vistaprint Limited v. ICANN</i> , ICDR Case No. 01-14-0000-6505, Final Declaration of the Independent Review Panel (9 July 2015)
<b>CLA-005</b>	<i>DotConnectAfrica Trust v. ICANN</i> , ICDR Case No. 50-2013-001083, Hearing on the Merits transcript (22–23 May 2015)
<b>CLA-006</b>	<i>Vistaprint Limited v. ICANN</i> , ICDR Case No. 01-14-0000-6505, ICANN's Response to Claimant Vistaprint's Limited Request for Independent Review Process (21 July 2014)

<b>CLA-007</b>	<i>Merck KGaA v. ICANN</i> , ICDR Case No. 01-14-0000-9604, ICANN's Response to Claimant Merck's KGaA's Request for Independent Review Process (29 Aug. 2014)
<b>CLA-008</b>	<i>Merck KGaA v. ICANN</i> , ICDR Case No. 01-14-0000-9604, Final Declaration of the Independent Review Process Panel (10 Dec. 2015)
<b>CLA-009</b>	<i>The Gibraltar Football Association (GFA)/Union des Associations Européennes de Football (UEFA)</i> , Arbitration CAS 2002/O/410, Award (7 Oct. 2003)
<b>CLA-010</b>	<i>AEK Athens and SK Slavia Prague v. Union of European Football Associations (UEFA)</i> , Arbitration CAS 98/200, Award (20 Aug. 1999)
<b>CLA-011</b>	<i>A. / Fédération Internationale de Lutttes Associées (FILA)</i> , Arbitration CAS 2001/A/317, Award (9 July 2001)
<b>CLA-012</b>	<i>Federazione Italiana Nuoto (FIN) v. Fédération Internationale de Ntation Amateur (FINA)</i> , Arbitration CAS Case No. 1996/A/157, Award (23 Apr. 1997), in <i>Digest of CAS Awards 1986-1998</i>
<b>CLA-013</b>	<i>Ronald S. Lauder v. The Czech Republic</i> , UNCITRAL, Final Award (3 Sept. 2001)
<b>CLA-014</b>	<i>Metalclad Corporation v. The United Mexican States</i> , ICSID Case No. ARB/(AF)/97/1, Award (30 Aug. 2000)
<b>CLA-015</b>	<i>United States Olympic Committee v. International Olympic Committee and International Association of Athletics Federations</i> , Arbitration CAS 2004/A/725, Award (20 July 2005)
<b>CLA-016</b>	<i>Saluka Investments B.V. v. The Czech Republic</i> , UNCITRAL, Partial Award (17 Mar. 2006)
<b>CLA-017</b>	<i>Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States</i> , ICSID Case No. ARB (AF)/00/2, Award (29 May 2003)
<b>CLA-018</b>	<i>CME Czech Republic B.V. v. The Czech Republic</i> , UNCITRAL, Partial Award (13 Sept. 2001)

<b>CLA-019</b>	Jeswald W. Salacuse, <i>Law of Investment Treaties</i> , 2 <sup>nd</sup> Ed. (2015)
<b>CLA-020</b>	<i>Asian Agricultural Products Ltd. v. Republic of Sri Lanka</i> , ICSID Case No. ARB/87/3, Final Award (27 June 1990)
<b>CLA-021</b>	ECJ Case C-269/90, Judgment of the Court (21 Nov. 1991)
<b>CLA-022</b>	ECJ Case C-16/90, Judgment of the Court (21 Oct. 1991)
<b>CLA-023</b>	Draft articles on Prevention of Trans boundary Harm from Hazardous Activities, with comments (2001)
<b>CLA-024</b>	<i>Invesmart, B.V. v. Czech Republic</i> , UNCITRAL, Award (26 June 2009)
<b>CLA-025</b>	<i>ADC Affiliate Ltd. v. Republic of Hungary</i> , ICSID Case No. ARB/03/16, Award (2 Oct. 2006)
<b>CLA-26</b>	<i>DotConnectAfrica Trust v. ICANN</i> , ICDR Case No. 50-2013-001083, Determination of the Panel on the IRP Procedure (14 Aug. 2014)
<b>CLA-027</b>	<i>Gulf Cooperation Council v. ICANN</i> , ICDR Case No. 01-14-0002-1065 ICANN's Response to GCC's Request for Emergency Relief (17 Dec. 2014)
<b>CLA-028</b>	<i>Gulf Cooperation Council v. ICANN</i> , ICDR Case No. 01-14-0002-1065 ICANN's Response to GCC's Request for Independent Review Process (20 Jan. 2015)

**CLA-001**



INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION  
Independent Review Process Panel

---

In the Matter of an Independent Review Process

Between:

Booking.com B.V.

*Applicant*

-and-

ICDR Case No: 50-20-1400-0247

Internet Corporation for Assigned Names  
and Numbers (ICANN)

*Respondent*

---

FINAL DECLARATION

The Panel:

Hon. A. Howard Matz  
David H. Bernstein, Esq.  
Stephen L. Drymer (Chair)

**TABLE OF CONTENTS**

I.	INTRODUCTION.....	2
II.	THE PARTIES.....	3
	A. The Applicant: Booking.com .....	3
	B. The Respondent: ICANN.....	3
III.	FACTUAL AND PROCEDURAL BACKGROUND – IN BRIEF .....	3
	A. ICANN’s Adoption of the New gTLD Program and the Applicant Guidebook .....	3
	B. Booking.com’s Application for .hotels, and the Outcome .....	5
	C. DIDP Request and Request for Reconsideration .....	6
	D. The Cooperative Engagement Process .....	9
	E. The IRP Proceedings .....	10
	F. The Hearing.....	11
IV.	ICANN ARTICLES, BYLAWS AND POLICIES – KEY ELEMENTS.....	11
	A. Articles of Association .....	11
	B. Bylaws .....	11
	C. The gTLD Applicant Guidebook.....	16
	(i) <i>Initial Evaluation</i> .....	16
	(ii) <i>String Review, including String Similarity Review</i> .....	16
V.	SUMMARY OF THE PARTIES’ POSITIONS .....	21
	A. Booking.com’s position.....	21
	(i) <i>The Panel’s Authority</i> .....	21
	(ii) <i>Booking.com’s Claims</i> .....	22
	a. <i>The string similarity review process</i> .....	22
	b. <i>The case of .hotels</i> .....	24
	B. ICANN’s position .....	26
	(i) <i>The Panel’s Authority</i> .....	26
	(ii) <i>ICANN’s Response to Booking.com’s Claims</i> .....	27
	a. <i>The string similarity review process</i> .....	27
	b. <i>The case of .hotels</i> .....	29
VI.	ANALYSIS.....	29
	A. The Panel’s Authority .....	29
	B. The String Similarity Review Process .....	33
	C. The Case of .hotels .....	37
	D. Conclusion.....	42
VII.	THE PREVAILING PARTY; COSTS.....	43

## DECLARATION

WE, THE UNDERSIGNED PANELISTS, members of the Independent Review Process Panel (“**IRP Panel**” or “**Panel**”), having been designated in accordance with ICANN Bylaws dated 11 April 2013, hereby issue the following Final Declaration (“**Declaration**”):<sup>1</sup>

### I. INTRODUCTION

1. This Declaration is issued in the context of an Independent Review Process (“**IRP**”) as provided for in Article IV, Section 3 of the Bylaws of the Internet Corporation for Assigned Names and Numbers (“**ICANN**”; “**ICANN Bylaws**” or “**Bylaws**”). In accordance with those Bylaws, the conduct of this IRP is governed by the International Arbitration Rules of the International Centre for Dispute Resolution as amended and in effect June 1, 2009 (“**ICDR**”; “**ICDR Rules**”) as supplemented by the Supplementary Procedures for Internet Corporation for Assigned Names and Numbers (ICANN) Independent Review Process (“**Supplementary Procedures**”).
2. The subject matter of the dispute here concerns alleged conduct by the ICANN Board in relation to one particular facet of the process by which new generic top-level domains (“**gTLDs**”, also known as gTLD “**strings**”) are applied for, reviewed and delegated into the Internet’s domain name system (“**DNS**”) root zone.
3. As explained in this Declaration, the Applicant, Booking.com, alleges that, in establishing and overseeing the process by which so-called *string similarity reviews* are conducted, and in refusing to reconsider and overturn a decision to place Booking.com’s applied-for gTLD string .hotels in a so-called *string contention set*, the Board acted in a manner inconsistent with applicable policies, procedures and rules as set out in ICANN’s Articles of Incorporation, Bylaws and gTLD Applicant Guidebook (“**Guidebook**”).
4. Reading between the lines of the parties’ submissions, the Panel senses that both sides would welcome the opportunity to contribute to an exchange that might result in enabling disputants in future cases to avoid having to resort to an IRP to resolve issues such as have arisen here. Certainly the Panel considers that the present matter would ideally have been resolved amicably by the parties. This is particularly true given that the matter here concerns two of ICANN’s guiding principles – transparency and fairness – as applied to one of ICANN’s most essential activities – the delegation of new gTLDs<sup>2</sup> – in circumstances in which various members of the Internet community, including certain members of the ICANN Board’s New gTLD Program Committee, have expressed their own concerns regarding the string similarity review process. That being the case, though, the Panel does not shy away from the duty imposed by the Bylaws to address the questions before it and to render the

---

<sup>1</sup> As requested by the ICDR, the Declaration was provided to the ICDR in draft form on 26 January 2015 for non-substantive comments on the text (if any). It was returned to the Panel on 2 March 2015.

<sup>2</sup> As stated in the very first sentence of the Guidebook: “New gTLDs have been in the forefront of ICANN’s agenda since its creation.”

present Declaration, in accordance with, and within the constraints of the Bylaws, the ICDR Rules and the Supplementary Procedures.

## II. THE PARTIES

### A. The Applicant: Booking.com

5. The Applicant, Booking.com, is a limited liability company established under the law of the Netherlands. Booking.com describes itself as “the number one online hotel reservation service in the world, offering over 435,605 hotels and accommodations.”<sup>3</sup> Booking.com’s primary focus is on the U.S. and other English-language markets.
6. Booking.com is represented in this IRP by Mr. Flip Petillion and Mr. Jan Janssen of the law firm *Crowell & Moring* in Brussels, Belgium.

### B. The Respondent: ICANN

7. The Respondent, ICANN, is a California not-for-profit public benefit corporation, formed in 1998. As set forth in Article I, Section 1 of its Bylaws, ICANN’s mission is “to coordinate, at the overall level, the global Internet’s system of unique identifiers, and in particular to ensure the stable and secure operation of the Internet’s unique identifier systems.” ICANN describes itself as “a complex organization that facilitates input from a wide variety of Internet stakeholders. ICANN has a Board of Directors and staff members from around the globe, as well as an Ombudsman. ICANN, however, is much more than just the corporation—it is a community of participants.”<sup>4</sup>
8. ICANN is represented in this IRP by Mr. Jeffrey A. LeVee, Esq. and Ms. Kate Wallace, Esq. of the law firm *Jones Day* in Los Angeles, California, USA.

## III. FACTUAL AND PROCEDURAL BACKGROUND – IN BRIEF

9. We recount here certain uncontested elements of the factual and procedural background to the present IRP. Other facts are addressed in subsequent parts of the Declaration, where the parties’ respective claims and the Panel’s analysis are discussed.

### A. ICANN’s Adoption of the New gTLD Program and the Applicant Guidebook

10. Even before the introduction of ICANN’s New gTLD Program (“**Program**”), in 2011, ICANN had, over time, gradually expanded the DNS from the original six gTLDs (.com; .edu; .gov; .mil; .net; .org) to 22 gTLDs and over 250 two-letter country-code TLDs.<sup>5</sup> Indeed, as noted above, the introduction of new gTLDs has been “in the forefront of ICANN’s agenda” for as long as ICANN has existed.

---

<sup>3</sup> Request, ¶¶ 10.

<sup>4</sup> Response, ¶¶ 11-12.

<sup>5</sup> Request, ¶¶ 12; see also Guidebook, *Preamble*.

11. The Program has its origins in what the Guidebook refers to as “carefully deliberated policy development work” by the ICANN community.<sup>6</sup>
12. In 2005, ICANN’s Generic Names Supporting Organization (“GNSO”), one of the groups that coordinates global Internet policy at ICANN, commenced a policy development process to consider the introduction of new gTLDs.<sup>7</sup> As noted in the Guidebook:

*Representatives from a wide variety of stakeholder groups – governments, individuals, civil society, business and intellectual property constituencies, and the technology community – were engaged in discussions for more than 18 months on such questions as the demand, benefits and risks of new gTLDs, the selection criteria that should be applied, how gTLDs should be allocated, and the contractual conditions that should be required for new gTLD registries going forward.*

13. In October 2007, the GNSO formally completed its policy development work on new gTLDs and approved a set of 19 policy recommendations.
14. In June 2008, the ICANN Board decided to adopt the policies recommended by the GNSO.<sup>8</sup> As explained in the Guidebook, ICANN’s work next focused on implementation of these recommendations, which it saw as “creating an application and evaluation process for new gTLDs that is aligned with the policy recommendations and provides a clear roadmap for applicants to reach delegation, including Board approval.”<sup>9</sup>
15. This process concluded with the decision by the ICANN Board in June 2011 to implement the New gTLD Program and its foundational instrument, the Guidebook.<sup>10</sup>
16. As described by ICANN in these proceedings, the Program “constitutes by far ICANN’s most ambitious expansion of the Internet’s naming system. The Program’s goals include

---

<sup>6</sup> Guidebook, *Preamble*

<sup>7</sup> Request, ¶ 13, Reference Material 7, “Public Comment Forum for Terms of Reference for New gTLDs (6 December 2005), <http://www.icann.org/en/news/announcements/announcement-06dec05-en.htm#TOR>; Reference Material 8, “GNSO Issues Report, Introduction of New Top-Level Domains (5 December 2005) at pp. 3-4. See also Guidebook, *Preamble*. Booking.com refers to the GNSO as “ICANN’s main policy-making body for generic top-level domains”. Article X of ICANN’s Articles of Incorporation provides: “There shall be a policy-development body known as the Generic Names Supporting Organization (GNSO), which shall be responsible for developing and recommending to the ICANN Board substantive policies relating to generic top-level domains” (Section 1); the GNSO shall consist of “a number of Constituencies” and “four Stakeholder Groups” (Section 2).

<sup>8</sup> Guidebook, *Preamble*. A review of this policy process can be found at <http://gns0.icann.org/issues/new-gtlds> (last accessed on January 15, 2015).

<sup>9</sup> Guidebook, *Preamble*: “This implementation work is reflected in the drafts of the applicant guidebook that were released for public comment, and in the explanatory papers giving insight into rationale behind some of the conclusions reached on specific topics. Meaningful community input has led to revisions of the draft applicant guidebook.”

<sup>10</sup> RM 10 (ICANN resolution). The Guidebook (in its 30 May 2011 version) is one of seven “elements” of the Program implemented in 2011. The other elements were: a draft communications plan; “operational readiness activities”; a program to ensure support for applicants from developing countries; “a process for handling requests for removal of cross-ownership restrictions on operators of existing gTLDs who want to participate in the [Program]”; budgeted expenditures; and a timetable.

enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of new gTLDs ...”.<sup>11</sup>

17. The Guidebook is “continuously iterated and revised”, and “provides details to gTLD applicants and forms the basis for ICANN’s evaluation of new gTLD applications.”<sup>12</sup> As noted by Booking.com, the Guidebook “is the crystallization of Board-approved consensus policy concerning the introduction of new gTLDs.”<sup>13</sup>

#### **B. Booking.com’s Application for .hotels, and the Outcome**

18. In accordance with the process set out in the Guidebook, Booking.com filed an application (Application ID 1-1016-75482) for the gTLD string .hotels.
19. At the same time, Despegar Online SRL (“Despegar”), a corporation established under the law of Uruguay, applied (Application ID 1-1249-87712) for the string .hoteis.
20. “Hoteis” is the Portuguese word for “hotels”.
21. According to Booking.com, Despegar is “a competitor of Booking.com”.<sup>14</sup> Booking.com claims that it intends “to operate .hotels as a secure Internet environment providing hotel reservation services for consumers, hotels, and other stakeholders,”<sup>15</sup> while Despegar similarly intends .hoteis to be dedicated primarily to “individuals that are interested in, and businesses that offer, hotel- and travel-related content.”<sup>16</sup> That being said, a key difference between the two applications, as Booking.com acknowledges, is that Booking.com intends to focus the services it will offer under its proposed gTLD “on the U.S. (with its strongly Anglo-Saxon traditions) and other English-language markets,”<sup>17</sup> whereas Despegar intends to target “Portuguese-speaking” markets.<sup>18</sup>
22. As part of the Initial Evaluation to which all applied-for gTLDs were subject, .hotels and .hoteis were each required to undergo so-called *string review* in accordance with the Guidebook, the first component of which is a process known as *string similarity review*. As provided by the Guidebook, the string similarity review was conducted by an independent

---

<sup>11</sup> Response, ¶ 14.

<sup>12</sup> Response, ¶ 14. The resolution (RM 10) adopting the Guidebook explicitly “authorizes staff to make further updates and changes to the Applicant Guidebook as necessary and appropriate, including as the possible result of new technical standards, reference documents, or policies that might be adopted during the course of the application process, and to prominently publish notice of such changes.”

<sup>13</sup> Request, ¶ 13. See also Guidebook, Module 1-2: “This Applicant Guidebook is the implementation of Board approved consensus policy concerning the introduction of new gTLDs, and has been revised extensively via public comment and consultation over a two-year period.”

<sup>14</sup> Request, ¶ 17.

<sup>15</sup> Request, ¶ 5.

<sup>16</sup> Request, ¶ 17. See also Despegar Application for .hoteis (Request, Annex 2), § 18(a).

<sup>17</sup> Request, ¶ 16.

<sup>18</sup> Request, ¶ 17. See also Despegar Application for .hoteis (Request, Annex 2), § 18(a).

String Similarity Panel (“SSP”) selected and engaged by ICANN for this purpose. (Extracts of the relevant provisions of the Guidebook can be found below, at Part IV of this Declaration.) ICANN engaged InterConnect Communications Ltd. (“ICC”), a company registered under the law of England and Wales, specializing in communications sector strategy, policy and associated regulatory frameworks,<sup>19</sup> in cooperation with University College London, to act as the SSP.

23. On 26 February 2013 ICANN published the results of all of the string similarity reviews for all of the applications for new gTLDs submitted as part of the Program. The announcement revealed, among other things, that two “non-exact match” contention sets had been created: .hotels & .hoteis; and .unicorn & .unicom.<sup>20</sup> Booking.com’s applied for string .hotels (as well as the .hoteis, .uncorn and .unicom strings) had thus failed the string similarity review.
24. The results of the string similarity review were notified to Booking.com by ICANN that same day. In its letter of 26 February 2013 ICANN wrote:

*After careful consideration and extensive review performed against the criteria in Section 2.2.1.1 of the Applicant Guidebook, the String Similarity Panel has found that the applied-for string (.hotels) is visually similar to another applied-for string (.hoteis), creating a probability of user confusion.*

*Due to this finding, the ... two strings have been placed in a contention set.<sup>21</sup>*

25. The impact of being put into a contention set is that the proposed strings in the set will not be delegated in the root zone unless and until the applicants reach agreement on which single string should proceed (with the other proposed string therefore rejected), or until after an auction is conducted, with the highest bidder being given the right to proceed to the next step in the review process.

### **C. DIDP Request and Request for Reconsideration**

26. On 28 March 2013 Booking.com submitted a request for information under ICANN’s Documentary Information Disclosure Policy (“**DIDP Request**”) asking for “all documents directly and indirectly relating to (1) the standard used to determine whether gTLD strings are confusingly similar, and (2) the specific determination that .hotels and .hoteis are confusingly similar.”<sup>22</sup>
27. On the same date, Booking.com also filed a formal Request for Reconsideration (“**Request for Reconsideration**”). The “specific action(s)” that Booking.com asked to be reconsidered were: the decision to place .hotels and .hoteis in a contention set; and the decision not to

<sup>19</sup> See <http://www.icc-uk.com/>

<sup>20</sup> Request, Annex 3. ICANN published document dated 26 February 2013. As its name suggests, a “non-exact match” connotes a determination that two different (non-identical) strings are visually similar within the meaning of the Guidebook. Another 752 applied-for gTLDs were put into 230 identical contention sets.

<sup>21</sup> Request, Annex 3, ICANN letter dated 26 February 2013.

<sup>22</sup> Request, ¶ 30 and Annex 3.

provide a “detailed analysis or a reasoned basis” for the decision to place .hotels in contention.<sup>23</sup>

28. ICANN responded to the DIDP Request on 27 April 2013. Although ICANN provided certain information regarding the review process, in its response to the DIDP Request, ICANN also noted:

*The SSP is responsible for the development of its own process documentation and methodology for performing the string similarity review, and is also responsible for the maintenance of its own work papers. Many of the items that are sought from ICANN within the [DIDP] Request are therefore not in existence within ICANN and cannot be provided in response to the DIDP Request. ICANN will, however, shortly be posting the SSP's String Similarity Process and Workflow on the New gTLD microsite ...<sup>24</sup>*

29. By letter dated 9 May 2013 Booking.com replied to ICANN, writing that “ICANN’s response fails to provide any additional information or address any of Booking.com’s concerns as conveyed in its DIDP Request or Request for Reconsideration.”<sup>25</sup> On 14 May 2013, ICANN answered that it “intends to post the string similarity process documentation on or before ... 17 May 2013.”<sup>26</sup> ICANN further informed Booking.com that “ICANN will afford you 30 days from the posting of the process document for the submission of a revised Request for Reconsideration.”<sup>27</sup>
30. On 7 June 2013, ICANN published the “String Similarity New gTLD Evaluation Panel [i.e., the SSP] – Process Description” (“**SSP Process Description**”).<sup>28</sup>
31. On 26 June 2013 Booking.com wrote to ICANN regarding both its DIDP Request and its 28 March 2013 Request for Reconsideration. In its letter, Booking.com noted among other things that “the generalized information ICANN thus far has provided does not explain a rationale for or analysis for the decision to put .hotels and .hoteis in a contention set and therefore does not allow Booking.com to appropriately amend its Request for Reconsideration.” The letter concluded by stating: “Considering ICANN’s obligations of transparency and accountability, there cannot be any ‘compelling reason for confidentiality’.

<sup>23</sup> Request, Annex 12, §3. The Request for Reconsideration (which appears to be in the form of a template) expressly states at §2 that it is a “Request for Reconsideration of ... Staff [vs. Board] action/inaction.” The cover letter attaching the Request states that, “[d]espite the fact that the origin of the decisions is unclear, this Reconsideration Request is being submitted as a reconsideration of a ‘Staff action’. In the event that the decisions referenced above are determined to be a ‘Board action’, this request may be amended.” As explained below, the Request for Reconsideration was amended on 7 July 2013. That amendment did not alter the stated nature of the request in §2 or the description of the specific actions that Booking.com sought to have reconsidered (§3). Unless otherwise indicated, all further references in this Declaration to the Request for Reconsideration are understood to be the *amended* Request for Reconsideration.

<sup>24</sup> Request, Annex 5.

<sup>25</sup> Request, Annex 6.

<sup>26</sup> Request, Annex 7.

<sup>27</sup> Request, Annex 7.

<sup>28</sup> Request, Annex 8.



And ... there are numerous compelling reasons for publication of [the information requested by Booking.com].<sup>29</sup>

32. ICANN responded on 25 July 2013, explaining among other things that “the evaluation of the .hotels string by the SSP panel was performed according to the [SSP Process Description] ...” and “[t]he SSP’s work was subjected to quality review, as has been publicly discussed.”<sup>30</sup> Approximately six months later, on 9 January 2014, ICANN posted a letter dated 18 December 2013 addressed to ICANN by the SSP Manager at ICC (Mr. Mark McFadden) providing a further “summary of the process, quality control mechanisms and some considerations surrounding the non-exact contention sets for the string similarity evaluation ...” (“**SSP Manager’s Letter**”).<sup>31</sup> According to that Letter:

*When ALL of the following features of a pairwise comparison [of non-exact match strings] are evident the evaluators found the string pair to be confusingly similar:*

- *Strings of similar visual length on the page;*
- *Strings within +/- 1 character of each other;*
- *Strings where the majority of characters are the same and in the same position in each string; and*
- *The two strings possess letter combinations that visually appear similar to other letters in the same position in each string*

*o For example m~m & l~i*

33. Meanwhile, on 7 July 2013 Booking.com had submitted its amended Request for Reconsideration. In its letter attaching the amended Request for Reconsideration, Booking.com stated: “Booking.com reserves the right to further amend its Request for Reconsideration upon receipt of the information it previously requested and urges ICANN to publish the requested information as specified in our letter of 26 June 2013.”<sup>32</sup>
34. By virtue of Article IV, Section 3 of the Bylaws, ICANN’s Board Governance Committee (“**BGC**”) is charged with evaluating and making recommendation to the Board with respect to requests for reconsideration. The Board’s New gTLD Program Committee (“**NGPC**”) receives and acts on such recommendations on behalf of the ICANN Board. In accordance with this procedure, Booking.com’s Request for Reconsideration was evaluated by the BGC. In a detailed analysis dated 1 August 2013, the BGC “conclude[d] that Booking.com has not

---

<sup>29</sup> Request, Annex 9.

<sup>30</sup> Request, Annex 10.

<sup>31</sup> Request, Annex 11.

<sup>32</sup> Request, Annex 13.

stated proper grounds for reconsideration and we therefor recommend that Booking.com's request be denied" ("BGC Recommendation").<sup>33</sup>

35. At a telephone meeting held on 10 September 2013 the NGPC, "bestowed with the powers of the Board", considered, discussed and accepted the BGC Recommendation. Booking.com's Request for Reconsideration was denied.<sup>34</sup>

#### **D. The Cooperative Engagement Process**

36. Booking.com thereafter filed a request for a Cooperative Engagement Process ("CEP") on 25 September 2013, with a view to attempting to reach an amicable resolution of its dispute with ICANN. In its CEP request, Booking.com wrote:

*Booking.com is of the opinion that Resolution 2013.09.10.NG02 [the Board resolution denying its Request for Reconsideration] violates various provisions of ICANN's Bylaws and Articles of Incorporation. In particular Booking.com considers that ICANN's adoption of [the Resolution] is in violation of Articles I, II(3), II and IV of the ICANN Bylaws as well as Article 4 of ICANN's Articles of Incorporation. In addition, Booking.com considers that ICANN has acted in violation of Articles 3, 5, 7 and 9 of ICANN's Affirmation of Commitment ...*<sup>35</sup>

37. The CEP ultimately did not result in a resolution, and Booking.com duly commenced the present IRP.
38. One further point should be made, here, prior to describing the commencement and conduct of the present IRP proceedings: The determination by the SSP that .hotels and .hoteis are so visually similar as to give rise to the probability of user confusion, and the resulting placement of those applied-for strings into a contention set, does *not* mean that Booking.com's application for .hotels has been denied or that .hotels will not proceed to delegation to the root zone. Rather, as noted above and explained in the extracts from the Guidebook reproduced below, the Guidebook establishes a process for resolving such contention, under which the applicants for the contending strings in the set – here, Booking.com and Despegar – may resolve the contention by negotiation, failing which the matter will proceed to auction. Ultimately, no matter the outcome of these IRP proceedings, Booking.com may yet be successful and .hotels may yet be delegated into the Internet root zone. However, the fact that .hotels has been put into a contention set does raise the risk that .hotels may never be delegated into the root zone, or that it may be more costly for Booking.com to obtain approval of its proposed string. It also has caused a significant delay in the potential delegation of the string into the root zone (which could prove to be detrimental to the ultimate success of Booking.com's proposed string if other applicants

---

<sup>33</sup> Request, Annex 14, BGC Recommendation dated 1 August 2013, p.9. See also Request, Annex 15, NGPC Resolution dated 10 September 2013. As noted in footnote 1 to the BGC Recommendation, the Recommendation was ultimately finalized and submitted for posting on 21 August 2013.

<sup>34</sup> Request, Annex 15, NGPC Resolution dated 10 September 2013.

<sup>35</sup> Request, Annex 17.

whose strings were not put into a contention set are able to establish themselves as pioneer providers of hotel- and travel-related services under a different new gTLD).

#### **E. The IRP Proceedings**

39. On 19 March 2014, Booking.com submitted a Notice of Independent Review, dated 18 March 2014, as well as a Request for Independent Review Process (“**Request**”) accompanied by numerous supporting documents and reference materials.
40. In accordance with Article IV, Section 3(9) of the ICANN Bylaws, Booking.com requested that a three-member IRP panel be constituted to consider and determine the Request. As the omnibus standing panel referred to in Article IV, Section 3(6) of the ICANN Bylaws had yet to be established, Booking.com further proposed, in accordance with Article 6 of the ICDR Rules, that each party appoint one panelist, with the third (the Chair of the panel) to be appointed by the two party-appointed panelists.
41. On 25 April 2014, ICANN submitted a Response to ICANN’s Request with supporting documents (“**Response**”).
42. The parties having thereafter agreed on the number of panelists and the method of their appointment, David H. Bernstein, Esq. was duly appointed as panelist by Booking.com on 1 May 2014, and the Hon. A Howard Matz was duly appointed as panelist by ICANN on 30 May 2014.
43. On 17 July 2014, the ICDR notified the parties that Mr. Stephen L. Drymer had been duly nominated by the two party-appointed panelists as Chair of the Panel. Mr. Drymer’s appointment became effective and the Panel was duly constituted as of 1 August 2014.
44. On 21 August 2014, further to consultations among the panelists and between the Panel and the parties, the Panel convened a preparatory conference with the parties (by telephone) for the purpose of discussing organizational matters, including a timetable for any further written statements or oral argument. Both parties requested the opportunity to make supplemental submissions and to present oral argument.
45. On 22 August 2014 the Panel issued Procedural Order No. 1 in which, among other things, it established a Procedural Timetable for the IRP. As specifically requested by the parties, the Procedural Order and Timetable provided for the submission of additional written statements by the parties as well as for a brief oral hearing to take place by telephone, all on dates proposed by and agreed between the parties.<sup>36</sup>
46. In accordance with the Procedural Timetable, on 6 October 2014 Booking.com submitted its Reply to ICANN’s Response, accompanied by additional documents (“**Reply**”).

---

<sup>36</sup> Paragraph 6 of Procedural Order No. 1 provided that, in its forthcoming Reply to ICANN’s Response, “Booking.com shall only address two issues raised in Respondent’s Response: (1) the nature and scope of the IRP requested; (2) the nature of the relief sought by Claimant.” Paragraph 7 of Procedural Order No. 1 provided that “Respondent’s Sur-Reply ... shall address only the issues raised in the Reply.”

47. In accordance with the Procedural Timetable, ICANN submitted a Sur-Reply on 20 November 2014 (“Sur-Reply”).

#### **F. The Hearing**

48. As provided by Procedural Order No. 1 and the Procedural Timetable, a hearing was held (by telephone) on 10 December 2011, commencing at 9:00 PST/18:00 CET.
49. In the light of the significance of the issues raised by the parties, and given the many questions prompted by those issues and by the parties’ extensive written submissions and supporting materials, the Panel indicated that it would allow the hearing to continue beyond the approximately one hour originally envisaged. The hearing ultimately lasted two and one-half hours. Counsel for each party made extensive oral submissions, including rebuttal and sur-rebuttal submissions, and responded to the panelists’ questions.
50. Prior to the close of the hearing each party declared that it had no objection concerning the conduct of the proceedings, that it had no further oral submissions that it wished to make, and that it considered that it had had a full opportunity to present its case and to be heard.
51. As agreed and ordered prior to the close of the hearing, the parties were provided the opportunity to file limited additional materials post-hearing, in relation to a certain question asked of them by the Panel. This was done, and, on 13 December 2014, the proceedings were declared closed.

### **IV. ICANN ARTICLES, BYLAWS AND POLICIES – KEY ELEMENTS**

52. We set out here the key elements of ICANN’s Articles of Association, Bylaws and policies on which the parties rely in their submissions and to which the Panel will refer later in this Declaration.

#### **A. Articles of Association**

*4. The Corporation shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law and, to the extent appropriate and consistent with these Articles and its Bylaws, through open and transparent processes that enable competition and open entry in Internet-related markets. To this effect, the Corporation shall cooperate as appropriate with relevant international organizations.*

*[Underlining added]*

#### **B. Bylaws**

##### **ARTICLE I: MISSION AND CORE VALUES**

###### **Section 1. MISSION**

*The mission of The Internet Corporation for Assigned Names and Numbers (“ICANN”) is to coordinate, at the overall level, the global Internet’s systems of unique identifiers,*

*and in particular to ensure the stable and secure operation of the Internet's unique identifier systems.*

*[...]*

## *Section 2. CORE VALUES*

*In performing its mission, the following core values should guide the decisions and actions of ICANN:*

- 1. Preserving and enhancing the operational stability, reliability, security, and global interoperability of the Internet.*
- 2. Respecting the creativity, innovation, and flow of information made possible by the Internet by limiting ICANN's activities to those matters within ICANN's mission requiring or significantly benefiting from global coordination.*
- 3. To the extent feasible and appropriate, delegating coordination functions to or recognizing the policy role of other responsible entities that reflect the interests of affected parties.*
- 4. Seeking and supporting broad, informed participation reflecting the functional, geographic, and cultural diversity of the Internet at all levels of policy development and decision-making.*
- 5. Where feasible and appropriate, depending on market mechanisms to promote and sustain a competitive environment.*
- 6. Introducing and promoting competition in the registration of domain names where practicable and beneficial in the public interest.*
- 7. Employing open and transparent policy development mechanisms that (i) promote well-informed decisions based on expert advice, and (ii) ensure that those entities most affected can assist in the policy development process.*
- 8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.*
- 9. Acting with a speed that is responsive to the needs of the Internet while, as part of the decision-making process, obtaining informed input from those entities most affected.*
- 10. Remaining accountable to the Internet community through mechanisms that enhance ICANN's effectiveness.*
- 11. While remaining rooted in the private sector, recognizing that governments and public authorities are responsible for public policy and duly taking into account governments' or public authorities' recommendations.*

*These core values are deliberately expressed in very general terms, so that they may provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each new situation will necessarily depend on many factors that cannot be fully anticipated or enumerated; and because they are statements of principle rather than practice, situations will inevitably arise in which perfect fidelity to all eleven core values simultaneously is not possible. Any ICANN*

body making a recommendation or decision shall exercise its judgment to determine which core values are most relevant and how they apply to the specific circumstances of the case at hand, and to determine, if necessary, an appropriate and defensible balance among competing values.

[...]

#### **ARTICLE III: TRANSPARENCY**

##### **Section 1. PURPOSE**

ICANN and its constituent bodies shall operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness.

[...]

#### **ARTICLE IV: ACCOUNTABILITY AND REVIEW**

##### **Section 1. PURPOSE**

In carrying out its mission as set out in these Bylaws, ICANN should be accountable to the community for operating in a manner that is consistent with these Bylaws, and with due regard for the core values set forth in Article I of these Bylaws. The provisions of this Article, creating processes for reconsideration and independent review of ICANN actions and periodic review of ICANN's structure and procedures, are intended to reinforce the various accountability mechanisms otherwise set forth in these Bylaws, including the transparency provisions of Article III and the Board and other selection mechanisms set forth throughout these Bylaws.

##### **Section 2. RECONSIDERATION**

1. ICANN shall have in place a process by which any person or entity materially affected by an action of ICANN may request review or reconsideration of that action by the Board.

2. Any person or entity may submit a request for reconsideration or review of an ICANN action or inaction ("Reconsideration Request") to the extent that he, she, or it have been adversely affected by:

a. one or more staff actions or inactions that contradict established ICANN policy(ies); or

b. one or more actions or inactions of the ICANN Board that have been taken or refused to be taken without consideration of material information, except where the party submitting the request could have submitted, but did not submit, the information for the Board's consideration at the time of action or refusal to act; or

c. one or more actions or inactions of the ICANN Board that are taken as a result of the Board's reliance on false or inaccurate material information.

3. The Board has designated the Board Governance Committee to review and consider any such Reconsideration Requests. The Board Governance Committee shall have the authority to:

a. evaluate requests for review or reconsideration;

- b. summarily dismiss insufficient requests;
- c. evaluate requests for urgent consideration;
- d. conduct whatever factual investigation is deemed appropriate;
- e. request additional written submissions from the affected party, or from other parties;
- f. make a final determination on Reconsideration Requests regarding staff action or inaction, without reference to the Board of Directors; and
- g. make a recommendation to the Board of Directors on the merits of the request, as necessary.

[...]

### Section 3. INDEPENDENT REVIEW OF BOARD ACTIONS

1. In addition to the reconsideration process described in Section 2 of this Article, ICANN shall have in place a separate process for independent third-party review of Board actions alleged by an affected party to be inconsistent with the Articles of Incorporation or Bylaws.

2. Any person materially affected by a decision or action by the Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws may submit a request for independent review of that decision or action. In order to be materially affected, the person must suffer injury or harm that is directly and causally connected to the Board's alleged violation of the Bylaws or the Articles of Incorporation, and not as a result of third parties acting in line with the Board's action.

3. A request for independent review must be filed within thirty days of the posting of the minutes of the Board meeting (and the accompanying Board Briefing Materials, if available) that the requesting party contends demonstrates that ICANN violated its Bylaws or Articles of Incorporation. Consolidated requests may be appropriate when the causal connection between the circumstances of the requests and the harm is the same for each of the requesting parties.

4. Requests for such independent review shall be referred to an Independent Review Process Panel ("IRP Panel"), which shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws. The IRP Panel must apply a defined standard of review to the IRP request, focusing on:

- a. did the Board act without conflict of interest in taking its decision?;
- b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company [ICANN]?

[...]

11. The IRP Panel shall have the authority to:

- a. summarily dismiss requests brought without standing, lacking in substance, or that are frivolous or vexatious;
- b. request additional written submissions from the party seeking review, the Board, the Supporting Organizations, or from other parties;
- c. declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws; and
- d. recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP;
- e. consolidate requests for independent review if the facts and circumstances are sufficiently similar; and
- f. determine the timing for each proceeding.

[...]

14. Prior to initiating a request for independent review, the complainant is urged to enter into a period of cooperative engagement with ICANN for the purpose of resolving or narrowing the issues that are contemplated to be brought to the IRP. [...]

15. Upon the filing of a request for an independent review, the parties are urged to participate in a conciliation period for the purpose of narrowing the issues that are stated within the request for independent review. A conciliator will be appointed from the members of the omnibus standing panel by the Chair of that panel. [...]

16. Cooperative engagement and conciliation are both voluntary. However, if the party requesting the independent review does not participate in good faith in the cooperative engagement and the conciliation processes, if applicable, and ICANN is the prevailing party in the request for independent review, the IRP Panel must award to ICANN all reasonable fees and costs incurred by ICANN in the proceeding, including legal fees.

[...]

18. The IRP Panel should strive to issue its written declaration no later than six months after the filing of the request for independent review. The IRP Panel shall make its declaration based solely on the documentation, supporting materials, and arguments submitted by the parties, and in its declaration shall specifically designate the prevailing party. The party not prevailing shall ordinarily be responsible for bearing all costs of the IRP Provider, but in an extraordinary case the IRP Panel may in its declaration allocate up to half of the costs of the IRP Provider to the prevailing party based upon the circumstances, including a consideration of the reasonableness of the parties' positions and their contribution to the public interest. Each party to the IRP proceedings shall bear its own expenses.

[Underlining added]

53. Lest there be any misunderstanding as regards the proper subject matter of IRP proceedings or the role of the Panel, we note that, as was clearly established during the hearing, it is common ground between the parties that the term "action" (or "actions") as used in Article IV, Section 3 of the Bylaws is to be understood as action(s) or inaction(s) by the ICANN Board. The Panel observes that this understanding comports not only with the provisions of Article



IV, Section 2 of the Bylaws concerning “Reconsideration”, which expressly refer to “actions or inactions of the ICANN Board”, but with the clear intent of Section 3 itself, which stipulates at sub-section 11 that “[t]he IRP Panel shall have the authority to: ... (c) declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws.”

### **C. The gTLD Applicant Guidebook**

54. As noted above and as understood by all, the Guidebook is (to borrow Booking.com’s phrase) “the crystallization of Board-approved consensus policy concerning the introduction of new gTLDs.”<sup>37</sup>
55. The Guidebook is divided into “Modules”, each of which contains various sections and sub-sections. The three Modules of primary relevance here are Modules 1, 2 and 4. Module 1, titled “Introduction to the gTLD Application Process,” provides an “overview of the process for applying for a new generic top-level domains.”<sup>38</sup> Module 2, titled “Evaluation Procedures,” describes the “evaluation procedures and criteria used to determine whether applied-for gTLDs are approved for delegation.”<sup>39</sup> Module 4, titled “String Contention Procedures,” concerns “situations in which contention over applied-for gTLD strings occurs, and the methods available to applicants for resolving such contention cases.”

#### **(i) *Initial Evaluation***

56. As explained in Module 1, “[i]mmediately following the close of the application submission period, ICANN will begin checking all applications for completeness.”<sup>40</sup> Initial Evaluation begins “immediately after the administrative completeness check concludes. All complete applications will be reviewed during Initial Evaluation.”<sup>41</sup>
57. Initial Evaluation is comprised of two main elements or types of review: *string review*, which concerns the applied-for gTLD string; and *applicant review*, which concerns the entity applying for the gTLD and its proposed registry services. It is the first of these – string review, including more specifically the component known as *string similarity review* – that is particularly relevant.

#### **(ii) *String Review, including String Similarity Review***

58. String review is itself comprised of several components, each of which constitutes a separate assessment or review of the applied-for gTLD string, conducted by a separate reviewing body or panel. As explained in Module 2:

*The following assessments are performed in the Initial Evaluation:*

---

<sup>37</sup> Request, ¶ 13.

<sup>38</sup> Module 1-2. Each Module of the Guidebook is paginated separately. “Module 1-2” refers to Guidebook Module 1, page 2.

<sup>39</sup> Module 2-2.

<sup>40</sup> Guidebook, §1.1.2.2: “Administrative Completeness Check”, Module 1-5.

<sup>41</sup> Guidebook, §1.1.2.5: “Initial Evaluation”, Module 1-8 (underlining added).

- *String Reviews*
  - *String similarity*
  - *Reserved names*
  - *DNS stability*
  - *Geographic names*

[...]

*An application must pass all these reviews to pass the Initial Evaluation. Failure to pass any one of these reviews will result in a failure to pass the Initial Evaluation.*<sup>42</sup>

59. As indicated, all complete applications are subject to Initial Evaluation, which means that all applied-for gTLD strings are subject to string review. String review is further described in Module 2 as follows:

*[String review] focuses on the applied-for gTLD string to test:*

- *Whether the applied-for gTLD string is so similar to other strings that it would create a probability of user confusion;*
- *Whether the applied-for gTLD string might adversely affect DNS security or stability; and*
- *Whether evidence of requisite government approval is provided in the case of certain geographic names.*<sup>43</sup>

60. The various assessments or reviews (i.e., string similarity, reserved names, DNS stability, etc.) that comprise string review are elaborated at Section 2.2.1 of Module 2. As mentioned, the most relevant of these reviews for our purposes is *string similarity review*, which is described in detail at Section 2.2.1.1. Because of the central importance of the string similarity review process in the context of the present dispute, this section of the Guidebook is reproduced here at some length:

#### **2.2.1.1 String Similarity Review**

*This review involves a preliminary comparison of each applied-for gTLD string against existing TLDs, Reserved Names (see subsection 2.2.1.2), and other applied-for strings. The objective of this review is to prevent user confusion and loss of confidence in the DNS resulting from delegation of many similar strings.*

*Note: In this Applicant Guidebook, “similar” means strings so similar that they create a probability of user confusion if more than one of the strings is delegated into the root zone.*

<sup>42</sup> Module 2-2. The same is true of applicant review, which is also comprised of various assessments concerning the applicant entity.

<sup>43</sup> Guidebook, §2.2: “Initial Evaluation”, Module 2-4 (underlining added). See also Module 1-9: “String reviews include a determination that the applied-for gTLD string is not likely to cause security or stability problems in the DNS ...”

The visual similarity check that occurs during Initial Evaluation is intended to augment the objection and dispute resolution process (see Module 3, Dispute Resolution Procedures) that addresses all types of similarity.

This similarity review will be conducted by an independent String Similarity Panel.

#### **2.2.1.1.1 Reviews Performed**

The String Similarity Panel's task is to identify visual string similarities that would create a probability of user confusion.

The panel performs this task of assessing similarities that would lead to user confusion in four sets of circumstances, when comparing:

[...]

- Applied-for gTLD strings against other applied-for gTLD strings;

[...]

**Similarity to Other Applied-for gTLD Strings (String Contention Sets)** – All applied-for gTLD strings will be reviewed against one another to identify any similar strings. In performing this review, the String Similarity Panel will create contention sets that may be used in later stages of evaluation.

A contention set contains at least two applied-for strings identical or similar to one another. Refer to Module 4, String Contention Procedures, for more information on contention sets and contention resolution.

[...]

#### **2.2.1.1.2 Review Methodology**

The String Similarity Panel is informed in part by an algorithmic score for the visual similarity between each applied-for string and each of other existing and applied- for TLDs and reserved names. The score will provide one objective measure for consideration by the panel, as part of the process of identifying strings likely to result in user confusion. In general, applicants should expect that a higher visual similarity score suggests a higher probability that the application will not pass the String Similarity review. However, it should be noted that the score is only indicative and that the final determination of similarity is entirely up to the Panel's judgment.

The algorithm, user guidelines, and additional background information are available to applicants for testing and informational purposes. [footnote in the original: See <http://icann.sword-group.com/algorithm/>] Applicants will have the ability to test their strings and obtain algorithmic results through the application system prior to submission of an application.

[...]

The panel will examine all the algorithm data and perform its own review of similarities between strings and whether they rise to the level of string confusion. In cases of strings in scripts not yet supported by the algorithm, the panel's assessment process is entirely manual.

The panel will use a common standard to test for whether string confusion exists, as follows:

**Standard for String Confusion** – String confusion exists where a string so nearly resembles another visually that it is likely to deceive or cause confusion. For the likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user. Mere association, in the sense that the string brings another string to mind, is insufficient to find a likelihood of confusion.

#### 2.2.1.1.3 Outcomes of the String Similarity Review

An application that fails the String Similarity review due to similarity to an existing TLD will not pass the Initial Evaluation, and no further reviews will be available. Where an application does not pass the String Similarity review, the applicant will be notified as soon as the review is completed.

An application for a string that is found too similar to another applied-for gTLD string will be placed in a contention set.<sup>44</sup>

[Underlining added]

61. Module 4 of the Guidebook, as mentioned, concerns "situations in which contention over applied-for gTLD strings occurs, and the methods available to applicants for resolving such contention cases." As explained in Module 4:

#### 4.1 String Contention

String contention occurs when either:

1. Two or more applicants for an identical gTLD string successfully complete all previous stages of the evaluation and dispute resolution processes; or
2. Two or more applicants for similar gTLD strings successfully complete all previous stages of the evaluation and dispute resolution processes, and the similarity of the strings is identified as creating a probability of user confusion if more than one of the strings is delegated.

ICANN will not approve applications for proposed gTLD strings that are identical or that would result in user confusion, called contending strings. If either situation above occurs, such applications will proceed to contention resolution through either community priority evaluation, in certain cases, or through an auction. Both processes are described in this module. A group of applications for contending strings is referred to as a contention set.

<sup>44</sup> Module 2-5 to 2-9. As regards the concept of string contention, see also Guidebook, §1.1.2.10: "String Contention", Module 1-13: "String contention applies only when there is more than one qualified application for the same or similar gTLD strings. String contention refers to the scenario in which there is more than one qualified application for the identical gTLD string or for similar gTLD strings. In this Applicant Guidebook, "similar" means strings so similar that they create a probability of user confusion if more than one of the strings is delegated into the root zone."

*(In this Applicant Guidebook, "similar" means strings so similar that they create a probability of user confusion if more than one of the strings is delegated into the root zone.)*

#### **4.1.1 Identification of Contention Sets**

*Contention sets are groups of applications containing identical or similar applied-for gTLD strings. Contention sets are identified during Initial Evaluation, following review of all applied-for gTLD strings. ICANN will publish preliminary contention sets once the String Similarity review is completed, and will update the contention sets as necessary during the evaluation and dispute resolution stages.*

*Applications for identical gTLD strings will be automatically assigned to a contention set.*

*[...]*

*The String Similarity Panel will also review the entire pool of applied-for strings to determine whether the strings proposed in any two or more applications are so similar that they would create a probability of user confusion if allowed to coexist in the DNS. The panel will make such a determination for each pair of applied-for gTLD strings. The outcome of the String Similarity review described in Module 2 is the identification of contention sets ...*

*[...]*

*As described elsewhere in this guidebook, cases of contention might be resolved by community priority evaluation [NB: community priority evaluation applies only to so-called "community" applications; it is not relevant here] or an agreement among the parties. Absent that, the last-resort contention resolution mechanism will be an auction.*

*[...]*

62. As provided in Module 4, the two methods relevant to resolving a contention such as between .hotels and .hoteis are *self-resolution* (i.e., an agreement between the two applicants for the contending strings) and *auction*:

#### **4.1.3 Self-Resolution of String Contention**

*Applicants that are identified as being in contention are encouraged to reach a settlement or agreement among themselves that resolves the contention. This may occur at any stage of the process, once ICANN publicly posts the applications received and the preliminary contention sets on its website.*

*Applicants may resolve string contention in a manner whereby one or more applicants withdraw their applications.*

*[...]*

#### **4.3 Auction: Mechanism of Last Resort**

*It is expected that most cases of contention will be resolved by the community priority evaluation, or through voluntary agreement among the involved applicants. Auction is a tie-breaker method for resolving string contention among the applications within a contention set, if the contention has not been resolved by other means.*

63. Module 5 of the Guidebook, titled *Transition to Delegation*, describes “the final steps required of an applicant for completion of the process, including execution of a registry agreement with ICANN and preparing for delegation of the new gTLD into the root zone.”<sup>45</sup> Section 5.1 states:

*ICANN’s Board of Directors has ultimate responsibility for the New gTLD Program. The Board reserves the right to individually consider an application for a new gTLD to determine whether approval would be in the best interest of the Internet community. Under exceptional circumstances, the Board may individually consider a gTLD application. For example, the Board might individually consider an application as a result of GAC Advice on New gTLDs or of the use of an ICANN accountability mechanism.*<sup>46</sup>

[Underlining added]

## V. SUMMARY OF THE PARTIES’ POSITIONS

64. The following brief summary of the parties’ respective positions is provided with a view solely to assisting the reader to understand the present Declaration. It is *not* intended to recapitulate – and it does not recapitulate – the entirety of the parties’ allegations and arguments. Additional references to the parties’ positions, including submissions made by them in the course of the proceedings, are contained in the discussion at Part VI below.

### A. Booking.com’s position

#### (i) *The Panel’s Authority*

65. Booking.com submits that the mandate of the Panel is “to determine whether the contested actions of the ICANN Board are consistent with applicable rules”.<sup>47</sup> According to Booking.com:

*The set of rules against which the actions of the ICANN Board must be assessed includes: (i) ICANN’s Articles of Incorporation and Bylaws – both of which must be interpreted in light of ICANN’s Affirmation of Commitments, and both of which require compliance with inter alia International law and generally accepted good governance principles – and (ii) secondary rules created by ICANN, such as the Applicant Guidebook. In setting up, implementing and supervising its policies and processes, the Board must comply with the fundamental principles embodied in these rules. That obligation includes a duty to ensure compliance with its obligations to act in good faith, transparently, fairly, and in a manner that is non-discriminatory and ensures due process.*<sup>48</sup>

<sup>45</sup> Module 5-2.

<sup>46</sup> Module 5-4.

<sup>47</sup> Reply, ¶¶ 3.

<sup>48</sup> Reply, ¶¶ 3.

66. Booking.com submits that IRP panels have broad authority to evaluate actions of the ICANN Board. An overly restrictive interpretation of the standard of review, such as proposed by ICANN in these proceedings, would, says Booking.com, “fail to ensure accountability on the part of ICANN and would be incompatible with ICANN’s commitment to maintain (and improve) robust mechanisms for accountability, as required by Article 9.1 of ICANN’s Affirmation of Commitments and ICANN’s core values.”<sup>49</sup>

**(ii) Booking.com’s Claims**

67. The purpose of the IRP initiated by Booking.com is, in its own words, “to challenge the ICANN Board’s handling of Booking.com’s application for the new gTLD .hotels.”<sup>50</sup> This includes the determination of the SSP to place .hotels and .hoteis in contention and the refusal of the Board (and its committees) to revise that determination. Elsewhere in its submissions, Booking.com makes an even broader claim; it asserts that it challenges the conduct of the ICANN Board in relation to what Booking.com refers to as the *setting up, implementation, supervision and review* of the entire of string similarity review process, and the Board’s alleged failure “to ensure due process and to respect its fundamental obligations to ensure good faith, transparency, fairness and non-discrimination” throughout.<sup>51</sup>
68. In effect, Booking.com’s specific claims can be divided into two broad categories: claims related to the string similarity review process generally; and claims related to the particular case of .hotels.
69. Booking.com professes that this case “is not about challenging a decision on the merits [i.e., the decision to place .hotels in contention]”; it is about “ICANN’s failure to respect fundamental [procedural] rights and principles in handling New gTLD applications, in particular in the context of String Similarity Review.”<sup>52</sup>
70. Booking.com also repeatedly emphasizes – and this is crucial – that *it does not challenge the validity or fairness of the process as set out in the Guidebook*. Rather, as indicated, it contests “the way in which that process was established, implemented and supervised by (or under the authority of) the ICANN Board.”<sup>53</sup> Equally crucial, as will be seen, is Booking.com’s acknowledgment that *the established process was followed* in the case of the review of .hotels.

**a. The string similarity review process**

71. According to Booking.com, the problem began when the ICANN Board failed to “provide transparency in the SSP selection process,” in particular by failing “to make clear how

---

<sup>49</sup> Reply, ¶ 6.

<sup>50</sup> Reply, ¶ 7.

<sup>51</sup> Reply, ¶ 15.

<sup>52</sup> Reply, ¶ 14.

<sup>53</sup> Reply, ¶ 17.

[ICANN] would evaluate candidate responses or how it ultimately did so.”<sup>54</sup> The problem was compounded by the selection of ICC/University College London to perform string similarity reviews as the independent SSP. In Booking.com’s words:

*[T]he identities of the unsuccessful candidates (if any) to perform the String Similarity Review remain unknown. Applicants have never been given any information in relation to the candidate responses that were submitted. ... There is no indication that any other candidate expressed an interest in performing the String Similarity Review. No information has been provided as to the steps (if any) taken by ICANN to reach out to other potential candidates. Numerous questions remain: How did ICANN deal with the situation if there was only one (or only a very few) respondent(s) wishing to perform the String Similarity Review? How did this impact on the discussions with InterConnect Communications? What are the terms of ICANN’s contract with InterConnect Communications?*<sup>55</sup>

72. Booking.com also faults ICANN for “allowing the appointed SSP to develop and perform an unfair and arbitrary review process”, specifically, by allowing the SSP “to perform the String Similarity Review (i) without any (documented) plan or methodology ... (ii) without providing any transparency regarding the evaluators or the evaluation criteria ... and (iii) without informing applicants of its reasoning ...”.<sup>56</sup>
73. Among other things, Booking.com takes ICANN to task for establishing and posting the SSP Process Description and the SSP Manager’s Letter (see Part III.C above) only long after the string similarity review process had ended.<sup>57</sup>
74. It also alleges that the factors identified in the SSP Manager’s Letter are “arbitrary and baseless ... not supported by any methodology capable of producing compelling and defensible conclusions ... [which] has allowed applications with at least equally serious visual string similarity concerns – such as .parts/.paris, .maif/.mail, .srt/.srl, .vote/.voto and .date/.data ... – to proceed while singling out .hotels/.hoteis.”<sup>58</sup> According to Booking.com: “The failure to take actual human performance into account is at odds with the standard for assessment, *i.e.*, the likelihood of confusion on the part of the average Internet user. Hence, the approach is directly contrary to ICANN’s own policy.”<sup>59</sup>
75. Booking.com further contends that the SSP process is unfair and non-transparent due to the fact that the identity of SSP members has never been publicly disclosed.<sup>60</sup>
76. Further, Booking.com argues that the process is unfair, non-transparent and arbitrary – and thus violates ICANN policy – for failing to provide for a “well-documented rationale” for each

---

<sup>54</sup> Reply, ¶ 20.

<sup>55</sup> Reply, ¶ 20.

<sup>56</sup> Reply, ¶ 23.

<sup>57</sup> Reply, ¶ 24.

<sup>58</sup> Reply, ¶ 25.

<sup>59</sup> Reply, ¶ 25.

<sup>60</sup> Reply, ¶ 26-27.



SSP determination. In the absence of reasons for each string similarity determination, says Booking.com, “there is no basis on which decisions can be evaluated and, where appropriate, challenged.”<sup>61</sup>

77. Another ground for Booking.com’s challenge is the alleged failure by the ICANN Board to providing “effective supervision or quality control” of the SSP: “If nobody but the evaluator has any insight into how the evaluation was carried out, no effective quality control can be performed.”<sup>62</sup> Nor, according to Booking.com, does the quality review of the SSP’s work supposedly performed by JAS Advisers (the independent consultant engaged by ICANN for this purpose) overcome the problem of a lack of transparency:

*Booking.com is not aware that any selection process was put in place in relation to the appointment of JAS Advisors to perform the String Similarity Review quality control. No criteria for performing the quality control were published. When ICANN was looking for evaluators, no call for expressions of interest or similar document was issued for the selection of quality controllers.*<sup>63</sup>

78. In any case, says Booking.com, the “quality control review over a random sampling of applications to, among other things, test whether the process [set out in the Guidebook] was followed,” which ICANN claims was performed on the SSP’s work,<sup>64</sup> could not provide adequate quality control of the string similarity review process.<sup>65</sup> Finally, Booking.com argues that the arbitrary and unfair result of the string similarity review concerning .hotels – i.e., the decision to place .hotels and .hoteis in contention – demonstrates that, “whatever quality control review ICANN may have engaged in ... must therefore have been deficient.”<sup>66</sup>

*b. The case of .hotels*

79. Booking.com argues, in part on the basis of expert evidence which it adduces in this IRP proceeding,<sup>67</sup> that “[t]here is no probability of user confusion if both .hotels and .hoteis were delegated as gTLD strings into the Internet root zone ... The SSP could not have reasonably found that the average reasonable Internet user is likely to be confused between the two strings.”<sup>68</sup> It continues:

---

<sup>61</sup> Reply, ¶¶ 28-29.

<sup>62</sup> Reply, ¶¶ 30.

<sup>63</sup> Reply, ¶¶ 31. Booking.com states that it “doubts” that any quality review was in fact performed, whether by JAS Advisers or any other entity.

<sup>64</sup> Response, ¶¶ 30.

<sup>65</sup> Reply, ¶¶ 34.

<sup>66</sup> Reply, ¶¶ 38.

<sup>67</sup> Request, Annex 20, Expert Report of Prof. Dr. Piet Desmet of the Faculty of Arts, Department of Linguistics of Leuven University, dated 10 March 2014. Portions of the work underlying Prof. Desmet’s report were performed by Dr. Emmanuel Keuleers, Research Fellow in the Department of Experimental Psychology at Ghent University.

<sup>68</sup> Request, ¶¶ 58.

*Since .hotels and .hoteis are not confusingly similar, the determination that they are is contradictory to ICANN policy as established in the Applicant Guidebook. Acceptance of the determination, and repeated failure to remedy the wrongful determination, is a failure to act with due diligence and independent judgment, and a failure to neutrally and fairly apply established policies as required by Bylaws and Articles of Incorporation.<sup>69</sup>*

80. According to Booking.com, the Board should have acted to overturn the determination of the SSP either in the context of the Request for Reconsideration or under the authority accorded it by Module 5-4 of the Guidebook to “individually consider a gTLD application”.<sup>70</sup>
81. Booking.com claims that its DIDP Request alerted the Board to the need to intervene to “correct the errors in the process” related to .hotels, and that its Request for Reconsideration of the SSP determination further informed the Board of the many errors in the SSP’s review of .hotels, “giving the Board ample opportunity to correct those errors.”<sup>71</sup> Booking.com claims that the Board’s failure, when responding to the DIDP Request, “to offer any insight into the SSP’s reasoning”, its refusal to reconsider and overturn the SSP determination regarding .hotels on the sole ground (says Booking.com) that “the Reconsideration process is not available as a mechanism to re-try the decisions of evaluation panels”, and its failure to investigate Booking.com’s complaints of a lack of fairness and transparency in the SSP process, constitute violations of ICANN’s governing rules regarding string similarity review.<sup>72</sup>
82. According to Booking.com, among the most compelling evidence of ICANN’s failure in this regard are the statements made on the record by several members of the NGPC during its 10 September 2013 meeting at which Booking.com’s Request for Reconsideration was denied.<sup>73</sup> Given the importance that the Panel attaches to these statements, they are addressed in some detail in the Analysis in Part VI, below.
83. In its written submissions Booking.com asks the Panel to grant the following relief:

*Finding that ICANN breached its Articles of Incorporation, its Bylaws, and the gTLD Applicant Guidebook;*

*Requiring that ICANN reject the determination that .hotels and .hoteis are confusingly similar and disregard the resulting contention set;*

*Awarding Booking.com its costs in this proceeding; and*

---

<sup>69</sup> Request, ¶ 59.

<sup>70</sup> Reply, ¶ 39.

<sup>71</sup> Reply, ¶ 41.

<sup>72</sup> Reply, ¶ 41. In the passage of Booking.com’s submissions referred to here (as elsewhere), Booking.com speaks of violations of ICANN’s obligations of “due process”, which, it says, comprise concepts such as the right to be heard, the right to receive reasons for decisions, publicity, etc. For reasons explained in Part VI, below, the Panel prefers to use the terms *fairness* and *transparency* to connote the essence of ICANN’s obligations under review in this IRP.

<sup>73</sup> See Part II.C, above.

*Awarding such other relief as the Panel may find appropriate or Booking.com may request.*

84. At the hearing Booking.com *further* requested that the Panel not only require ICANN to disregard the SSP determination regarding .hotels/.hoteis, but also order ICANN to “delegate both .hotels and .hoteis.”

#### **B. ICANN’s position**

85. ICANN’s position is best summed up by ICANN itself:

*Booking.com’s IRP Request is really about Booking.com’s disagreement with the merits of the String Similarity Panel’s conclusion that .hotels and .hoteis are confusingly similar. But the Panel’s determination does not constitute Board action, and the Independent Review Process is not available as a mechanism to re-try the decisions of an independent evaluation panel. The IRP Panel is tasked only with comparing contested actions of the ICANN Board to ICANN’s Bylaws and Articles of Incorporation; it is not within the IRP Panel’s mandate to evaluate whether the String Similarity Panel’s conclusion that .hotels and .hoteis are confusingly similar was wrong.<sup>74</sup>*

86. According to ICANN, the Board “did exactly what it was supposed to do under its Bylaws, its Articles of Incorporation, and the Guidebook.”<sup>75</sup>

##### ***(i) The Panel’s Authority***

87. Throughout its submissions ICANN repeatedly stresses what it says is the very limited authority enjoyed by IRP panels.
88. As provided in Article IV, Section 3(4) of ICANN’s Bylaws, ICANN observes that this Panel (as all IRP panels) is charged only with “comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws.”<sup>76</sup>
89. ICANN notes that, in undertaking this *compare-and-declare* mission, the Panel is further constrained to apply the very specific “standard of review” set out in Bylaw Article IV, Section 3(4), which requires the Panel to focus on three particular questions: “did the Board act without conflict of interest in taking its decision?”; “did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?”; and “did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company [ICANN]?”<sup>77</sup>

<sup>74</sup> Response, ¶ 9.

<sup>75</sup> Response, ¶ 8. Both parties agree that, as submitted by Booking.com, the “rules” at issue, against which the conduct of the ICANN Board is to be assessed, include the relevant provisions of the Guidebook.

<sup>76</sup> See for example Response, ¶ 2, ¶ 9.

<sup>77</sup> Response, ¶ 2.

90. ICANN further asserts that the IRP process “is not available as a mechanism to challenge the actions or inactions of ICANN staff or third parties that may be involved in ICANN activities,”<sup>78</sup> such as the action of the SSP which resulted in .hotels and .hoteis being placed in contention. Nor, says ICANN, may the IRP process be used as an “appeal mechanism” by which to overturn substantive decisions – such as the determination that .hotels and .hoteis are confusingly visually similar – with which an applicant may disagree.<sup>79</sup>
91. In this regard ICANN states that the affirmative relief sought by Booking.com – specifically, a declaration requiring that ICANN “reject the determination that .hotels and .hoteis are confusingly similar and disregard the resulting contention set” and (as requested at the hearing) that ICANN “delegate both .hotels and .hoteis” – exceeds the authority of the Panel.<sup>80</sup>

***(ii) ICANN’s Response to Booking.com’s Claims***

***a. The string similarity review process***

92. According to ICANN, “[e]arly on in the iterations of the Guidebook, it was determined that, in the initial evaluation stage, the String Similarity Panel would only examine strings for visual confusion;” and “[i]f applied-for strings are determined to so nearly resemble each other visually that it is likely to deceive or cause confusion, the string will be placed in a contention set, which is then resolved pursuant to the contention set resolution processes in Module 4 of the Guidebook.”<sup>81</sup>
93. According to ICANN, it was also determined early on that, as stated in Section 2.2.1.1 of the Guidebook, “[t]his similarity review will be conducted by an independent String Similarity Panel,” not by ICANN itself. ICC was duly selected to perform the string similarity review further to “an open and public request for proposals,” pursuant to which, as the successful bidder, “ICC was responsible for the development of its own process documents and methodology for performing the String Similarity Review consistent with the provisions of the Guidebook.”<sup>82</sup> ICANN emphasizes that “the Guidebook does not provide for any process by which ICANN (or anyone else) may conduct a substantive review of ICC’s results.”<sup>83</sup>
94. In ICANN’s submission, the alternative proposed by Booking.com, that “the ICANN Board – and the ICANN Board alone – was obligated to perform the String Similarity Review for the more than 1,900 new gTLD applications submitted,” is “untenable and is not supported by ICANN’s Bylaws or Articles.”<sup>84</sup> As noted by ICANN, the Guidebook defines six distinct

---

<sup>78</sup> Response, ¶ 3.

<sup>79</sup> Response, ¶ 49.

<sup>80</sup> Response, ¶ 55.

<sup>81</sup> Response, ¶ 15 (underlining in original).

<sup>82</sup> Response, ¶ 16.

<sup>83</sup> Response, ¶ 17.

<sup>84</sup> Sur-Reply, ¶ 7.

review processes that every gTLD application is required to go through, including string similarity review; each of those review processes was conducted by independent experts specifically engaged by ICANN staff for the purpose.

95. ICANN submits that “there simply is no requirement – under ICANN’s governing documents or imposed by law – that would mandate that the ICANN Board inject itself into the day-to-day affairs of the evaluation process in the manner Booking.com proposes.”<sup>85</sup> It asserts that, consistent with well-settled legal principles, “neither ICANN’s Bylaws, nor the Articles, nor the Guidebook requires the ICANN Board to conduct any analysis of the decisions of third party experts retained to evaluate string similarity.”<sup>86</sup>
96. Moreover, ICANN asserts that “[s]imply because the ICANN Board has the discretion [under Section 5.1 (Module 5-4) of the Guidebook] to consider individual applications does not mean it is required to do so or that it should do so, particularly at an initial evaluation stage.”<sup>87</sup>
97. ICANN claims that that Booking.com’s repeated invocation of the Board’s so-called obligation to ensure “due process” in the administration of the New gTLD Program is misplaced. First, neither applicable California law nor any provision of the Bylaws, Articles of Incorporation or Guidebook “specifically affords any gTLD applicant a right to procedural ‘due process’ similar to that which is afforded in courts of law.”<sup>88</sup> Second, because ICANN conducts its activities in the public interest it nevertheless provides “more opportunity for parties to be heard and to dispute actions taken”<sup>89</sup> than most private corporate entities. Third, the “decision to proceed with the New gTLD Program followed many years of discussion, debate and deliberation within the ICANN community, including participation from end users, civil society, technical experts, business groups, governments and others.”<sup>90</sup> Fourth, and perhaps most importantly, “ICANN adhered to the policies and procedures articulated in its Bylaws, Articles of Incorporation, and the Guidebook, the latter of which was adopted only after being publicly vetted with ICANN’s stakeholders and the broader Internet community.”<sup>91</sup>
98. ICANN’s response to Booking.com’s various allegations regarding particular elements of the string similarity review process – including for example the selection of the SSP, the publication of the SSP’s methodology, the anonymity of the individuals SSP members, the supposed lack of quality control – is essentially three-fold: first, the actions challenged by Booking.com are *not Board actions*, but actions of ICANN staff or third parties, which cannot

---

<sup>85</sup> Sur-Reply, ¶ 10.

<sup>86</sup> Sur-Reply, ¶ 10.

<sup>87</sup> Sur-Reply, ¶ 11. It was established during the hearing that the several references to this discretionary authority in ICANN’s written and oral submissions refer specifically to the authority conferred by Section 5.1 (Module 5-4) of the Guidebook.

<sup>88</sup> Sur-Reply, ¶ 18.

<sup>89</sup> Sur-Reply, ¶ 18.

<sup>90</sup> Sur-Reply, ¶ 18, fn 18.

<sup>91</sup> Sur-Reply, ¶ 18, fn 18.

be challenged by means of IRP proceedings; second, in any case, Booking.com's claims are *factually incorrect*, and there has been no violation of the Bylaws, Articles of Incorporation or Guidebook; third, Booking.com's claims are *time-barred* given that Article IV, Section 3(3) of the Bylaws requires that IRP requests "must be filed within thirty days of the posting of the minutes of the Board meeting ... that the requesting party contends demonstrates that ICANN violated its Bylaws or Articles of Incorporation."<sup>92</sup>

*b. The case of .hotels*

99. ICANN's position as regards the determination to place .hotels and .hoteis in contention is similar in many respects to its position regarding the string similarity review process generally. ICANN argues that the Board played no role whatsoever in performing the review of .hotels; that the SSP's determination was in any event well supported and there was no violation of applicable rules; and that the Guidebook does not provide for any process by which ICANN (or any other body, including an IRP panel) may conduct a substantive review of a string similarity determination.
100. In any event, ICANN asserts that .hotels and .hoteis in fact meet every one of the visual similarity criteria applied by the SSP, as set out in the SSP Manager's Letter. Moreover, .hotels and .hoteis scored a stunning 99% for visual similarity under the publicly available SWORD algorithm which, as provided by Section 2.2.1.1.2 (Module 2-7) of the Guidebook, establishes "one objective measure for consideration by the [SSP]". According to ICANN (in response to a question posed by the Panel during the hearing), this was the highest algorithmic score among the comparison of all non-identical pairs within the 1917 new gTLD applications received by ICANN;<sup>93</sup> the only other pair of non-exact match strings found to be confusingly visually similar – .unicorn and .unicom – scored only 94%.<sup>94</sup>
101. According to ICANN, "it was not clearly 'wrong,' as Booking.com argues, for the [SSP] to find that .hotels/.hoteis are confusingly similar."<sup>95</sup>
102. In conclusion, ICANN states that its conduct with respect to Booking.com's application for .hotels, including in evaluating Booking.com's Request for Reconsideration, was fully consistent with ICANN's Articles of Incorporation, its Bylaws and the procedures established in the Guidebook; and the fact that Booking.com disagrees with the SSP's determination to put .hotels and .hoteis in a contention set does not give rise to an IRP.
103. ICANN asks the Panel to deny Booking.com's IRP Request.

## VI. ANALYSIS

### A. The Panel's Authority

---

<sup>92</sup> Sur-Reply, ¶ 20-42.

<sup>93</sup> A number of these applications were subsequently withdrawn.

<sup>94</sup> Identical pairs, of course, received a score of 100% for visual similarity under the SWORD algorithm.

<sup>95</sup> Response, ¶ 53.

104. The jurisdiction and authority of an IRP panel is expressly prescribed – and expressly limited – by the ICANN Bylaws. To recap, Article IV, Section 3 of the Bylaws provides:

*4. [The IRP Panel] shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws. The IRP Panel must apply a defined standard of review to the IRP request, focusing on:*

- a. did the Board act without conflict of interest in taking its decision?;*
- b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and*
- c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company [ICANN]?*

*[...]*

- 11. The IRP Panel shall have the authority to:*

*[...]*

*c. declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws; and*

*d. recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP;*

*[...]*

*18. [...] The IRP Panel shall make its declaration based solely on the documentation, supporting materials, and arguments submitted by the parties [...]*

*[Underlining added]*

105. Similarly, Article 8 of the Supplementary Procedures reads:

**8. Standard of Review**

*The IRP is subject to the following standard of review: (i) did the ICANN Board act without conflict of interest in taking its decision; (ii) did the ICANN Board exercise due diligence and care in having sufficient facts in front of them; (iii) did the ICANN Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?*

*If a requestor demonstrates that the ICANN Board did not make a reasonable inquiry to determine it had sufficient facts available, ICANN Board members had a conflict of interest in participating in the decision, or the decision was not an exercise in independent judgment, believed by the ICANN Board to be in the best interests of the company, after taking account of the Internet community and the global public interest, the requestor will have established proper grounds for review.*

106. There is no dispute as regards the Panel's duty to compare the actions of the Board to ICANN's Articles of Incorporation and Bylaws (and, in this case, Guidebook) with a view to

declaring whether those actions are inconsistent with applicable policies. Where the parties disagree is with respect to the standard of review to be applied by the Panel in assessing Board conduct.

107. ICANN submits that its Bylaws “specify that a deferential standard of review be applied when evaluating the actions of the ICANN Board ... the rules are clear that the appointed IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.”<sup>96</sup> Booking.com argues that this “is simply wrong. No such specification is made in ICANN’s Bylaws or elsewhere, and a restrictive interpretation of the standard of review would ... fail to ensure accountability on the part of ICANN and would be incompatible with ICANN’s commitment to maintain (and improve) robust mechanisms for accountability.”<sup>97</sup>
108. In the opinion of the Panel, there can be no question but that the provisions of the ICANN Bylaws establishing the Independent Review Process and defining the role of an IRP panel specify that the ICANN Board enjoys a large degree of discretion in its decisions and actions. So long as the Board acts without conflict of interest and with due care, it is entitled – indeed, required – to exercise its independent judgment in acting in what it believes to be the best interests of ICANN. The only substantive check on the conduct of the ICANN Board is that such conduct may not be inconsistent with the Articles of Incorporation or Bylaws – or, the parties agree, with the Guidebook. In that connection, the Panel notes that Article 1, Section 2 of the Bylaws also clearly states that in exercising its judgment, the Board (indeed “[a]ny ICANN body making a recommendation or decision”) shall itself “determine which core values are most relevant and how they apply to the specific circumstances of the case at hand.”
109. In other words, in making decisions the Board is required to conduct itself reasonably in what it considers to be ICANN’s best interests; where it does so, the only question is whether its actions are or are not consistent with the Articles, Bylaws and, in this case, with the policies and procedures established in the Guidebook.
110. There is also no question but that the authority of an IRP panel to compare contested actions of the Board to the Articles of Incorporation and Bylaws, and to declare whether the Board has acted consistently with the Articles and Bylaws, does not extend to opining on the nature of those instruments. Nor, in this case, does our authority extend to opining on the nature of the policies or procedures established in the Guidebook. In this regard it is recalled that Booking.com itself repeatedly stresses that it does not contest the validity or fairness of the string similarity review process as set out in the Guidebook, but merely whether ICANN’s actions were consistent with various elements of that process. Stated differently, our role in this IRP includes assessing whether the applicable rules – in this case, the rules regarding string similarity review – were followed, not whether such rules are appropriate or advisable.
111. Nevertheless, this does not mean that the IRP Panel may only review ICANN Board actions or inactions under the deferential standard advocated by ICANN in these proceedings. Rather, as explained below, the IRP Panel is charged with “objectively” determining whether

---

<sup>96</sup> Response, ¶ 24.

<sup>97</sup> Reply, ¶ 6.



or not the Board's actions are in fact consistent with the Articles, Bylaws and Guidebook, which the Panel understands as requiring that the Board's conduct be appraised independently, and without any presumption of correctness.

112. In the only other IRP of which the Panel is aware in which such questions were addressed in a published decision, the distinguished members of the IRP panel had this to say about the role of an IRP panel, and the applicable standard of review, in appraising Board action:

*The Internet Corporation for Assigned Names and Numbers is a not-for profit corporation established under the law of the State of California. That law embodies the 'business judgment rule'. Section 309 of the California Corporations Code provides that a director must act 'in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders...' and shields from liability directors who follow its provisions. However ICANN is no ordinary non-profit California corporation. The Government of the United States vested regulatory authority of vast dimension and pervasive global reach in ICANN. In 'recognition of the fact that the Internet is an international network of networks, owned by no single nation, individual or organization' – including ICANN – ICANN is charged with 'promoting the global public interest in the operational stability of the Internet...' ICANN 'shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law...' Thus, while a California corporation, it is governed particularly by the terms of its Articles of Incorporation and Bylaws, as the law of California allows. Those Articles and Bylaws, which require ICANN to carry out its activities in conformity with relevant principles of international law, do not specify or imply that the International [sic] Review Process provided for shall (or shall not) accord deference to the decisions of the ICANN Board. The fact that the Board is empowered to exercise its judgment in the application of ICANN's sometimes competing core values does not necessarily import that that judgment must be treated deferentially by the IRP. In the view of the Panel, the judgments of the ICANN Board are to be reviewed and appraised by the Panel objectively, not deferentially. The business judgment rule of the law of California, applicable to directors of California corporations, profit and nonprofit, in the case of ICANN is to be treated as a default rule that might be called upon in the absence of relevant provisions of ICANN's Articles and Bylaws and of specific representations of ICANN ... that bear on the propriety of its conduct. In the instant case, it is those Articles and Bylaws, and those representations, measured against the facts as the Panel finds them, which are determinative.<sup>98</sup>*

[Underlining added.]

113. While on no way bound by that decision, we agree with its conclusions in this respect.
114. At the end of the day we fail to see any significant difference between the parties' positions in this regard. The process is clear, and both parties acknowledge, that the Panel is tasked with determining whether or not the Board's actions are consistent with ICANN's Articles of Incorporation, Bylaws and the Guidebook. Such a determination calls for what the panel in

<sup>98</sup> ICDR Case No. 50 117 T 00224 08, *ICM Registry, LLC v. ICANN*, Declaration dated 19 February 2010 ("*ICM Registry*"), ¶ 136.

the *ICM Registry* matter called an “objective” appraisal of Board conduct as measured against the policies and rules set out in those instruments; all agree that it is the Articles, Bylaws and Guidebook which are determinative.

115. That being said, we also agree with ICANN to the extent that, in determining the consistency of Board action with the Articles, Bylaws and Guidebook, an “IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.” In other words, it is not for the Panel to opine on whether the Board could have acted differently than it did; rather, our role is to assess whether the Board’s action was consistent with applicable rules found in the Articles, Bylaws and Guidebook. Nor, as stated, is it for us to purport to appraise the policies and procedures established by ICANN in the Guidebook (since, again, this IRP is not a challenge to those policies and procedures themselves<sup>99</sup>), but merely to apply them to the facts.
116. With the foregoing firmly in mind, the Panel turns now to the issues to be determined in order to resolve the present dispute.

#### **B. The String Similarity Review Process**

117. The Panel is not unsympathetic to Booking.com’s complaints regarding the string similarity review process as established by the Guidebook. There is no question but that that process lacks certain elements of transparency and certain practices that are widely associated with requirements of fairness. For example, the Guidebook provides no means for applicants to provide evidence or make submissions to the SSP (or any other ICANN body) and so be fully “heard” on the substantive question of the similarity of their applied-for gTLD strings to others.
118. Indeed, as stated at the outset of this Declaration, these observations and the concerns that they engender were voiced by several members of the ICANN Board’s New gTLD Program Committee which voted to accept the BGC’s Recommendation to deny Booking.com’s Request for Reconsideration. The Panel can do no better than reproduce the statements made by the NGPC members in this respect, as recorded in the minutes of the NGPC’s 10 September 2013 meeting:<sup>100</sup>

---

<sup>99</sup> As discussed in more detail in the following section (at para. 117 and following) and again at Part IV of this Declaration, the important questions that Booking.com highlights in its pleadings, as to whether the string similarity review process is consistent with ICANN’s guiding principles of transparency and fairness, and regarding the published views of various members of ICANN’s NGPC in this respect, are matters which the ICANN Board, in its discretion, may wish to consider on its own motion in the context of the present case, in accordance with its authority under Section 5.1 (Module 5-4) of the Guidebook, or when it issues the Guidebook for round two of the New gTLD Program. Those questions include a lack of clarity surrounding the way in which the string similarity review is conducted by the SSP, and the absence of any means for applicants to be heard in the string similarity review process where they may have evidence to adduce or arguments to make (such as the evidence and arguments presented by Booking.com to this Panel), which could in fact be relevant to the SSP’s determination.

<sup>100</sup> Request, Annex 16.

- Mr. George Sadowski stated his intention to abstain from the vote because, although “he understood that the BGC did the right thing, [he] thought the end result that was contrary to ICANN’s ... and the user’s best interests.”
  - Ms. Olga Madruga-Forti also stated her intention to abstain from voting on the BGC recommendation “because there was not sufficient rationale provided for why the string similarity review panel made its determination.”
  - In response to a comment by the Chair that the Request for Reconsideration deserved to be denied “[b]ecause the process was followed,” Mr. Ray Plzak “agreed that the process was followed, but noted that the process needs to be reviewed to potentially add a mechanism that would allow persons who don’t agree with the outcome to make an objection, other than using a Reconsideration Request.”
  - Mr. Plzak “recommended the Committee send a strong signal to the BGC, or adopt a resolution recommending that the BGC consider development of a different mechanism to provide an avenue for the community to appeal the outcome of a decision based on the merits.”
  - Ms. Madruga-Forti agreed and “recommended that in the future, a remand or appeals mechanism may help alleviate the concerns noted.”
  - Mr. Bill Graham also agreed with Mr. Plzak’s suggestion, and noted that “generally, there is a considerable level of discomfort and dissatisfaction with the process as expressed by Committee members.”
  - The Chair “agreed with [Mr. Graham’s] sentiment.”
  - The General Counsel and Secretary noted that ICANN ... “has tried to encourage more use of the ombudsman, or other accountability mechanisms for these types of concerns.”
119. Ultimately, five members of the NGPC voted in favour of the resolution accepting the BGC’s Recommendation; two members were unavailable to vote; and four members abstained. The abstaining members offered the following voting statements:
- Mr. Plzak stated that he abstained from voting “because he is disappointed in what is being done to remedy the situation. [He] would like to see more resolve to fix the process.”
  - Ms. Madruga-Forti stated that:  
  
*[T]he BGC has done an appropriate job of applying a limited review standard to the application for reconsideration, but unfortunately, in this circumstance, to apply that limited review accompanied by a lack of information regarding the rationale of the string similarity review panel is not possible in a logical and fair manner. The public interest would not be served by applying the limited review standard without proper information on the basis and reasoning for the decision of the panel. In my opinion, the public interest would be better served by abstaining and continuing to explore ways to*

*establish a better record of the rationale of the string similarity review panel in circumstances such as this.*

- Mr. Kuo-Wei Wu agreed with Ms. Madruga-Forti's and Mr. Plzak's voting statements.
- Mr. Sadowsky provided the following detailed statement:

*I have a strong concern regarding the ratification of the BGC recommendation to deny the reconsideration request regarding string contention between .hoteis and .hotels, and I therefore have therefore abstained when the vote on this issue was taken.*

*The reconsideration process is a very narrowly focused instrument, relying solely upon investigating deviations from established and agreed upon process. As such, it can be useful, but it is limited in scope. In particular, it does not address situations where process has in fact been followed, but the results of such process have been regarded, sometimes quite widely, as being contrary to what might be best for significant or all segments of the ... community and/or Internet users in general.*

*The rationale underlying the rejection of the reconsideration claim is essentially that the string similarity process found that there was likely to be substantial confusion between the two, and that therefore they belonged in a contention set. Furthermore, no process has been identified as having been violated and therefore there is nothing to reconsider. As a Board member who is aware of ICANN's ... Bylaws, I cannot vote against the motion to deny reconsideration. The motion appears to be correct based upon the criteria in the Bylaws that define the reconsideration process and the facts in this particular case. However, I am increasingly disturbed by the growing sequence of decisions that are based upon a criterion for user confusion that, in my opinion, is not only both incomplete and flawed, but appears to work directly against the concept that users should not be confused. I am persuaded by the argument made by the proponents of reconsideration in this case that users will in fact not be confused by .hoteis and .hotels, since if they enter the wrong name, they are very likely to be immediately confronted by information in a language that they did not anticipate.*

*Confusion is a perceptual issue. String similarity is only one consideration in thinking about perceptual confusion and in fact it is not always an issue. In my opinion, much more perceptual confusion will arise between .hotel and .hotels than between .hotels and .hoteis. Yet if we adhere strictly to the Guidebook and whatever instructions have or have not been given to string similarity experts, it is my position that we work against implementing decisions that assist in avoiding user confusion, and we work in favor of decisions that are based upon an incorrect, incomplete and flawed ex ante analysis of the ICANN Network real issues with respect to user confusion.*

*The goal of the string similarity process is the minimization of user confusion and ensuring user trust in using the DNS ... The string similarity exercise is one of the means in the new gTLD ... process to minimize such confusion and to strengthen user trust. In placing our emphasis, and in fact our decisions, on string similarity only, we are unwittingly substituting the means for the goal, and making decisions regarding the goal on the basis of a means test. This is a disservice to the Internet user community.*

*I cannot and will not vote in favor of a motion that reflects, directly or indirectly, an unwillingness to depart from what I see as such a flawed position and which does not reflect in my opinion an understanding of the current reality of the situation.*

120. These statements reflect to an important degree the Panel's own analysis.
121. The elements of the string similarity review process were established and widely published several years ago, after extensive consultation and debate among ICANN stakeholders and the Internet community. Booking.com correctly describes the process established (or "crystallized") in the Guidebook as a component of "a consensus policy" concerning the introduction of new gTLDs.<sup>101</sup>
122. The Guidebook makes clear that, as part of the initial evaluation to which all applied-for gTLDs are subject, each string would be reviewed for a number of factors, one of which is "string similarity", which involves a determination of "whether the applied-for gTLD string is so similar to other strings that it would create a probability of user confusion"<sup>102</sup>. The term "user" is elaborated elsewhere in the Guidebook, which speaks of confusion arising "in the mind of the average, reasonable Internet user."<sup>103</sup>
123. The Guidebook explains that string similarity review comprises merely a "visual similarity check",<sup>104</sup> with a view to identifying only "visual string similarities that would create a probability of user confusion."<sup>105</sup>
124. The Guidebook makes clear that string similarity reviews would be conducted by an independent third party – the SSP – that would have wide (though not complete) discretion both in formulating its methodology and in determining string similarity on the basis of that methodology.
125. Section 2.2.1.1.2 of the Guidebook, titled "Review Methodology", provides that the SSP "is informed in part by an algorithmic score for ... visual similarity," which "will provide one objective measure for consideration by the [SSP]." Section 2.2.1.1.2 further states that, in addition to "examin[ing] all the algorithm data," the SSP will "perform its own review of similarities between strings and whether they rise to the level of string confusion." It is noted that the objective algorithmic score is to be treated as "only indicative". Crucially, "the final determination of similarity is entirely up to the [SSP's] judgment." (Underlining added)
126. In sum, the Guidebook calls for the SSP to determine whether two strings are so "visually similar" as to create a "probability of confusion" in the mind of an "average, reasonable Internet user." In making this determination, the SSP is informed by an "algorithmic score", to ensure that the process comprises at least one "objective measure". However, the algorithmic score is not determinative. The SSP also develops and performs "its own review". At the end of the day, the determination is entirely a matter of "the [SSP's] judgment."

---

<sup>101</sup> Request, ¶ 13.

<sup>102</sup> Guidebook, §2.2 (Module 2-4).

<sup>103</sup> Guidebook, §2.2.1.1.2. (Underlining added)

<sup>104</sup> Guidebook, §2.2.1.1. (Underlining added)

<sup>105</sup> Guidebook, §2.2.1.1.1. (Underlining added)

127. By its very nature this process is highly discretionary. It is also, to an important degree, subjective. The Guidebook provides no definition of “visual similarity”, nor any indication of how such similarity is to be objectively measured other than by means of the SWORD algorithm. The Guidebook provides no definition of “confusion,” nor any definition or description of an “average, reasonable Internet user.” As Mr. Sadowski of the NGPC put it: “Confusion is a perceptual issue.” (Mr. Sadowski further noted: “String similarity is only one consideration in thinking about perceptual confusion, and in fact it is not always an issue.) The Guidebook mandates the SSP to develop and apply “its own review” of visual similarity and “whether similarities rise to the level of user confusion”, in addition to SWORD algorithm, which is intended to be merely “indicative”, yet provides no substantive guidelines in this respect.
128. Nor does the process as it exists provide for gTLD applicants to benefit from the sort of procedural mechanisms – for example, to inform the SSP’s review, to receive reasoned determinations from the SSP, or to appeal the merits of those determinations – which Booking.com claims are required under the applicable rules. Clearly, certain ICANN NGPC members themselves consider that such input would be desirable and that changes to the process are required in order for the string similarity review process to attain its true goal, which Mr. Sadowski referred to as “the minimization of user confusion and ensuring user trust in using the DNS”. However, as even the abstaining members of the NGPC conceded, the fact is that the sort of mechanisms that Booking.com asserts are required (and which those NGPC members believe should be required) are simply not part of the string similarity review process as currently established. As to whether they *should* be, it is not our place to express an opinion, though we note that such additional mechanisms surely would be consistent with the principles of transparency and fairness.
129. We add that we agree with ICANN that the time has long since passed for Booking.com or any other interested party to ask an IRP panel to review the actions of the ICANN Board in relation to the establishment of the string similarity review process, including Booking.com’s claims that specific elements of the process and the Board decisions to implement those elements are inconsistent with ICANN’s Articles and Bylaws. Any such claims, even if they had any merit, are long since time-barred by the 30-day limitation period set out in Article IV, Section 3(3) of the Bylaws. As ICANN expressed during the hearing, if Booking.com believed that there were problems with the Guidebook, it should have objected at the time the Guidebook was first implemented.
130. When asked during the hearing about its failure to object timely, Booking.com argued that it could not have known how the Board’s actions – that is, how the process established in the Guidebook – would affect it prior to the submission of its application for .hotels. However, that is not a persuasive or meritorious answer. As did all stakeholders, Booking.com had the opportunity to challenge the Board’s adoption of the Guidebook, at the time, if it considered any of its elements to be inconsistent with ICANN’s Articles of Incorporation or Bylaws.

### **C. The Case of .hotels**

131. In the light of the preceding analysis of Booking.com’s challenge concerning the ICANN Board’s actions in relation to the string similarity review process generally, the Panel is not

persuaded by its challenge concerning the Board's conduct in relation to the review of .hotels specifically.

132. There are two principal elements to this part of Booking.com's case: a challenge in relation to the process followed by the SSP; and a challenge in relation to the Board's handling of Booking.com's Request for Reconsideration of the SSP's determination. However, the fundamental obstacle to Booking.com's case is that *the established process was followed in all respects*.
133. Booking.com itself acknowledges that "the process was followed" by the SSP, which determined that .hotels and .hotels were so visually similar as to warrant being placed in a contention set. So too did all of the NGPC members who commented on the matter recognize that "the process was followed" – for all their stated misgivings concerning the outcome of the process.
134. The same is true of the Request for Reconsideration. The Panel is struck by the extent and thoughtfulness not only of the NGPC's consideration of the issue, certain aspects of which are discussed above, but of the BGC's detailed analysis and its Recommendation to the NGPC, on the basis of which Booking.com's Request for Reconsideration was denied. Contrary to Booking.com's allegations, in neither instance was this merely a blind acceptance of a decision of a subordinate body. In fact, the reconsideration process itself, however limited and perhaps imperfect it may be, is inconsistent with Booking.com's claims of lack of "due process".
135. Although not addressed in great detail by the parties, the Panel considers several observations made by the BGC in its 1 August 2013 Recommendation to be particularly apposite:
- *These standing requirements [for Requests for Reconsideration] are intended to protect the reconsideration process from abuse and to ensure that it is not used as a mechanism simply to challenge an action with which someone disagrees, but that it is limited to situations where the staff [or the Board] acted in contravention of established policies.<sup>106</sup>*
  - *Although the String Similarity Review was performed by a third party, ICANN has determined that the Reconsideration process can properly be invoked for challenges of the third party's decisions where it can be stated that either the vendor failed to follow its process in reaching the decision, or that ICANN staff failed to follow its process in accepting that decision.<sup>107</sup>*
  - *Booking.com does not suggest that the process for String Similarity Review set out in the Applicant Guidebook was not followed, or that ICANN staff violated any established ICANN policy in accepting the [SSP] decision on placing .hotels and .hotels in contention sets. Instead, Booking.com is supplanting what it believes the review*

<sup>106</sup> BGC Recommendation, p. 2.

<sup>107</sup> BGC Recommendation, p. 4. The BGC explains that "Because the basis for the Request is not Board conduct, regardless of whether the 20 December 2012 version, or the 11 April 2013 version, of the Reconsideration Bylaws is operative, the BGC's analysis and recommendation below would not change."

methodology for assessing visual similarity should have been, as opposed to the methodology set out at Section 2.2.1.1.2 of the Applicant Guidebook. In asserting a new review methodology, Booking.com is asking the BGC (and the Board through the New gTLD Program Committee (NGPC)) to make a substantive evaluation of the confusability of the strings and to reverse the decision. In the context of the New gTLD Program, the Reconsideration process is not however intended for the Board to perform a substantive review of [SSP] decisions. While Booking.com may have multiple reasons as to why it believes that its application for .hotels should not be in contention set with .hoteis, Reconsideration is not available as a mechanism to re-try the decisions of the evaluation panels.<sup>108</sup>

▪ Booking.com also claims that its assertions regarding the non-confusability of the .hotels and .hoteis strings demonstrate that “it is contrary to ICANN policy to put them in a contention set.” (Request, pages 6-7.) This is just a differently worded attempt to reverse the decision of the [SSP]. No actual policy or process is cited by Booking.com, only the suggestion that – according to Booking.com – the standards within the Applicant Guidebook on visual similarity should have resulted in a different outcome for the .hotels string. This is not enough for Reconsideration.<sup>109</sup>

▪ Booking.com argues that the contention set decision was taken without material information, including Booking.com’s linguistic expert’s opinion, or other “information that would refute the mistaken contention that there is likely to be consumer confusion between ‘.hotels’ and ‘.hoteis.’” (Request, page 7.) However, there is no process point in the String Similarity Review for applicants to submit additional information. This is in stark contrast to the reviews set out in Section 2.2.2 of the Applicant Guidebook, including the Technical/Operational review and the Financial Review, which allow for the evaluators to seek clarification or additional information through the issuance of clarifying questions. (AGB, Section 2.2.2.3 (Evaluation Methodology).)<sup>110</sup>

▪ Just as the process does not call for additional applicant inputs into the visual similarity review, Booking.com’s call for further information on the decision to place .hotels and .hoteis in a contention set ... is similarly not rooted in any established ICANN process at issue.[...] While applicants may avail themselves of accountability mechanism to challenge decisions, the use of an accountability mechanism when there is no proper ground to bring a request for review under the selected mechanism does not then provide opportunity for additional substantive review of decisions already taken.<sup>111</sup>

▪ [W]hile we understand the impact that Booking.com faces by being put in a contention set, and that it wishes for more narrative information regarding the [SSP’s] decision, no such narrative is called for in the process.<sup>112</sup>

▪ The Applicant Guidebook sets out the methodology used when evaluating visual similarity of strings. The process documentation provided by the String Similarity Review Panel describes the steps followed by the [SSP] in applying the methodology

<sup>108</sup> BGC Recommendation, p. 5.

<sup>109</sup> BGC Recommendation, p. 6.

<sup>110</sup> BGC Recommendation, p. 6.

<sup>111</sup> BGC Recommendation, pp. 6-7.

<sup>112</sup> BGC Recommendation, p. 7.



set out in the Applicant Guidebook. ICANN then coordinates a quality assurance review over a random selection of [SSP's] reviews to gain confidence that the methodology and process were followed. That is the process used for a making and assessing a determination of visual similarity. Booking.com's disagreement as to whether the methodology should have resulted in a finding of visual similarity does not mean that ICANN (including the third party vendors performing String Similarity Review) violated any policy in reaching the decision (nor does it support a conclusion that the decision was actually wrong).<sup>113</sup>

▪ The [SSP] reviewed all applied for strings according to the standards and methodology of the visual string similarity review set out in the Applicant Guidebook. The Guidebook clarifies that once contention sets are formed by the [SSP], ICANN will notify the applicants and will publish results on its website. (AGB, Section 2.2.1.1.1.) That the [SSP] considered its output as "advice" to ICANN (as stated in its process documentation) is not the end of the story. Whether the results are transmitted as "advice" or "outcomes" or "reports", the important query is what ICANN was expected to do with that advice once it was received. ICANN had always made clear that it would rely on the advice of its evaluators in the initial evaluation stage of the New gTLD Program, subject to quality assurance measures. Therefore, Booking.com is actually proposing a new and different process when it suggests that ICANN should perform substantive review (instead of process testing) over the results of the String Similarity Review Panel's outcomes prior to the finalization of contention sets.<sup>114</sup>

▪ As there is no indication that either the [SSP] or ICANN staff violated any established ICANN policy in reaching or accepting the decision on the placement of .hotels and .hoteis in a non-exact contention set, this Request should not proceed.<sup>115</sup>

136. These excerpts of the BGC Recommendation not only illustrate the seriousness with which Booking.com's Request for Reconsideration was heard, they mirror considerations to which we fully subscribe and which we find apply as well, with equal force and effect, in the context of Booking.com's IRP Request.
137. It simply cannot be said – indeed, it is not even alleged by Booking.com – that the established process was not followed by the ICANN Board or any third party either in the initial string similarity review of .hotels or in the reconsideration process.
138. Booking.com was asked at the hearing to identify *with particularity* the ICANN Board's actions (including inactions) in this case that it claims are inconsistent with ICANN's Articles of Incorporation, Bylaws or the Guidebook and regarding which it asks the Panel to render a declaration. It identified four:
- The Board's adoption of certain provisions of the Guidebook, including the allegedly ill-defined, unfair and non-transparent procedures for selecting the SSP and supervising the SSP's performance of the string similarity review process. As discussed, any claims in this regard are time-barred.

<sup>113</sup> BGC Recommendation, p. 7.

<sup>114</sup> BGC Recommendation, p. 8.

<sup>115</sup> BGC Recommendation, p. 10.

- The Board’s acceptance of the SSP determination. As ICANN argues, there was no action (or inaction) by the Board here, no decision made (or not made) by the Board or any other body to accept the SSP’s determination. The Guidebook provides that applied-for strings “will be placed in contention set” where the SSP determines the existence of visual similarity likely to give rise to user confusion. Simply put, under the Guidebook the Board is neither required nor entitled to intervene at this stage to accept or not accept the SSP’s determination. Booking.com is correct that the Board could nevertheless have stepped in and reversed the SSP determination under Section 5.1 (Module 5-4) of the Guidebook, but did not do so; that inaction is addressed below.
  - The Board’s denial of Booking.com’s Request for Reconsideration. As discussed above, there is nothing in the evidence that even remotely suggests that ICANN’s conduct in this regard was inconsistent with its Articles, Bylaws or the Guidebook. On the contrary, we have already stated that the detailed analysis performed by the BGC and the extensive consideration of the BGC Recommendation by the NGPC undermine any claim that ICANN failed to exercise due care and independent judgment, or that its handling of the Request for Reconsideration was inconsistent with applicable rules or policy. As discussed above, just as in the present IRP, the question in the reconsideration process is whether the established process was followed. This was the question that the BGC and NGPC asked themselves in considering Booking.com’s Request for Reconsideration, and which they properly answered in the affirmative in denying Booking.com’s request.
  - The Board’s refusal to “step in” and exercise its authority under Section 5.1 (Module 5-4) of the Guidebook to “individually consider an application for a new gTLD to determine whether approval would be in the best interest of the Internet community.” As pointed out by ICANN during the hearing, the fact that the ICANN Board enjoys such discretion and may choose to exercise it any time does not mean that it is bound to exercise it, let alone at the time and in the manner demanded by Booking.com. In any case, the Panel does not believe that the Board’s inaction in this respect was inconsistent with ICANN’s Articles of Incorporation or Bylaws or indeed with ICANN’s guiding principles of transparency and fairness, given (1) Booking.com’s concession that the string similarity review process was followed; (2) the indisputable conclusion that any challenge to the adoption of the SSP process itself is time-barred; (3) the manifestly thoughtful consideration given to Booking.com’s Request for Reconsideration by the BGC; and (4), the fact that, notwithstanding its protestations to the contrary, Booking.com’s real dispute seems to be with the process itself rather than how the process was applied in this case (given that, as noted, Booking.com concedes that the process was indeed followed).
139. The Panel further considers that these – in addition to any and all other potential (and allegedly reviewable) actions identified by Booking.com during the course of these proceedings – fail on the basis of Booking.com’s dual acknowledgement that it does not challenge the validity or fairness of the string similarity review process, and that that process was duly followed in this case.

140. Finally, the panel notes that Booking.com's claim – largely muted during the hearing – regarding alleged “discrimination” as regards the treatment of its application for .hotels also founders on the same ground. Booking.com acknowledges that the established string similarity review process was followed; and there is absolutely no evidence whatsoever that .hotels was treated any differently than any other applied-for gTLD string in this respect. The mere fact that the *result* of the string similarity review of .hotels differed from the results of the reviews of the vast majority of other applied-for strings does not suggest discriminatory treatment. In any event, the Panel cannot but note the obvious, which is that .hotels is not alone in having been placed in contention by the SSP. So too was .hoteis; and so too were .unicom and .unicorn. Moreover, and once again, it is recalled that Booking.com does not claim to challenge the merits of the string similarity review, that is, the determination that .hotels and .hoteis are so visually similar as to warrant placement in a contention set.

#### **D. Conclusion**

141. In launching this IRP, Booking.com no doubt realized that it faced an uphill battle. The very limited nature of IRP proceedings is such that any IRP applicant will face significant obstacles in establishing that the ICANN Board acted inconsistently with ICANN's Articles of Incorporation or Bylaws. In fact, Booking.com acknowledges those obstacles, albeit inconsistently and at times indirectly.
142. Booking.com purports to challenge “the way in which the [string similarity review] process was established, implemented and supervised by (or under the authority of) the ICANN Board”; yet it also claims that it *does not challenge the validity or fairness of the string similarity review process as set out in the Guidebook*. It asks the Panel to overturn the SSP's determination in this case and to substitute an alternate result, in part on the basis of its own “expert evidence” regarding similarity and the probability of user confusion as between .hotels and .hoteis; yet it claims that it *does not challenge the merits of the SSP determination and it acknowledges that the process set out in the Guidebook was duly followed* in the case of its application for .hotels.
143. In sum, Booking.com has failed to overcome the very obstacles that it recognizes exist.
144. The Panel finds that Booking.com has failed to identify any instance of Board action or inaction, including any action or inaction of ICANN staff or a third party (such as ICC, acting as the SSP), that could be considered to be inconsistent with ICANN's Articles of Incorporation or Bylaws or with the policies and procedures established in the Guidebook. This includes the challenged actions of the Board (or any staff or third party) in relation to what Booking.com calls the implementation and supervision of the string similarity review process generally, as well as the challenged actions of the Board (or any staff or third party) in relation to the string similarity review of .hotels in particular.
145. More particularly, the Panel finds that the string similarity review performed in the case of .hotels was not inconsistent with the Articles or Bylaws or with what Booking.com refers to as the “applicable rules” as set out in the Guidebook.
146. To the extent that the Board's adoption and implementation of specific elements of the new gTLD Program and Guidebook, including the string similarity review process, could

potentially be said to be inconsistent with the principles of transparency or fairness that underlie ICANN's Articles and Incorporation and Bylaws (which the Panel does not say is the case), the time to challenge such action has long since passed.

147. Booking.com's IRP Request must be denied.

## VII. THE PREVAILING PARTY; COSTS

148. Article IV, Section 3(18) of the Bylaws requires that the Panel "specifically designate the prevailing party." This designation is germane to the allocation of costs, given that Article IV, Section 3(18) provides that the "party not prevailing shall ordinarily be responsible for bearing all costs of the IRP Provider."
149. The same provision of the Bylaws also states that "in an extraordinary case the IRP Panel may in its declaration allocate up to half of the costs of the IRP Provider to the prevailing party based upon the circumstances, including a consideration of the reasonableness of the parties' positions and their contribution to the public interest. Each party to the IRP proceedings shall bear its own expenses."
150. Similarly, the Supplementary Procedures state, at Article 11:

*The IRP PANEL shall fix costs in its DECLARATION. The party not prevailing in an IRP shall ordinarily be responsible for bearing all costs of the proceedings, but under extraordinary circumstances the IRP PANEL may allocate up to half of the costs to the prevailing party, taking into account the circumstances of the case, including the reasonableness of the parties' positions and their contribution to the public interest.*

*In the event the Requestor has not availed itself, in good faith, of the cooperative engagement or conciliation process, and the requestor is not successful in the Independent Review, the IRP PANEL must award ICANN all reasonable fees and costs incurred by ICANN in the IRP, including legal fees.*

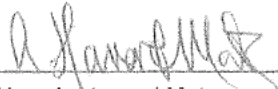
151. The "IRP Provider" is the ICDR, and, in accordance with the ICDR Rules, the costs to be allocated between the parties – what the Bylaws call the "costs of the IRP Provider", and the Supplementary Procedures call the "costs of the proceedings" – include the fees and expenses of the Panel members and of the ICDR (we refer to all of these costs as "**IRP costs**").
152. ICANN is undoubtedly the prevailing party in this case. That being said, the Panel considers that the nature and significance of the issues raised by Booking.com, and the contribution to the "public interest" of its submissions, are such that it is appropriate and reasonable that the IRP costs be shared equally by the parties. We consider that the extraordinary circumstances of case – in which some members of ICANN's New gTLD Program Committee have publicly declared that, in their view, the rules on the basis of which Booking.com's claims fail should be reconsidered by ICANN – warrants such a holding.
153. The Panel cannot grant Booking.com the relief that it seeks. A panel such as ours can only declare whether, on the facts as we find them, the challenged actions of ICANN are

or are not inconsistent with ICANN's Articles of Incorporation and Bylaws. We have found that the actions in question are not inconsistent with those instruments. The process established by ICANN under its Articles of Incorporation and Bylaws and set out in the Guidebook was followed, and the time to challenge that process (which Booking.com asserts is not its intention in these proceedings in any event) has long passed.

154. However, we can – and we do – acknowledge certain legitimate concerns regarding the string similarity review process raised by Booking.com, discussed above, which are evidently shared by a number of prominent and experienced ICANN NGPC members. And we can, and do, encourage ICANN to consider whether it wishes to address these issues in an appropriate manner and forum, for example, when drafting the Guidebook for round two of the New gTLD Program or, more immediately, in the exercise of its authority under Section 5.1 (Module 5-4) of the Guidebook (which it may choose to exercise at any time, in its discretion) to consider whether, notwithstanding the result of the string similarity review of .hotels and .hoteis, approval of both of Booking.com's and Despegar's proposed strings would be in the best interest of the Internet community.

FOR THE FOREGOING REASONS, the Panel hereby declares:

- (1) Booking.com's IRP Request is denied;
- (2) ICANN is the prevailing party;
- (3) In view of the circumstances, each party shall bear one-half of the costs of the IRP Provider, including the fees and expenses of the Panel members and the fees and expenses of the ICDR. As a result, the administrative fees and expenses of the ICDR, totaling US\$4,600.00, as well as the compensation and expenses of the Panelists totaling US\$163,010.05 are to be borne equally. Therefore, ICANN shall pay to Booking.com the amount of US\$2,300.00 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by Booking.com
- (4) This Final Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Final Declaration of this IRP Panel.

  
\_\_\_\_\_  
Hon. A. Howard Matz  
Date: March 2, 2015

\_\_\_\_\_  
David H. Bernstein  
Date:

\_\_\_\_\_  
Stephen L. Drymer,  
Chair of the IRP Panel  
Date:

I, Hon. A. Howard Matz, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

March 2, 2015  
Date

  
Hon. A. Howard Matz

I, David H. Bernstein, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
David H. Bernstein

I, Stephen L. Drymer, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Stephen L. Drymer


or are not inconsistent with ICANN's Articles of Incorporation and Bylaws. We have found that the actions in question are not inconsistent with those instruments. The process established by ICANN under its Articles of Incorporation and Bylaws and set out in the Guidebook was followed, and the time to challenge that process (which Booking.com asserts is not its intention in these proceedings in any event) has long passed.

154. However, we can – and we do – acknowledge certain legitimate concerns regarding the string similarity review process raised by Booking.com, discussed above, which are evidently shared by a number of prominent and experienced ICANN NGPC members. And we can, and do, encourage ICANN to consider whether it wishes to address these issues in an appropriate manner and forum, for example, when drafting the Guidebook for round two of the New gTLD Program or, more immediately, in the exercise of its authority under Section 5.1 (Module 5-4) of the Guidebook (which it may choose to exercise at any time, in its discretion) to consider whether, notwithstanding the result of the string similarity review of .hotels and .hoteis, approval of both of Booking.com's and Despegar's proposed strings would be in the best interest of the Internet community.

FOR THE FOREGOING REASONS, the Panel hereby declares:

- (1) Booking.com's IRP Request is denied;
- (2) ICANN is the prevailing party;
- (3) In view of the circumstances, each party shall bear one-half of the costs of the IRP Provider, including the fees and expenses of the Panel members and the fees and expenses of the ICDR. As a result, the administrative fees and expenses of the ICDR, totaling US\$4,600.00, as well as the compensation and expenses of the Panelists totaling US\$163,010.05 are to be borne equally. Therefore, ICANN shall pay to Booking.com the amount of US\$2,300.00 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by Booking.com
- (4) This Final Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Final Declaration of this IRP Panel.

\_\_\_\_\_  
Hon. A. Howard Matz  
Date:

  
\_\_\_\_\_  
David H. Bernstein  
Date: March 2, 2015

\_\_\_\_\_  
Stephen L. Drymer,  
Chair of the IRP Panel  
Date:


I, Hon. A. Howard Matz, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Hon. A. Howard Matz

I, David H, Bernstein, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

March 2, 2015  
Date

  
\_\_\_\_\_  
David H, Bernstein

I, Stephen L. Drymer, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Stephen L. Drymer



or are not inconsistent with ICANN's Articles of Incorporation and Bylaws. We have found that the actions in question are not inconsistent with those instruments. The process established by ICANN under its Articles of Incorporation and Bylaws and set out in the Guidebook was followed, and the time to challenge that process (which Booking.com asserts is not its intention in these proceedings in any event) has long passed.

154. However, we can – and we do – acknowledge certain legitimate concerns regarding the string similarity review process raised by Booking.com, discussed above, which are evidently shared by a number of prominent and experienced ICANN NGPC members. And we can, and do, encourage ICANN to consider whether it wishes to address these issues in an appropriate manner and forum, for example, when drafting the Guidebook for round two of the New gTLD Program or, more immediately, in the exercise of its authority under Section 5.1 (Module 5-4) of the Guidebook (which it may choose to exercise at any time, in its discretion) to consider whether, notwithstanding the result of the string similarity review of .hotels and .hotels, approval of both of Booking.com's and Despegar's proposed strings would be in the best interest of the Internet community.

FOR THE FOREGOING REASONS, the Panel hereby declares:

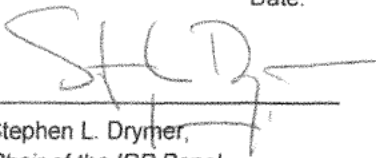
- (1) Booking.com's IRP Request is denied;
- (2) ICANN is the prevailing party;
- (3) In view of the circumstances, each party shall bear one-half of the costs of the IRP Provider, including the fees and expenses of the Panel members and the fees and expenses of the ICDR. As a result, the administrative fees and expenses of the ICDR, totaling US\$4,600.00, as well as the compensation and expenses of the Panelists totaling US\$163,010.05 are to be borne equally. Therefore, ICANN shall pay to Booking.com the amount of US\$2,300.00 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by Booking.com
- (4) This Final Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Final Declaration of this IRP Panel.

\_\_\_\_\_  
Hon. A. Howard Matz

Date:

\_\_\_\_\_  
David H. Bernstein

Date:

  
\_\_\_\_\_  
Stephen L. Drymer,  
Chair of the IRP Panel

Date: 3 March 2015

I, Hon. A. Howard Matz, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Hon. A. Howard Matz

I, David H. Bernstein, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
David H. Bernstein

I, Stephen L. Drymer, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is the Final Declaration of the IRP Panel.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Stephen L. Drymer

3 March 2015



**CLA-002**

INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION  
Independent Review Panel

CASE #50 2013 001083

---

**FINAL DECLARATION**

---

In the matter of an Independent Review Process (IRP) pursuant to the Internet Corporation For Assigned Names and Number's (ICANN's) Bylaws, the *International Dispute Resolution Procedures* (ICDR Rules) and the *Supplementary Procedures for ICANN Independent Review Process* of the International Centre for Dispute Resolution (ICDR),

**Between:** **DotConnectAfrica Trust;**  
("Claimant" or "DCA Trust")

Represented by Mr. Arif H. Ali, Ms. Meredith Craven, Ms. Erin Yates and Mr. Ricardo Ampudia of Weil, Gotshal & Manges, LLP Redacted

**And**

**Internet Corporation for Assigned Names and Numbers (ICANN);**  
("Respondent" or "ICANN")

Represented by Mr. Jeffrey A. LeVee and Ms. Rachel Zernik of Jones Day, LLP Redacted

Claimant and Respondent will together be referred to as "Parties".

**IRP Panel**

**Prof. Catherine Kessedjian**  
**Hon. William J. Cahill (Ret.)**  
**Babak Barin, *President***

## **I. BACKGROUND**

1. DCA Trust is non-profit organization established under the laws of the Republic of Mauritius on 15 July 2010 with its registry operation – DCA Registry Services (Kenya) Limited – as its principal place of business in Nairobi, Kenya.
2. DCA Trust was formed with the charitable purpose of, among other things, advancing information technology education in Africa and providing a continental Internet domain name to provide access to internet services for the people of Africa and not for the public good.
3. In March 2012, DCA Trust applied to ICANN for the delegation of the .AFRICA top-level domain name in its 2012 General Top-Level Domains (“gTLD”) Internet Expansion Program (the “New gTLD Program”), an internet resource available for delegation under that program.
4. ICANN is a non-profit corporation established on 30 September 1998 under the laws of the State of California, and headquartered in Marina del Rey, California, U.S.A. According to its Articles of Incorporation, ICANN was established for the benefit of the Internet community as a whole and is tasked with carrying out its activities in conformity with relevant principles of international law, international conventions and local law.
5. On 4 June 2013, the ICANN Board New gTLD Program Committee (“NGPC”) posted a notice that it had decided not to accept DCA Trust’s application.
6. On 19 June 2013, DCA Trust filed a request for reconsideration by the ICANN Board Governance Committee (“BGC”), which denied the request on 1 August 2013.
7. On 19 August 2013, DCA Trust informed ICANN of its intention to seek relief before an Independent Review Panel under ICANN’s Bylaws. Between August and October 2013, DCA Trust and ICANN participated in a Cooperative Engagement Process (“CEP”) to try and resolve the issues relating to DCA Trust’s application. Despite several meetings, no resolution was reached.
8. On 24 October 2013, DCA Trust filed a Notice of Independent Review Process with the ICDR in accordance with Article IV, Section 3 of ICANN’s Bylaws.

9. In an effort to safeguard its rights pending the ongoing constitution of the IRP Panel, on 22 January 2014, DCA Trust wrote to ICANN requesting that it immediately cease any further processing of all applications for the delegation of the .AFRICA gTLD, failing which DCA Trust would seek emergency relief under Article 37 of the ICDR Rules.
10. DCA Trust also indicated that it believed it had the right to seek such relief because there was no standing panel as anticipated in the Supplementary Procedures for ICANN Independent Review Process (“Supplementary Procedures”), which could otherwise hear requests for emergency relief.
11. In response, on 5 February 2014, ICANN wrote:

Although ICANN typically is refraining from further processing activities in conjunction with pending gTLD applications where a competing applicant has a pending reconsideration request, ICANN does not intend to refrain from further processing of applications that relate in some way to pending independent review proceedings. In this particular instance, ICANN believes that the grounds for DCA’s IRP are exceedingly weak, and that the decision to refrain from the further processing of other applications on the basis of the pending IRP would be unfair to others.
12. In its Request for Emergency Arbitrator and Interim Measures of Protection subsequently submitted on 28 March 2014, DCA Trust pleaded, *inter alia*, that, in an effort to preserve its rights, in January 2014, DCA requested that ICANN suspend its processing of applications for .AFRICA during the pendency of this proceeding. ICANN, however, summarily refused to do so.
13. DCA Trust also submitted that “on 23 March 2014, DCA became aware that ICANN intended to sign an agreement with DCA’s competitor (a South African company called ZACR) on 26 March 2014 in Beijing [...] Immediately upon receiving this information, DCA contacted ICANN and asked it to refrain from signing the agreement with ZACR in light of the fact that this proceeding was still pending. Instead, according to ICANN’s website, ICANN *signed its agreement with ZACR the very next day, two days ahead of plan, on 24 March instead of 26 March.*”
14. According to DCA Trust, that same day, “ICANN then responded to DCA’s request by presenting the execution of the contract as a *fait accompli*, arguing that DCA should have sought to stop ICANN from proceeding with ZACR’s application, as ICANN had already informed DCA of its intention [to] ignore its obligations to participate in this proceeding in good faith.”

15. DCA Trust also submitted that on 25 March 2014, as per ICANN's email to the ICDR, "ICANN for the first time informed DCA that it would accept the application of Article 37 of the ICDR Rules to this proceeding contrary to the express provisions of the Supplementary Procedures of ICANN has put in place for the IRP Process."
16. In its Request, DCA Trust argued that it "is entitled to an accountability proceeding with legitimacy and integrity, with the capacity to provide a meaningful remedy. [...] DCA has requested the opportunity to compete for rights to .AFRICA pursuant to the rules that ICANN put into place. Allowing ICANN to delegate .AFRICA to DCA's only competitor – which took actions that were instrumental in the process leading to ICANN's decision to reject DCA's application – would eviscerate the very purpose of this proceeding and deprive DCA of its rights under ICANN's own constitutive instruments and international law."
17. Finally, among other things, DCA Trust requested the following interim relief:
  - a. An order compelling *ICANN to refrain from any further steps toward delegation of the .AFRICA gTLD*, including but not limited to execution or assessment of pre-delegation testing, negotiations or discussions relating to delegation with the entity ZACR or any of its officers or agents; [...]
18. On 24 April and 12 May 2014, the Panel issued Procedural Order No. 1, a Decision on Interim Measures of Protection, and a list of questions for the Parties to answer.
19. In its 12 May 2014 Decision on Interim Measures of Protection, the Panel required ICANN to "immediately refrain from any further processing of any application for .AFRICA until [the Panel] heard the merits of DCA Trust's Notice of Independent Review Process and issued its conclusions regarding the same".
20. In the Panel's unanimous view, among other reasons, it would have been "unfair and unjust to deny DCA Trust's request for interim relief when the need for such a relief...[arose] out of ICANN's failure to follow its own Bylaws and procedures." The Panel also reserved its decision on the issue of costs relating to that stage of the proceeding until the hearing of the merits.
21. On 27 May and 4 June 2015, the Panel issued Procedural Order No. 2 and a Decision on ICANN's request for Partial Reconsideration of certain portions of its Decision on Interim Measures of Protection.

22. In its 4 June 2014 Decision on ICANN's request for Partial Reconsideration, the Panel unanimously concluded that ICANN's request must be denied. In that Decision, the Panel observed:

9. After careful consideration of the Parties' respective submissions, the Panel is of the unanimous view that ICANN's Request must be denied for two reasons.

10. First, there is nothing in ICANN's Bylaws, the International Dispute Resolution Procedures of the ICDR effective as at 1 June 2009 or the Supplementary Procedures for ICANN Independent Review Process that in any way address the Panel's ability to address ICANN's Request. The Panel has not been able to find any relevant guidance in this regard in any of the above instruments and ICANN has not pointed to any relevant provision or rule that would support its argument that the Panel has the authority to reconsider its Decision of 12 May 2014.

11. Moreover, ICANN has not pointed to any clerical, typographical or computation error or shortcoming in the Panel's Decision and it has not requested an interpretation of the Panel's Decision based on any ambiguity or vagueness. To the contrary, ICANN has asked the Panel to reconsider its prior findings with respect to certain references in its Decision that ICANN disagrees with, on the basis that those references are in ICANN's view, inaccurate.

12. Second, even if the Panel were to reconsider based on any provision or rule available, its findings with respect to those passages complained of by ICANN as being inaccurate in its Decision – namely paragraphs 29 to 33 – after deliberation, the Panel would still conclude that ICANN has failed to follow its own Bylaws as more specifically explained in the above paragraphs, in the context of addressing which of the Parties should be viewed as responsible for the delays associated with DCA Trust's Request for Interim Measures of Protection. It is not reasonable to construe the By-law proviso for consideration by a provider-appointed *ad hoc* panel when a standing panel is not in place as relieving ICANN indefinitely of forming the required standing panel. Instead, the provider appointed panel is properly viewed as an interim procedure to be used before ICANN has a chance to form a standing panel. Here, more than a year has elapsed, and ICANN has offered no explanation why the standing panel has not been formed, nor indeed any indication that formation of that panel is in process, or has begun, or indeed even is planned to begin at some point.

The Panel also reserved its decision on the issue of costs relating to that stage of the proceeding until the hearing of the merits.

23. On 14 August 2014, the Panel issued a Declaration on the IRP Procedure ("2014 Declaration") pursuant to which it (1) ordered a reasonable documentary exchange, (2) permitted the Parties to benefit from additional filings and supplementary briefing, (3) allowed a video hearing, and (4) permitted both Parties at the hearing to



challenge and test the veracity of any written statements made by witnesses.

The Panel also concluded that its Declaration on the IRP and its future Declaration on the Merits of the case were binding on the Parties. In particular, the Panel decided:

98. Various provisions of ICANN's Bylaws and the Supplementary Procedures support the conclusion that the Panel's decisions, opinions and declarations are binding. There is certainly nothing in the Supplementary Rules that renders the decisions, opinions and declarations of the Panel either advisory or non-binding.

[...]

100. Section 10 of the Supplementary Procedures resembles Article 27 of the ICDR Rules. Whereas Article 27 refers to "Awards", section 10 refers to "Declarations". Section 10 of the Supplementary Procedures, however, is silent on whether Declarations made by the IRP Panel are "final and binding" on the parties.

101. As explained earlier, as per Article IV, Section 3, paragraph 8 of the Bylaws, the Board of Directors of ICANN has given its approval to the ICDR to establish a set of operating rules and procedures for the conduct of the IRP set out in section 3. The operating rules and procedures established by the ICDR are the ICDR Rules as referred to in the preamble of the Supplementary Procedures. These Rules have been supplemented with the Supplementary Procedures.

102. This is clear from two different parts of the Supplementary Procedures. First, in the preamble, where the Supplementary Procedures state that: "These procedures supplement the International Centre for Dispute Resolution's International Arbitration Rules in accordance with the independent review procedures set forth in Article IV, Section 3 of the ICANN Bylaws".

103. And second, under section 2 entitled (Scope), that states that the "ICDR will apply these Supplementary Procedures, in addition to the INTERNATIONAL DISPUTE RESOLUTION PROCEDURES, in all cases submitted to the ICDR in connection with the Article IV, Section 3(4) of the ICANN Bylaws". It is therefore clear that ICANN intended the operating rules and procedures for the independent review to be an international set of arbitration rules supplemented by a particular set of additional rules.

104. There is also nothing inconsistent between section 10 of the Supplementary Procedures and Article 27 of the ICDR Rules.

105. One of the hallmarks of international arbitration is the binding and final nature of the decisions made by the adjudicators. Binding arbitration is the essence of what the ICDR Rules, the ICDR itself and its parent, the American Arbitration Association, offer. The selection of the ICDR Rules as the baseline set of procedures for IRP's, therefore, points to a binding adjudicative process.

106. Furthermore, the process adopted in the Supplementary Procedures is an adversarial one where counsel for the parties present competing evidence and arguments, and a panel decides who prevails, when and in what circumstances. The panellists who adjudicate the parties' claims are also selected from among experienced arbitrators, whose usual charter is to make binding decisions.

107. The above is further supported by the language and spirit of section 11 of ICANN's Bylaws. Pursuant to that section, the IRP Panel has the authority to summarily dismiss requests brought without standing, lacking in substance, or that are frivolous or vexatious. Surely, such a decision, opinion or declaration on the part of the Panel would not be considered advisory.

[...]

110. ICANN points to the extensive public and expert input that preceded the formulation of the Supplementary Procedures. The Panel would have expected, were a mere advisory decision, opinion or declaration the objective of the IRP, that this intent be clearly articulated somewhere in the Bylaws or the Supplementary Procedures. In the Panel's view, this could have easily been done.

111. The force of the foregoing textual and construction considerations as pointing to the binding effect of the Panel's decisions and declarations are reinforced by two factors: 1) the exclusive nature of the IRP whereby the non-binding argument would be clearly in contradiction with such a factor; and, 2) the special, unique, and publicly important function of ICANN. As explained before, ICANN is not an ordinary private non-profit entity deciding for its own sake who it wishes to conduct business with, and who it does not. ICANN rather, is the steward of a highly valuable and important international resource.

[...]

115. Moreover, assuming for the sake of argument that it is acceptable for ICANN to adopt a remedial scheme with no teeth, the Panel is of the opinion that, at a minimum, the IRP should forthrightly explain and acknowledge that the process is merely advisory. This would at least let parties know before embarking on a potentially expensive process that a victory before the IRP panel may be ignored by ICANN. And, a straightforward acknowledgment that the IRP process is intended to be merely advisory might lead to a legislative or executive initiative to create a truly independent compulsory process. The Panel seriously doubts that the Senators questioning former ICANN President Stuart Lynn in 2002 would have been satisfied had they understood that a) ICANN had imposed on all applicants a waiver of all judicial remedies, *and* b) the IRP process touted by ICANN as the "ultimate guarantor" of ICANN accountability was only an advisory process, the benefit of which accrued only to ICANN. [Underlining is from the original decision.]

The Panel also reserved its decision on the issue of costs relating to that stage of the proceeding until the hearing of the merits.

24. On 5 September and 25 September 2014, the Panel issued Procedural Orders No. 3 and No. 4. In Procedural Order No. 3, the Panel notably required the Parties to complete their respective filing of briefs in accordance with the IRP Procedure Guidelines by 3 November 2014 for DCA Trust and 3 December 2014 for ICANN.
25. In Procedural Order No. 4 dated 25 September 2014, the Panel reached a decision regarding document production issues.
26. On 3 November 2014 and 3 December 2014, the Parties filed their Memorial and Response Memorial on the Merits in accordance with the timetable set out in Procedural Order No. 3.
27. On 26 February 2015, following the passing away of the Hon. Richard C. Neal (Ret.) and confirmation by the ICDR of his replacement arbitrator, the Hon. William J. Cahill (Ret.), ICANN requested that this Panel consider revisiting the part of this IRP relating to the issue of hearing witnesses addressed in the Panel's 2014 Declaration.
28. In particular, ICANN submitted that given the replacement of Justice Neal, Article 15.2 of the ICDR Rules together with the Supplementary Procedures permitted this IRP to in its sole discretion, determine "whether all or part" of this IRP should be repeated.
29. According to ICANN, while it was not necessary to repeat all of this IRP, since the Panel here had exceeded its authority under the Supplementary Procedures when it held in its 2014 Declaration that it could order live testimony of witnesses, the Panel should then at a minimum consider revisiting that issue.
30. According to ICANN, panelists derived "their powers and authority from the relevant applicable rules, the parties' requests, and the contractual provisions agreed to by the Parties (in this instance, ICANN's Bylaws, which establish the process of independent review). The authority of panelists is limited by such rules, submissions and agreements."
31. ICANN emphasized that "compliance with the Supplementary Procedures [was] critical to ensure predictability for ICANN, applicants for and objectors to gTLD applications, and the entire ICANN community...", and while "ICANN [was] committed to fairness and accessibility...ICANN [was] also committed to predictability and the like treatment of all applicants. For this Panel to change the rules

for this single applicant [did] not encourage any of these commitments.”

32. ICANN also pleaded that, DCA specifically agreed to be bound by the Supplementary Procedures when it initially submitted its application, the Supplementary Procedures apply to both ICANN and DCA alike, ICANN is now in the same position when it comes to testing witness declarations and finally, in alternative dispute resolution proceedings where cross examination of witnesses is allowed, parties often waive cross-examination.

33. Finally, ICANN advanced that:

[T]he Independent Review process is an alternative dispute resolution procedure adapted to the specific issues to be addressed pursuant to ICANN’s Bylaws. The process cannot be transformed into a full-fledged trial without amending ICANN’s Bylaws and the Supplementary Procedures, which specifically provide for a hearing that includes counsel argument only. Accordingly, ICANN strongly urges the Panel to follow the rules for this proceeding and to declare that the hearing in May will be limited to argument of counsel.

34. On 24 March 2015, the Panel issued its Declaration on ICANN’s Request for Revisiting of the 14 August Declaration on the IRP Procedure following the Replacement of Panel Member. In that Declaration, the newly constituted Panel unanimously concluded that it was not necessary for it to reconsider or revisit its 2014 Declaration.

35. In passing and not at all as a result of any intended or inadvertent reconsideration or revisiting of its 2014 Declaration, the Panel referred to Articles III and IV of ICANN’s Bylaws and concluded:

Under the general heading, Transparency, and title “Purpose”, Section 1 of Article III states: “ICANN and its constituent bodies shall operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness.” Under the general heading, Accountability and Review, and title “Purpose”, Section 1 of Article IV reads: “In carrying out its mission as set out in these Bylaws, ICANN should be accountable to the community for operating in a manner that is consistent with these Bylaws, and with due regard for the core values set forth in Article I of these Bylaws.” In light of the above, and again in passing only, it is the Panel’s unanimous view, that the filing of fact witness statements (as ICANN has done in this IRP) and limiting telephonic or in-person hearings to argument only is inconsistent with the objectives setout in Articles III and IV setout above.

The Panel again reserved its decision on the issue of costs relating to that stage of the proceeding until the hearing of the merits.

36. On 24 March and 1 April 2015, the Panel rendered Procedural Orders No. 5 and 6, in which, among other things, the Panel recorded the Parties' "agreement that there will no cross-examination of any of the witnesses" at the hearing of the merits.
37. On 20 April 2015, the Panel rendered its Third Declaration on the IRP Procedure. In that Declaration, the Panel decided that the hearing of this IRP should be an in-person one in Washington, D.C. and required all three witnesses who had filed witness statements to be present at the hearing.
38. The Panel in particular noted that:

13. [...] Article IV, Section 3, and Paragraph 4 of ICANN's Bylaws (reproduced above) – the Independent Review Process – was designed and set up to offer the Internet community, an accountability process that would ensure that ICANN acted in a manner consistent with ICANN's Articles of Incorporation and Bylaws.

14. Both ICANN's Bylaws and the Supplementary Rules require an IRP Panel to *examine* and *decide* whether the Board has acted consistently with the provisions of the Articles of Incorporation and Bylaws. As ICANN's Bylaws explicitly put it, an IRP Panel is "*charged with* comparing contested actions of the Board [...], and with *declaring* whether the Board has acted consistently with the provisions of the Articles of Incorporation and Bylaws.

15. The IRP is the only independent third party process that allows review of board actions to ensure their consistency with the Articles of Incorporation or Bylaws. As already explained in this Panel's 14 August 2014 Declaration on the IRP Procedure ("August 2014 Declaration"), the avenues of accountability for applicants that have disputes with ICANN do *not* include resort to the courts. Applications for gTLD delegations are governed by ICANN's Guidebook, which provides that applicants waive all right to resort to the courts:

"Applicant hereby releases ICANN [...] from any and all claims that arise out of, are based upon, or are in any way related to, any action or failure to act by ICANN [...] in connection with ICANN's review of this application, investigation, or verification, any characterization or description of applicant or the information in this application, any withdrawal of this application or the decision by ICANN to recommend or not to recommend, the approval of applicant's gTLD application. APPLICANT AGREES NOT TO CHALLENGE, IN COURT OR ANY OTHER JUDICIAL FORA, ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION, AND IRREVOCABLY WAIVES ANY RIGHT TO SUE OR PROCEED IN COURT OR ANY OTHER JUDICIAL FORA ON THE BASIS OF ANY OTHER LEGAL CLAIM AGAINST ICANN ON THE BASIS OF ANY OTHER LEGAL CLAIM."

Thus, assuming that the foregoing waiver of any and all judicial remedies is valid and enforceable, then the only and ultimate "accountability" remedy for an applicant is the IRP.

16. Accountability requires an organization to explain or give reasons for its activities, accept responsibility for them and to disclose the results in a transparent manner.

[...]

21. In order to keep the costs and burdens of independent review as low as possible, ICANN's Bylaws, in Article IV, Section 3 and Paragraph 12, suggests that the IRP Panel conduct its proceedings by email and otherwise via the Internet to the maximum extent feasible, and where necessary the IRP Panel may hold meetings by telephone. Use of the words "should" and "may" versus "shall" are demonstrative of this point. In the same paragraph, however, ICANN's Bylaws state that, "in the unlikely event that a telephonic or in-person hearing is convened, the hearing *shall* be limited to argument only; all evidence, including witness statements, must be submitted in writing in advance."

22. The Panel finds that this last sentence in Paragraph 12 of ICANN's Bylaws, unduly and improperly restricts the Panel's ability to conduct the "independent review" it has been explicitly mandated to carryout in Paragraph 4 of Section 3 in the manner it considers appropriate.

23. How can a Panel compare contested actions of the Board and declare whether or not they are consistent with the provisions of the Articles of Incorporation and Bylaws, without the ability to fact find and make enquiries concerning those actions in the manner it considers appropriate?

24. How can the Panel for example, determine, if the Board acted without conflict of interest, exercised due diligence and care in having a reasonable amount of facts in front of it, or exercised independent judgment in taking decisions, if the Panel cannot ask the questions it needs to, in the manner it needs to or considers fair, just and appropriate in the circumstances?

25. How can the Panel ensure that the parties to this IRP are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case with respect to the mandate the Panel has been given, if as ICANN submits, "ICANN's Bylaws do not permit any examination of witnesses by the parties or the Panel during the hearing"?

26. The Panel is unanimously of the view that it cannot. The Panel is also of the view that any attempt by ICANN in this case to prevent it from carrying out its independent review of ICANN Board's actions in the manner that the Panel considers appropriate under the circumstances deprives the accountability and review process set out in the Bylaws of any meaning.

27. ICANN has filed two 'Declarations' in this IRP, one signed by Ms. Heather Dryden, a Senior Policy Advisor at the International Telecommunications Policy and Coordination Directorate at Industry Canada, and Chair of ICANN Government Advisory Committee from 2010 to 2013, and the other by Mr. Cherine Chalaby, a member of the Board of Directors of ICANN since 2010. Mr. Chalaby is also, since its inception, one of three members of the Subcommittee on Ethics and Conflicts of ICANN's Board of Governance Committee.

28. In their respective statements, both individuals have confirmed that they "have personal knowledge of the matters set forth in [their] declaration and [are] competent to testify to these matters *if called as a witness*."

[...]

29. In his Declaration, Mr. Chalaby states that “all members of the NGPC were asked to and did specifically affirm that they did not have a conflict of interest related to DCA’s application for .AFRICA when they voted on the GAC advice. In addition, the NGPC asked the BGC to look into the issue further, and the BGC referred the matter to the Subcommittee. After investigating the matter, the Subcommittee concluded that Chris Disspain and Mike Silber did not have conflicts of interest with respect to DCA’s application for .AFRICA.”

30. The Panel considers it important and useful for ICANN’s witnesses, and in particular, Mr. Chalaby as well as for Ms. Sophia Bekele Eshete to be present at the hearing of this IRP.

31. While the Panel takes note of ICANN’s position depicted on page 2 of its 8 April 2015 letter, the Panel nonetheless invites ICANN to reconsider its position.

32. The Panel also takes note of ICANN’s offer in that same letter to address written questions to its witnesses before the hearing, and if the Panel needs more information after the hearing to clarify the evidence presented during the hearing. The Panel, however, is unanimously of the view that this approach is fundamentally inconsistent with the requirements in ICANN’s Bylaws for it to act openly, transparently, fairly and with integrity.

33. As already indicated in this Panel’s August 2014 Declaration, analysis of the propriety of ICANN’s decisions in this case will depend at least in part on evidence about the intentions and conduct of ICANN’s top personnel. Even though the Parties have explicitly agreed that neither will have an opportunity to cross-examine the witnesses of the other in this IRP, the Panel is of the view that ICANN should not be allowed to rely on written statements of its top officers attesting to the propriety of their actions and decisions without an opportunity for the Panel and thereafter DCA Trust’s counsel to ask any follow-up questions arising out of the Panel’s questions of ICANN’s witnesses. The same opportunity of course will be given to ICANN to ask questions of Ms. Bekele Eshete, after the Panel has directed its questions to her.

34. The Parties having agreed that there will be no cross-examination of witnesses in this IRP, the procedure for asking witnesses questions at the hearing shall be as follows:

- a) The Panel shall first have an opportunity to ask any witness any questions it deems necessary or appropriate;
- b) Each Party thereafter, shall have an opportunity to ask any follow-up questions the Panel permits them to ask of any witness.

The Panel again reserved its decision on the issue of costs relating to that stage of the proceeding until the hearing of the merits.

39. On 27 April and 4 May 2015, the Panel issued its Procedural Order No. 7 and 8, and on that last date, it held a prehearing conference call with the Parties as required by the ICDR Rules. In Procedural

Order No. 8, the Panel set out the order of witness and party presentations agreed upon by the Parties.

40. On 18 May 2015, and in response to ZA Central Registry's (ZACR) request to have two of its representatives along with a representative from the African Union Commission (AUC) attend at the IRP hearing scheduled for 22 and 23 May 2015 in Washington, D.C., the Panel issued its Procedural Order No. 9, denying the requests made by ZACR and AUC to be at the merits hearing of this matter in Washington, D.C.
41. In a letter dated 11 May 2015, ZACR and AUC's legal representative had submitted that both entities had an interest in this matter and it would be mutually beneficial for the IRP to permit them to attend at the hearing in Washington, D.C.
42. ZACR's legal representative had also argued that "allowing for interests of a materially affected party such as ZACR, the successful applicant for the dotAfrica gTLD, as well as broader public interests, to be present enhances the legitimacy of the proceedings and therefore the accountability and transparency of ICANN and its dispute resolution procedures."
43. For the Panel, Article 20 of the ICDR Rules, which applied in this matter, stated that the hearing of this IRP was "private unless the parties agree otherwise". The Parties in this IRP did not consent to the presence of ZACR and AUC. While ICANN indicated that it had no objection to the presence of ZACR and AUC, DCA Trust was not of the same view. Therefore, ZACR and AUC were not permitted to attend.
44. The in-person hearing of the merits of this IRP took place on 22 and 23 May 2015 at the offices of Jones Day LLP in Washington, D.C. All three individuals who had filed witness statements in this IRP, namely Ms. Sophia Bekele Eshete, representative for DCA Trust, Ms. Heather Dryden and Mr. Cherine Chalaby, representatives for ICANN, attended in person and answered questions put to them by the Panel and subsequently by the legal representatives of both Parties. In attendance at the hearing was also Ms. Amy Stathos, Deputy General Counsel of ICANN.
45. The proceedings of the hearing were reported by Ms. Cindy L. Sebo of TransPerfect Legal Solutions, who is a Registered Merit Real-Time Court Reporter.



46. On the last day of the hearing, DCA Trust was asked by the Panel to clearly and explicitly articulate its prayers for relief. In a document entitled Claimant's Final Request for Relief which was signed by the Executive Director of DCA Trust, Ms. Sophia Bekele and marked at the hearing as Hearing Exhibit 4, DCA Trust asked the Panel to:

Declare that the Board violated ICANN's Articles of Incorporation, Bylaws and the Applicant Guidebook (AGB) by:

- Discriminating against DCA and wrongfully assisting the AUC and ZACR to obtain rights to the .AFRICA gTLD;
- Failing to apply ICANN's procedures in a neutral and objective manner, with procedural fairness when it accepted the GAC Objection Advice against DCA; and
- Failing to apply its procedures in a neutral and objective manner, with procedural fairness when it approved the BGC's recommendation not to reconsider the NGPC's acceptance of the GAC Objection Advice against DCA;

And to declare that:

- DCA is the prevailing party in this IRP and, consequently, shall be entitled to its costs in this proceeding; and
- DCA is entitled to such other relief as the Panel may find appropriate under the circumstances described herein.

Recommend, as a result of each of these violations, that:

- ICANN cease all preparations to delegate the .AFRICA gTLD to ZACR;
- ICANN permit DCA's application to proceed through the remainder of the new gTLD application process and be granted a period of no less than 18 months to obtain Government support as set out in the AGB and interpreted by the Geographic Names Panel, or accept that the requirement is satisfied as a result of the endorsement of DCA Trust's application by UNECA; and
- ICANN compensate DCA for the costs it has incurred as a result of ICANN's violations of its Articles of Incorporation, Bylaws and AGB.

47. In its response to DCA Trust's Final Request for Relief, ICANN submitted that, "the Panel should find that no action (or inaction) of the ICANN Board was inconsistent with the Articles of Incorporation or Bylaws, and accordingly none of DCA's requested relief is appropriate."

48. ICANN also submitted that:

DCA urges that the Panel issue a declaration in its favor...and also asks that the Panel declare that DCA is the prevailing party and entitled to its costs. Although ICANN believes that the evidence does not support the

declarations that DCA seeks, ICANN does not object to the form of DCA's requests.

At the bottom of DCA's Final Request for Relief, DCA asks that the Panel recommend that ICANN cease all preparations to delegate the .AFRICA gTLD to ZACR, and that ICANN permit DCA's application to proceed and give DCA no less than 18 additional months from the date of the Panel's declaration to attempt to obtain the requisite support of the countries in Africa. ICANN objects to that appropriateness of these requested recommendations because they are well outside the Panel's authority as set forth in the Bylaws.

[...]

Because the Panel's authority is limited to declaring whether the Board's conduct was inconsistent with the Articles or the Bylaws, the Panel should limit its declaration to that question and refrain from recommending how the Board should then proceed in light of the Panel's declaration. Pursuant to Paragraph 12 of that same section of the Bylaws, the Board will consider the Panel's declaration at its next meeting, and if the Panel has declared that the Board's conduct was inconsistent with the Articles or the Bylaws, the Board will have to determine how to act upon the opinion of the Panel.

By way of example only, if the Panel somehow found that the unanimous NGPC vote on 4 June 2013 was not properly taken, the Board might determine that the vote from that meeting should be set aside and that the NGPC should consider the issue anew. Likewise, if the Panel were to determine that the NGPC did not adequately consider the GAC advice at [the] 4 June 2013 meeting, the Board might require that the NGPC reconsider the GAC advice.

In all events, the Bylaws mandate that the Board has the responsibility of fashioning the appropriate remedy once the Panel has declared whether or not it thinks the Board's conduct was inconsistent with ICANN's Articles of Incorporation and Bylaws. The Bylaws do not provide the Panel with the authority to make any recommendations or declarations in this respect.

49. In response to ICANN's submissions above, on 15 June 2015, DCA Trust advanced that the Panel had already ruled that its declaration on the merits will be binding on the Parties and that nothing in ICANN's Bylaws, the Supplementary Procedures or the ICDR Rules applicable in these proceedings prohibits the Panel from making a recommendation to the ICANN Board of Directors regarding an appropriate remedy. DCA Trust also submitted that:

According to ICANN's Bylaws, the Independent Review Process is designed to provide a remedy for "any" person materially affected by a decision or action by the Board. Further, "in order to be materially affected, the person must suffer injury or harm that is directly and causally connected to the Board's alleged violation of the Bylaws or the Articles of Incorporation. Indeed, the ICANN New gTLD Program Committee, operating under the delegated authority of the ICANN Board, itself suggested that DCA could seek relief through ICANN's accountability

mechanisms or, in other words, the Reconsideration process and the Independent Review Process. If the IRP mechanism – the mechanism of last resort for gTLD applicants – is intended to provide a remedy for a claimant materially injured or harmed by Board action or inaction, and it serves as the only alternative to litigation, then naturally the IRP Panel may recommend how the ICANN Board might fashion a remedy to redress such injury or harm.

50. On 25 June 2015, the Panel issued its Procedural Order No. 10, directing the Parties to by 1 July 2015 simultaneously file their detailed submissions on costs and their allocation in these proceedings.
51. The additional factual background and reasons in the above decisions, procedural orders and declarations rendered by the Panel are hereby adopted and incorporated by reference in this Final Declaration.
52. On 1 and 2 July 2015, the Parties filed their respective positions and submissions on costs.

## **II. BRIEF SUMMARY OF THE PARTIES' POSITIONS ON THE MERITS & REQUEST FOR RELIEF**

53. According to DCA Trust and as elaborated on in its Memorial on Merits dated 3 November 2014, the central dispute between it and ICANN in this IRP may be summarized as follows:

32. By preventing DCA'S application from proceeding through the new gTLD review process and by coordinating with the AUC and others to ensure that the AUC obtained the rights to .AFRICA, ICANN breached its obligations of independence, transparency and due process contained in its Articles of Incorporation and Bylaws, including its obligation to conduct itself consistent with its duty of good faith under relevant principles of international law.

54. According to DCA Trust, among other things, "instead of functioning as a disinterested regulator of a fair and transparent gTLD application process, ICANN used its authority and oversight over that process to assist ZACR and to eliminate its only competitor, DCA, from the process."
55. DCA Trust also advanced that, "as a result, ICANN deprived DCA of the right to compete for .AFRICA in accordance with the rules ICANN established for the new gTLD program, in breach of the Applicant Guidebook ("AGB") and ICANN's Articles of Incorporation and Bylaws."

56. In its 3 December 2014 Response to DCA's Memorial on the Merits, among other things, ICANN submitted that, "ICANN's conduct with respect to DCA's application for .AFRICA was fully consistent with ICANN's Bylaws, its Articles of Incorporation and the Applicant Guidebook. ICANN also pleaded that it acted through open and transparent processes, evaluated DCA's application for .AFRICA in accordance with the procedures set forth in the Guidebook, and followed the procedures set forth in its Bylaws in evaluating DCA's Request for Reconsideration."
57. ICANN advanced that, "DCA is using this IRP as a mean to challenge the right of African countries to support a specific (and competing) application for .AFRICA, and to rewrite the Guidebook."
58. ICANN also added that, "ICANN provided assistance to those who requested, cooperated with governmental authorities, and respected the consensus advice issued by the GAC, which speaks on behalf of the governments of the world."
59. In its Final Request for Relief filed on 23 May 2015, DCA Trust asked this Panel to:
  1. Declare that the Board violated ICANN's Articles of Incorporation, Bylaws and the Applicant Guidebook (AGB);
  2. Declare that DCA Trust is the prevailing party in this IRP and, consequently entitled to its costs in this proceeding; and
  3. Recommend as a result of the Board violations a course of action for the Board to follow going forward.
60. In its response letter of 1 June 2015, ICANN confirmed that it did not object to the form of DCA Trust's requests above, even though it believes that the evidence does not support the declarations that DCA Trust seeks. ICANN did, however, object to the appropriateness of the request for recommendations on the ground that they are outside of the Panel's authority as set forth in the Bylaws.

### **III. THE ISSUES RAISED AND THE PANEL'S DECISION**

61. After carefully considering the Parties' written and oral submissions, perusing the three witness statements filed and hearing *viva voce* the testimonies of the witnesses at the in-person hearing of this IRP in Washington, D.C., the Panel answers the following four questions put to it as follows:

1. Did the Board act or fail to act in a manner inconsistent with ICANN's Articles of Incorporation, Bylaws or the Applicant Guidebook?

Answer: Yes.

2. Can the IRP Panel recommend a course of action for the Board to follow as a consequence of any declaration that the Board acted or failed to act in a manner inconsistent with ICANN's Articles of Incorporation, Bylaws or the Applicant Guidebook (AGB)?

Answer: Yes.

3. Who is the prevailing party in this IRP?

Answer: DCA Trust

4. Who is responsible for bearing the costs of this IRP and the cost of the IRP Provider?

Answer: ICANN, in full.

### **Summary of Panel's Decision**

For reasons explained in more detail below, and pursuant to Article IV, Section 3, paragraph 11 (c) of ICANN's Bylaws, the Panel declares that both the actions and inactions of the Board with respect to the application of DCA Trust relating to the .AFRICA gTLD were inconsistent with the Articles of Incorporation and Bylaws of ICANN.

Furthermore, pursuant to Article IV, Section 3, paragraph 11 (d) of ICANN's Bylaws, the Panel recommends that ICANN continue to refrain from delegating the .AFRICA gTLD and permit DCA Trust's application to proceed through the remainder of the new gTLD application process.

Finally, DCA Trust is the prevailing party in this IRP and ICANN is responsible for bearing, pursuant to Article IV, Section 3, paragraph 18 of the Bylaws, Article 11 of Supplementary Procedures and Article 31 of the ICDR Rules, the totality of the costs of this IRP and the totality of the costs of the IRP Provider.

As per the last sentence of Article IV, Section 3, paragraph 18 of the Bylaws, DCA Trust and ICANN shall each bear their own expenses. The Parties shall also each bear their own legal representation fees.

#### IV. ANALYSIS OF THE ISSUES AND REASONS FOR THE PANEL'S DECISION

##### 1) Did the Board act or fail to act in a manner inconsistent with ICANN's Articles of Incorporation, Bylaws or the Applicant Guidebook?

62. Before answering this question, the Panel considers it necessary to quickly examine and address the issue of "standard of review" as referred to by ICANN in its 3 December 2014 Response to DCA's Memorial on the Merits or the "law applicable to these proceedings" as pleaded by DCA Trust in its 3 November 2014 Memorial on the Merits.

63. According to DCA Trust:

30. The version of ICANN's Articles of Incorporation and its Bylaws in effect at the time DCA filed its Request for IRP applies to these proceedings. [Articles of Incorporation of Internet Corporation for Assigned Names and Numbers (21 November 1998) and Bylaws of the Internet Corporation for Assigned Names and Numbers (11 April 2013)]. ICANN's agreement with the U.S. Department of Commerce, National Telecommunications & Information Administration ("NTIA"), the "Affirmation of Commitments," is also instructive, as it explains ICANN's obligations in light of its role as regulator of the Domain Name System ("DNS"). The standard of review is a *de novo* "independent review" of whether the actions of the Board violated the Bylaws, with focus on whether the Board acted without conflict of interest, with due diligence and care, and exercised independent judgment in the best interests of ICANN and its many stakeholders. (Underlining added).

31. All of the obligations enumerated in these documents are to be carried out *first* in conformity with "relevant principles of international law" and *second* in conformity with local law. As explained by Dr. Jack Goldsmith in his Expert Report submitted in *ICM v. ICANN*, the reference to "principles of international law" in ICANN's Articles of Incorporation should be understood to include both customary international law and general principles of law.

64. In response, ICANN submits that:

11. The IRP is a unique process available under ICANN's Bylaws for persons or entities that claim to have been materially and adversely affected by a decision or action of the ICANN Board, but only to the extent that Board action was inconsistent with ICANN's Bylaws or Articles. This IRP Panel is tasked with providing its opinion as to whether the challenged Board actions violated ICANN's Bylaws or Articles. ICANN's Bylaws specifically identify the deferential standard of review that the IRP Panel must apply when evaluating the actions of the ICANN Board, focusing on:

- a. Did the Board act without conflict of interest in taking its decision?;
- b. Did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. Did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?

12. DCA disregards the plain language of ICANN's Bylaws and relies instead on the IRP Panel's declaration in a prior Independent Review proceeding, *ICM v. ICANN*. However, *ICM* was decided in 2010 under a previous version of ICANN's Bylaws. In its declaration, the *ICM* Panel explicitly noted that ICANN's then-current Bylaws "d[id] not specify or imply that the [IRP] process provided for s[hould] (or s[hould] not) accord deference to the decisions of the ICANN Board." As DCA acknowledges, the version of ICANN's Bylaws that apply to this proceeding are the version as amended in April 2013. The current Bylaws provide for the deferential standard of review set forth above. [Underlining is added]

- 65. For the following reasons, the Panel is of the view that the standard of review is a *de novo*, objective and independent one examining whether the Board acted or failed to act in a manner inconsistent with ICANN's Articles of Incorporation and Bylaws.
- 66. ICANN is not an ordinary California nonprofit organization. Rather it has a large international purpose and responsibility to coordinate and ensure the stable and secure operation of the Internet's unique identifier systems.
- 67. Indeed, Article 4 of ICANN's Articles of Incorporation require ICANN to "operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law and, to the extent appropriate and consistent with these Articles and its Bylaws, through open and transparent processes that enable competition and open entry in Internet-related markets." ICANN's Bylaws also impose duties on it to act in an open, transparent and fair manner with integrity.
- 68. ICANN's Bylaws (as amended on 11 April 2013) which both Parties explicitly agree that applies to this IRP, reads in relevant parts as follows:

**ARTICLE IV: ACCOUNTABILITY AND REVIEW**

**Section 3. INDEPENDENT REVIEW OF BOARD ACTIONS**

1. In addition to the reconsideration process described in Section 2 of this Article, ICANN shall have in place a separate process for independent third-party review of Board actions alleged by an affected party to be inconsistent with the Articles of Incorporation or Bylaws.

[...]

4. Requests for such independent review shall be referred to an Independent Review Process Panel [...], which shall be charged with comparing contested actions of the Board to Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws. The IRP Panel must apply a defined standard of review to the IRP request, focusing on:
  - a. did the Board act without conflict of interest in taking its decision?
  - b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
  - c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?

69. Section 8 of the Supplementary Procedures similarly subject the IRP to the standard of review set out in subparagraphs a., b., and c., above, and add:

If a requestor demonstrates that the ICANN Board did not make a reasonable inquiry to determine it had sufficient facts available, ICANN Board members had a conflict of interest in participating in the decision, or the decision was not an exercise in independent judgment, believed by the ICANN Board to be in the best interests of the company, after taking account of the internet community and the global public interest, the requestor will have established proper grounds for review.

70. In the Panel's view, Article IV, Section 3, and Paragraph 4 of ICANN's Bylaws (reproduced above) – the Independent Review Process – was designed and set up to offer the Internet community, a *de novo, objective and independent* accountability process that would ensure that ICANN acted in a manner consistent with ICANN's Articles of Incorporation and Bylaws.
71. Both ICANN's Bylaws and the Supplementary Rules require an IRP Panel to *examine* and *decide* whether the Board has acted consistently with the provisions of the Articles of Incorporation and Bylaws. As ICANN's Bylaws explicitly put it, an IRP Panel is "*charged with* comparing contested actions of the Board [...], and with *declaring* whether the Board has acted consistently with the provisions of the Articles of Incorporation and Bylaws.



72. The IRP is the only independent third party process that allows review of board actions to ensure their consistency with the Articles of Incorporation or Bylaws. As already explained in this Panel’s 14 August 2014 Declaration on the IRP Procedure (“August 2014 Declaration”), the avenues of accountability for applicants that have disputes with ICANN do *not* include resort to the courts. Applications for gTLD delegations are governed by ICANN’s Guidebook, which provides that applicants waive all right to resort to the courts:

Applicant hereby releases ICANN [...] from any and all claims that arise out of, are based upon, or are in any way related to, any action or failure to act by ICANN [...] in connection with ICANN’s review of this application, investigation, or verification, any characterization or description of applicant or the information in this application, any withdrawal of this application or the decision by ICANN to recommend or not to recommend, the approval of applicant’s gTLD application. APPLICANT AGREES NOT TO CHALLENGE, IN COURT OR ANY OTHER JUDICIAL FORA, ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION, AND IRREVOCABLY WAIVES ANY RIGHT TO SUE OR PROCEED IN COURT OR ANY OTHER JUDICIAL FORA ON THE BASIS OF ANY OTHER LEGAL CLAIM AGAINST ICANN ON THE BASIS OF ANY OTHER LEGAL CLAIM.

73. Thus, assuming that the foregoing waiver of any and all judicial remedies is valid and enforceable, then the only and ultimate “accountability” remedy for an applicant is the IRP.
74. As previously decided by this Panel, such accountability requires an organization to explain or give reasons for its activities, accept responsibility for them and to disclose the results in a transparent manner.
75. Such accountability also requires, to use the words of the IRP Panel in the *Booking.com B.V. v. ICANN* (ICDR Case Number: 50-20-1400-0247), this IRP Panel to “objectively” determine whether or not the Board’s actions are in fact consistent with the Articles of Incorporation, Bylaws and Guidebook, which this Panel, like the one in *Booking.com* “understands as requiring that the Board’s conduct be appraised independently, and without any presumption of correctness.”
76. The Panel therefore concludes that the “standard of review” in this IRP is a *de novo, objective and independent* one, which does not require any presumption of correctness.
77. With the above in mind, the Panel now turns its mind to whether or not the Board in this IRP acted or failed to act in a manner inconsistent

with ICANN's Articles of Incorporation, Bylaws or the Applicant Guidebook.

### **DCA Trust's Position**

78. In its 3 November 2014 Memorial on the Merits, DCA Trust criticizes ICANN for variety of shortcomings and breaches relating to the Articles of Incorporation, Bylaws and Applicant Guidebook. DCA Trust submits:

32. By preventing DCA's application from proceeding through the new gTLD review process and by coordinating with the AUC and others to ensure that the AUC obtained the rights to .AFRICA, ICANN breached its obligations of independence, transparency and due process contained in its Articles of Incorporation and Bylaws, including its obligation to conduct itself consistent with its duty of good faith under relevant principles of international law.

79. DCA Trust also pleads that ICANN breached its Articles of Incorporation and Bylaws by discriminating against DCA Trust and failing to permit competition for the .AFRICA gTLD, ICANN abused its Regulatory authority in its differential treatment of the ZACR and DCA Trust applications, and in contravention of the rules for the New gTLD Program, ICANN colluded with AUC to ensure that the AUC would obtain control over .AFRICA.

80. According to DCA Trust:

34. ICANN discriminated against DCA and abused its regulatory authority over new gTLDs by treating it differently from other new gTLD applicants without justification or any rational basis— particularly relative to DCA's competitor ZACR—and by applying ICANN's policies in an unpredictable and inconsistent manner so as to favor DCA's competitor for .AFRICA. ICANN staff repeatedly disparaged DCA and portrayed it as an illegitimate bidder for .AFRICA, and the Board failed to stop the discriminatory treatment despite protests from DCA.

35. Moreover, ICANN staff Redacted to ensure that ZACR, but not DCA, would be able to pass the GNP evaluation, even going so far as to Redacted

While ICANN staff purported to hold DCA to the strict geographic support requirement set forth in the AGB, once DCA was removed from contention for .AFRICA, ICANN staff immediately bypassed these very same rules in order to allow ZACR's application to pass the GNP evaluation. After DCA's application was pulled from processing on 7 June 2013, ICANN staff Redacted

Redacted This was a complete change of policy for ICANN, which had insisted (until DCA's application was no longer being considered) that the AUC endorsement was not material to the geographic requirement.

36 However Redacted Redacted  
Redacted ICANN staff then took the  
remarkable step of Redacted

# Redacted

37. In its Response to the GAC Advice rendered against its application, DCA raised concerns that the two .AFRICA applications had been treated differently, though at the time it had no idea of just how far ICANN was going or would go to push ZACR's application through the process. Apparently the NGPC failed to make any inquiry into those allegations. .AFRICA was discussed at one meeting only, and there is no rationale listed for the NGPC's decision in the "Approved Resolutions" for the 4 June 2013 meeting. An adequate inquiry into ICANN staff's treatment of DCA's and ZACR's application—even simply asking the Director of gTLD Operations whether there was any merit to DCA's concerns—would have revealed a pattern of discriminatory behavior against DCA and special treatment by both ICANN staff and the ICANN Board in favor of ZACR's application.

38. In all of these acts and omissions, ICANN breached the AGB and its own Articles of Incorporation and Bylaws, which require it to act in good faith, avoid discriminating against any one party, and ensure open, accurate and unbiased application of its policies. Furthermore, ICANN breached principles of international law by failing to exercise its authority over the application process in good faith and committing an abuse of right by Redacted

Redacted ZACR to pass.  
Finally, the Board's failure to inquire into the actions of its staff, even when on notice of the myriad of discriminatory actions, violates its obligation to comply with its Bylaws with appropriate care and diligence.

81. DCA Trust submits that the NGPC breached ICANN's Articles of Incorporation and Bylaws by failing to apply ICANN's Procedures in a neutral and objective manner with procedural fairness, when it accepted the GAC Objection Advice against DCA Trust, the NGPC should have investigated questions about the GAC Objection Advice being obtained through consensus, and the NGPC should have consulted with an independent expert about the GAC advice given that the AUC used the GAC to circumvent the AGB's community objection procedures.

82. According to DCA Trust:

44. The decision of the NGPC, acting pursuant to the delegated authority of the ICANN Board, to accept the purported "consensus" GAC Objection Advice, violated ICANN's Articles of Incorporation and Article III § 1 of its Bylaws, requiring transparency, consistency and fairness. ICANN ignored

the serious issues raised by DCA and others with respect to the rendering and consideration of the GAC Objection Advice, breaching its obligation to operate “to the maximum extent possible in an open and transparent manner and consistent with procedures designed to ensure fairness.” It also breaches ICANN’s obligation under Article 4 of its Articles of Incorporation to abide by principles of international law, including good faith application of rules and regulations and the prohibition on the abuse of rights.

45. The NGPC gave undue deference to the GAC and failed to investigate the serious procedural irregularities and conflicts of interest raised by DCA and others relating to the GAC’s Objection Advice on .AFRICA. ICANN had a duty under principles of international law to exercise good faith and due diligence in evaluating the GAC advice rather than accepting it wholesale and without question, despite having notice of the irregular manner in which the advice was rendered. Importantly, ICANN was well aware that the AUC was using the GAC to effectively reserve .AFRICA for itself, pursuant to ICANN’s own advice that it should use the GAC for that purpose and contrary to the New gTLD Program objective of enhancing competition for TLDs. The AUC’s very presence on the GAC as a member rather than an observer demonstrates the extraordinary lengths ICANN took to ensure that the AUC was able to reserve .AFRICA for its own use notwithstanding the new gTLD application process then underway.

46. The ICANN Board and staff members had actual knowledge of information calling into question the notion that there was a consensus among the GAC members to issue the advice against DCA’s application, prohibiting the application of the rule in the AGB concerning consensus advice (which creates a “strong presumption” for the Board that a particular application “should not proceed” in the gTLD evaluation process).The irregularities leading to the advice against DCA’s application included proposals offered by Alice Munyua, who no longer represented Kenya as a GAC advisor at the time, and the fact that the genuine Kenya GAC advisor expressly refused to endorse the advice. Redacted

**Redacted**

Redacted Finally, the ICANN Board knew very well that the AUC might attempt to use the GAC in an anticompetitive manner, since it was ICANN itself that informed the AUC it could use the GAC to achieve that very goal.

47. At a bare minimum, this information put ICANN Board and staff members on notice that further investigation into the rationale and support for the GAC’s decision was necessary. During the very meeting wherein the NGPC accepted the Objection Advice, the NGPC acknowledged that due diligence required a conversation with the GAC, even where the advice was consensus advice. The evidence shows that ICANN simply decided to push through the AUC’s appointed applicant in order to allow the AUC to control .AFRICA, as it had previously requested.

48. Even if the GAC’s Objection Advice could be characterized as “consensus” advice, the NGPC’s failure to consult with an independent expert about the GAC’s Objection Advice was a breach of ICANN’s duty to act to the “maximum extent feasible in an open and transparent manner

and consistent with procedures designed to ensure fairness.” The AGB specifically provides that when the Board is considering any form of GAC advice, it “may consult with independent experts, such as those designated to hear objections in the New gTLD Dispute Resolution Procedure, in cases where the issues raised in the GAC advice are pertinent to one of the subject matter areas of the objection procedures.”

49. Given the unique circumstances surrounding the applications for .AFRICA—namely that one applicant was the designee of the AUC, which wanted to control .AFRICA without competition— ICANN should not have simply accepted GAC Objection Advice, proposed and pushed through by the AUC. If it was in doubt as to how to handle GAC advice sponsored by DCA’s only competitor for .AFRICA, it could have and should have consulted a third-party expert in order to obtain appropriate guidance. Its failure to do so was, at a minimum, a breach of ICANN’s duty of good faith and the prohibition on abuse of rights under international law. In addition, in light of the multiple warning signs identified by DCA in its Response to the GAC Objection Advice and its multiple complaints to the Board, failure to consult an independent expert was certainly a breach of the Board’s duty to ensure its fair and transparent application of its policies and its duty to promote and protect competition.

83. DCA Trust also submits that the NGPC breached ICANN’s Articles of Incorporation and Bylaws by failing to apply its procedures in a neutral and objective manner, with procedural fairness, when it approved the BGC’s recommendation not to reconsider the NGPC’s acceptance of the GAC Objection Advice against DCA.

84. According to DCA Trust:

50. Not only did the NGPC breach ICANN’s Articles of Incorporation and its Bylaws by accepting the GAC’s Objection Advice, but the NGPC also breached ICANN’s Articles of Incorporation and its Bylaws by approving the BGC’s recommendation not to reconsider the NGPC’s earlier decision to accept the GAC Objection Advice. Not surprisingly, the NGPC concluded that its earlier decision should not be reconsidered.

51. First, the NGPC’s decision not to review its own acceptance of the GAC Objection Advice lacks procedural fairness, because the NGPC literally reviewed its own decision to accept the Objection Advice. It is a well-established general principle of international law that a party cannot be the judge of its own cause. No independent viewpoint entered into the process. In addition, although Mr. Silber recused himself from the vote on .AFRICA, he remained present for the entire discussion of .AFRICA, and Mr. Disspain apparently concluded that he did not feel conflicted, so both participated in the discussion and Mr. Disspain voted on DCA’s RFR.

52. Second, the participation of the BGC did not provide an independent intervention into the NGPC’s decision-making process, because the BGC is primarily a subset of members of the NGPC. At the time the BGC made its recommendation, the majority of BGC members were also members of the NGPC.

53. Finally, the Board did not exercise due diligence and care in accepting the BGC's recommendation, because the BGC recommendation essentially proffered the NGPC's inadequate diligence in accepting the GAC Objection Advice in the first place, in order to absolve the NGPC of the responsibility to look into any of DCA's grievances in the context of the Request for Review. The basis for the BGC's recommendation to deny was that DCA did not state proper grounds for reconsideration, because failure to follow correct procedure is not a ground for reconsideration, and DCA did not identify the actual information an independent expert would have provided, had the NGPC consulted one. Thus, the BGC essentially found that the NGPC did not fail to take account of material information, because the NGPC did not have before it the material information that would have been provided by an independent expert's viewpoint. The BGC even claimed that if DCA had wanted the NGPC to exercise due diligence and consult an independent expert, DCA should have made such a suggestion in its Response to the GAC Objection Advice. Applicants should not have to remind the Board to comply with its Bylaws in order for the Board to exercise due diligence and care.

54. ICANN's acts and omissions with respect to the BGC's recommendation constitute further breaches of ICANN's Bylaws and Articles of Incorporation, including its duty to carry out its activities in good faith and to refrain from abusing its position as the regulator of the DNS to favor certain applicants over others.

85. Finally, DCA Trust pleads that:

[As] a result of the Board's breaches of ICANN's Articles of Incorporation, Bylaws and general principles of international law, ICANN must halt the process of delegating .AFRICA to ZACR and ZACR should not be permitted to retain the rights to .AFRICA it has procured as a result of the Board's violations. Because ICANN's handling of the new gTLD application process for .AFRICA was so flawed and so deeply influenced by ICANN's relationships with various individuals and organizations purporting to represent "the African community," DCA believes that any chance it may have had to compete for .AFRICA has been irremediably lost and that DCA's application could not receive a fair evaluation even if the process were to be re-set from the beginning. Under the circumstances, DCA submits that ICANN should remove ZACR's application from the process altogether and allow DCA's application to proceed under the rules of the New gTLD Program, allowing DCA up to 18 months to negotiate with African governments to obtain the necessary endorsements so as to enable the delegation and management of the .AFRICA string.

### **ICANN's Position**

86. In its Response to DCA's Memorial on the Merits filed on 3 December 2014 ("ICANN Final Memorial"), ICANN submits that:

2. [...] Pursuant to ICANN's New gTLD Applicant Guidebook ("Guidebook"), applications for strings that represent geographic regions—such as "Africa"—require the support of at least 60% of the respective national governments in the relevant region. As DCA has acknowledged on

multiple occasions, including in its Memorial, DCA does not have the requisite governmental support; indeed, DCA now asks that ICANN be required to provide it with eighteen more months to try to gather the support that it was supposed to have on the day it submitted its application in 2012.

3. DCA is using this IRP as a means to challenge the right of African countries to support a specific (and competing) application for .AFRICA, and to rewrite the Guidebook. The Guidebook provides that countries may endorse multiple applications for the same geographic string. However, in this instance, the countries of Africa chose to endorse only the application submitted by ZA Central Registry (“ZACR”) because ZACR prevailed in the Request for Proposal (“RFP”) process coordinated by the African Union Commission (“AUC”), a process that DCA chose to boycott. There was nothing untoward about the AUC’s decision to conduct an RFP process and select ZACR, nor was there anything inappropriate about the African countries’ decision to endorse only ZACR’s application.

4. Subsequently, as they had every right to do, GAC representatives from Africa urged the GAC to issue advice to the ICANN Board that DCA’s application for .AFRICA not proceed (the “GAC Advice”). One or more countries from Africa—or, for that matter, from any continent—present at the relevant GAC meeting could have opposed the issuance of this GAC Advice, yet not a single country stated that it did not want the GAC to issue advice to the ICANN Board that DCA’s application should not proceed. As a result, under the GAC’s rules, the GAC Advice was “consensus” advice.

5. GAC consensus advice against an application for a new gTLD creates a “strong presumption” for ICANN’s Board that the application should not proceed. In accordance with the Guidebook’s procedures, the Board’s New gTLD Program Committee (the “NGPC”) considered the GAC Advice, considered DCA’s response to the GAC Advice, and properly decided to accept the GAC Advice that DCA’s application should not proceed. As ZACR’s application for .AFRICA subsequently passed all evaluation steps, ICANN and ZACR entered into a registry agreement for the operation of .AFRICA. Following this Panel’s emergency declaration, ICANN has thus far elected not to proceed with the delegation of the .AFRICA TLD into the Internet root zone.

6. DCA’s papers contain much mudslinging and many accusations, which frankly do not belong in these proceedings. According to DCA, the entire ICANN community conspired to prevent DCA from being the successful applicant for .AFRICA. However, the actions that DCA views as nefarious were, in fact, fully consistent with the Guidebook. They also were not actions taken by the Board or the NGPC that in any way violated ICANN’s Bylaws or Articles, the only issue that this IRP Panel is tasked with assessing.

87. ICANN submits that the Board properly advised the African Union’s member states of the Guidebook Rules regarding geographic strings, the NGPC did not violate the Bylaws or Articles of Incorporation by accepting the GAC Advice, the AUC and the African GAC members properly supported the .AFRICA applicant chosen through the RFP

process, the GAC issued consensus advice opposing DCA's application and the NGPC properly accepted the consensus GAC Advice.

88. According to ICANN:

13. DCA's first purported basis for Independent Review is that ICANN improperly responded to a 21 October 2011 communiqué issued by African ministers in charge of Communication and Information Technologies for their respective countries ("Dakar Communiqué"). In the Dakar Communiqué, the ministers, acting pursuant to the Constitutive Act of the African Union, committed to continued and enhanced participation in ICANN and the GAC, and requested that ICANN's Board take numerous steps aimed at increasing Africa's representation in the ICANN community, including that ICANN "include ['Africa'] and its representation in any other language on the Reserved Names List in order [for those strings] to enjoy [] special legislative protection, so [they could be] managed and operated by the structure that is selected and identified by the African Union."

14. As DCA acknowledges, in response to the request in the Dakar Communiqué that .AFRICA (and related strings) be reserved for a operator of the African ministers' own choosing, ICANN advised that .AFRICA and its related strings could not be placed on the Reserved Names List because ICANN was "not able to take actions that would go outside of the community-established and documented guidelines of the program." Instead, ICANN explained that, pursuant to the Guidebook, "protections exist that w[ould] allow the African Union and its member states to play a prominent role in determining the outcome of any application for these top-level domain name strings."

15. It was completely appropriate for ICANN to point the AU member states to the publicly-stated Guidebook protections for geographic names that were put in place to address precisely the circumstance at issue here—where an application for a string referencing a geographic designation did not appear to have the support of the countries represented by the string. DCA argues that ICANN was giving "instructions . . . as to how to bypass ICANN's own rules," but all ICANN was doing was responding to the Dakar Communiqué by explaining the publicly-available rules that ICANN already had in place. This conduct certainly did not violate ICANN's Bylaws or Articles.

16. In particular, ICANN explained that, pursuant to the Guidebook, "Africa" constitutes a geographic name, and therefore any application for .AFRICA would need: (i) documented support from at least 60% of the national governments in the region; and (ii) no more than one written statement of objection . . . from "relevant governments in the region and/or from public authorities associated with the continent and region." Next, ICANN explained that the Guidebook provides an opportunity for the GAC, whose members include the AU member states, to provide "Early Warnings" to ICANN regarding specific gTLD applications. Finally, ICANN explained that there are four formal objection processes that can be initiated by the public, including the Community Objection process, which may be filed where there is "substantial opposition to the gTLD application from a significant



portion of the community to which the gTLD string may be explicitly or implicitly targeted. Each of these explanations was factually accurate and based on publicly available information. Notably, ICANN did not mention the possibility of GAC consensus advice against a particular application (and, of course, such advice could not have occurred if even a single country had voiced its disagreement with that advice during the GAC meeting when DCA's application was discussed).

17. DCA's objection to ICANN's response to the Dakar Communiqué reflects nothing more than DCA's dissatisfaction with the fact that African countries, coordinating themselves through the AUC, opposed DCA's application. However, the African countries had every right to voice that opposition, and ICANN's Board acted properly in informing those countries of the avenues the Guidebook provided them to express that opposition.

18. In another attempt to imply that ICANN improperly coordinated with the AUC, DCA insinuates that the AUC joined the GAC at ICANN's suggestion. ICANN's response to the Dakar Communiqué does not even mention this possibility. Further, in response to DCA's document requests, ICANN searched for communications between ICANN and the AUC relating to the AUC becoming a voting member of the GAC, and the search revealed no such communications. This is not surprising given that ICANN has no involvement in, much less control over, whether the GAC grants to any party voting membership status, including the AUC; that decision is within the sole discretion of the GAC. ICANN's Bylaws provide that membership in the GAC shall be open to "multinational governmental organizations and treaty organizations, on the invitation of the [GAC] through its Chair." In any event, whether the AUC was a voting member of the GAC is irrelevant to DCA's claims. As is explained further below, the AUC alone would not have been able to orchestrate consensus GAC Advice opposing DCA's application.

19. DCA's next alleged basis for Independent Review is that ICANN's NGPC improperly accepted advice from the GAC that DCA's application should not proceed. However, nearly all of DCA's Memorial relates to conduct of the AUC, the countries of the African continent, and the GAC. None of these concerns is properly the subject of an Independent Review proceeding because they do not implicate the conduct of the ICANN Board or the NGPC. The only actual decision that the NGPC made was to accept the GAC Advice that DCA's application for .AFRICA should not proceed, and that decision was undoubtedly correct, as explained below.

20. Although the purpose of this proceeding is to test whether ICANN's Board (or, in this instance, the NGPC) acted in conformance with its Bylaws and Articles, ICANN addresses the conduct of third parties in the next few sections because that additional context demonstrates that the NGPC's decision to accept the GAC Advice—the only decision reviewable here—was appropriate in all aspects.

21. After DCA's application was posted for public comment (as are all new gTLD applications), sixteen African countries—Benin, Burkina Faso, Comoros, Cameroon, Democratic Republic of Congo, Egypt, Gabon, Ghana, Kenya, Mali, Morocco, Nigeria, Senegal, South Africa, Tanzania and Uganda—submitted GAC Early Warnings regarding DCA's application.

Early Warnings are intended to “provid[e] [] applicant[s] with an indication that the[ir] application is seen as potentially sensitive or problematic by one or more governments.” These African countries used the Early Warnings to notify DCA that they had requested the AUC to conduct an RFP for .AFRICA, that ZACR had been selected via that RFP, and that they objected to DCA’s application for .AFRICA. They further notified DCA that they did not believe that DCA had the requisite support of 60% of the countries on the African continent.

22. DCA minimizes the import of these Early Warnings by arguing that they did not involve a “permissible reason” for objecting to DCA’s application. But DCA does not explain how any of these reasons was impermissible, and the Guidebook explicitly states that Early Warnings “may be issued for any reason.” DCA demonstrated the same dismissive attitude towards the legitimate concerns of the sixteen governments that issued Early Warnings by arguing to the ICANN Board and the GAC that the objecting governments had been “teleguided (or manipulated).”

23. In response to these Early Warnings, DCA conceded that it did not have the necessary level of support from African governments and asked the Board to “waive th[e] requirement [that applications for geographic names have the support of the relevant countries] because of the confusing role that was played by the African Union.” DCA did not explain how the AUC’s role was “confusing,” and DCA ignored the fact that, pursuant to the Guidebook, the AUC had every right to promote one applicant over another. The AUC’s decision to promote an applicant other than DCA did not convert the AUC’s role from proper to improper or from clear to confusing.

24. Notably, long before the AUC opposed DCA’s application, DCA itself recognized the AUC’s important role in coordinating continent-wide technology initiatives. In 2009, DCA approached the AUC for its endorsement prior to seeking the support of individual African governments. DCA obtained the AUC’s support at that time, including the AUC’s commitment to “assist[] in the coordination of [the] initiative with African Ministers and Governments.”

25. The AUC, however, then had a change of heart (which it was entitled to do, particularly given that the application window for gTLD applications had not yet opened and would not open for almost two more years). On 7 August 2010, African ministers in charge of Communication and Information Technologies for their respective countries signed the Abuja Declaration. In that declaration, the ministers requested that the AUC coordinate various projects aimed at promoting Information and Communication Technologies projects on the African continent. Among those projects was “set[ting] up the structure and modalities for the [i]mplementation of the DotAfrica Project.”

26. Pursuant to that mandate, the AUC launched an open RFP process, seeking applications from private organizations (including DCA) interested in operating the .AFRICA gTLD. Redacted

Redacted

Redacted—hardly an inappropriate decision (and not a decision of ICANN or its Board). DCA then refused to participate in the RFP process, thereby setting up an inevitable clash with whatever entity the AUC selected. When DCA submitted its gTLD application in 2012 and attached its 2009 endorsement letter from the AUC, DCA knew full well (but did not disclose) that the AUC had retracted its support.

27. In sum, the objecting governments' concerns were the result of DCA's own decision to boycott the AUC's selection process, resulting in the selection of a different applicant, ZACR, for .AFRICA. Instead of addressing those governments' concerns, and instead of obtaining the necessary support of 60% of the countries on the African continent, DCA asked ICANN to re-write the Guidebook in DCA's favor by eliminating the most important feature of any gTLD application related to a geographic region—the support of the countries in that region. ICANN, in accordance with its Bylaws, Articles and Guidebook, properly ignored DCA's request to change the rules for DCA's benefit.

28. At its 10 April 2013 meeting in Beijing, the GAC advised ICANN that DCA's application for .AFRICA should not proceed.<sup>40</sup> As noted earlier, the GAC operates on the basis of consensus: if a single GAC member at the 10 April 2013 meeting (from any continent, not just from Africa) had opposed the advice, the advice would not have been considered "consensus."<sup>41</sup> As such, the fact that the GAC issued consensus GAC Advice against DCA's application shows that not a single country opposed that advice. Most importantly, this included Kenya: Michael Katundu, the GAC Representative for Kenya, and Kenya's only official GAC representative, was present at the 10 April 2013 Beijing meeting and did not oppose the issuance of the consensus GAC Advice.

29. DCA attempts to argue that the GAC Advice was not consensus advice and relies solely on the purported email objection of Sammy Buruchara, Kenya's GAC advisor (as opposed to GAC representative). As a preliminary matter (and as DCA now appears to acknowledge), the GAC's Operating Principles require that votes on GAC advice be made in person. Operating Principle 19 provides that:

If a Member's accredited representative, or alternate representative, is not present at a meeting, then it shall be taken that the Member government or organisation is not represented at that meeting. Any decision made by the GAC without the participation of a Member's accredited representative shall stand and nonetheless be valid.

Similarly, Operating Principle 40 provides:

One third of the representatives of the Current Membership with voting rights shall constitute a quorum at any meeting. A quorum shall only be necessary for any meeting at which a decision or decisions must be made. The GAC may conduct its general business face-to-face or online.

25. DCA argues that Mr. Buruchara objected to the GAC Advice via email, but even if objections could be made via email (which they cannot), Mr. Katundu, Kenya's GAC representative who was in Beijing at the GAC

meeting, not Mr. Buruchara, Kenya's GAC advisor, was authorized to speak on Kenya's behalf. Accordingly, under the GAC rules, Mr. Buruchara's email exchanges could not have constituted opposition to the GAC Advice.

26. **Redacted**  
**Redacted**

**Redacted** And, tellingly, DCA did not to submit a declaration from Mr. Buruchara, which might have provided context or support for DCA's argument.

27. **Redacted**

# Redacted

28. Notably, immediately prior to becoming Kenya's GAC advisor, Mr. Buruchara had served as the chairman of DCA's Strategic Advisory Board. But despite Mr. Buruchara's close ties with DCA and with Ms. Bekele, the Kenyan government had: (i) endorsed the Abuja Declaration; (ii) supported the AUC's processes for selecting the proposed registry operator; and (iii) issued an Early Warning objecting to DCA's application.

In other words, the Kenyan government was officially on record as supporting ZACR's application and opposing DCA's application, regardless of what Mr. Buruchara was writing in emails.

29. **Redacted**

# Redacted

# Redacted

30. Because DCA did not submit a declaration from Mr. Buruchara (and because Ms. Bekele's declaration is, of course, limited to her own interpretation of email correspondence drafted by others), the Panel is left with a record demonstrating that: (i) Mr.

Buruchara was not authorized by the Kenyan government to oppose the GAC Advice; (ii) Redacted Redacted and (iii) the actual GAC representative from Kenya (Mr. Katundu) attended the 10 April 2013 meeting in Beijing and did not oppose the issuance of the consensus GAC Advice that DCA's application for .AFRICA should not proceed.

31. In short, DCA's primary argument in support of this Independent Review proceeding—that the GAC should not have issued consensus advice against DCA's application—is not supported by any evidence and is, instead, fully contradicted by the evidence. And, of course, Independent Review proceedings do not test whether the GAC's conduct was appropriate (even though in this instance there is no doubt that the GAC appropriately issued consensus advice).

32. As noted above, pursuant to the Guidebook, GAC consensus advice that a particular application should not proceed creates a "strong presumption for the ICANN Board that the application should not be approved." The ICANN Board would have been required to develop a reasoned and well-supported rationale for not accepting the consensus GAC Advice; no such reason existed at the time the NGPC resolved to accept that GAC Advice (5 June 2013), and no such reason has since been revealed. The consensus GAC Advice against DCA's application was issued in the ordinary course, it reflected the sentiment of numerous countries on the African continent, and it was never rescinded.

33. DCA's objection to the Board's acceptance of the GAC Advice is twofold. First, DCA argues that the NGPC failed to investigate DCA's allegation that the GAC advice was not consensus advice. Second, DCA argues that the NGPC should have consulted an independent expert prior to accepting the advice. DCA also argued in its IRP Notice that two NGPC members had conflicts of interest when they voted to accept the GAC Advice, but DCA does not pursue that argument in its Memorial (and the facts again demonstrate that DCA's argument is incorrect).

34. As to the first argument, the Guidebook provides that, when the Board receives GAC advice regarding a particular application, it publishes that advice and notifies the applicant. The applicant is given 21 days from the date of the publication of the advice to submit a response to the Board. Those procedures were followed here. Upon receipt of the GAC Advice, ICANN posted the advice and provided DCA with an opportunity to respond. DCA submitted a lengthy response explaining "[w]hy DCA Trust disagree[d]" with the GAC Advice. A primary theme was that its application had been unfairly blocked by the very countries whose support the Guidebook required DCA to obtain, and that the AUC should not have been allowed to endorse an applicant for .AFRICA. DCA argued that it had been

unfairly “victimized” and “muzzled into insignificance” by the “collective power of the governments represented at ICANN,” and that “the issue of government support [should] be made irrelevant in the process so that both contending applications for .Africa would be allowed to move forward . . . .” In other words, DCA was arguing that the AUC’s input was inappropriate, and DCA was requesting that ICANN change the Guidebook requirement regarding governmental support for geographic names in order to accommodate DCA. ICANN’s NGPC reviewed and appropriately rejected DCA’s arguments.

35. One of DCA’s three “supplementary arguments,” beginning on page 10 of its response to the GAC Advice, was that there had been no consensus GAC advice, in part allegedly evidenced by Mr. Buruchara’s (incomplete) email addressed above. DCA, however, chose not to address the fact that: (i) DCA lacked the requisite support of the African governments; (ii) Mr. Buruchara was not the Kenyan GAC representative; (iii) Mr. Buruchara was not at the Beijing meeting; (iv) the government of Kenya had withdrawn any support it may have previously had for DCA’s application; and (iv) the actual Kenyan GAC representative (Mr. Katundu) was at the ICANN meeting in Beijing and did not oppose the issuance of the GAC Advice against DCA’s application for .AFRICA. All of these facts were well known to DCA at the time of its response to the GAC Advice.

36. The NGPC’s resolution accepting the GAC Advice states that the NGPC considered DCA’s response prior to accepting the GAC Advice, and DCA presents no evidence to the contrary. DCA’s disagreement with the NGPC’s decision does not, of course, demonstrate that the NGPC failed to exercise due diligence in determining to accept the consensus GAC Advice.

37. As to DCA’s suggestion that the NGPC should have consulted an independent expert, the Guidebook provides that it is within the Board’s discretion to decide whether to consult with an independent expert:

ICANN will consider the GAC Advice on New gTLDs as soon as practicable. The Board may consult with independent experts, such as those designated to hear objections in the New gTLD Dispute Resolution Procedure, in cases where the issues raised in the GAC advice are pertinent to one of the subject matter areas of the objection procedures.

The NGPC clearly did not violate its Bylaws, Articles or Guidebook in deciding that it did not need to consult any independent expert regarding the GAC Advice. Because DCA’s challenge to the GAC Advice was whether one or more countries actually had opposed the advice, there was no reason for the NGPC to retain an “expert” on that subject, and DCA has never stated what useful information an independent expert possibly could have provided.

89. ICANN also submits that the NGPC properly denied DCA’s request for reconsideration, ICANN’s actions following the acceptance of the GAC Advice are not relevant to the IRP, and in any event they were not improper, the ICANN staff directed the ICC to treat the two

90. According to ICANN:

38. DCA argues that the NGPC improperly denied DCA's Reconsideration Request, which sought reconsideration of the NGPC's acceptance of the GAC Advice. Reconsideration is an accountability mechanism available under ICANN's Bylaws and administered by ICANN's Board Governance Committee ("BGC"). DCA's Reconsideration Request asked that the NGPC's acceptance of the GAC Advice be rescinded and that DCA's application be reinstated. Pursuant to the Bylaws, reconsideration of a Board (or in this case NGPC) action is appropriate only where the NGPC took an action "without consideration of material information" or in "reliance on false or inaccurate material information."

39. In its Reconsideration Request, DCA argued (as it does here) that the NGPC failed to consider material information by failing to consult with an independent expert prior to accepting the GAC Advice. The BGC noted that DCA had not identified any material information that the NGPC had not considered, and that DCA had not identified what advice an independent expert could have provided to the NGPC or how such advice might have altered the NGPC's decision to accept the GAC Advice. The BGC further noted that, as discussed above, the Guidebook is clear that the decision to consult an independent expert is at the discretion of the NGPC.

40. DCA does not identify any Bylaws or Articles provision that the NGPC violated in denying the Reconsideration Request. Instead, DCA simply disagrees with the NGPC's determination that DCA had not identified any material information on which the NGPC failed to rely. That disagreement is not a proper basis for a Reconsideration Request or an IRP. DCA also argues (again without citing to the Bylaws or Articles) that, because the NGPC accepted the GAC Advice, the NGPC could not properly consider DCA's Reconsideration Request. In fact, the DCA's Reconsideration Request was handled exactly in the manner prescribed by ICANN's Bylaws: the BGC—a separate Board committee charged with considering Reconsideration Requests—reviewed the material and provided a recommendation to the NGPC. The NGPC then reviewed the BGC's recommendation and voted to accept it. In short, the various Board committees conducted themselves exactly as ICANN's Bylaws require.

41. The NGPC accepted the GAC Advice on 4 June 2013. As a result, DCA's application for .AFRICA did not proceed. In its Memorial, DCA attempts to cast aspersions on ICANN's evaluation of ZACR's application, but that evaluation has no bearing on whether the NGPC acted consistently with its Bylaws and Articles in handling the GAC advice related to DCA's application. Indeed, the evaluation of ZACR's application did not involve any action by ICANN's Board (or NGPC), and is therefore not a proper basis for Independent Review. Although the actions of ICANN's staff are not relevant to this proceeding, ICANN addresses DCA's allegations for the sake of thoroughness and because the record demonstrates that ZACR's application was evaluated fully in conformance with the Guidebook requirements.

42. DCA alleges that “ICANN staff worked with [the ICC] to ensure that ZACR, but not DCA, would be able to pass the GNP evaluation.” DCA’s argument is based on false and unsupported characterizations of the ICC’s evaluation of the two .AFRICA applications.

43. First, DCA claims (without relevant citation) that ICANN determined that

# Redacted

44. The Guidebook provides that the Geographic Names Panel is responsible for “verifying the relevance and authenticity of supporting documentation.” Accordingly, it was the ICC’s responsibility to evaluate how the <sup>Redacted</sup> endorsement should be treated. Redacted

# Redacted

45. DCA also claims that ICANN determined that Redacted

# Redacted

46. DCA argues that, after ICANN had stopped processing DCA’s application, Redacted

## Redacted

Redacted the Guidebook contains specific requirements for letters of support from governments and public authorities. In addition to “clearly express[ing] the government’s or public authority’s support for or non-objection to the applicant’s application,” letters must “demonstrate the government’s or public authority’s understanding of the string being requested and its intended use” and that “the string is being sought through the gTLD application process and that the applicant is willing to accept the conditions under which the string will be available, i.e., entry into a registry agreement with ICANN . . .”. In light of these specific requirements, the Guidebook even includes a sample letter of support.



47. Redacted

# Redacted

Redacted

DCA

paints this cooperation as nefarious, but there was absolutely nothing wrong Redacted

Redacted which ICANN would have provided, had the AUC been supporting DCA instead of ZACR.

91. Finally, ICANN submits:

50. ICANN's conduct with respect to DCA's application for .AFRICA was fully consistent with ICANN's Bylaws, its Articles of Incorporation and the Applicant Guidebook. ICANN acted through open and transparent processes, evaluated DCA's application for .AFRICA in accordance with the procedures set forth in the Guidebook, and followed the procedures set forth in its Bylaws in evaluating DCA's Request for Reconsideration. ICANN provided assistance to those who requested, cooperated with governmental authorities, and respected the consensus advice issued by the GAC, which speaks on behalf of the governments of the world.

51. DCA knew, as did all applicants for new gTLDs, that some of the applications would be rejected. There can only be one registry operator for each gTLD string, and in the case of strings that relate to geographic regions, no application can succeed without the significant support of the countries in that region. There is no justification whatsoever for DCA's repeated urging that the support (or lack thereof) of the countries on the African continent be made irrelevant to the process.

52. Ultimately, the majority of the countries in Africa chose to support another application for the .AFRICA gTLD, and decided to oppose DCA's application. At a critical time, no country stood up to defend DCA's application. These countries—and the AUC— had every right to take a stand and to support the applicant of their choice. In this instance, that choice resulted in the GAC issuing consensus advice, which the GAC had every right to do. Nothing in ICANN's Bylaws or Articles, or in the Guidebook, required ICANN to challenge that decision, to ignore that decision, or to change the rules so that the input of the AUC, much less the GAC, would become irrelevant. To the contrary, the AUC's role with respect to the African community is critical, and it was DCA's decision to pursue a path at odds with the AUC that placed its application in jeopardy, not anything that ICANN (or ICANN's Board or the NGPC) did. The NGPC did exactly what it was supposed to do in this circumstance, and ICANN urges this IRP Panel to find as such. Such a finding would allow the countries of Africa to soon provide their citizens with what all parties involved believe to be a very important step for Africa – access to .AFRICA on the internet.

## The Panel's Decision

92. The Panel in this IRP, has been asked to determine whether, in the case of the application of DCA Trust for the delegation of the .AFRICA top-level domain name in its 2012 General Top-Level Domains (“gTLD”) Internet Expansion Program (the “New gTLD Program”), the Board acted or failed to act in a manner inconsistent with ICANN’s Articles of Incorporation, Bylaws or the Applicant Guidebook?
93. After reviewing the documentation filed in this IRP, reading the Parties’ respective written submissions, reading the written statements and listening to the testimony of the three witnesses brought forward, listening to the oral presentations of the Parties’ legal representatives at the hearing in Washington, D.C., reading the transcript of the hearing, and deliberating, the Panel is of the unanimous view that certain actions and inactions of the ICANN Board (as described below) with respect to the application of DCA Trust relating to the .AFRICA gTLD were inconsistent with the Articles of Incorporation and Bylaws of ICANN.
94. ICANN is bound by its own Articles of Incorporation to act fairly, neutrally, non-discriminatorily and to enable competition. Article 4 of ICANN’s Articles of Incorporation sets this out explicitly:
4. The Corporation shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law and, to the extent appropriate and consistent with these Articles and its Bylaws, through open and transparent processes that enable competition and open entry in Internet-related markets. To this effect, the Corporation shall cooperate as appropriate with relevant international organizations.
95. ICANN is also bound by its own Bylaws to act and make decisions “neutrally and objectively, with integrity and fairness.”
96. These obligations and others are explicitly set out in a number of provisions in ICANN’s Bylaws:

### **ARTICLE I: MISSION AND CORE (Council of Registrars) VALUES**

#### **Section 2. CORE (Council of Registrars) VALUES**

In performing its mission, the following core values should guide the decisions and actions of ICANN (Internet Corporation for Assigned Names and Numbers):

1. Preserving and enhancing the operational stability, reliability, security, and global interoperability of the Internet.

[...]

7. Employing open and transparent policy development mechanisms that (i) promote well-informed decisions based on expert advice, and (ii) ensure that those entities most affected can assist in the policy development process.

8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.

9. Acting with a speed that is responsive to the needs of the Internet while, as part of the decision-making process, obtaining informed input from those entities most affected.

10. Remaining accountable to the Internet community through mechanisms that enhance ICANN (Internet Corporation for Assigned Names and Numbers)'s effectiveness.

11. While remaining rooted in the private sector, recognizing that governments and public authorities are responsible for public policy and duly taking into account governments' or public authorities' recommendations.

These core values are deliberately expressed in very general terms, so that they may provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each new situation will necessarily depend on many factors that cannot be fully anticipated or enumerated; and because they are statements of principle rather than practice, situations will inevitably arise in which perfect fidelity to all eleven core values simultaneously is not possible. Any ICANN (Internet Corporation for Assigned Names and Numbers) body making a recommendation or decision shall exercise its judgment to determine which core values are most relevant and how they apply to the specific circumstances of the case at hand, and to determine, if necessary, an appropriate and defensible balance among competing values.

## **ARTICLE II: POWERS**

### **Section 1. GENERAL POWERS**

Except as otherwise provided in the Articles of Incorporation or these Bylaws, the powers of ICANN (Internet Corporation for Assigned Names and Numbers) shall be exercised by, and its property controlled and its business and affairs conducted by or under the direction of, the Board.

### **Section 3. NON-DISCRIMINATORY TREATMENT**

ICANN (Internet Corporation for Assigned Names and Numbers) shall not apply its standards, policies, procedures, or practices inequitably or single out any particular party for disparate treatment unless justified by

substantial and reasonable cause, such as the promotion of effective competition.

### **ARTICLE III: TRANSPARENCY**

#### **Section 1. PURPOSE**

ICANN (Internet Corporation for Assigned Names and Numbers) and its constituent bodies shall operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness. [Underlining and bold is that of the Panel]

97. As set out in Article IV (Accountability and Review) of ICANN's Bylaws, in carrying out its mission as set out in its Bylaws, ICANN should be accountable to the community for operating in a manner that is consistent with these Bylaws and with due regard for the core values set forth in Article I of the Bylaws.
98. As set out in Section 3 (Independent Review of Board Actions) of Article IV, "any person materially affected by a decision or action by the Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws may submit a request for independent review of that decision or action. In order to be materially affected, the person must suffer injury or harm that is directly and casually connected to the Board's alleged violation of the Bylaws or Articles of Incorporation, and not as a result of third parties acting in line with the Board's action."
99. In this IRP, among the allegations advanced by DCA Trust against ICANN, is that the ICANN Board, and its constituent body, the GAC, breached their obligation to act transparently and in conformity with procedures that ensured fairness. In particular, DCA Trust criticizes the ICANN Board here, for allowing itself to be guided by the GAC, a body "with apparently no distinct rules, limited public records, fluid definitions of membership and quorums" and unfair procedures in dealing with the issues before it.
100. According to DCA Trust, ICANN itself asserts that the GAC is a "constituent body." The exchange between the Panel and counsel for ICANN at the in-person hearing in Washington, D.C. is a living proof of that point.

#### **HONORABLE JUDGE CAHILL:**

Are you saying we should only look at what the Board does? The reason I'm asking is that your -- the Bylaws say that ICANN and its constituent bodies shall operate, to the maximum extent feasible, in an open and transparent manner. Does the constituent bodies include, I don't know,

GAC or anything? What is "constituent bodies"?

**MR. LEVEE:**

Yeah. What I'll talk to you about tomorrow in closing when I lay out what an IRP Panel is supposed to address, the Bylaws are very clear. Independent Review Proceedings are for the purpose of testing conduct or inaction of the ICANN Board. They don't apply to the GAC. They don't apply to supporting organizations. They don't apply to Staff.

**HONORABLE JUDGE CAHILL:**

So you think that the situation is a -- we shouldn't be looking at what the constituent -- whatever the constituent bodies are, even though that's part of your Bylaws?

**MR. LEVEE:**

Well, when I say not -- when you say not looking, part of DCA's claims that the GAC did something wrong and that ICANN knew that.

**HONORABLE JUDGE CAHILL:**

So is GAC a constituent body?

**MR. LEVEE:**

It is a constituent body, to be clear --

**HONORABLE JUDGE CAHILL:**

Yeah.

**MR. LEVEE:**

-- whether -- I don't think an IRP Panel -- if the only thing that happened here was that the GAC did something wrong --

**HONORABLE JUDGE CAHILL:**

Right.

**MR. LEVEE:**

-- an IRP Panel would not be -- an Independent Review Proceeding is not supposed to address that, whether the GAC did something wrong.

Now, if ICANN knew -- the Board knew that the GAC did something wrong, and that's how they link it, they say, Look, the GAC did something wrong, and ICANN knew it, the Board -- if the Board actually knew it, then we're dealing with Board conduct.

The Board knew that the GAC did not, in fact, issue consensus advice. That's the allegation. So it's fair to look at the GAC's conduct.

101. The Panel is unanimously of the view that the GAC is a constituent body of ICANN. This is not only clear from the above exchange between the Panel and counsel for ICANN, but also from Article XI (Advisory Committees) of ICANN's Bylaws and the Operating Principles of the GAC. Section 1 (General) of Article XI of ICANN's Bylaws states:

The Board may create one or more Advisory Committees in addition to those set forth in this Article. Advisory Committee membership may consist of Directors only, Directors and non-directors, or non-directors only, and may also include non-voting or alternate members. Advisory Committees shall have no legal authority to act for ICANN (Internet Corporation for Assigned Names and Numbers), but shall report their findings and recommendations to the Board.

Section 2, under the heading, Specific Advisory Committees states:

There shall be at least the following Advisory Committees:

1. Governmental Advisory Committee

a. The Governmental Advisory Committee should consider and provide advice on the activities of ICANN (Internet Corporation for Assigned Names and Numbers) as they relate to concerns of governments, particularly matters where there may be an interaction between ICANN (Internet Corporation for Assigned Names and Numbers)'s policies and various laws and international agreements or where they may affect public policy issues. [Underlining is that of the Panel]

Section 6 of the preamble of GAC's Operating Principles is also relevant. That Section reads as follows:

The GAC commits itself to implement efficient procedures in support of ICANN and to provide thorough and timely advice and analysis on relevant matters of concern with regard to government and public interests.

102. According to DCA Trust, based on the above, and in particular, Article III (Transparency), Section 1 of ICANN's Bylaws, therefore, the GAC was bound to the transparency and fairness obligations of that provision to "operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness", but as ICANN's own witness, Ms. Heather Dryden acknowledged during the hearing, the GAC did not act with transparency or in a manner designed to insure fairness.

**Mr. ALI:**

Q. But what was the purpose of the discussion at the Prague meeting with respect to AUC? If there really is no difference or distinction between voting/nonvoting, observer or whatever might be the opposite of observer,

or the proper terminology, what was -- what was the point?

**THE WITNESS:**

A. I didn't say there was no difference. The issue is that there isn't GAC agreement about what are the -- the rights, if you will, of -- of entities like the AUC. And there might be in some limited circumstances, but it's also an extremely sensitive issue. And so not all countries have a shared view about what those -- those entities, like the AUC, should be able to do.

Q. So not all countries share the same view as to what entities, such as the AUC, should be able to do. Is that what you said? I'm sorry. I didn't --

A. Right, because that would only get clarified if there is a circumstance where that link is forced. In our business, we talk about creative ambiguity. We leave things unclear so we don't have conflict.

103. As explained by ICANN in its Closing Presentation at the hearing, ICANN's witness, Ms. Heather Dryden also asserted that the GAC Advice was meaningless until the Board acted upon it. This last point is also clear from examining Article 1, Principle 2 and 5 of ICANN GAC's Operating Principles. Principle 2 states that "the GAC is not a decision making body" and Principle 5 states that "the GAC shall have no legal authority to act for ICANN".

**MR. ALI:**

Q. I would like to know what it is that you, as the GAC Chair, understand to be the consequences of the actions that the GAC will take --

**HONORABLE JUDGE CAHILL:**

The GAC will take?

**MR. ALI:**

Q. -- the GAC will take -- the consequences of the actions taken by the GAC, such as consensus advice?

**HONORABLE JUDGE CAHILL:**

There you go.

**THE WITNESS:**

That isn't my concern as the Chair. It's really for the Board to interpret the outputs coming from the GAC.

104. Ms. Dryden also stated that the GAC made its decision without providing any rationale and primarily based on politics and not on potential violations of national laws and sensitivities.

**ARBITRATOR KESSEDJIAN:**

So, basically, you're telling us that the GAC takes a decision to object to an applicant, and no reasons, no rationale, no discussion of the concepts that are in the rules?

**THE WITNESS:**

I'm telling you the GAC did not provide a rationale. And that was not a requirement for issuing a GAC --

**HONORABLE JUDGE CAHILL:**

But you also want to check to see if the countries are following the right -- following the rules, if there are reasons for rejecting this or it falls within the three things that my colleague's talking about.

**THE WITNESS:**

The practice among governments is that governments can express their view, whatever it may be. And so there's a deference to that.

That's certainly the case here as well.

105. ICANN was bound by its Bylaws to conduct adequate diligence to ensure that it was applying its procedures fairly. Section 1 of Article III of ICANN's Bylaws, require it and its constituent bodies to "operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness. The Board must also as per Article IV, Section 3, Paragraph 4 exercise due diligence and care in having a reasonable amount of facts in front of it.
106. In this case, on 4 June 2013, the NGPC accepted the GAC Objection Advice to stop processing DCA Trust's application. On 1 August 2013, the BGC recommended to the NGPC that it deny DCA Trust's Request for Reconsideration of the NGPC's 4 June 2013 decision, and on 13 August 2013, the NGPC accepted the BGC's recommendation (i.e., the NGPC declined to reconsider its own decision) without any further consideration.
107. In this case, ICANN through the BGC was bound to conduct a meaningful review of the NGPC's decision. According to ICANN's Bylaws, Article IV, Section 2, the Board has designated the Board Governance Committee to review and consider any such Reconsideration Requests. The [BGC] shall have the authority to, among other things, conduct whatever factual investigation is deemed appropriate, and request additional written submissions from the affected party, or from others.



108. Finally, the NGPC was not bound by – nor was it required to give deference to – the decision of the BGC.

109. The above, combined with the fact that DCA Trust was never given any notice or an opportunity in Beijing or elsewhere to make its position known or defend its own interests before the GAC reached consensus on the GAC Objection Advice, and that the Board of ICANN did not take any steps to address this issue, leads this Panel to conclude that both the actions and inactions of the Board with respect to the application of DCA Trust relating to the .AFRICA gTLD were not procedures designed to insure the fairness required by Article III, Sec. 1 above, and are therefore inconsistent with the Articles of Incorporation and Bylaws of ICANN.

110. The following excerpt of exchanges between the Panel and one of ICANN's witnesses, Ms. Heather Dryden, the then Chair of the GAC, provides a useful background for the decisions reached in this IRP:

**PRESIDENT BARIN:**

But be specific in this case. Is that what happened in the .AFRICA case?

**THE WITNESS:**

The decision was very quick, and --

**PRESIDENT BARIN:**

But what about the consultations prior? In other words, were -- were you privy to --

**THE WITNESS:**

No. If -- if colleagues are talking among themselves, then that's not something that the GAC, as a whole, is -- is tracking or -- or involved in. It's really those interested countries that are.

**PRESIDENT BARIN:**

Understood. But I assume -- I also heard you say, as the Chair, you never want to be surprised with something that comes up. So you are aware of -- or you were aware of exactly what was happening?

**THE WITNESS:**

No. No. You do want to have a good sense of where the problems are, what's going to come unresolved back to the full GAC meeting, but that's -- that's the extent of it.

And that's the nature of -- of the political process.

# Redacted

**HONORABLE JUDGE CAHILL:**

Okay.

**THE WITNESS:**

-- that question was addressed via having that meeting.

**PRESIDENT BARIN:**

And what's your understanding of what -- what the consequence of that decision is or was when you took it? So what happens from that moment on?

**THE WITNESS:**

It's conveyed to the Board, so all the results, the agreed language coming out of GAC is conveyed to the Board, as was the case with the communiqué from the Beijing meeting.

**PRESIDENT BARIN:**

And how is that conveyed to the Board?

**THE WITNESS:**

Well, it's a written document, and usually Support Staff are forwarding it to Board Staff.

**ARBITRATOR KESSEDJIAN:**

Could you speak a little bit louder? I don't know whether I am tired, but I --

**THE WITNESS:**

Okay. So as I was saying, the document is conveyed to the Board once it's concluded.

**PRESIDENT BARIN:**

When you say "the document", are you referring to the communiqué?

**THE WITNESS:**

Yes.

**PRESIDENT BARIN:**

Okay. And there are no other documents?

**THE WITNESS:**

The communiqué --

**PRESIDENT BARIN:**

In relation to .AFRICA. I'm not interested in any other.

**THE WITNESS:**

Yes, it's the communiqué.

**PRESIDENT BARIN:**

And it's prepared by your staff? You look at it?

**THE WITNESS:**

Right --

**PRESIDENT BARIN:**

And then it's sent over to --

**THE WITNESS:**

-- right, it's agreed by the GAC in full, the contents.

**PRESIDENT BARIN:**

And then sent over to the Board?

**THE WITNESS:**

And then sent, yes.

**PRESIDENT BARIN:**

And what happens to that communiqué? Does the Board receive that and say, Ms. Dryden, we have some questions for you on this, or --

**THE WITNESS:**

Not really. If they have questions for clarification, they can certainly ask that in a meeting. But it is for them to receive that and then interpret it and -- and prepare the Board for discussion or decision.

**PRESIDENT BARIN:**

Okay. And in this case, you weren't asked any questions or anything?

**THE WITNESS:**

I don't believe so. I don't recall.

**PRESIDENT BARIN:**

Any follow-ups, right?

**THE WITNESS:**

Right.

**PRESIDENT BARIN:**

And in the subsequent meeting, I guess the issue was tabled. The Board meeting that it was tabled, were you there?

**THE WITNESS:**

Yes. I don't particularly recall the meeting, but yes.

[...]

**ARBITRATOR KESSEDJIAN:**

Can I turn your attention to Paragraph 5 of your declaration?

Here, you basically repeat what is in the ICANN Guidebook literature, whatever. These are the exact words, actually, that you use in your declaration in terms of why there could be an objection to an applicant -- to a specific applicant. And you use three criteria: problematic, potentially violating national law, and raise sensitivities.

Now, I'd like you to, for us -- for our benefit, to explain precisely, as concrete as you can be, what those three concepts -- how those three concepts translate in the DCA case. Because this must have been discussed in order to get this very quick decision that you are mentioning. So I'd like to understand, you know, because these are the criteria -- these are the three criteria; is that correct?

**THE WITNESS:**

That is what the witness statement says, but the link to the GAC and the role that I played in terms of the GAC discussion did not involve me interpreting those three things. In fact, the GAC did not provide rationale for the consensus objection.

**ARBITRATOR KESSEDJIAN:**

No.

But, I mean, look, the GAC is taking a decision which -- very quickly -- I'm using your words, "very quickly" -- erases years and years and years of work, a lot of effort that have been put by a single applicant. And the way I understand the rules is that the -- the GAC advice -- consensus advice against that applicant are -- is based on those three criteria. Am I wrong in that analysis?

**THE WITNESS:**

I'm saying that the GAC did not identify a rationale for those governments that put forward a string or an application for consensus objection. They might have identified their reasons, but there was not GAC agreement about those reasons or -- or -- or -- or rationale for that. We had some discussion earlier about Early Warnings. So Early Warnings were issued by individual countries, and they indicated their rationale. But, again, that's not a GAC view.

**ARBITRATOR KESSEDJIAN:**

So, basically, you're telling us that the GAC takes a decision to object to an applicant, and no reasons, no rationale, no discussion of the concepts that are in the rules?

**THE WITNESS:**

I'm telling you the GAC did not provide a rationale. And that was not a requirement for issuing a GAC --

**HONORABLE JUDGE CAHILL:**

But you also want to check to see if the countries are following the right -- following the rules, if there are reasons for rejecting this or it falls within the three things that my colleague's talking about.

**THE WITNESS:**

The practice among governments is that governments can express their view, whatever it may be. And so there's [...] deference to that. That's certainly the case here as well. The -- if a country tells -- tells the GAC or says it has a concern, that's not really something that -- that's evaluated, in the sense you mean, by the other governments. That's not the way governments work with each other.

**HONORABLE JUDGE CAHILL:**

So you don't go into the reasons at all with them?

**THE WITNESS:**

To issue a consensus objection, no.

**HONORABLE JUDGE CAHILL:**

Okay. ---

[...]

**PRESIDENT BARIN:**

I have one question for you. We spent, now, a bit of time or a considerable amount of time talking to you about the process, or the procedure leading to the consensus decision.

Can you tell me what your understanding is of why the GAC consensus objection was made finally?

[...]

But in terms of the .AFRICA, the decision -- the issue came up, the agenda -- the issue came up, and you made a decision, correct?

**THE WITNESS:**

The GAC made a decision.

**PRESIDENT BARIN:**

Right. When I say "you", I mean the GAC.

Do you know -- are you able to express to us what your understanding of the substance behind that decision was? I mean, in other words, we've spent a bit of time dealing with the process.

Can you tell us why the decision happened?

**THE WITNESS:**

The sum of the GAC's advice is reflected in its written advice in the communiqué. That is the view to GAC. That's -- that's --

[...]

**ARBITRATOR KESSEDJIAN:**

I just want to come back to the point that I was making earlier. To your Paragraph 5, you said -- you answered to me saying that is my declaration, but it was not exactly what's going on. Now, we are here to --

at least the way I understand the Panel's mandate, to make sure that the rules have been obeyed by, basically. I'm synthesizing. So I don't understand how, as the Chair of the GAC, you can tell us that, basically, the rules do not matter -- again, I'm rephrasing what you said, but I'd like to give you another opportunity to explain to us why you are mentioning those criteria in your written declaration, but, now, you're telling us this doesn't matter.

If you want to read again what you wrote, or supposedly wrote, it's Paragraph 5.

**THE WITNESS:**

I don't need to read again my declaration. Thank you. The header for the GAC's discussions throughout was to refer to strings or applications that were controversial or sensitive. That's very broad. And –

**ARBITRATOR KESSEDJIAN:**

I'm sorry. You say the rules say problematic, potentially violate national law, raise sensitivities. These are precise concepts.

**THE WITNESS:**

Problematic, violate national law -- there are a lot of laws -- and sensitivities does strike me as being quite broad.

[...]

**ARBITRATOR KESSEDJIAN:**

Okay. So we are left with what? No rules?

**THE WITNESS:**

No rationale with the consensus objections.

That's the -- the effect.

**ARBITRATOR KESSEDJIAN:**

I'm done.

**HONORABLE JUDGE CAHILL:**

I'm done.

**PRESIDENT BARIN:**

So am I.

111. The Panel understands that the GAC provides advice to the ICANN Board on matters of public policy, especially in cases where ICANN activities and policies may interact with national laws or international agreements. The Panel also understands that GAC advice is developed through consensus among member nations. Finally, the Panel understands that although the ICANN Board is required to consider GAC advice and recommendations, it is not obligated to follow those recommendations.

112. Paragraph IV of ICANN’s Beijing, People’s Republic of China 11 April 2013 Communiqué [Exhibit C-43] under the heading “GAC Advice to the ICANN Board” states:

**IV. GAC Advice to the ICANN Board**

**1. New gTLDs**

**a. GAC Objections to the Specific Applications**

**i. The GAC Advises the ICANN Board that:**

i. The GAC has reached consensus on GAC Objection Advice according to Module 3.1 part I of the Applicant Guidebook on the following applications:

1. The application for .africa (Application number 1-1165-42560)

[...]

Footnote 3 to Paragraph IV.1. (a)(i)(i) above in the original text adds, “Module 3.1: The GAC advises ICANN that it is the consensus of the GAC that a particular application should not proceed. This will create a strong presumption for the ICANN Board that the application should not be approved.” A similar statement in this regard can be found in paragraph 5 of Ms. Dryden’s 7 February 2014 witness statement.

113. In light of the clear “Transparency” obligation provisions found in ICANN’s Bylaws, the Panel would have expected the ICANN Board to, at a minimum, investigate the matter further before rejecting DCA Trust’s application.

114. The Panel would have had a similar expectation with respect to the NGPC Response to the GAC Advice regarding .AFRICA which was expressed in ANNEX 1 to NGPC Resolution No. 2013.06.04.NG01 [Exhibit C-45]. In that document, in response to DCA Trust’s application, the NGPC stipulated:



The NGPC accepts this advice. The AGB provides that “if GAC advised ICANN that it is the consensus of the GAC that a particular application should not proceed. This will create a strong presumption for the ICANN Board that the application should not be approved. The NGPC directs staff that pursuant to the GAC advice and Section 3.1 of the Applicant Guidebook, Application number 1-1165-42560 for .africa will not be approved. In accordance with the AGB the applicant may withdraw [...] or seek relief according to ICANN’s accountability mechanisms (see ICANN’s Bylaws, Articles IV and V) subject to the appropriate standing and procedural requirements.

115. Based on the foregoing, after having carefully reviewed the Parties’ written submissions, listened to the testimony of the three witnesses, listened to the oral submissions of the Parties in various telephone conference calls and at the in-person hearing of this IRP in Washington, D.C. on 22 and 23 May 2015, and finally after much deliberation, pursuant to Article IV, Section 3, paragraph 11 (c) of ICANN’s Bylaws, the Panel declares that both the actions and inactions of the Board with respect to the application of DCA Trust relating to the .AFRICA gTLD were inconsistent with the Articles of Incorporation and Bylaws of ICANN.

116. As indicated above, there are perhaps a number of other instances, including certain decisions made by ICANN, that did not proceed in the manner and spirit in which they should have under the Articles of Incorporation and Bylaws of ICANN.

117. DCA Trust has criticized ICANN for its various actions and decisions throughout this IRP and ICANN has responded to each of these criticisms in detail. However, the Panel, having carefully considered these criticisms and decided that the above is dispositive of this IRP, it does not find it necessary to determine who was right, to what extent and for what reasons in respect to the other criticisms and other alleged shortcomings of the ICANN Board identified by DCA Trust.

**2) Can the IRP Panel recommend a course of action for the Board to follow as a consequence of any declaration that the Board acted or failed to act in a manner inconsistent with ICANN’s Articles of Incorporation, Bylaws or the Applicant Guidebook?**

118. In the conclusion of its Memorial on the Merits filed with the Panel on 3 November 2014, DCA Trust submitted that ICANN should remove ZACR’s application from the process altogether and allow DCA’s application to proceed under the rules of the New gTLD Program, allowing DCA up to 18 months to negotiate with African governments

to obtain the necessary endorsements so as to enable the delegation and management of the .AFRICA string.

119. In its Final Request for Relief filed with the Panel on 23 May 2015, DCA Trust requested that this Panel recommend to the ICANN Board that it cease all preparations to delegate the .AFRICA gTLD to ZACR and recommend that ICANN permit DCA's application to proceed through the remainder of the new gTLD application process and be granted a period of no less than 18 months to obtain Government support as set out in the AGB and interpreted by the Geographic Names Panel, or accept that the requirement is satisfied as a result of the endorsement of DCA Trust's application by UNECA.

120. DCA Trust also requested that this Panel recommend to ICANN that it compensate DCA Trust for the costs it has incurred as a result of ICANN's violations of its Articles of Incorporation, Bylaws and AGB.

121. In its response to DCA Trust's request for the recommendations set out in DCA Trust's Memorial on the Merits, ICANN submitted that this Panel does not have the authority to grant the affirmative relief that DCA Trust had requested.

122. According to ICANN:

48. DCA's request should be denied in its entirety, including its request for relief. DCA requests that this IRP Panel issue a declaration requiring ICANN to "rescind its contract with ZACR" and to "permit DCA's application to proceed through the remainder of the application process." Acknowledging that it currently lacks the requisite governmental support for its application, DCA also requests that it receive "18 months to negotiate with African governments to obtain the necessary endorsements." In sum, DCA requests not only that this Panel remove DCA's rival for .AFRICA from contention (requiring ICANN to repudiate its contract with ZACR), but also that it rewrite the Guidebook's rules in DCA's favor.

49. IRP Panels do not have authority to award affirmative relief. Rather, an IRP Panel is limited to stating its opinion as to "whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws" and recommending (as this IRP Panel has done previously) that the Board stay any action or decision, or take any interim action until such time as the Board reviews and acts upon the opinion of the IRP Panel. The Board will, of course, give extremely serious consideration to the Panel's recommendations.

123. In its response to DCA Trust's amended request for recommendations filed on 23 May 2015, ICANN argued that because the Panel's authority is limited to declaring whether the Board's conduct was inconsistent with the Articles or the Bylaws, the Panel should limit its declaration to that question and refrain from

recommending how the Board should then proceed in light of the Panel's declaration.

124. In response, DCA Trust submitted that according to ICANN's Bylaws, the Independent Review Process is designed to provide a remedy for "any" person materially affected by a decision or action by the Board. Further, "in order to be materially affected, the person must suffer injury or harm that is directly and causally connected to the Board's alleged violation of the Bylaws or the Articles of Incorporation.

125. According to ICANN, "indeed, the ICANN New gTLD Program Committee, operating under the delegated authority of the ICANN Board, itself [suggests] that DCA could seek relief through ICANN's accountability mechanisms or, in other words, the Reconsideration process and the Independent Review Process." Furthermore:

If the IRP mechanism – the mechanism of last resort for gTLD applicants – is intended to provide a remedy for a claimant materially injured or harmed by Board action or inaction, and it serves as the only alternative to litigation, then naturally the IRP Panel may recommend how the ICANN Board might fashion a remedy to redress such injury or harm.

126. After considering the Parties' respective submissions in this regard, the Panel is of the view that it does have the power to recommend a course of action for the Board to follow as a consequence of any declaration that the Board acted or failed to act in a manner inconsistent with ICANN's Articles of Incorporation, Bylaws or the Applicant Guidebook.

127. Article IV, Section 3, paragraph 11 (d) of ICANN's Bylaws states:

**ARTICLE IV: ACCOUNTABILITY AND REVIEW**  
**Section 3. INDEPENDENT REVIEW OF BOARD ACTIONS**

11. The IRP Panel shall have the authority to:

d. recommend that the Board stay any action or decision or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP.

128. The Panel finds that both the language and spirit of the above section gives it authority to recommend how the ICANN Board might fashion a remedy to redress injury or harm that is directly related and causally connected to the Board's violation of the Bylaws or the Articles of Incorporation.

129. As DCA Trust correctly points out, with which statement the Panel agrees, "if the IRP mechanism – the mechanism of last resort for

gTLD applicants – is intended to provide a remedy for a claimant materially injured or harmed by Board action or inaction, and it serves as the only alternative to litigation, then naturally the IRP Panel may recommend how the ICANN Board might fashion a remedy to redress such injury or harm.”

130. Use of the imperative language in Article IV, Section 3, paragraph 11 (d) of ICANN’s Bylaws, is clearly supportive of this point. That provision clearly states that the IRP Panel has the authority to recommend a course of action until such time as the Board considers the opinion of the IRP and acts upon it.
131. Furthermore, use of the word “opinion”, which means the formal statement by a judicial authority, court, arbitrator or “Panel” of the reasoning and the principles of law used in reaching a decision of a case, is demonstrative of the point that the Panel has the authority to recommend affirmative relief. Otherwise, like in section 7 of the Supplementary Procedures, the last sentence in paragraph 11 would have simply referred to the “declaration of the IRP”. Section 7 under the heading “Interim Measures of Protection” says in part, that an “IRP PANEL may recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the IRP declaration.”
132. The scope of Article IV, Section 3, paragraph 11 (d) of ICANN’s Bylaws is clearly broader than Section 7 of the Supplementary Procedures.
133. Pursuant to Article IV, Section 3, paragraph 11 (d) of ICANN’s Bylaws, therefore, the Panel recommends that ICANN continue to refrain from delegating the .AFRICA gTLD and permit DCA Trust’s application to proceed through the remainder of the new gTLD application process.

### **3) Who is the prevailing party in this IRP?**

134. In its letter of 1 July 2015, ICANN submits that, “ICANN believes that the Panel should and will determine that ICANN is the prevailing party. Even so, ICANN does not seek in this instance the putative effect that would result if DCA were required to reimburse ICANN for all of the costs that ICANN incurred. This IRP was much longer [than] anticipated (in part due to the passing of one of the panelists last summer), and the Panelists’ fees were far greater than an ordinary IRP, particularly because the Panel elected to conduct a live hearing.”

135.DCA Trust on the other hand, submits that, “should it prevail in this IRP, ICANN should be responsible for all of the costs of this IRP, including the interim measures proceeding.” In particular, DCA Trust writes:

On March 23, 2014, DCA learned via email from a supporter of ZA Central Registry (“ZACR”), DCA’s competitor for .AFRICA, that ZACR would sign a registry agreement with ICANN in three days’ time (March 26) to be the registry operator for .AFRICA. The very same day, we sent a letter on behalf of DCA to ICANN’s counsel asking ICANN to refrain from executing the registry agreement with ZACR in light of the pending IRP proceedings. See DCA’s Request for Emergency Arbitrator and Interim Measures of Protection, Annex I (28 Mar. 2014). Instead, ICANN entered into the registry agreement with ZACR the very next day—two days ahead of schedule. [...] Later that same day, ICANN responded to DCA’s request by treating the execution of the contract as a *fait accompli* and, for the first time, informed DCA that it would accept the application of Rule 37 of the 2010 [ICDR Rules], which provides for emergency measures of protection, even though ICANN’s Supplementary Procedures for ICANN Independent Review Process expressly provide that Rule 37 does not apply to IRPs. A few days later, on March 28, 2014, DCA filed a Request for Emergency Arbitrator and Interim Measures of Protection with the ICDR. ICANN responded to DCA’s request on April 4, 2014. An emergency arbitrator was appointed by the ICDR; however, the following week, the original panel was fully constituted and the parties’ respective submissions were submitted to the Panel for its review on April 13, 2014. After a teleconference with the parties on April 22 and a telephonic hearing on May 5, the Panel ruled that “ICANN must immediately refrain from any further processing of any application for .AFRICA” during the pendency of the IRP. Decision on Interim Measures of Protection, ¶ 51 (12 May 2014).

136.A review of the various procedural orders, decisions, and declarations in this IRP clearly indicates that DCA Trust prevailed in many of the questions and issues raised.

137.In its letter of 1 July 2015, DCA Trust refers to several instances in which ICANN was not successful in its position before this Panel. According to DCA Trust, the following are some examples, “ICANN’s Request for Partial Reconsideration, ICANN’s request for the Panel to rehear the proceedings, and the evidentiary treatment of ICANN’s written witness testimony in the event it refused to make its witnesses available for questioning during the merits hearing.”

138.The Panel has no doubt, as ICANN writes in its letter of 1 July 2015, that the Parties’ respective positions in this IRP “were asserted in good faith.” According to ICANN, “although those positions were in many instances diametrically opposed, ICANN does not doubt that DCA believed in the credibility of the positions that it took, and

[ICANN believes] that DCA feels the same about the positions ICANN took.”

139. The above said, after reading the Parties’ written submissions concerning the issue of costs and deliberation, the Panel is unanimously of the view that DCA Trust is the prevailing party in this IRP.

#### **4) Who is responsible for bearing the costs of this IRP and the cost of the IRP Provider?**

140. DCA Trust submits that ICANN should be responsible for *all* costs of this IRP, including the interim measures proceeding. Among other arguments, DCA Trust submits:

This is consistent with ICANN’s Bylaws and Supplementary Procedures, which together provide that in ordinary circumstances, the party not prevailing shall be responsible for all costs of the proceeding. Although ICANN’s Supplementary Procedures do not explain what is meant by “all costs of the proceeding,” the ICDR Rules that apply to this IRP provide that “costs” include the following:

- (a) the fees and expenses of the arbitrators;
- (b) the costs of assistance required by the tribunal, including its experts;
- (c) the fees and expenses of the administrator;
- (d) the reasonable costs for legal representation of a successful party; and
- (e) any such costs incurred in connection with an application for interim or emergency relief pursuant to Article 21.

Specifically, these costs include all of the fees and expenses paid and owed to the [ICDR], including the filing fees DCA paid to the ICDR (totaling \$4,750), all panelist fees and expenses, including for the emergency arbitrator, incurred between the inception of this IRP and its final resolution, legal costs incurred in the course of the IRP, and all expenses related to conducting the merits hearing (*e.g.*, renting the audiovisual equipment for the hearing, printing hearing materials, shipping hard copies of the exhibits to the members of the Panel).

Although in “extraordinary” circumstances, the Panel may allocate up to half of the costs to the prevailing party, DCA submits that the circumstances of this IRP do not warrant allocating costs to DCA should it prevail. The reasonableness of DCA’s positions, as well as the meaningful contribution this IRP has made to the public dialogue about both ICANN’s accountability mechanisms and the appropriate deference owed by ICANN to its Governmental Advisory Committee, support a full award of costs to

DCA.

[...]

To the best of DCA's knowledge, this IRP was the first to be commenced against ICANN under the new rules, and as a result there was little guidance as to how these proceedings should be conducted. Indeed, at the very outset there was controversy about the applicable version of the Supplemental Rules as well as the form to be filed to initiate a proceeding. From the very outset, ICANN adopted positions on a variety of procedural issues that have increased the costs of these proceedings. In DCA's respectful submission, ICANN's positions throughout these proceedings are inconsistent with ICANN's obligations of transparency and the overall objectives of the IRP process, which is the only independent accountability mechanism available to parties such as DCA.

141. DCA Trust also submits that ICANN's conduct in this IRP increased the duration and expense of this IRP. For example, ICANN failed to appoint a standing panel, it entered into a registry agreement with DCA's competitor for .AFRICA during the pendency of this IRP, thereby forcing DCA Trust to request for interim measures of protection in order to preserve its right to a meaningful remedy, ICANN attempted to appeal declarations of the Panel on procedural matters where no appeal mechanism was provided for under the applicable procedures and rules, and finally, ICANN refused only a couple of months prior to the merits hearing, to make its witnesses available for viva voce questioning at the hearing.

142. ICANN in response submits that, "both the Bylaws and the Supplementary Procedures provide that, in the ordinary course, costs shall be allocated to the prevailing party. These costs include the Panel's fees and the ICDR's fees, [they] would also include the costs of the transcript."

143. ICANN explains on the other hand that this case was extraordinary and this Panel should exercise its discretion to have each side bear its own costs as this IRP "was in many senses a first of its kind." According to ICANN, among other things:

This IRP was the first associated with the Board's acceptance of GAC advice that resulted in the blocking of an application for a new gTLD under the new gTLD Program;

This was the first IRP associated with a claim that one or more ICANN Board members had a conflict of interest with a Board vote; and

This was the first (and still only) IRP related to the New gTLD Program that involved a live hearing, with a considerable amount of debate associated with whether to have a hearing.

144. After reading the Parties' written submissions concerning the issue of costs and their allocation, and deliberation, the Panel is unanimous in deciding that DCA Trust is the prevailing party in this IRP and ICANN shall bear, pursuant to Article IV, Section 3, paragraph 18 of the Bylaws, Article 11 of Supplementary Procedures and Article 31 of the ICDR Rules, the totality of the costs of this IRP and the totality of the costs of the IRP Provider.

145. As per the last sentence of Article IV, Section 3, paragraph 18 of the Bylaws, however, DCA Trust and ICANN shall each bear their own expenses, and they shall also each bear their own legal representation fees.

146. For the avoidance of any doubt therefore, the Panel concludes that ICANN shall be responsible for paying the following costs and expenses:

- a) the fees and expenses of the panelists;
- b) the fees and expenses of the administrator, the ICDR;
- c) the fees and expenses of the emergency panelist incurred in connection with the application for interim emergency relief sought pursuant to the Supplementary Procedures and the ICDR Rules; and
- d) the fees and expenses of the reporter associated with the hearing on 22 and 23 May 2015 in Washington, D.C.

147. The above amounts are easily quantifiable and the Parties are invited to cooperate with one another and the ICDR to deal with this part of this Final Declaration.

## **V. DECLARATION OF THE PANEL**

148. Based on the foregoing, after having carefully reviewed the Parties' written submissions, listened to the testimony of the three witness, listened to the oral submissions of the Parties in various telephone conference calls and at the in-person hearing of this IRP in Washington, D.C. on 22 and 23 May 2015, and finally after much deliberation, pursuant to Article IV, Section 3, paragraph 11 (c) of ICANN's Bylaws, the Panel declares that both the actions and inactions of the Board with respect to the application of DCA Trust relating to the .AFRICA gTLD were inconsistent with the Articles of Incorporation and Bylaws of ICANN.

149. Furthermore, pursuant to Article IV, Section 3, paragraph 11 (d) of ICANN's Bylaws, the Panel recommends that ICANN continue to



refrain from delegating the .AFRICA gTLD and permit DCA Trust's application to proceed through the remainder of the new gTLD application process.

150. The Panel declares DCA Trust to be the prevailing party in this IRP and further declares that ICANN is to bear, pursuant to Article IV, Section 3, paragraph 18 of the Bylaws, Article 11 of Supplementary Procedures and Article 31 of the ICDR Rules, the totality of the costs of this IRP and the totality of the costs of the IRP Provider as follows:

- a) the fees and expenses of the panelists;
- b) the fees and expenses of the administrator, the ICDR;
- c) the fees and expenses of the emergency panelist incurred in connection with the application for interim emergency relief sought pursuant to the Supplementary Procedures and the ICDR Rules; and
- d) the fees and expenses of the reporter associated with the hearing on 22 and 23 May 2015 in Washington, D.C.
- e) As a result of the above, the administrative fees of the ICDR totaling US\$4,600 and the Panelists' compensation and expenses totaling US\$403,467.08 shall be born entirely by ICANN, therefore, ICANN shall reimburse DCA Trust the sum of US\$198,046.04

151. As per the last sentence of Article IV, Section 3, paragraph 18 of the Bylaws, DCA Trust and ICANN shall each bear their own expenses. The Parties shall also each bear their own legal representation fees.

The Panel finally would like to take this opportunity to fondly remember its collaboration with the Hon. Richard C. Neal (Ret. and now Deceased) and to congratulate both Parties' legal teams for their hard work, civility and responsiveness during the entire proceedings. The Panel was extremely impressed with the quality of the written work presented to it and oral advocacy skills of the Parties' legal representatives.

**This Final Declaration has sixty-three (63) pages.**

**Date: Thursday, 9 July 2015.**

**Place of the IRP, Los Angeles, California.**



Professor Catherine Kessedjian



Hon. William J. Cahill (Ret.)



Babak Barin, President

**CLA-003**

INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

ICDR Case No. 50 117 T 00224 08

In the Matter of an Independent Review Process:

ICM REGISTRY, LLC,

Claimant,

v.

INTERNET CORPORATION FOR ASSIGNED NAMES  
AND NUMBERS ("ICANN"),

Respondent

DECLARATION OF THE INDEPENDENT REVIEW PANEL

Judge Stephen M. Schwebel, *Presiding*  
Mr. Jan Paulsson  
Judge Dickran Tevrizian

February 19, 2010

## PART ONE: INTRODUCTION

1. From its beginning in 1965, an exchange over a telephone line between a computer at the Massachusetts Institute of Technology and a computer in California, to the communications colossus that the Internet has become, the Internet has constituted a transformative technology. Its protocols and domain name system standards and software were invented, perfected, and for some 25 years before the formation of the Internet Corporation for Assigned Names and Numbers (ICANN), essentially overseen, by a small group of researchers working under contracts financed by agencies of the Government of the United States of America, most notably by the late Professor Jon Postel of the Information Sciences Institute of the University of Southern California and Dr. Vinton Cerf, founder of the Internet Society. Dr. Cerf, later the distinguished leader of ICANN, played a major role in the early development of the Internet and has continued to do so. European research centers also contributed. From the origin of the Internet domain name system in 1980 until the incorporation of ICANN in 1998, a small community of American computer scientists controlled the management of Internet identifiers. However the utility, reach, influence and exponential growth of the Internet quickly became quintessentially international. In 1998, in recognition of that fact, but at the same time determined to keep that management within the private sector rather than to subject it to the ponderous and politicized processes of international governmental control, the U.S. Department of Commerce, which then contracted on behalf of the U.S. Government with the managers of the Internet, transferred operational responsibility over the protocol and domain names system of the Internet to the newly formed Internet Corporation for Assigned Names and Numbers ("ICANN").

2. ICANN, according to Article 3 of its Articles of Incorporation of November 21, 1998, is a nonprofit public benefit corporation organized under the California Nonprofit Public Benefit Corporation Law "in recognition of the fact that the Internet is an international network of networks, owned by no single nation, individual or organization..." ICANN is charged with

"promoting the global public interest in the operational stability of the Internet by (i) coordinating the assignment of Internet technical parameters as needed to maintain universal connectivity on the Internet; (ii) performing and overseeing functions related to the coordination of the Internet Protocol ("IP") address space; (iii) performing and overseeing functions related to the coordination of the Internet domain name system ("DNS"), including the development of

policies for determining the circumstances under which new top-level domains are added to the DNS root system; (iv) overseeing operation of the authoritative Internet DNS root server system..." (Claimant's Exhibits, hereafter "C", at C-4.)

ICANN was formed as a California corporation apparently because early proposals for it were prepared at the instance of Professor Postel, who lived and worked in Marina del Rey, California, which became the site of ICANN's headquarters.

3. ICANN, Article 4 of its Articles of Incorporation provides,

"shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law and, to the extent appropriate and consistent with these Articles and its Bylaws, through open and transparent processes that enable competition and open entry in Internet-related markets. To this effect, the Corporation shall cooperate as appropriate with relevant international organizations."

4. ICANN's Bylaws, as amended effective May 29, 2008, in Section 1, define the mission of ICANN as that of coordination of the allocation and assignment

"of the three sets of unique identifiers for the Internet, ...(a) domain names forming a system referred to as "DNS", (b) ...Internet protocol ("IP") addresses and autonomous system ("AS") numbers and (c) Protocol port and parameter numbers". ICANN "coordinates the operation and evolution of the DNS root server system" as well as "policy development reasonably and appropriately related to these technical functions." (C-5.)

5. Section 2 of ICANN's Bylaws provides that, in performing its mission, core values shall apply, among them:

"1. Preserving and enhancing the operational stability, reliability, security, and global interoperability of the Internet.

"2. Respecting the creativity, innovation, and flow of information made possible by the Internet by limiting ICANN's activities to those matters within ICANN's mission requiring or significantly benefiting from global coordination.

"3. To the extent feasible and appropriate, delegating coordination functions to or recognizing the policy role of other responsible entities that reflect the interest of affected parties.

"4. Seeking and supporting broad, informed participation reflecting the functional, geographic, and cultural diversity of the Internet at all levels of policy development and decision-making.

...

"6. Introducing and promoting competition in the registration of domain names where practicable and beneficial in the public interest.

...

"8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.

...

"11. While remaining rooted in the private sector, recognizing that governments and public authorities are responsible for public policy and duly taking into account governments' or public authorities' recommendations." (C-5.)

6. The Bylaws provide in Article II that the powers of ICANN shall be exercised and controlled by its Board, whose international composition, representative of various stakeholders, is otherwise detailed in the Bylaws. Article VI, Section 4.1 of the Bylaws provides that "no official of a national government or a multinational entity established by treaty or other agreement between national governments may serve as a Director". They specify that "ICANN shall not apply its standards, policies, procedures, or practices inequitably, or single out any particular party for disparate treatment unless justified by substantial and reasonable cause, such as the promotion of effective competition." ICANN is to operate in an open and transparent manner "and consistent with procedures designed to ensure fairness" (Article III, Section 1.) In those cases "where the policy action affects public policy concerns," ICANN shall "request the opinion of the Governmental Advisory Committee and take duly into account any advice timely presented by the Governmental Advisory Committee on its own initiative or at the Board's request" (Article III, Section 6).

7. Article IV of the Bylaws, Section 3, provides that: "ICANN shall have in place a separate process for independent third-party review of Board actions alleged by an affected party to be inconsistent with the Articles of Incorporation or Bylaws." Any person materially affected by a decision or action of the Board that he or she asserts "is inconsistent" with those Articles and Bylaws may submit a request for independent review which shall be referred to an Independent Review Panel ("IRP"). That Panel "shall be charged with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws". "The IRP shall be operated by an international arbitration provider appointed from time to time by ICANN...using arbitrators...nominated by that provider." The IRP shall have the authority to "declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or the Bylaws" and "recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP". Section 3 further specifies that declarations of the IRP shall be in writing, based solely on the documentation and arguments of the parties, and shall "specifically designate the prevailing party." The Section concludes by providing that, "Where feasible, the Board shall consider the IRP declaration at the Board's next meeting."

8. The international arbitration provider appointed by ICANN is the International Centre for Dispute Resolution ("ICDR") of the American Arbitration Association. It appointed the members of the instant Independent Review Panel in September 2008. Thereafter exchanges of written pleadings and extensive exhibits took place, followed by five days of oral hearings in Washington, D.C. September 21-25, 2009.

9. Article XI of ICANN's Bylaws provides, *inter alia*, for a Governmental Advisory Committee ("GAC") to "consider and provide advice on the activities of ICANN as they relate to concerns of governments, particularly matters where there may be an interaction between ICANN's policies and various laws and international agreements or where they may affect public policy issues". It further provides that the Board shall notify the Chair of the GAC in a timely manner of any proposal raising public policy issues. "The advice of the Governmental Advisory Committee on public policy matters shall be duly taken into account, both in the formulation and adoption of policies. In the event that the ICANN Board determines to take an action that is not consistent with the Governmental Advisory Committee advice, it shall so inform the Committee and state the reasons why it decided not to follow that advice. The Governmental Advisory Committee and the ICANN Board will then try, in good faith and in a timely and efficient manner, to find a mutually



acceptable solution." If no such solution can be found, the Board will state in its final decision the reasons why the GAC's advice was not followed.

## PART TWO: FACTUAL BACKGROUND OF THE DISPUTE

10. The Domain Name System ("DNS"), a hierarchical name system, is at the heart of the Internet. At its summit is the so-called "root", managed by ICANN, although the U.S. Department of Commerce retains the ultimate capacity of implementing decisions of ICANN to insert new top-level domains into the root. The "root zone file" is the list of top-level domains. Top-level domains ("TLDs"), are identified by readable, comprehensible, "user-friendly" addresses, such as ".com", ".org", and ".net". There are "country-code TLDs" (ccTLDs), two letter codes that identify countries, such as .uk (United Kingdom), .jp (Japan), etc. There are generic TLDs ("gTLDs"), which are subdivided into sponsored TLDs ("sTLDs") and unsponsored TLDs ("gTLDs"). An unsponsored TLD operates under policies established by the global Internet community directly through ICANN, while a sponsored TLD is a specialized TLD that has a sponsor representing the narrower community that is most affected by the TLD. The sponsor is delegated, and carries out, policy-formulation responsibilities over matters concerning the TLD. Thus, under the root, top-level domains are divided into gTLDs such as .com, .net, and .info, and sTLDs such as .aero, .coop, and .museum. And there are ccTLDs, such as .fr (France). Second level domains, under the top-level domains, are legion; e.g., Microsoft.com, dassault.fr. While the global network of computers communicate with one another through a decentralized data routing mechanism, the Internet is centralized in its naming and numbering system. This system matches the unique Internet Protocol address of each computer in the world -- a string of numbers -- with a recognizable domain name. Computers around the world can communicate with one another through the Internet because their Internet Protocol addresses uniquely and reliably correlate with domain names.

11. When ICANN was formed in 1998, there were three generic TLDs: .com, .org, and .net. They were complemented by a few limited-use TLDs, .edu, .gov, .mil, and .int. Since its formation, ICANN has endeavored to introduce new TLDs. In 2000, ICANN opened an application process for the introduction of new gTLDs. This initial round was a preliminary effort to test a "proof of concept" in respect of new gTLDs. ICANN received forty-seven applications for both sponsored and unsponsored TLDs.

12. Among them was an application by the Claimant in these proceedings, ICM Registry (then under another ownership), for an unsponsored .XXX TLD,

which would responsibly present “adult” entertainment (*i.e.*, pornographic entertainment). ICANN staff recommended that the Board not select .XXX during the “proof of concept” round because “it did not appear to meet unmet needs”, there was “controversy” surrounding the application, and the definition of benefits of .XXX was “poor”. It observed that, “at this early ‘proof of concept’ stage with a limited number of new TLDs contemplated, other proposed TLDs without the controversy of an adult TLD would better serve the goals of this initial introduction of new TLDs.” (C-127, p. 230.) In the event, the ICANN Board authorized ICANN’s President and General Counsel to commence contract negotiations with seven applicants including three sponsored TLDs, .museum, .aero and .coop. Agreements were “subject to further Board approval or ratification.” (Minutes of the Second Annual Meeting of the Board, November 16, 2000, ICANN Exhibit G.)

13. In 2003, the ICANN Board passed resolutions for the introduction of new sponsored TLDs in another Round. The Board resolved that “upon the successful completion of the sTLD selection process, an agreement reflecting the commercial and technical terms shall be negotiated.” (C-78.) It posted a “Request for Proposals” (“RFP”), which included an application form setting out the selection criteria that would be used to evaluate proposals. The RFP’s explanatory notes provided that the sponsorship criteria required “the proposed sTLD [to] address the needs and interest of a ‘clearly defined community’...which can benefit from the establishment of a TLD operating in a policy formulation environment in which the community would participate.” Applicants had to show that the Sponsored TLD Community was (a) “Precisely defined, so it can readily be determined which persons or entities make up that community” and (b) “Comprised of persons that have needs and interests in common but which are differentiated from those of the general global Internet community”. (ICANN, New gTLD Program, ICANN Exhibit N.) The sponsorship criteria further required applicants to provide an explanation of the Sponsoring Organization’s policy-formulation procedures. They additionally required the applicant to demonstrate “broad-based support” from the sponsored TLD community. None of the criteria explicitly addressed “morality” issues or the content of websites to be registered in the new sponsored domains.

14. ICANN in 2004 received ten sTLD applications, including that of ICM Registry of March 16, 2004 for a .XXX sTLD. ICM’s application was posted on ICANN’s website. Its application stated that it was to

[REDACTED]

[REDACTED] and who are interested in the [REDACTED] [REDACTED] (C-Confidential Exh. B.) The International Foundation for Online Responsibility ("IFFOR"), a Canadian organization whose creation by ICM was in process, was proposed to be ICM's sponsoring organization. The President of ICM Registry, Stuart Lawley, a British entrepreneur, was to explain that the XXX sTLD is a

"significant step towards the goal of protecting children from adult content, and [to] facilitate the efforts of anyone who wishes to identify, filter or avoid adult content. Thus, the presence of ".XXX" in a web address would serve a dual role: both indicating to users that the website contained adult content, thereby allowing users to choose to avoid it, and also indicating to potential adult-entertainment consumers that the websites could be trusted to avoid questionable business practices." (Lawley Witness Statement, para. 15.)

15. ICANN constituted an independent panel of experts (the "Evaluation Panel") to review and recommend those sTLD applications that met the selection criteria. That Panel found that two of the ten applicants met all the selection criteria; that three met some of the criteria; and that four had deficiencies that could not be remedied within the applicant's proposed framework. As for .XXX, the Evaluation Panel found that ICM was among the latter four; it fully met the technical and financial criteria but not some of the sponsorship criteria. The three-member Evaluation Panel, headed by Ms. Elizabeth Williams of Australia, that analyzed sponsorship and community questions did not believe that the .XXX application represented "a clearly defined community"; it found that "the extreme variability of definitions of what constitutes the content which defines this community makes it difficult to establish which content and associated persons or services would be in or out of the community". The Evaluation Panel further found that the lack of cohesion in the community and the planned involvement of child advocates and free expression interest groups would preclude effective formulation of policy for the community; it was unconvinced of sufficient support outside of North America; and "did not agree that the application added new value to the Internet name space". Its critical evaluation of ICM's application concluded that it fell into the category of those "whose deficiencies cannot be remedied with the applicant's proposed framework" (C-110.)

16. Because only two of ten applicants were recommended by the Evaluation Panel, and because the Board remained desirous of expanding the number of sTLDs, the ICANN Board resolved to give the other sTLD applicants further opportunity to address deficiencies found by the

Evaluation Panel. ICM Registry responded with an application revised as of December 7, 2004. It noted that the independent teams that evaluated the technical merits and business soundness of ICM's application had unreservedly recommended its approval. It submitted, contrary to the analysis of the Evaluation Panel, that ICM and IFFOR also met the sponsorship criteria. "Nonetheless, the Applicants fully understand that the topic of adult entertainment on the Internet is controversial. The Applicants also understand that the Board might be criticized whether it approves or disapproves the Proposal." (C-127, p. 176.) In accordance with ICANN's practice, ICM's application again was publicly posted on ICANN's website.

17. Following discussion of its application in the Board, ICM was invited to give a presentation to the Board, which it did in April 2005, in Mar del Plata, Argentina. Child protection and free speech advocates were among the representatives of ICM Registry. The Chairman of the Governmental Advisory Committee, Mohamed Sharil Tarmizi, was in attendance for part of the meeting as well as other meetings of the Board. ICM offered then and at ICANN meetings in Capetown (December 2004) and Luxembourg (July 2005) to discuss its proposal with the GAC or any of its members, a proposal that was not taken up (C-127, p. 231; C-170, p.2). In a letter of April 3, 2005, the GAC Chairman informed the ICANN President and CEO, Paul Twomey, that: "No GAC members have expressed specific reservations or comments, in the GAC, about applications for sTLDs in the current round." (C-158, p.1.) ICM's Mar del Plata presentation to the ICANN Board included the results of a poll conducted by XBiz in February 2005 of "adult" websites that asked: "What do you think of Internet suffixes (.sex, .xxx) to designate adult sites?" 22% of the responders checked, "A Horrible Idea"; 57% checked, "A Good Idea"; 21% checked, "It's No Big Deal Either Way". ICM, while recognizing that its proposal aroused some opposition in the adult entertainment community, maintained throughout that it fully met the RFP requirement of demonstrating that it had "broad-based support from the community to be represented". (C-45.)

18. The ICANN Board held a special meeting by teleconference on May 3, 2005, the Chairman of the ICANN Board, Dr. Vinton G. Cerf, presiding. The minutes record, in respect of the .XXX sTLD application, that there was broad discussion of whether ICM's application met the RFP criteria, "particularly relating to whether or not there was a 'sponsored community'". It was agreed to "discuss this issue" at the next Board meeting. (C-134.)

19. On June 1, 2005, the Board met by teleconference and after considerable discussion adopted the following resolutions, with a 6-3 vote in favor, 2 abstentions and 4 Board members absent:

“Resolved...the Board authorizes the President and General Counsel to enter into negotiations relating to proposed commercial and technical terms for the .XXX sponsored top-level domain (sTLD) with the applicant.”

“Resolved...if after entering into negotiations with the .XXX sTLD applicant the President and General Counsel are able to negotiate a set of proposed commercial and technical terms for a contractual arrangement, the President shall present such proposed terms to this board, for approval and authorization to enter into an agreement relating to the delegation of the sTLD.” (C-120.)

20. While a few of the other applications that were similarly cleared to enter into negotiations relating to proposed commercial and technical terms, e.g., those of .JOBS, and .MOBI, contained conditions, the foregoing resolutions relating to ICM Registry contained no conditions. The .JOBS resolution, for example, specified that

“the board authorizes the President and General Counsel to enter into negotiations relating to proposed commercial and technical terms for the .JOBS sponsored top-level domain (sTLD) with the applicant. During these negotiations, the board requests that special consideration be taken as to how broad-based policy-making would be created for the sponsored community, and how this sTLD would be differentiated in the name space.”

In contrast, the .XXX resolutions do not refer to further negotiations concerning sponsorship, nor do the resolutions refer to further consideration by the Board of the matter of sponsorship. Upon the successful conclusion of the negotiation, the terms of an agreement with ICM Registry were to be presented to the Board “for approval and authorization to enter into an agreement relating to the delegation of the sTLD”.

21. At the meeting of the Governmental Advisory Committee in Luxembourg July 11-12, 2005, under the chairmanship of Mr. Tarmizi, the foregoing resolutions gave rise to comment. The minutes contain the following summary reports:

"The Netherlands, supported by several members, including Brazil, EC and Egypt, raised the point about what appears to be a change in policy as regards the evaluation for the .xxx TLD.

"On that issue, the Chair stressed that the Board came to a decision after a very difficult and intense debate which has included the moral aspects. He wondered what the GAC could have done in this context.

"Brazil asked clarification about the process to provide GAC advice to the ICANN Board and to consult relevant communities on matter such as the creation of new gTLDs. The general public was likely to assume that GAC had discussed and approved the proposal; otherwise GAC might be perceived as failing to address the matter. This is a public policy issue rather than a moral issue.

"Denmark commented on the fact that the issue of the creation of the .xxx extension should have been presented to the GAC as a public policy issue. EC drew attention to the 2000 Evaluation report on .xxx that had concluded negatively.

"France asked about the methodology to be followed for the evaluation of new gTLDs in future and if an early warning system could be put in place. Egypt wished to clarify whether the issue was the approval by ICANN or the apparent change in policy.

"USA remarked that GAC had several opportunities to raise questions, notably at Working Group level, as the process had been open for several years. In addition there are not currently sufficient resources in the WGI to put sufficient attention to it. We should be working on an adequate methodology for the future. Netherlands commented that the ICANN decision making process was not sufficiently transparent for GAC to know in time when to reach [sic; react] to proposals.

"The Chair thanked the GAC for these comments which will be given to the attention of the ICANN Board." (C-139, p. 3.)

22. There followed a meeting of the GAC with the ICANN Board, at which the following statements are recorded in the summary minutes:

"Netherlands asked about the new criteria to be retained for new TLDs as it seems there was a shift in policy during the evaluation process.

"Mr. Twomey replied that there might be key policy differences due to learning experiences, for example it is now accepted not to put a limit on the number of new TLDs. He also noted that no comments had been received from governments regarding .xxx.

"Dr. Cerf added, taking the example of .xxx that there was a variety of proposals for TLDs before, including for this extension, but this time the way to cope with the selection was different. The proposal this time met the three main criteria, financial, technical and sponsorship. They [sic: There] were doubts expressed about the last criteria [sic] which were discussed extensively and the Board reached a positive decision considering that ICANN should not be involved in content matters.

"France remarked that there might be cases where the TLD string did infer the content matter. Therefore the GAC could be involved if public policies issues are to be raised.

"Dr. Cerf replied that in practice there is no correlation between the TLD string and the content. The TLD system is neutral, although filtering systems could be solutions promoted by governments. However, to the extent the governments do have concerns they relate to the issues across TLDs. Furthermore one could not slip into censorship.

"Chile and Denmark asked about the availability of the evaluation Report for .xxx and wondered if the process was in compliance with the ICANN Bylaws.

"Brazil asserted that content issues are relevant when ICANN is creating a space linked to pornography. He considered the matter as a public policy issue in the Brazilian context and repeated that the outside world would assume that GAC had been fully cognizant of the decision-making process.

"Mr. Twomey referred to the procedure for attention for GAC in the ICANN Bylaws that could be initiated if needed. The bylaws could work both ways: GAC could bring matters to ICANN's attention. Dr. Cerf invited GAC to comment in the context of the ICANN public

comments process. Spain suggested that ICANN should formally request GAC advice in such cases.

"The Chair [Dr. Cerf] noted in conclusion that it is not always clear what the public policy issues are and that an early warning mechanism is called for." (C-139, P. 5.)

23. When it came to drafting the GAC Communique, the following further exchanges were summarized:

"Brazil referred to the decision taken for the creation of .xxx and asked if anything could be done at this stage...

"On .xxx, USA thought that it would be very difficult to express some views at this late stage. The process had been public since the beginning, and the matter could have been raised before at Plenary or Working group level...

"Italy would be in favour of inserting the process for the creation of new TLDs in the Communique as GAC failed in some way to examine in good time the current set of proposal [sic] for questions of methodology and lack of resources.

"Malaysia recalled the difficult situation in which governments are faced with the evolution of the DNS system and the ICANN environment. ICANN and GAC should be more responsive to common issues...

"Canada raise [sic] the point of the advisory role of the GAC vis-à-vis ICANN and it would be difficult to go beyond this function for the time being.

"Denmark agreed with Canada but considered that the matter could have been raised before within the framework of the GAC; if necessary issues could be raised directly in Plenary.

"France though [sic] that the matter should be referred to in the Communique. Since ICANN was apparently limiting its consideration to financial, technical and sponsorship aspects, the content aspects should be treated as a problem for the GAC from the point of view of the general public interest."



"The Chair took note of the comments that had been made. He mentioned that the issues of new gTLDs...would be mentioned in the Communique." (C-139, p. 7.)

24. Finally, in respect of "New Top Level Domains"

"...the Chair recalled that members had made comments during the consultation period regarding the *.tel* and *.mobi* proposals, but not regarding other sTLD proposals.

"The GAC has requested ICANN to provide the Evaluation Report on the basis of which the application for *.xxx* was approved. GAC considered that some aspects of content related to top level extensions might give rise of [sic] public policies [sic] issues.

"The Chair confirmed that, having consulted the ICANN Legal Counsel, GAC could still advise ICANN about the *.xxx* proposal, should it decide to do so. However, no member has yet raised this as an issue for formal comments to be given to ICANN in the Communique." (C-139, p. 13.)

25. The Luxembourg Communique of the GAC as adopted made no express reference to the application of ICM Registry nor to the June 1, 2005 ICANN Board resolutions adopted in response to it. In respect of "New Top Level Domains", the Communique stated:

"The GAC notes from recent experience that the introduction of new TLDs can give rise to significant public policy issues, including content. Accordingly, the GAC welcomes the initiative of ICANN to hold consultations with respect to the implementation of the new Top Level Domains strategy. The GAC looks forward to providing advice to the process." (C-159, p. 1.)

26. Negotiations on commercial and technical terms for a contract between ICANN's General Counsel, John Jeffrey, and the counsel of ICM Registry, Ms. J. Beckwith Burr, in pursuance of the ICANN Board's resolutions of June 1, 2005, progressed smoothly, resulting in the posting in early August 2005 of the First Draft Registry Agreement. It was expected that the Board would vote on the contract at its meeting of August 16, 2005.

27. This expectation was overturned by ICANN's receipt of two letters. On August 11, 2005, Michael D. Gallagher, Assistant Secretary for

Communications and Information of the U.S. Department of Commerce, wrote Dr. Cerf, with a copy to Mr. Twomey, as follows:

"I understand that the Board of Directors of the Internet Corporation for Assigned Names and Numbers (ICANN) is scheduled to consider approval of an agreement with the ICM Registry to operate the .xxx top level domain (TLD) on August 16, 2005. I am writing to urge the Board to ensure that the concerns of all members of the Internet community on this issue have been adequately heard and resolved before the Board takes action on this application.

"Since the ICANN Board voted to negotiate a contract with ICM Registry for the .xxx TLD in June 2005, this issue has garnered widespread public attention and concern outside of the ICANN community. The Department of Commerce has received nearly 6000 letters and emails from individuals expressing concern about the impact of pornography on families and children and opposing the creation of a new top level domain devoted to adult content. We also understand that other countries have significant reservations regarding the creation of a .xxx TLD. I believe that ICANN has also received many of these concerned comments. The volume of correspondence opposed to the creation of a .xxx TLD is unprecedented. Given the extent of the negative reaction, I request that the Board will provide a proper process and adequate additional time for these concerns to be voiced and addressed before any additional action takes place on this issue.

"It is of paramount importance that the Board ensure the best interests of the Internet community as a whole are fully considered as it evaluates the addition to this new top level domain..." (C-162, p. 1.)

28. On August 12, 2005, Mohamed Sharil Tarmizi, Chairman, GAC, wrote to the ICANN Board of Directors, in his personal capacity and not on behalf of the GAC, with a copy to the GAC, as follows:

"As you know, the Board is scheduled to consider approval of a contract for a new top level domain intended to be used for adult content...

"You may recall that during the session between the GAC and the Board in Luxembourg that some countries had expressed strong positions to the Board on this issue. In other GAC sessions, a number of other governments also expressed some concern with the potential

introduction of this TLD. The views are diverse and wide ranging. Although not necessarily well articulated in Luxembourg, as Chairman, I believe there remains a strong sense of discomfort in the GAC about the TLD, notwithstanding the explanations to date.

“I have been approached by some of these governments and I have advised them that apart from the advice given in relation to the creation of new TLDs in the Luxembourg Communiqué that implicitly refers to the proposed TLD, sovereign governments are also free to write directly to ICANN about their specific concerns.

“In this regard, I would like to bring to the Board’s attention the possibility that several governments will choose to take this course of action. I would like to request that in any further debate that we may have with regard to this TLD that we keep this background in mind.

“Based on the foregoing, I believe that the Board should allow time for additional governmental and public policy concerns to be expressed before reaching a final decision on this TLD.”

29. The *volte face* in the position of the United States Government evidenced by the letter of Mr. Gallagher appeared to have been stimulated by a cascade of protests by American domestic organizations such as the Family Research Council and Focus on the Family. Thousands of email messages of identical text poured into the Department of Commerce demanding that .XXX be stopped. Copies of messages obtained by ICM under the Freedom of Information Act show that while officials of the Department of Commerce concerned with Internet questions earlier did not oppose and indeed apparently favored ICANN’s approval of the application of ICM, the Department of Commerce was galvanized into opposition by the generated torrent of negative demands, and by representations by leading figures of the so-called “religious right”, such as Jim Dobson, who had influential access to high level officials of the U.S. Administration. There was even indication in the Department of Commerce that, if ICANN were to approve a top level domain for adult material, it would not be entered into the root if the United States Government did not approve (C-165, C-166.) The intervention of the United States came at a singularly delicate juncture, in the run-up to a United Nations sponsored conference on the Internet, the World Summit on the Information Society, which was anticipated to be the forum for concentration of criticism of the continuing influence of the United States over the Internet. The *Congressional Quarterly Weekly* ran a story entitled, “Web Neutrality vs. Morality” which said: “The flap over .xxx has put ICANN

in an almost impossible position. It is facing mounting pressure from within the United States and other countries to reject the domain. But if it goes back on its earlier decision, many countries will see that as evidence of its allegiance to and lack of independence from the U.S. government. 'The politics of this are amazing,' said Cerf. 'We're damned if we do and damned if we don't.' (C-284.)

30. Doubt about the desirability of allocating a top-level domain to ICM Registry, or opposition to so doing, was not confined to the U.S. Department of Commerce, as illustrated by the proceedings at Luxembourg quoted above. A number of other governments also expressed reservations or raised questions about ICM's application on various grounds, including, at a later stage, those of Australia (letter from the Minister for Communications, Information Technology and the Arts of February 28, 2007 expressing Australia's "strong opposition to the creation of a .XXX sTLD"), Canada (comment expressing concern that ICANN may be drawn into becoming a global Internet content regulator, Exhibit DJ) and the United Kingdom (letter of May 4, 2006 stressing the importance of ICM's monitoring all .XXX content from "day one", C-182). The EC expressed the view that consultation with the GAC had been inadequate. The Deputy Director-General of the European Commission on September 16, 2005 wrote Dr. Cerf stating that the June 1, 2005 resolutions were adopted without the benefit of such consultation and added:

"Moreover, while the .xxx TLD raises obvious and predictable public policy issues, the fact that a similar application from the same applicants had been rejected in 2000 (following a negative evaluation) had, not surprisingly, led many GAC representatives to expect that a similar decision would have been reached on this occasion...such a change in approach would benefit from an explanation to the GAC.

"I would therefore ask ICANN to reconsider the decision to proceed with this application until the GAC have had an opportunity to review the evaluation report." (C-172, p. 1.)

31. The State Secretary for Communications and Regional Policy of the Government of Sweden, Jonas Bjelfvenstam, wrote Dr. Twomey a letter carrying the date of November 23, 2005, as follows:

"I have followed recent discussions by the Board of Directors of ...ICANN concerning the proposed top level domain (TLD) .xxx. I appreciate that the Board has deferred further discussions on the

subject...taking account of requests from the applicant ICM, as well as the ...GAC Chairman's and the US Department of Commerce's request to allow for additional time for comments by interested parties.

"Sweden strongly supports the ICANN mission and the process making ICANN an organization independent of the US Government. We appreciate the achievements of ICANN in the outstanding technical and innovative development of the Internet, an ICANN exercising open, transparent and multilateral procedures.

"The Swedish line on pornography is that it is not compatible with gender equality goals. The constant exposure of pornography and degrading pictures in our everyday lives normalizes the exploitation of women and children and the pornography industry profits on the documentation.

"A TLD dedicated for pornography might increase the volume of pornography on the Internet at the same time as foreseen advantages with a dedicated TLD might not materialize. These and other comments have been made in the many comments made directly to ICANN through the ICANN web site. There are a considerable number of negative reactions within and outside the Internet community.

"I know that all TLD applications are dealt with in procedures open to everyone for comment. However, in a case like this, where public interests clearly are involved, we feel it could have been appropriate for ICANN to request advice from GAC. Admittedly, GAC could have given advice to ICANN anyway at any point in time in the process and to my knowledge, no GAC members have raised the question before the GAC meeting July 9-12 in Luxembourg. However, we all probably rested assured that ICANN's negative opinion on .xxx, expressed in 2000, would stand.

"From the ICANN decision on June 1, 2005, there was too little time for GAC to have an informed discussion on the subject at its Luxembourg summer meeting. ..

"Therefore we would ask ICANN to postpone conclusive discussions on .xxx until after the upcoming GAC meeting in November 29-30 in Vancouver...In due time before that meeting, it would be helpful if ICANN could present in detail how it means that .xxx fulfils the criteria set in advance..." (C-168, p. 1.)

32. At its meeting by teleconference of September 15, 2005, the Board, "after lengthy discussion involving nearly all of the directors regarding the sponsorship criteria, the application, and additional supplemental materials, and the specific terms of the proposed agreement," adopted a resolution providing that:

" ...

"Whereas the ICANN Board has expressed concerns regarding issues relating to the compliance with the proposed .XXX Registry Agreement (including possible proposals for codes of conduct and ongoing obligations regarding potential changes in ownership)...

"Whereas, ICANN has received significant levels of correspondence from the Internet community users over recent weeks, as well as inquiries from a number of governments,

"Resolved...that the ICANN President and General Counsel are directed to discuss possible additional contractual provisions or modifications for inclusion in the XXX Registry Agreement, to ensure that there are effective provisions requiring development and implementation of policies consistent with the principles in the ICM application. Following such additional discussions, the President and General Counsel are requested to return to the board for additional approval, disapproval or advice." (C-119, p. 1.)

33. At the Vancouver meeting of the Board in December 2005, the GAC requested an explanation of the processes that led to the adoption of the Board's resolutions of June 1. Dr. Twomey replied with a lengthy and detailed letter of February 11, 2006. The following extracts are of interest:

"Where an applicant passed all three sets of criteria and there were no other issues associated with the application, the Board was briefed and the application was allowed to move on to the stage of technical and commercial negotiations designed to establish a new sTLD. One application – POST – was in this category. In other cases – where an evaluation team indicated that a set of criteria was not met, or there were other issues to be examined – each applicant was provided an opportunity to submit clarifying or additional documentation before presenting the evaluation panel's recommendation to the Board for a decision on whether the applicant could proceed to the next stage. The other nine applications, including .XXX, were in this category.

"Because of the more subjective nature of the sponsorship/community value issues being reviewed, it was decided to ask the Board to review these issues directly.

...

"It should be noted that, consistent with Article II, Section 1 of the Bylaws, it is the ICANN Board that has the authority to decide, upon the conclusion of technical and commercial negotiations, whether or not to approve the creation of a new sTLD...Responsibility for resolving issues relating to an applicant's readiness to proceed to technical and commercial negotiations and, subsequently, whether or not to approve delegation of a new sTLD, rests with the Board.

...

#### "Extensive Review of ICM Application

...

"On 3 May 2005, the Board held a 'broad discussion...regarding whether or not there was a 'sponsored community' . The Board agreed that it would discuss this issue again at the next Board Meeting.'

"Based on the extensive public comments received, the independent evaluation panel's recommendations, the responses of ICM and the proposed Sponsoring Organization (IFFOR) to those evaluations, ...at its teleconference on June 1, 2005, the Board authorized the President and General Counsel to enter into negotiations relating to proposed commercial and technical terms with ICM. It also requested the President to present any such negotiated agreement to the Board for approval and authorization..." (C-175.)

34. Subsequent draft registry agreements of ICM were produced in response to specific requests of ICANN staff for amendments, to which requests ICM responded positively. In particular, a provision was included stating that all requirements for registration would be "in addition to the obligation to comply with all applicable law[s] and regulation[s]". (Claimant's Memorial on the Merits, pp. 128-129.)

35. Just before the Board met in Wellington, New Zealand in March 2006, the GAC convened and, among other matters, discussed the above letter of the

ICANN President of February 11, 2006. Its Communique of March 28 states that the GAC

“does not believe that the February 11 letter provides sufficient detail regarding the rationale for the Board determination that the application [of ICM Registry] had overcome the deficiencies noted in the Evaluation Report. The Board would request a written explanation of the Board decision, particularly with regard to the sponsored community and public interest criteria outlined in the sponsored top level domain selection criteria.

“...ICM promised a range of public interest benefits as part of its bid to operate the .xxx domain. To the GAC’s knowledge, these undertakings have not yet been included as ICM obligations in the proposed .xxx Registry Agreement negotiated with ICANN.”

“The public policy aspects identified by members of the GAC include the degree to which the .xxx application would:

- Take appropriate measures to restrict access to illegal and offensive content;

- Support the development of tools and programs to protect vulnerable members of the community;

- Maintain accurate details of registrants and assist law enforcement agencies to identify and contact the owners of particular websites, if need be; and

“Without in any way implying an endorsement of the ICM application, the GAC would request confirmation from the Board that any contract currently under negotiation between ICANN and ICM Registry would include enforceable provisions covering all of ICM Registry’s commitments, and such information on the proposed contract being made available to member countries through the GAC.

“Nevertheless without prejudice to the above, several members of the GAC are emphatically opposed from a public policy perspective to the introduction of a .xxx sTLD.”

36. At the Board’s meeting in Wellington of March 31, 2006, a resolution was adopted by which it was:



“Resolved, the President and General Counsel are directed to analyze all publicly received inputs, to continue negotiations with ICM Registry, and to return to the Board with any recommendations regarding amendments to the proposed sTLD registry agreement, particularly to ensure that the TLD sponsor will have in place adequate mechanisms to address any potential registrant violations of the sponsor’s policies.” (C-184, p. 1.)

37. On May 4, 2006, Dr. Twomey sent a further letter to the Chairman and members of the GAC in response to the GAC’s request for information regarding the decision of the ICANN Board to proceed with several sTLD applications, notwithstanding negative reports from one or more evaluation teams. The following extracts are of interest:

“It is important to note that the Board decision as to the .XXX application is still pending. The decision by the ICANN Board during its 1 June 2005 Special Board Meeting reviewed the criteria against the materials supplied and the results of the independent evaluations. ...the board voted to authorize staff to enter into contractual negotiations without prejudicing the Board’s right to evaluate the resulting contract and to decide whether it meets all the criteria before the Board including public policy advice such as might be offered by the GAC. The final conclusion on the Board’s decision to accept or reject the .XXX application has not been made and will not be made until such time as the Board either approves or rejects the registry agreement relating to the .XXX application. In fact, it is important to note that the Board has reviewed previous proposed agreements with ICM for the .XXX registry and has expressed concerns regarding the compliance structures established in those drafts.

...

In some instances, such as with .XXX, while the additional materials provided sufficient clarification to proceed with contractual discussions, the Board still expressed concerns about whether the applicant met all of the criteria, but took the view that such concerns could possibly be addressed by contractual obligations to be stated in a registry agreement.” (C-188, pp. 1, 2.)

38. On May 10, 2006, the Board held a telephonic special meeting and addressed ICM’s by now Third Draft Registry Agreement. After a roll call, there were 9 votes against accepting the agreement and 5 in favor. Those

who voted against (including Board Chairman Cerf and President Twomey), in brief explanations of vote, indicated that they so voted because the undertakings of ICM could not in their view be fulfilled; because the conditions required by the GAC could not be met; because doubts about sponsorship remained and had magnified as a result of opposition from elements of the adult entertainment community; because the agreement's reference to "all applicable law" raised a wide and variable test of compliance and enforcement; and because guaranty of compliance with obligations of the contract was lacking. Those who voted in favor indicated that changing ICANN's position after an extended process weakens ICANN and encourages the exertions of pressure groups; found that there was sufficient support of the sponsoring community, while invariable support was not required; held it unfair to impose on ICM a complete compliance model before it is allowed to start, a requirement imposed on no other applicant; maintained that ICANN is not in the business and should not be in the business of judging content which rather is the province of each country, that ICANN should not be a "choke-point for content limitations of governments"; and contended that ICANN should avoid applying subjective and arbitrary criteria and should concern itself with the technical merits of applications. (C-189.) The vote of May 10, 2006 was not to approve the agreement as proposed "but it did not reject the application" of ICM (C-197.)

39. ICM Registry filed a Request for Reconsideration of Board Action on May 21, 2006, pursuant to Article IV, Section 2 of ICANN's Bylaws providing for reconsideration requests. (C-190.) However, after being informed by ICANN's general counsel that the Board would be prepared to consider still another revised draft agreement, ICM withdrew that request on October 29, 2006. Working as she had throughout in consultation with ICANN's staff, particularly its general counsel, Ms. Burr, on behalf of ICM, engaged in further negotiations with ICANN endeavoring to accommodate its requirements, demonstrate that the concerns raised by the GAC had been met to the extent possible, and provide ICANN with additional support for ICM's commitment to abide by the provisions of the proposed agreement. Among the materials provided, earlier and then, were a list of persons within the child safety community willing to serve on the board of IFFOR, commitments to enter into agreements with rating associations to provide tags for filtering .XXX websites and to monitor compliance with rules for the suppression of child pornography provisions, and data about a "pre-reservation service" for reservations for .XXX from webmasters operating adult sites on other ICANN-recognized top level domains. ICANN claimed to have registered more than 75,000 pre-reservations in the first six months that this service was publicly available. (Claimant's Memorial on the Merits,

pp. 138-139.) The proposed agreement was revised to include, *inter alia*, provision for imposing certain requirements on registrants; develop mechanisms for compliance with those requirements; create dispute resolution mechanisms; and engage independent monitors. ICM agreed to enter into a contract with the Family Online Safety Institute. The clause regarding registrants' obligations to comply with "all applicable law" was deleted because, in ICM's view, it had given rise to misunderstanding about whether ICANN would become involved in monitoring content. ICM maintains that, in the course of exchanges about making these revisions and preparing its Fourth Draft Registry Agreement, "ICANN never sought to have ICM attempt to re-define the sponsored community or otherwise demonstrate that it met any of the RFP criteria". (*Id.*, p. 141.)

40. On February 2, 2007, the Chairman and Chairman-Elect of the GAC wrote the Chairman of the ICANN Board, speaking for themselves and not necessarily for the GAC, as follows:

"We note that the Wellington Communique...requested clarification from the ICANN Board regarding its decision of 1 June 2005 authorising staff to enter into contractual negotiations with ICM Registry, despite deficiencies identified by the Sponsorship...Panel...we reiterate the GAC's request for a clear explanation of why the ICANN Board is satisfied that the .xxx application has overcome the deficiencies relating to the proposed sponsorship community.

"In Wellington, the GAC also requested confirmation from the ICANN Board that the proposed .xxx agreement would include enforceable provisions covering all of ICM Registry's commitments...

"...GAC members would urge the Board to defer any final decision on this application until the Lisbon meeting." (C-198.)

41. A special meeting of the ICANN Board on February 12, 2007, was held by teleconference. Consideration of the proposed .XXX Registry Agreement was introduced by Mr. Jeffrey, who asked the Board to consider (a) public comment on the proposed agreement (which had been posted by ICANN on its website) (b) advice proffered by the GAC and (c) "how ICM measures up against the RFP criteria" (C-199, p.1). He noted in relation to community input that since the initial ICM application over 200,000 pertinent emails had been sent to ICANN.

42. Rita Rodin, a new Board member, noted that she had not been on the Board at previous discussions of the ICM application, but based on her

review of the papers “she had some concerns about whether the proposal met the criteria set forth in the RFP. For example, she noted that it was not clear to her whether the sponsoring community seeking to run the domain genuinely could be said to represent the adult on-line community. However Rita requested that John Jeffrey and Paul Twomey confirm that this sort of discussion should take place during this meeting. She said that she did not want to reopen issues if they had already been decided by the Board.” (*Id.*, pp. 2-3.)

43. While there was no direct response to the foregoing request of Ms. Rodin, Dr. Cerf noted “that had been the subject of debate by the Board in earlier discussions in 2006...over the last six months, there seem to have been a more negative reaction from members of the online community to the proposal.” Rita Rodin agreed; “there seems to be a ‘splintering of support in the adult on-line community.” She was also concerned “that approval of this domain in these circumstances would cause ICM to become a de facto arbiter of policies for pornography on the Internet...she was not comfortable with ICANN saying to a self-defined group that they could define policy around pornography on the internet. This was not part of ICANN’s technical decision-making remit...” (*Id.*, p. 3) Dr. Twomey said that the Board needed to focus on whether there was a need for further public comment on the new version, the GAC comments, “and whether ICM had demonstrated to the Board’s satisfaction that it had met criteria against the RFP for sTLDs.” Dr. Cerf agreed that “the sponsorship grouping for a new TLD was difficult to define.”

44. Susan Crawford expressed the view that “no group can demonstrate in advance that they will meet the interests and concerns of all members in their community and that this was an unrealistic expectation to place on any applicant...if that test was applied to any sponsor group for a new sTLD, none would ever be approved.”

45. The Acting Chair conducted a “straw poll” of the Board as to whether members held “serious concerns” about the level of support for the creation of the domain from this sponsoring community. A majority indicated that they did, while a minority indicated that “it was an inappropriate burden to place on ICM to ensure that the entire adult online community was supportive of the proposed domain”. (*Id.*) The following resolution was unanimously adopted:

"Whereas a majority of the Board has serious concerns about whether the proposed .XXX domain has the support of a clearly-defined sponsored community as per the criteria for sponsored TLDs;

"Whereas a minority of the Board believed that the self-described community of sponsorship made known by the proponent of the .XXX domain, ICM Registry, was sufficient to meet the criteria for an sTLD.

"Resolved that:

- I. The revised version [now the fifth version of the draft agreement] be exposed to a public comment period of no less than 21 days, and
- II. ICANN staff consult with ICM and provide further information to the Board prior to its next meeting, so as to inform a decision by the Board about whether sponsorship criteria is [sic] met for the creation of a new .XXX sTLD." (*Id.*, p. 4.)

46. The Governmental Advisory Committee met in Lisbon on March 28, 2007 and issued "formal advice to the Board". It reaffirmed the Wellington Communique as "a valid and important expression of the GAC's views on .xxx. The GAC does not consider the information provided by the Board to have answered the GAC concerns as to whether the ICM application meets the sponsorship criteria." It called attention to an expression of concern by Canada that, with the revised proposed ICANN-ICM Registry agreement, "the Corporation could be moving towards assuming an ongoing management and oversight role regarding Internet content, which would be inconsistent with its technical mandate." (C-200, pp. 4, 5.) It also adopted "Principles Regarding New TLDs" which contain the following provision in respect of delegation of new gTLDs:

"2.5 The evaluation and selection procedure for new gTLD registries should respect the principles of fairness, transparency and non-discrimination. All applicants for a new gTLD registry should therefore be evaluated against transparent and predictable criteria, fully available to the applicants prior to the initiation of the process. Normally, therefore, no subsequent additional selection criteria should be used in the selection process." (*Id.*, p. 12.)

47. The climactic meeting of the ICANN Board took place in Lisbon, Portugal, on March 30, 2007. A resolution was adopted by a vote of nine to five, with one abstention (that of Dr. Twomey), whose operative paragraphs provide that:

"...the board has determined that

"ICM's application and the revised agreement failed to meet, among other things, the sponsored community criteria of the RFP specification.

"Based on the extensive public comment and from the GAC's communiqués, that this agreement raises public policy issues.

"Approval of the ICM application and revised agreement is not appropriate, as they do not resolve the issues raised in the GAC communiqués, and ICM's response does not address the GAC's concern for offensive content and similarly avoids the GAC's concern for the protection of vulnerable members of the community. The board does not believe these public policy concerns can be credibly resolved with the mechanisms proposed by the applicant.

"The ICM application raises significant law enforcement compliance issues because of countries' varying laws relating to content and practices that define the nature of the application, therefore obligating ICANN to acquire responsibility related to content and conduct.

"The board agrees with the reference in the GAC communiqué from Lisbon that under the revised agreement, there are credible scenarios that lead to circumstances in which ICANN would be forced to assume an ongoing management and oversight role regarding Internet content, which is inconsistent with its technical mandate.

Accordingly, it is resolved...that the proposed agreement with ICM concerning the .xxx sTLD is rejected and the application request for delegation of the .XXX sTLD is hereby denied."

48. Debate in the Board over adoption of the resolution was intense. Dr. Cerf, who was to vote in favor of the resolution (and hence against the ICM application) observed that he had voted in favor of proceeding to negotiate a contract.

"Part of the reason for that was to try to understand more deeply exactly how this proposal would be implemented, and seeing the contractual terms...would put much more meat on the bones of the initial proposal. I have been concerned about the definition of 'responsible'...there's uncertainty in my mind about what behavioral

patterns to expect...over time, the two years that we've considered this, there has been a growing disagreement within the adult content community as to the advisability of this proposal. As I looked at the contract...the mechanisms for assuring the behavior of the registrants in this top-level domain seemed, to me, uncertain. And I was persuaded ... that there were very credible scenarios in which the operation of IFFOR and ICM might still lead to ICANN being propelled into responding to complaints that some content on some of the registered .xxx sites didn't somehow meet the expectations of the general public this would propel ICANN and its staff into making decisions or having to examine content to decide whether or not it met the IFFOR criteria ... I would also point out that the GAC has raised public policy concerns about this particular top level domain." (C-201, p. 6.)

49. Rita Rodin said that she did not believe

"that this is an appropriate sponsored community...it's inappropriate to allow an applicant in any sTLD to simply define out ...any people that are not in favor of this TLD..as irresponsible...this will be an enforcement headache...for ICANN..way beyond the technical oversight role of ICANN's mandate...there's porn all over the Internet and...there isn't a mechanism with this TLD to have it all exclusively within one string to actually effect some of the purposes of the TLD...to be responsible with respect to the distribution of pornography, to prevent child pornography on the Internet..." (*id.*, p. 7.)

50. Peter Dengate Thrush, who favored acceptance of the ICM contract, voted against the resolution. On the issue of the sponsored community,

"there is on the evidence a sufficiently identifiable, distinct community which the TLD could serve. It's the adult content providers wanting to differentiate themselves by voluntary adoption of this labeling system. It's not affected ... by the fact that that's a self-selecting community...or impermanence of that community...This is the first time in any of these sTLD applications that we have had active opposition. And we have no metrics...to establish what level of opposition by members of the potential community might have caused us concern...the resolution I am voting against is particularly weak on this issue. On why the board thinks this community is not sufficiently identified. No fact or real rationale are provided in the resolution, and...given the considerable importance that the board has placed on this...and the cost and effort that the applicant has gone to answer the

board's concern demonstrating the existence of a sponsored community...this silence is disrespectful to the applicant and does a disservice to the community...I've also been concerned ... about the scale of the obligations accepted by the applicant...some of those have been forced upon them by the process..in the end I am satisfied that the compliance rules raise no new issues in kind from previous contracts. And I say that if ICANN is going to raise this kind of objection, then it better think seriously of getting out of the business of introducing new TLDs ... I do not think that this contract would make ICANN a content regulator..." (*Id.*, pp. 7-8.)

51. Njeri Ronge stated that, in addition to the reasons stated in the resolution, "the ICM proposal will not protect the relevant or interested community from the adult entertainment Web sites by a significant percentage; ... the ICM proposal focuses on content management which is not in ICANN's technical mandate." (*Id.*, p. 8.)

52. Susan Crawford dissented from the resolution, which she found "not only weak but unprincipled".

"I am troubled by the path the board has followed on this issue...ICANN only creates problems for itself when it acts in an ad hoc fashion in response to political pressures. ICANN...should resist efforts by governments to veto what it does...The most fundamental value of the global Internet community is that people who propose to use the Internet protocols and infrastructures for otherwise lawful purposes, without threatening the operational stability or security of the Internet, should be presumed to be entitled to do so. In a nutshell, everything not prohibited is permitted. This understanding...has led directly to the striking success of the Internet around the world. ICANN's role in gTLD policy development is to seek to assess and articulate the broadly shared values of the Internet community. We have very limited authority. I am personally not aware that any global consensus against the creation of a triple X domain exists. In the absence of such a prohibition, and given our mandate to create TLD competition, we have no authority to block the addition of this TLD to the root. It is very clear that we do not have a global shared set of values about content on line, save for the global norm against child pornography. But the global Internet community clearly does share the core value that no centralized authority should set itself up as the arbiter of what people may do together on line, absent a demonstration that most of those affected by the proposed activity agree that it should be banned...the



fact is that ICANN evaluated the strength of the sponsorship of triple X, the relationship between the applicant and the community behind the TLD, and...concluded that this criteria [sic] had been met as of June 2005. ICANN then went on to negotiate specific contractual terms with the applicant. Since then, real and AstroTurf comments – that’s an Americanism meaning filed comments claiming to be grass roots opposition that have actually been generated by organized campaigns – have come into ICANN that reflect opposition to this application. I do not find these recent comments sufficient to warrant revisiting the question of the sponsorship strength of this TLD which I personally believe to be closed. No applicant for any sponsored TLD could ever demonstrate unanimous, cheering approval for its application. We have no metric against which to measure this opposition....We will only get in the way of useful innovation if we take the view that every new TLD must prove itself to us before it can be added to the root...what is meant by sponsorship...is that there is enough interest in a particular TLD that it will be viable. We also have the idea that registrants should participate in and be bound by the creation of policies for a particular string. Both of these requirements have been met by this applicant. There is clearly enough interest, including more than 70,000 preregistrations from a thousand or more unique registrants who are member of the adult industry, and the applicant has undertaken to us that it will require adherence to its self-regulatory policies by all of its registrants...Many of my fellow board members are undoubtedly uncomfortable with the subject of adult entertainment material. Discomfort may have been sparked anew by first the letter from individual GAC members...and second the letter from the Australian Government. But the entire point of ICANN's creation was to avoid the operation of chokepoint control over the domain name system by individual or collective governments. The idea was the U.S. would serve as a good steward for other governmental concerns by staying in the background and...not engaging in content-related control. Australia’s letter and concerns expressed...by Brazil and other countries about triple X are explicitly content-based and, thus, inappropriate...If after the creation of a triple X TLD certain governments of the world want to ensure that their citizens do not see triple X content, it is within their prerogative as sovereigns to instruct Internet access providers physically located within their territory to block such content...But content-related censorship should not be ICANN's concern...To the extent there are public policy concerns with this TLD, they can be dealt with through local laws.” (*Id.*, pp. 9-11.)

53. Demi Getschko declared that her vote in favor of the resolution was her own decision "without any kind of pressure". (*Id.*, p. 12.) Alejandro Pisanty denied that "the board has been swayed by political pressure of any kind" and affirmed that, "ICANN has acted carefully and strictly within the rules." He accepted "that there is no universal set of values regarding adult content other than those related to child pornography...the resolution voted is based precisely on that view, not on any view of content itself." (*Id.*

### PART THREE: THE ARGUMENTS OF THE PARTIES

#### *The Contentions of ICM Registry*

54. ICM Registry contends that (a) the Independent Review Process is an arbitration; (b) that Process does not afford the ICANN Board a "deferential standard of review"; (c) the law to be applied by that Process comprises the relevant principles of international law and local law, *i.e.*, California law, and that the particularly relevant principle is good faith; (d) in its treatment and rejection of the application of ICM Registry, ICANN did not act consistently with its Articles of Incorporation and Bylaws.

#### *The Nature of the Independent Review Process*

55. In respect of the nature of the Independent Review Process, ICM, noting that these proceedings are the first such Process brought under ICANN's Bylaws, maintains that they are arbitral and not advisory in character. It observes that the current provisions governing the Independent Review Process were added to the Bylaws in December 2002 partly as a result of international and domestic concern about ICANN's lack of accountability. It recalls that ICANN's then President, Stuart Lynn, announced in a U.S. Senate hearing in 2002 that ICANN planned to "strengthen ... confidence in the fairness of ICANN decision-making through... creating a workable mechanism for speedy independent review of ICANN Board actions by experienced arbitrators..." (Claimant's Memorial on the Merits, p. 162). His successor, Dr. Twomey, stated to a committee of the U.S. House of Representatives in 2006 that, "ICANN does have well-established principles and processes for accountability in its decision-making and in its bylaws...there is ability for appeal to...independent arbitration." (*Id.*, p. 163.) Article IV, Section 3, of ICANN's Bylaws provides that: "The IRP shall be operated by an international arbitration provider appointed from time to time by ICANN...using arbitrators...nominated by that provider." Pursuant to that provision, ICANN appointed the International Centre for Dispute Resolution ("ICDR") of the American Arbitration Association as the international arbitration provider

(which in turn appointed the members of the instant Independent Review Panel). The term "arbitration" imports the binding resolution of a dispute. Courts in the United States – including the Supreme Court of California – have held that the term "arbitration" connotes a binding award. (*Id.*, pp. 168-169.) Article 27(1) of the ICDR Rules provides that "[a]wards...shall be final and binding on the parties. The parties undertake to carry out any such award without delay." (C-11.) The Supplementary Procedures for Internet Corporation for Assigned Names and Numbers (ICANN) Independent Review Process specify that "the ICDR's International Arbitration Rules...will govern the Process in combination with these Supplementary Procedures." They provide that the "Independent Review Panel (IRP) refers to the neutral(s) appointed to decide the issue(s) presented." "The Declaration shall specifically designate the prevailing party." (C-12.) In view of all of the foregoing, ICM maintains that the IRP is an arbitral process designed to produce a decision on the issues that is binding on the parties.

*The Standard of Review is Not Deferential*

56. ICM also maintains that, contrary to the position now advanced by counsel for ICANN, ICANN's assertion that the Panel must afford the ICANN Board "a deferential standard of review" has no support in the instruments governing this proceeding. The term "independent review" connotes a review that is not deferential. Both Federal law and California law treat provision for an independent review as the equivalent of *de novo* review. In California law, when an appellate court employs independent, *de novo* review, it generally gives no special deference to the findings or conclusions of the court from which appeal is taken. (Claimant's Memorial on the Merits, with citations, pp. 173-174.) ICANN's reliance on the "business judgment rule" and the related doctrine of "judicial deference" under California law is misplaced, because under California law the business judgment rule is employed to protect directors from personal liability (typically in shareholder suits) when the directors have made good faith business decisions on behalf of the corporation. The IRP is not a court action seeking to impose individual liability on the ICANN board of directors. Rather, this is an Independent Review Process with the specific purpose of declaring "whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws." As California courts have explicitly stated, "the rule of judicial deference to board decision-making can be limited ... by the association's governing documents." The IRP, to quote Dr. Twomey's testimony before Congress, is a process meant to establish a "final method of accountability."

The notion now advanced on behalf of ICANN, that this Panel should afford the Board “a deferential standard of review” and only “question” the Board’s actions upon “a showing of bad faith” is at odds with that purpose as well as with the plain meaning of “independent review”. (*Id.*, pp. 176-177.)

*The Applicable Law of this Proceeding*

57. Article 4 of ICANN’s Articles of Incorporation provides that, “The Corporation shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with the relevant principles of international law and applicable international conventions and local law...” (C-4). The prior version of the draft Articles had provided for ICANN’s “carrying out its activities with due regard for applicable local and international law”. This language was regarded as inadequate, and was revised, as the then Interim Chairman of ICANN explained, “to mak[e] it clear that ICANN will comply with relevant and applicable international and local law”. (*Id.*, p. 180.) As ICANN’s President testified in the U.S. Congress in 2003, the International Review Process was put in place so that disputes could “be referred to an independent review panel operated by an international arbitration provider with an appreciation for and understanding of applicable international laws, as well as California not-for-profit corporation law.” (*Id.*, p. 182.) According to the Expert Report of Professor Jack Goldsmith, on which ICM relies:

“...in an attempt to bring accountability and thus legitimacy to its decisions, ICANN (a) assumed in its Articles of Incorporation an obligation to act in conformity with ‘relevant principles of international law’ and (b) in its Bylaws extended to adversely affected third parties a novel right of independent review in this arbitration proceeding for consistency with ICANN’s Articles and Bylaws. The parties have agreed to international arbitration in this forum to determine consistency with the international law standards set forth in Article 4 of the Articles of Incorporation. California law allows a California non-profit corporation to bind itself in this way.” (*Id.*, p. 11.)

In ICM’s view, Article 4 of ICANN’s Articles of Incorporation acts as a choice-of-law provision. It notes that Article 28 of the ICDR Arbitration Rules specifically provides that “the Tribunal shall apply the substantive law(s) or rules of law designated by the parties as applicable to this dispute.” (C-11.) It points out that the choice of a concurrent law clause – as in ICANN’s Articles providing for the application of relevant principles of both

international and domestic law – is not unusual, especially in transactions involving a public resource.

58. Professor Goldsmith observes that: "... "principles of international law and applicable international conventions and local law" refers to three types of law. Local law means the law of California. Applicable international conventions refers to treaties. "The term 'principles of international law' includes general principles of law. Given that the canonical reference to the sources of international law is Article 38 of the Statute of the International Court of Justice, which lists international conventions, customary international law, and "the general principles of law recognized by civilized nations", the reference to "principles of international law" in ICANN's Articles must refer to customary international law and to the general principles of law. (Expert Report, p. 12.) Professor Goldsmith notes that the Iran-United States Claims Tribunal has interpreted the "principles of commercial and international law" to include the general principles of law. ICSID tribunals similarly have interpreted "the rules of international law" to include general principles of law.

"It is perfectly appropriate to apply general principles in this IRP even though ICANN is technically a non-profit corporation and ICM is a private corporation. ICANN voluntarily subjected itself to these general principles in its Articles of Incorporation, something that both California law permits and that is typical in international arbitrations, especially when public goods are at stake. The 'international' nature of this arbitration – ... is evidenced by the global impact of ICANN's decisions...ICANN is only nominally a private corporation. It exercises extraordinary authority, delegated from the U.S. Government, over one of the globe's most important resources...its control over the Internet naming and numbering system does make sense of its embrace of the 'general principles' standard. While there is no doubt that ICANN can and has bound itself to general principles of law as that phrase is understood in international law... the general principles relevant here complement, amplify and give detail to the requirements of independence, transparency and due process that ICANN has otherwise assumed in its Articles and Bylaws and under California law. General principles thus play their classic supplementary role in this proceeding." (*Id.*, pp. 15-16.)

59. Professor Goldsmith continues: "The general principle of good faith is 'the foundation of all law and all conventions'" (quoting the seminal work of Bin Cheng, *General Principles of Law as Applied by International Courts and*

*Tribunals*, p. 105). "As the International Court of Justice has noted, 'the principle of good faith is a well established principle of international law'". (*Case concerning the Land and Maritime Boundary between Cameroon and Nigeria, Preliminary Objections, Judgment, I.C.J. Reports 1998*, p. 296, with many citations.) Applications of the principle are "the requirement of good faith in complying with legal restrictions" and "the requirement of good faith in the exercise of discretion, also known as the doctrine of non-abuse of rights..." as well as the requirement of good faith in contractual negotiations. (*Id.*, pp. 17-18.) The principle is "equally applicable to relations between individuals and to relations between nations." (Cheng, *loc. cit.*).

60. Professor Goldsmith maintains that the abuse of right alleged by ICM that is

"most obvious is the clearly fictitious basis ICANN gave for denying ICM's application...the concern about 'law enforcement compliance issues because of countries' varying laws relating to content and practices that define the nature of the application' applies to many top-level domains besides .XXX. The website 'pornography.com' would be no less subject to various differing laws around the world than the website 'pornography.xxx.' ...a website on the .XXX domain is *easier* for nations to regulate and exclude from computers in their countries because they can block all sites on the .XXX domain with relative ease but have to look at the content, or make guesses based on domain names, to block unwanted pornography on .COM and other top level domains. In short, this reason for ICANN's denial, if genuine, would extend to many top-level domains and would certainly apply to all generic top-level domains (like .COM, .INFO, .NET and .ORG) where pornographic sites can be found. But ICANN has only applied this reason for denial to the .XXX domain. This strongly suggests that the reasons for the denial are pretextual and thus the denial is an abuse of right..."

61. Professor Goldsmith further argues that "similarly pretextual is ICANN's claim that 'there are credible scenarios that leads to circumstances in which ICANN would be forced to assume an ongoing management and oversight role regarding Internet content.'" He contends that the scenario is "unlikely", but, more importantly, "*the same logic applies to generic top level domains* like .COM. The identical scenario could arise if a national court ordered...the registry operator for .COM...to shut down one of the hundreds of thousands of pornography sites on .COM. But ICANN has only expressed concern about ICM..."

ICANN Did Not Act Consistently with its Articles of Incorporation and Bylaws

62. ICM Registry contends that ICANN failed to act consistently with its Articles of Incorporation and Bylaws in the following respects.

63. ICANN, ICM maintains, conducted the 2004 Round of applications for top-level domains as a two-step process, in which it was first determined whether or not each applicant met the RFP criteria. If the criteria were met, "upon the successful completion of the sTLD process" (ICANN Board resolution of October 31, 2003, C-78), the applicant then would proceed to negotiate the commercial and technical terms of a registry agreement. (This Declaration, paras. 13-16, *supra*.) The RFP included detailed description of the criteria to be met to enable the applicant to proceed to contract negotiations, and specified that the selection criteria would be applied "based on principles of objectivity, non-discrimination and transparency". (C-45.) On June 1, 2005, the ICANN Board concluded that ICM had met all of the RFP criteria - financial, technical and sponsorship - and authorized ICANN's President and General Counsel to enter into negotiations over the "commercial and technical terms" of a registry agreement with ICM. "The record evidence in this case demonstrates overwhelmingly that when the Board approved ICM to proceed to contract negotiations on 1 June 2005, the Board concluded that ICM had met all of the RFP criteria - including, specifically, sponsorship." (Claimant's Post-Hearing Submission, p. 11.) While ICANN now claims that the sponsorship criterion remained open, and that the Board's resolution of June 1, 2005, authorized negotiations in which whether ICM met sponsorship requirements could be more fully tested, ICM argues that no credible evidence, in particular, no contemporary documentary evidence, supports these contentions. To the contrary, ICM:

- (a) recalls that ICANN's written announcement of applications received provided: "The applications will be reviewed by independent evaluation teams beginning in May 2004. The criteria for evaluation were posted with the RFP. All applicants that are found to satisfy the posted criteria will be eligible to enter into technical and commercial negotiations with ICANN for agreements for the allocation and sponsorship of the requested TLDs." (C-82.)

- (b) emphasizes that ICANN's Chairman of the Board, Dr. Cerf, is recorded in the GAC's Luxembourg minutes as stating, shortly after the adoption of the June 1, 2005, resolution, that the application of .xxx "this time met the three main criteria, financial, technical and sponsorship". Sponsorship was

extensively discussed "and the Board reached a positive decision considering that ICANN should not be involved in content matters." (C-139; *supra*, para. 22.)

- (c) notes that a letter of ICANN's President of February 11, 2006. states that: "...it is the ICANN Board that has the authority to decide, upon the conclusion of technical and commercial negotiations, whether or not to approve the creation of a new sTLD...Responsibility for resolving issues relating to an applicant's readiness to proceed to technical and commercial negotiations...rests with the Board." (*Supra*, paragraph 33.)

- (d) notes that the GAC's Wellington Communique states, in respect of a letter of February 11, 2006 of ICANN's President, that the GAC "does not believe that the February 11 letter provides sufficient detail regarding the rationale for the Board determination" that ICM's application "had overcome the deficiencies noted in the Evaluation Report". (*Supra*, paragraph 35.)

- (e) stresses that the ICANN Vice President in charge of the Round, Kurt Pritz, whom ICANN chose not to call as a witness in the hearing, stated in a public forum meeting in April 2005 that: "If it was determined that an application met those three baseline criteria, technical, commercial and sponsorship community, they, then, were informed that they would enter into a phase of commercial and technical negotiation with ICANN, the culmination of those negotiations is and was intended to result in the designation of the new top-level domain. At the conclusion of that, we would sign agreements that would be forwarded to the Board for their approval." (C-88.)

- (f) recalls that Dr. Pritz stated in Luxembourg that ICM was among the "applicants that have been found to satisfy the baseline criteria and they're presently in negotiation for the designation of registries..." (C-140, p. 28).

- (g) observes that the General Counsel of ICANN, Mr. Jeffery, in an exchange with Ms. Burr acting as counsel of ICM, accepted a draft press release in respect of the June 1, 2005 resolution stating that, "ICANN's board of directors today determined that the proposal for a new top level domain submitted by ICM Registry meets the criteria established by ICANN." (C-221.)

- (h) reproduces a Fox News Internet story of June 2, 2005, captioned, "Internet Group OKs New Suffix for Porn Sites," which cites ICANN spokesman Kieran Baker as saying that adult oriented sites, a \$12 billion industry, "could begin buying .xxx addresses as early as fall or winter depending on ICM's plans." (C-283.)



- (i) recalls that a member of the Board when the June 1, 2005 resolution was adopted, Joicho Ito, posted on his blog the next day that "the .XXX proposal, in my opinion, has met the criteria set out in the RFP. Our approval of .XXX is a decision based on whether .XXX met the criteria and does not endorse or condone any particular type of content or moral belief." (Burr Exhibit 35.)

ICM argues that ICANN's witnesses had no response to the foregoing evidence, other than to say that they could not remember or had not seen it (testimony of Dr. Cerf, Tr. 615:18-21, 660:9-12, 675:3-16; Testimony of Dr. Twomey, 914: 4-11, 915:2-11).

64. Dr. Cerf testified at the hearing that,

"At the point where the question arose whether we should proceed or could proceed to contract negotiation, in the absence of having decided that the sponsorship criteria had been met, the board consulted with counsel [the General Counsel, Mr. Jeffery] and my recollection of this discussion is that we could leave undetermined and undecided the question of sponsorship and could use the discussions with regard to the contract as a means of exposing and understanding more deeply whether the sponsorship criteria had been or could be adequately met...prior to the board vote on the question, should we proceed to contract, this question was raised, and it was my understanding that we were not deciding the question of sponsorship. We were using the contract negotiations as a means of clarifying whether or not...the sponsorship criteria could be or had been met or would be met..." (Tr. 600:6-18, 601: 1-8).

65. ICM however claims that Dr. Cerf's testimony "is flatly contradicted by the numerous contemporaneous statements of ICANN Board members and officials that ICM had, in fact, met the criteria, including Dr. Cerf's own contemporaneous statement to the GAC in Luxembourg..." (Claimant's Post-Hearing Submissions, p. 14.) ICM maintains that there is no contemporary documentary evidence that sustains Dr. Cerf's recollection. Nor did ICANN present Mr. Jeffery as a witness, despite his presence in the hearing room. No mention of reservations about sponsorship is to be found in the June 1, 2005 resolution; it contains no caveats, unlike the resolutions adopted in respect of the applications for .JOBS and .MOBI adopted by the Board in 2004.

66. ICANN further argues, ICM observes, that the June 1, 2005, resolution provides that the contract would be entered into "if" the parties were able to negotiate "commercial and technical terms"; therefore ICM should have known that all other issues also remained open. But, responds ICM, "Complete silence on an issue -- when other issues are specifically mentioned -- does not create ambiguity on the missing issue. It means that the missing issue is no longer an issue." (*Id.*, pp. 15-16.)

67. Shortly after adoption of the June 1, 2005 resolution, contract negotiations commenced. As predicted by Mr. Jeffrey in a June 13, 2005, email to Ms. Burr, the negotiations were "quick" and "straightforward". (C-150.) Agreement on the terms of a registry contract was reached between them by August 1, 2005. That draft registry agreement was posted on the ICANN website on August 9, 2005. The Board was scheduled to discuss it at a meeting to be held on August 16.

68. But then came the intervention of the U.S. Department of Commerce described *supra*, paragraphs 27 and 29. ICM argues that it is remarkable that the U.S. Government responded in the way it did to a lobbying campaign largely generated by the website of the Family Research Council. "What is even more remarkable is the extent to which ICANN altered its course of conduct with respect to ICM in response to the U.S. government's intervention." ICM contends that: "The unilateral intervention by the U.S. government was entirely inappropriate and ICANN knew it. But rather than adhere to the principles of its Articles and Bylaws, ICANN quickly bowed to the U.S. intervention, and, at the same time tried to conceal it." (Claimant's Post-Hearing Submission, p. 27.) The charge of concealment relates to Dr. Twomey's having "suggested" to the Chairman of the GAC that he write to ICANN requesting delay in considering the draft contract with ICM (*supra*, paragraph 28). Dr. Twomey acknowledged at the hearing that he so suggested but explained that the letter was nothing more than a confirmation of what Board members had heard weeks before from the GAC in Luxembourg. (Tr. 856:8-19, 859:1-12, 861:10-20, and *supra*, paragraphs 21-25.)

69. ICM invokes the witness statement provided by the chair of the Sponsorship Evaluation Team, Dr. Williams, who, as a fellow Australian, had a close working relationship with Dr. Twomey. She wrote that:

"The June 2005 vote should have marked the completion of the substantive discussions of the .XXX application, especially in light of the Board resolution that approved the .XXX application with no

reservations or caveats. Instead, following the vote, the ICANN Governmental Advisory Committee 'woke up' to the .XXX application, and ICANN began to feel pressure from a number of governments, especially from the United States and Australia...An open dispute with the United States would have been very damaging to ICANN's credibility, and it was therefore very difficult to resist pressure from the United States...Dr. Twomey expressed to me his anxiety about the .XXX registry agreement as a result of this [Gallagher] intervention. This concern went to the heart of ICANN's legitimacy as a quasi-independent technical regulatory organization with the power to establish the process by which new TLDs could be created and put on the root. If the United States Government disagreed with ICANN's process or decision at any point and did not enter a TLD accepted by ICANN to the root, it would call into question ICANN's authority, competence, and entire reason for existence." (Witness Statement of Elizabeth Williams, pp. 26-28.)

70. ICM points out that the Wellington Communique of the GAC (*supra*, paragraph 35) referred to "the Board determination that the [ICM] application had overcome the deficiencies noted in the Evaluation Report." ICM maintains that, at ICANN's staff prompting, ICM responded to all of the concerns raised in the GAC's Wellington Communique. Thus, the Third Draft Registry Agreement of April 18, 2006, included commitments of ICM to establish policies and procedures to label the sites on the domain, to use automated tools to detect and prevent child pornography, to maintain accurate lists of registrants and assist law enforcement agencies to identify and contact the owners of particular sites, and to ensure the intellectual property and trademark rights, personal names, country names, names of historical, cultural and religious significance and names of geographic identifiers, drawing on domain name registry best practices (C-171).

71. ICM construes a statement of Dr. Cerf at the hearing as indicating that the reason, or a reason, why ICM ultimately did not obtain a registry agreement was that ICM could not provide adequate solutions "to deal with the problem of pornography on the Net". It counters that ICM had never undertaken to "deal with" or solve "the problem of pornography on the Net". "The purpose of .XXX was to create an sTLD where responsible adult content providers would agree, *inter alia*, to submit to technological tools to help tag and filter their sites; allow their sites to be 'crawled' for indicia of child pornography (real or virtual); and otherwise adhere to best practices for responsible members of the industry (including practices to prevent credit card fraud, spam, misuse of personal data, the sending of unsolicited

promotional email, the 'capture' of visitors to their sites, *etc.*).” (Claimant’s Post-Hearing Submission, p. 42.) However, Dr. Twomey seized on a phrase in the Wellington Communique “in order to impose an impossible burden on ICM.” According to ICM, Dr. Twomey asserted that “the GAC was now insisting that ICM be responsible for ‘enforcing restrictions’ around the world on access to illegal and offensive content.” (*Id.*, pp. 42-43.) But, ICM argues, to the extent that the GAC was requesting ICM to enforce restrictions on illegal and offensive content, ICANN was

“not merely acting outside its mission. It was also imposing a requirement on ICM that had never been imposed on any other registrant for any other top level domain, and that, indeed, no registrant could possibly fulfil. .COM, for example, is unquestionably filled with content that is considered ‘illegal and offensive’ in many countries. Some of its content is considered ‘illegal and offensive’ in all countries. Adult content can be found on numerous other TLDs...Dr. Cerf had told the GAC in Luxembourg in July 2005, when he was explaining the Board’s determination that ICM had met the RFP criteria: ‘to the extent that governments do have concerns they relate to the issues across TLDs.’ ICANN has never suggested that the registries for those other TLDs must ‘enforce’ restrictions on access to illegal or offensive content for sites on their TLDs.” (*Id.*, pp. 43-44.)

72. ICM adds that if “the GAC was in fact asking ICANN to impose such an absurd requirement on ICM, then ICANN should have told the GAC that it could not do so.” The GAC is no more than an advisory body supposed to provide “advice” on a “timely” basis. “ICANN is by no means under any obligation to do whatever the GAC tells it to do.” Indeed, ICANN’s Bylaws specifically contemplate that the Board may decide not to follow the GAC’s advice. (*Id.*, p. 44.)

73. ICM invokes the terms of the Bylaws, Section 2(1)(j), which provide that:

“The advice of the Governmental Advisory Committee on public policy matters shall be duly taken into account, both in the formulation and adoption of policies. In the event that the ICANN Board determines to take an action that is not consistent with the Governmental Advisory Committee advice, it shall so inform the Committee and state the reasons why it decided not to follow that advice. The Governmental Advisory Committee and the ICANN Board will then try, in good faith and in a timely and efficient manner, to find a mutually acceptable solution. If no such solution can be found, the ICANN Board will state

in its final decision the reasons why the Governmental Advisory Committee's advice was not followed, and such statement will be without prejudice to the rights or obligations of Governmental Advisory Committee members with regard to public policy issues falling within their responsibilities." (C-5, and *supra*, paragraph 9.)

74. ICM further argues however that Dr. Twomey's reading of the Wellington Communique was not a reasonable one. The Wellington Communique recalls that "ICM promised a range of public interest benefits as part of its bid to operate the .xxx domain...The public policy aspects identified by members of the GAC include the degree to which .xxx application would: Take appropriate measures to restrict access to illegal and offensive content..." (*Id.* p. 45; C-181). As promised in its application, ICM in fact proposed numerous measures to restrict access to illegal and offensive content. But nowhere did the GAC state that ICM should be responsible for "enforcing" the restrictions of countries on access to illegal and offensive content. ICM argues that the very fact that the GAC wanted ICM to "maintain accurate details of registrants and assist law enforcement agencies to identify and contact the owners of particular websites" (C-181, p. 3) demonstrates that the GAC did *not* expect ICM to enforce various national restrictions on access to illegal and offensive content.

75. The numerous measures that ICM set out in its revised draft registry agreement in consultation with the staff of ICANN did not constitute an agreement or "representation to enforce the laws of the world on pornography" (testimony of Ms. Burr, Tr. 1044: 8-9). Actually the activation of an .XXX TLD would make it far easier for governments to restrict access to content that they deemed illegal or offensive. Indeed, as Dr. Cerf told the GAC in Luxembourg in July 2005 in defending ICANN's agreeing to enter into contract negotiations with ICM, "The TLD system is neutral, although filtering systems could be solutions promoted by governments." (C-139, p. 5.) "In other words," ICM argues, "the appropriate place for restricting access to content deemed illegal or offensive by any particular country is within that particular country. ICM offered far more tools for countries to effectuate such restrictions than have ever existed before. Thus, ICM provided 'appropriate measures to restrict access to illegal and offensive content.'" (Claimant's Post-Hearing Submission, p. 47.)

76. ICM alleges that, "Nonetheless, on 10 May 2006, the ICANN Board proceeded to reject ICM's registry agreement because, in Dr. Twomey's words, ICM had not demonstrated how it would 'ensure enforcement of these contractual terms' as they relate to various countries' individual laws

'concerning pornographic content' [citing C-189, p.6]. In other words, ICM's draft registry agreement was rejected on the basis of its inability to comply with a contractual undertaking to which it had never agreed in the first place." (*Id.*, p. 48.)

77. At that same meeting of the Board, Dr. Twomey drew attention to a letter of May 4, 2006 from Martin Boyle, UK Representative to the GAC, which read as follows:

"The discussions held by the Governmental Advisory Committee in Wellington in March have highlighted some of the key concerns, and strong opposition by some administrations, to the application for a new top-level domain for pornographic content, dot.xxx. I thought that it would be helpful to follow up those discussions by submitting directly to the ICANN Board the views of the UK Government. In preparing these views, we have consulted a number of stakeholders in the UK, including Internet safety groups...

"Having examined the proposal in detail, and recognizing ICANN's authority to grant such domain names, the UK expresses its firm view that if the dot .xxx domain name is to be authorized, it would be important that ICANN ensures that the benefits and safeguards proposed by the registry, ICM, including the monitoring of all dot.xxx content and rating of content on all servers pointed to by .xxx, are genuinely achieved from day one. Furthermore, it will be important to the integrity of ICANN's position as final approving authority for the dot.xxx domain name, to be seen as able to intervene promptly and effectively if for any reason failure on the part of ICM in any of these fundamental safeguards becomes apparent. It would also in our view be essential that ICM liaise with the relevant bodies in charge of policing illegal Internet content at national level, such as the Internet Watch Foundation (IWF) in the UK, so as to ensure the effectiveness of the solutions it proposes to avoid the further propagation of illegal content. Specifically, ICM should undertake to monitor all dot.xxx content as it proposed and cooperate closely with IWF and equivalent agencies.

"This is an important decision that the ICANN Board has to take and whatever you decide will probably attract criticism from one quarter or another. This makes it all the more important that in making a decision, you reach a clear view on the extent to which the benefits which ICM claim are likely to be sustainable and reliable." (C-182.)

78. Dr. Twomey said this about Mr. Boyle's position:

"...the contractual terms put forward by ICM to meet the sorts of public-policy concerns raised by the Governmental Advisory Committee in my view are very difficult to implement, and I retain concerns about their ability to actually be implemented in an international environment where the important phrase, 'all applicable law', would raise a very wide and variable test for enforcement and compliance. And I can't see how that will actually be achieved under the contract. The letter from the UK is an indication of the expectations of the international governmental community to ensure enforcement of these contractual terms as they individually interpret them against their own law concerning pornographic content. This will put ICANN in an untenable position." (C-189, p. 6.)

79. ICM contends that "it is impossible to reconcile the points made in Mr. Boyle's letter - *i.e.*, that ICANN should ensure that ICM delivered from "day one" on the 'benefits and safeguards' promised in its contract, and that ICM should liase with the IWF - as a requirement 'to ensure enforcement of the contractual terms as they each individually interpret them against their own law concerning pornographic content'. And even if Mr. Boyle had been making such a demand, it would have been entirely outside ICANN's mandate to impose it on ICM, and would have imposed a requirement on ICM that it has never imposed on any other registry." (Claimant's Post-Hearing Submission, p. 50.)

80. ICM however acknowledges that other members of the Board shared Dr. Twomey's analysis. It concludes that:

"...the ICANN Board was now imposing a requirement that was outside the mission of ICANN; that had never been imposed on any other registry; and that - had it been included in the RFP - would have kept any applicant from applying for an sTLD dealing with adult content." (*Id.*, p. 51.)

81. ICM observes that, following the ICANN Board's rejection of the ICM registry agreement on May 10, 2006, and then its renewed consideration of it after ICM withdrew its request for reconsideration (*supra*, paragraph 39), ICM responded to further requests of ICANN staff. It agreed to conclude a contract with what is now known as the Family Online Safety Institute ("FOSI") specifying that FOSI was "to use an automated tool to scan" the .XXX domain and develop other ways to monitor ICM's compliance with its

commitments. ICM notes that, throughout the entire negotiation process, the ICANN staff never asked ICM to change the definition of the sponsored community, which remained the same though each of the five renderings of the draft registry agreement.

82. At the Board's meeting of February 12, 2007, the question of the solidity of ICM's sponsorship was re-opened – in ICM's view, inappropriately --- as described above (*supra*, paragraphs 41-45 and C-199). ICM argues that the data that it responsively submitted to the ICANN Board in March 2007 demonstrated that its application met the RFP standard of "broad-based support from the community". 76,723 adult website names had been pre-reserved in .XXX since June 1, 2005; 1,217 adult webmasters from over 70 countries had registered on the ICM Registry website, saying that they supported .XXX. But, ICM observes, none of the Board members voting against acceptance of ICM's application at the dispositive meeting of March 30, 2007, mentioned the extensive evidence provided by ICM in support of sponsorship.

83. For the reasons set forth above in paragraphs 63-82, ICM contends that the Board's rejection of its application was not consistent with ICANN's Articles of Incorporation and Bylaws. As regards the five specific reasons for rejection set forth in the Board's resolution of March 30, 2007 (*supra*, paragraph 47), ICM makes the following allegations of inconsistency.

84. Reason 1: ICM's application and revised agreement fail to meet the sponsored community criteria of the RFP specification. ICM responds that the Board concluded by its resolution of June 1, 2005, that ICM had met the RFP's sponsorship criteria; and that the Board's abandonment of the two-step process and its reopening of sponsorship at the eleventh hour, and only in respect of ICM's application, violated ICANN's Articles and Bylaws. The manner in which it then "reapplied" the sponsorship criteria to ICM was "incoherent, discriminatory and pretextual". (Claimant's Post-Hearing Submission, pp. 61-62.) There was no evidence before the Board that ICM's support in the community was eroding. No other applicant was held to a similar standard of demonstrating community support. ICM produced sufficient evidence of what was required by the RFP: "broad-based support from the community".

85. ICANN also complained that ICM's community definition was self-identifying but that was true of numerous sTLDs; as Dr. Twomey acknowledged in a letter of May 6, 2006, "(m)embers of both .TEL and .MOBI communities are self-identified". Both sTLDs are now in the root.



86. ICANN further complained that the sponsored community as defined by ICM was not sufficiently differentiated from other adult entertainment providers. But, besides the fact that ICM had set forth numerous criteria by which members of its community would differentiate themselves from others providers of the adult community, this too could be said to apply to other TLDs. Thus .TRAVEL, much like .XXX, is designed to provide an sTLD for certain members of the industry that wish to follow the rules of a particular charter.

87. ICANN further complained that .XXX would merely duplicate content found elsewhere on the Internet. But again, the same was true for virtually all of the other sTLDs.

88. In sum "ICANN's reopening of the sponsorship criteria - which it did *only* for ICM - was unfair, discriminatory and pretextual, and a departure from transparent, fair and well documented policies...not done neutrally and objectively, with integrity and fairness...[it] singled out ICM for disparate treatment, without substantial and reasonable cause." (*Id.*, p. 65.)

89. Reason 2: based on the extensive comment and from the GAC's Communiques, ICM's agreement raises public policy issues. ICANN never precisely identified the "public policy" issues raised nor does it explain why they warrant rejection of the application. But, ICM argues, Reasons 2-5 all arise from the same flawed interpretation of the Wellington Communique and other governmental comments, namely, that ICM was to be responsible for enforcing the world's various and different laws and standards concerning pornography. That interpretation "was sufficiently absurd as to have been made in bad faith"; in any event it holds ICM to an "impossible standard", and is one never imposed on any other registrant and that no registrant could possibly perform. It led to further flawed conclusions, *viz.*, that if ICM could not meet its responsibility (and no one could) then ICANN would have to take it over, and, if it did so, ICANN would be taking on an oversight role regarding Internet content, which was beyond its technical mandate. ICANN's imposition of this impossible requirement on ICM alone was discriminatory. It rejected ICM's application on grounds that were not applied neutrally and objectively, which were suggestive of a "pretextual basis to 'cover' the real reason for rejecting .XXX, *i.e.*, that the U.S. government and several other powerful governments objected to its proposed content." (*Id.*, pp. 66-67.)

90. Reason 3: the ICM application and revised agreement do not resolve GAC's issues, its concern for offensive content and protection of the vulnerable; the Board finds that these public policy concerns cannot be

credibly resolved with the mechanisms proposed by the applicant. ICM responds that this is merely an elaboration of Reason 2. ICM's proposed agreement contained detailed provisions to address child pornography issues and detailed mechanisms that would permit the identification and filtration of content deemed to be illegal or offensive.

91. Reason 4: the ICM application raises significant law enforcement compliance issues because of countries' varying laws relating to content and practices that define the nature of the application, therefore obligating ICANN to acquire a responsibility related to content and conduct. ICM responds that this builds on the fallacy of Reasons 2 and 3: according to the Board's apparent reasoning, the GAC was requiring ICM to enforce local restrictions on access to illegal and offensive content and if proved unable to do so, ICANN would have to do so. ICM responds that ICANN could not properly require ICM to undertake such enforcement obligations, whether or not the GAC actually so requested. Given that it would have been discriminatory and unfeasible to require ICM to enforce varying national laws regarding adult content, ICANN would not have been obligated to take over that responsibility if ICANN were unable to fulfill it.

92. Reason 5: there are credible scenarios in which ICANN would be forced to assume an ongoing management and oversight role regarding Internet content, inconsistent with its technical mandate. ICM responds that this largely restates Reason 4. ICANN interpreted the GAC's advice to require ICM to be responsible for regulating content on the Internet - a task plainly outside ICANN's mandate. ICANN then criticized ICM for taking on that task and complained that it would have to undertake the task if ICM were unable to fulfill it. But ICANN could not properly require ICM to regulate content on the Internet and ICM did not undertake to do so.

93. The above exposition of the contentions of ICM, while long, does not exhaust the full range of its arguments, which were developed at length and in detail in its Memorial and in oral argument. It does not, for example, fully set out its contentions on the effect of international law and the local law on these proceedings. The essence of that argument is that ICANN is bound to act in good faith, an argument that the Panel does not find it necessary to expound since the conclusion is not open to challenge and is not challenged by counsel for ICANN. ICANN does not accept ICM's reliance on principles of international law but it agrees that the principle of good faith is found in the corporate law of California and hence is applicable in the instant dispute.

94. The "Relief Requested" by ICM Registry consists, *inter alia*, of requesting that the Panel declare that its Declaration is binding upon ICM and ICANN; and that ICANN acted inconsistently with its Articles of Incorporation and Bylaws by:

"i. Failing to conduct negotiations in good faith and to conclude an agreement with ICM to serve as registry operator for the .XXX sTLD;

"ii. Rejecting ICM's proposed agreement to serve as registry operator...

"iii. Rejecting ICM's application on 30 March 2007, after having previously concluded that it met the RFP criteria on 1 June 2005;

"iv. Rejecting ICM's application on 30 March 2007 on the basis of the five grounds set forth...none of which were based on criteria set forth in the RFP criteria...

"v. Rejecting ICM's application after ICANN had approved ICM to proceed to contract negotiations..." (Claimant's Memorial on the Merits, pp. 265-267.)

#### *The Contentions of ICANN*

95. ICANN maintains that (a) the Independent Review Process is advisory, not arbitral; (b) the judgments of the ICANN Board are to be deferentially appraised; (c) the governing law is that of the State of California, not the principles of international law; and (d) in its treatment and disposition of the application of ICM Registry, ICANN acted consistently with its Articles of Incorporation and Bylaws.

#### *The Nature of the Independent Review Process*

96. ICANN invokes the provisions of the Bylaws that govern the IRP process, entitled, "Independent Review of Board Actions". Article IV, Section 3, provides that:

"1. ...ICANN shall have in place a separate process for independent third-party review of Board actions alleged by an affected party to be inconsistent with the Articles of Incorporation or Bylaws.

"2. Any person materially affected by a decision or action of the Board that he or she asserts is inconsistent with the Articles of

Incorporation or Bylaws may submit a request for independent review of that decision or action.

"3. Requests for such independent review shall be referred to an Independent Review Panel ("IRP") which shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles and Bylaws.

"4. The IRP shall be operated by an international arbitration provider appointed from time to time by ICANN ("the IRP Provider") using arbitrators ...nominated by that provider.

"5. Subject to the approval of the Board, the IRP Provider shall establish operating rules and procedures, which shall implement and be consistent with this Section 3.

...

"8. The IRP shall have the authority to:

...

b. declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws; and

c. recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP.

...

"12. Declarations of the IRP shall be in writing. The IRP shall make its declaration based solely on the documentation, supporting materials, and arguments submitted by the parties, and in its declaration shall specifically designate the prevailing party. The party not prevailing shall ordinarily be responsible for bearing all costs of the IRP Provider, but in an extraordinary case the IRP may in its declaration allocate up to half of the costs of the IRP Provider to the prevailing party based upon the circumstances, including a consideration of the reasonableness of the parties' positions and their contribution to the public interest. Each party to the IRP proceedings shall bear its own expenses.

"13. The IRP operating procedures, and all petitions, claims and declarations, shall be posted on the Website when they become available.

...

"15. Where feasible, the Board shall consider the IRP declaration at the Board's next meeting." (C-5.)

97. ICANN contends that the foregoing terms make it clear that the IRP's declarations are advisory and not binding. The IRP provisions commit the Board to review and consideration of declarations of the Panel. The Bylaws direct the Board to "consider" the declaration. "The direction to 'consider' the Panel's declaration necessarily means that the Board has discretion whether and how to implement it; if the declaration were binding such as with a court judgment or binding arbitration ruling, there would be nothing to consider, only an order to implement." (ICANN's Response to Claimant's Memorial on the Merits, p. 32.) ICANN's Board is specifically directed to "review" the Panel's declarations, not to implement them. Moreover, the Board is "not even required to review or consider the declaration immediately, or at any particular time," but is encouraged to do so at the next Board meeting, where "feasible", reinforcing the fact that the Board's review and consideration of the Panel's declaration does not require its acceptance. The Panel may "recommend", but not require, interim action. If final Panel declarations were binding, it would make no sense for interim remedies to be merely recommended to the Board. (*Id.*, p. 33.)

98. ICANN maintains that the preparatory work of the Bylaws demonstrates that the Independent Review Process was designed to be advisory. The Draft Principles for Independent Review state that the IRP's authority would be persuasive, "rest[ing] on its independence, on the prestige and professional standing of its members, and on the persuasiveness of its reasoned opinions". But "the ICANN Board should retain ultimate authority over ICANN's affairs – after all, it is the Board...that will be chosen by (and is directly accountable to) the membership and supporting organizations". (*Id.*, p. 34.) The primary pertinent document, "ICANN: A Blueprint for Reform," calls for the creation of "a process to require non-binding arbitration by an international arbitration body to review any allegation that the Board has acted in conflict with ICANN's Bylaws". ICM Registry's counsel in its negotiations with ICANN for a top-level domain, Ms. Burr, who as a senior official of the U.S. Department of Commerce was the principal official figure immediately involved in the creation and launching of ICANN, in addressing

the independent review process, observed that “decisions will be nonbinding, because the Board will retain final decision-making authority”. (*Ibid.*, p. 36.) In accepting recommendations for an independent review process that expressly disclaimed creation of a “Supreme Court” for ICANN, the Board changed the reference to “decisions” of the IRP to “declarations” precisely to avoid any inference that IRP determinations are binding decisions akin to those of a judicial or arbitral tribunal. (*Ibid.*, p. 38.)

99. ICANN further points out that, while the IRP Provider selected by it is the American Arbitration Association’s International Centre for Dispute Resolution, and while its Rules apply to IRP proceedings, those Rules in their application to IRP were amended to omit provision for the binding effect of an award.

*The Standard of Review is Deferential*

100. ICANN contends that the actions of the ICANN Board are entitled to substantial deference from this Panel. It maintains that that conclusion follows from the terms of Article 1, Section 2 of the Bylaws that set out the core values of ICANN (*supra*, paragraph 5). Article 1, Section 2 of the Bylaws provides that, “In performing its mission, the following core values should guide the decisions and actions of ICANN”; and the core values referred to in paragraph 5 of this Declaration are then spelled out. Section 2 concludes:

“These core values are deliberately expressed in very general terms, so that they may provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each new situation will necessarily depend on many factors that cannot be fully anticipated or enumerated; and because they are statements of principle rather than practice, situations will inevitably arise in which perfect fidelity to all eleven core values simultaneously is not possible. Any ICANN body making a recommendation or decision shall exercise its judgment to determine which core values are most relevant and how they apply to the specific circumstances of the case at hand and to determine, if necessary, an appropriate and defensible balance among competing values.” (C-5.)

101. ICANN argues that since, pursuant to the foregoing provision, the ICANN Board “shall exercise its judgment” in the application of competing core values, and since those core values embrace the neutral, objective and fair decision-making at issue in these proceedings, “the deference expressly

accorded to the Board in implementing the core values applies..." ICANN continues:

"Thus, by its terms, the Bylaws' conferral of discretionary authority makes clear that any reasonable decision of the ICANN Board is, *ipso facto*, not inconsistent with the Bylaws and consequently must be upheld. Indeed, the Bylaws even go so far as to provide that outright departure from a core value is permissible in the judgment of the Board, so long as the Board reasonably 'exercise[s] its judgment' in determining that other relevant principles outweighed that value in the particular circumstances at hand."

While in the instant case, in ICANN's view, there was not even an arguable departure from the Articles of Incorporation or Bylaws, "...because such substantial deference is in fact due, there is no basis whatsoever for a declaration in ICM's favor because the Board's decisions in this matter were, at a minimum, clearly justified and within the range of reasonable conduct." (ICANN's Response to Claimant's Memorial on the Merits, pp. 45-47.)

102. ICANN further argues that the Bylaws governing the independent review process sustain this conclusion. Article 4, Section 3, "strictly limits the scope of independent review proceedings to the narrow question of whether ICANN acted in a manner 'inconsistent with' the Articles of Incorporation and the Bylaws. In confining the inquiry into whether ICANN's conduct was *inconsistent with* its governing documents, the presumption is one of consistency so that inconsistency must be established, rather than the reverse...independent review is not to be used as a mechanism to upset arguable or reasonable actions of the Board." (*Ibid.*, p. 48.)

103. ICANN contends, moreover, that,

"Basic principles of corporate law supply an independent basis for the deference due to the reasonable judgments of the ICANN Board in this matter. It is black-letter law that 'there is a presumption that directors of a corporation have acted in good faith and to the best interest of the corporation'...In California...these principles require deference to actions of a corporate board of directors so long as the board acted 'upon reasonable investigation, in good faith and with regard for the best interests' of the corporation and 'exercised discretion within the scope of its authority'". This includes the boards of not-for-profit corporations." (*Ibid.*, pp. 49-50.)

*The Applicable Law of This Proceeding*

104. ICANN contests ICM's invocation of principles of international law, in particular the principle of good faith, and allied principles, estoppel, legitimate expectations and abuse of right. It notes that ICM's invocation of international law depends upon a two-step argument: first, ICM interprets Article 4 of the Articles of Incorporation, providing that ICANN will operate for the benefit of the Internet community "in conformity with relevant principles of international law", as a "choice-of-law" provision; second, ICM infers that "any violation of any principles of international law" constitutes a violation of Article 4 (thus allegedly falling within the Panel's jurisdiction to evaluate the consistency of ICANN's actions with its Articles and Bylaws).

105. ICANN contends that that two-step argument contravenes the plain language of the governing provisions as well as their drafting history. Article 4 of the Articles does not operate as a "choice-of-law" provision for the IRP processes prescribed in the Bylaws. Rather the provisions of the Bylaws and Articles, as construed in the light of the law of California, govern the claims before the Panel. Nor are the particular principles of international law invoked by ICM relevant to the circumstances at issue in these proceedings.

106. Article 4 is quoted in full in paragraph 3 of this Declaration. The specific activities that ICANN must carry out "in conformity with the relevant principles of international law and applicable international conventions and local law" are specified in Article 3 (*supra*, paragraph 2). Thus "relevant" in Article 4 means only principles of international law relevant to the activities specified in Article 3. "ICANN did not adopt principles of international law indiscriminately, but rather to ensure consistency between its policies developed for the world-wide Internet community and well-established substantive international law on matters relevant to various stakeholders in the global Internet community, such as general principles on trademark law and freedom of expression relevant to intellectual property constituencies and governments." (ICANN's Response to Claimant's Memorial on the Merits, pp. 59-60.) The principles of international law relied upon by ICM in this proceeding – the requirement of good faith and related doctrines – are principles of general applicability, and are not specially directed to concerns relating to the Internet, such as freedom of expression or trademark law. Therefore, ICANN argues, they are not "relevant". (*Ibid.*) Article 4 does not operate as a choice-of-law provision requiring ICANN to adapt its conduct to any and all principles of international law. It is not worded as choice-of-law clauses are. As ICANN's expert, Professor David D. Caron notes, it is unlikely that a choice-of-law clause would designate three sources of law on the



same level. It is the law of California, the place of ICANN's incorporation, that – by reason of ICANN's incorporation under the law of California -- governs how ICANN runs its business and interacts with another U.S. corporation regarding a contract to be performed within the United States. The IRP provisions of the Bylaws, drafted years after the Articles of Incorporation, and their drafting history, do not even mention Article 4 of the Articles.

107. Moreover, the specification of "relevant" principles of international law in Article 4 "must mean principles of international law that apply to a private entity such as ICANN" (*id.*, p. 66.) As a private party, ICANN is not subject to law governing sovereigns. International legal principles do not apply to a dispute between private entities located in the same nation because the dispute may have global effects.

108. Furthermore, ICM's cited general principles perform no clarifying role in this proceeding. The applicable rules set forth in ICANN's Bylaws and Articles as well as California law render resort to general principles unnecessary. In any event, California law and the Bylaws and Articles themselves provide sufficient guidance for the Panel's analysis.

*ICANN Acted Consistently with its Articles of Incorporation and Bylaws*

109. ICANN contends that each of ICM's key factual assertions is wrong. In view of the deference that should be accorded to the judgments of the ICANN Board, the Panel should declare that ICANN's conduct was not inconsistent with its Bylaws and Articles even if ICM's treatment of the facts were largely correct (as it is not). The issues presented to the ICANN Board by ICM's .XXX sTLD application were "difficult", ICANN's Board addressed them with "great care", and devoted "an enormous amount of time trying to determine the right course of action". ICM was fully heard; the Board deliberated openly and transparently. ICANN is unaware of a corporate deliberative process more open and transparent than its own. After this intensive process, the Board twice concluded that ICM's proposal should be rejected, "with no hint whatsoever of the 'bad faith' ICM alleges." (ICANN's Response to Claimant's Memorial on the Merits, pp. 79-80.)

110. ICM's claims "begin with the notion that ICANN adopted, and was bound by, an inflexible, two-step procedure for evaluating sTLD applications. First, according to ICM, applications would be reviewed by the Evaluation Panel for the baseline selection criteria. Second, only after applications were finally and irrevocably approved by the ICANN Board would the applications

proceed to contract negotiations with ICANN staff with no ability by the Board to address any of the issues that the Board had previously raised in conjunction with the sTLD application.” But the RFP refutes this contention. It does not suggest that the Board’s “allowance for an application to proceed to contract negotiations confirms the close of the evaluation process.” ICANN recalls the public statement of Mr. Pritz in Kuala Lumpur in 2004: “Upon completion of the technical and commercial negotiations, successful applicants will be presented to the ICANN Board with *all* the associated information, so the Board can independently review the findings along with the information and make their own adjustments. *And then* final decisions will be made by the Board, and they’ll authorize staff to complete or execute the agreements with the sponsoring organizations...” (*Ibid.*, pp. 81-82.) It observes that Dr. Cerf affirmed that: “ICANN never intended that this would be a formal, ‘two-step’ process, where proceeding to contract negotiations automatically constituted a *de facto* final and irrevocable approval with respect to the baseline selection criteria, including sponsorship.” (At p. 82, quoting V. Cerf Witness Statement, para. 15.) ICANN maintains that there were “two overlapping phases in the evaluation of the sTLDs” and the Board always retained the right “to vote against a proposed sTLD should the Board find deficiencies in the proposed registry agreement or in the sTLD proposal as a whole”. (P. 83.) There was a two-stage process but the two phases could and often did overlap in time. This is confirmed not only by Dr. Cerf but by Dr. Twomey and the then Vice-Chairman of the Board, Alejandro Pisanty. Each explains that the ICANN Board retained the authority to review and assess the baseline RFP selection criteria even after an applicant was allowed to proceed to contract negotiations. After the June 1, 2005, vote, members supporting ICM’s application did not argue that the Board had already approved the .XXX sTLD. The following exchange with Dr. Cerf took place in the course of the hearing:

“Q. Now, ICM’s position in this proceeding is that if the board voted to proceed to contract negotiations, the board was at that time making a finding that a particular applicant had satisfied the technical, financial and sponsorship criteria and that that issue was closed. Is that consistent with your understanding of how the process worked?”

“A. Not, it’s not. The matter was discussed very explicitly during our consideration of the ICM proposal. We were using the contract negotiations as a means of clarifying whether or not...the sponsorship criteria could be or had been met...this was not a decision that all three of the criteria had been met.” (Tr. 601:4:13.)

111. ICM's evidence is not to the contrary. That evidence shows that there were two major steps in the evaluation process. It does not show that those steps could not be overlapping. The relevant question, not answered by ICM, is whether ICANN's Bylaws required these steps to be non-overlapping. "such that contract negotiations could not commence until the satisfaction of the RFP criteria was finally and irrevocably determined..." (*Ibid.*, p. 84.)

112. ICM's claims are also based on the argument that, by its terms, the Board's resolutions of June 1, 2005 gave "unconditional" approval of the .XXX sTLD application. (The June 1, 2005 resolutions are set out *supra*, paragraph 19.) But nothing in the resolutions actually says that ICM's application satisfied the RFP criteria, including sponsorship. In fact, nothing in the resolutions expresses approval at all because it provides that "if", after entering negotiations, the applicant is able to negotiate commercial and technical terms for a contractual arrangement, those terms shall be presented to the Board for approval and authorization to enter into an agreement relating to the delegation of the sTLD. "The plain language of the resolutions makes clear that they did not themselves constitute approval of the .XXX sTLD application. The resolutions thus track the RFP, which makes clear that a 'final decision will be made by the Board' only *after* 'completion of the technical and commercial negotiations'". (*Ibid.*, p. 86.)

113. ICANN maintains that as of June 2005, there remained numerous unanswered questions and concerns regarding ICM's ability to satisfy the baseline sponsorship criteria set forth in the RFP. An important purpose of the June 1 resolutions was to permit ICM to proceed to contract negotiations in an effort to determine whether ICM's sponsorship shortcomings could be resolved in the contract.

114. The ICANN Board also permitted other applicants for sTLDs -- .JOBS and .MOBI – to proceed to contract negotiations despite open questions relating to the initial RFP criteria. However, ICM was unique among the field of sTLD applicants due to "the extremely controversial nature of the proposed sTLD, and concerns as to whether ICM had identified a 'community' that existed and actually supported the proposed sTLD...there was a significant negative response to ICM's proposed .XXX sTLD by many adult entertainment providers, the very individuals and entities who logically would be in ICM's proposed community." (*Ibid.*, p. 87.)

115. ICM's position is further refuted by continued discussion by the Board of sponsorship criteria at meetings subsequent to June 1, 2005. The fact that most Board members expressed concern about sponsorship

shortcomings after the June 1, 2005, resolutions negates any notion that the Board had conclusively determined the sponsorship issue.

116. A member of the Board elected after the June 1, 2005, vote, Rita Rodin, expressed "some concerns about whether the [ICM] proposal met the criteria set forth in the RFP..." She said that she did not want to re-open issues if they had already been decided by the Board (*supra*, paragraphs 42-43). In response to her query, no one stated that the sponsorship issue had already been decided by the Board. (ICANN'S Response to Claimant's Memorial on the Merits, p. 90.)

117. ICANN also draws attention to Dr. Twomey's letter of May 4, 2006 (*supra*, paragraph 37) in which he wrote that the Board's decision of June 1, 2005, was without prejudice to the Board's right to decide whether the contract reached with ICM meets all the criteria before the Board.

118. ICANN recalls that within days of the posting of the June 1, 2005, resolutions, GAC Chairman Tarmizi wrote Dr. Cerf expressing the GAC's "diverse and wide-ranging concerns" with the .XXX sTLD. The ICANN Board was required by the ICANN Bylaws to take account of the views of the GAC. Nor could ICANN have ignored concerns expressed by the U.S. Government and other governments. ICANN recalls the concerns expressed thereafter, in the Wellington Communique and otherwise. It observes that "some countries were concerned that, because the .XXX application would not require all pornography to be located within the .XXX domain, a new .XXX sTLD would simply result in the expansion of the number of domain names that involved pornography." (*Ibid.*, p. 102.)

119. ICANN points out that:

"In revising its proposed registry agreement to address the GAC's concerns...ICM took the position that it would install 'appropriate measures to restrict access to illegal and offensive content,' including monitoring such content globally. This was immediately controversial among many ICANN Board members because complaints about ICM's 'monitoring' would inevitably be sent to ICANN, which is neither equipped nor authorized to monitor (much less resolve) 'content-based' objections to Internet sites." (*Ibid.*, pp. 103-104.)

120. ICANN recalls Board concerns that were canvassed at its meetings of May 10, 2006, (*supra*, paragraph 38) and February 12, 2007, (*supra*, paragraphs 41-45). Board members increasingly were concluding that the results promised by ICM were unachievable. Whether their conclusions were

or were not incorrect is “irrelevant for purposes of determining whether the Board violated its Bylaws or Articles in rejecting ICM’s application.” (*Ibid.*, p. 105.) Board doubts were accentuated by growing opposition to the .XXX sTLD from elements of the online adult entertainment industry (*ibid.*).

121. The Board’s May 10, 2006 vote (*supra*, paragraph 38) rejected ICM’s then current draft, but provided ICM “yet another opportunity to attempt to revise the agreement to conform to the RFP specifications. Notably, the Board’s decision to allow ICM to continue to work the problem is directly at odds with ICM’s position that the Board decided ‘for political reasons’ to reject ICM’s application; if so, it would have been much easier for the Board to reject ICM’s application in its entirety in 2006.” (*Ibid.*, p. 106.)

122. At its meeting of February 12, 2007, (*supra*, paragraphs 41-45), concerns in the Board about whether ICM’s application enjoyed the support of the community it purported to represent were amplified.

123. At the meeting of March 30, 2007 at which ICM’s application and agreement were definitively rejected, the majority was, first, concerned by ICM’s definition of its community to include only those members of the industry who supported the creation of .XXX sTLD and its exclusion from the sponsored community of all online adult entertainment industry members who opposed ICM’s application.

“Such self-selection and extreme subjectivity regarding what constituted the content that defined the .XXX community made it nearly impossible to determine which persons or services would be in or out of the community...without a precisely defined Sponsored TLD Community, the Board could not approve ICM’s sTLD application.” (*Ibid.*, pp. 108-109.)

124. Second, ICM’s proposed community was not adequately differentiated; ICM failed to demonstrate that excluded providers had separate needs or interests from the community it sought to represent. As contract negotiations progressed, it became increasingly evident that ICM was actually proposing an unsponsored TLD for adult entertainment, “a uTLD, disguised as an sTLD, just as ICM had proposed in 2000.” (*Ibid.*, p. 209.)

125. Third, whatever community support ICM may have had at one time, it had “fallen apart by early 2007” (*ibid.*). During the final public comment period in 2007, “a vast majority of the comments posted to the public forum and sent to ICANN staff opposed ICM’s .XXX sTLD...” (p. 110). “Broad-based support” was lacking. (P. 111.) 75,000 pre-registrations for .XXX... “Out of

the over 4.2 million adult content websites in operation" hardly represents broad-based support. (P. 115.)

126. Fourth, ICM could not demonstrate that it was adding new and valuable space to the Internet name space, as required by the RFP. "In fact, the existence of industry opposition to the .XXX sTLD demonstrated that the needs of online adult entertainment industry members were met via existing TLDs without any need for a new TLD." (P. 112.)

127. Fifth and finally, ICM and its supporting organization, IFFOR, proposed to "proactively reach out to governments and international organizations to provide information about IFFOR's activities and solicit input and participation". But such measures "diluted the possibility that their policies would be 'primarily in the interests of the Sponsored TLD Community' as required by the sponsorship selection criteria." (Pp. 112-113.)

128. ICANN concludes that, "despite the good-faith efforts of both ICANN and ICM over a lengthy period of time, the majority of the Board determined that ICM could not satisfy, among other things, the sponsorship requirements of the RFP." Reasonable people might disagree – as did a minority of the Board – "but that disagreement does not even approach a violation of a Bylaw or Article of Incorporation." (P. 113.)

129. The treatment of ICM's application was procedurally fair. It was not the object of discrimination. Applications for .JOBS and .MOBI were also allowed to proceed to contractual negotiations despite open questions relating to selection criteria. ICANN applied documented policies neutrally and objectively, with integrity and fairness. ICM was provided with every opportunity to address the concerns of the Board and the GAC. ICANN did not reject ICM's application only for reasons of public policy (although they were important). ICM's application was rejected because of its inability to show how the sTLD would meet sponsorship criteria. The Board ultimately rejected ICM's application for "many of the same sponsorship concerns noted in the initial recommendation of the Evaluation Panel." (*Ibid.*, p. 124.) It also rejected the application because ICM's proposed registry agreement "would have required ICANN to manage the content of the .XXX sTLD" (p. 126). The Board took into account the views of the GAC in arriving at its independent judgment. "Had the ICANN Board taken the view that the GAC's views must in every case be followed without independent judgment, the Board presumably would have rejected ICM's application in late 2005 or early 2006, rather than waiting another full year for the parties to try to identify a resolution that would have allowed the sTLD to proceed." (*Ibid.*)

130. As to whether ICM was treated unfairly and was the object of discrimination, ICANN relies on the following statement of Dr. Cerf at the hearing:

“...I am surprised at an assertion that ICM was treated unfairly...the board could have simply accepted the recommendations of the evaluation teams and rejected the proposal at the outset...the board went out of its way to try to work with ICM through the staff to achieve a satisfactory agreement. We spent more time on this particular proposal than any other...We repeatedly defended our continued consideration of this proposal...If...ICM believes that it was treated in a singular way, I would agree that we spent more time and effort on this than any other proposal that came to the board with regard to sponsored TLDs.” (Tr. 654:3-655:7.)

#### PART FOUR: THE ANALYSIS OF THE INDEPENDENT REVIEW PANEL

##### *The Nature of the Independent Review Panel Process*

131. ICM and ICANN differ on the question of whether the Declaration to be issued by the Independent Review Panel is binding upon the parties or advisory. The conflicting considerations advanced by them are summarized above at paragraphs 51 and 91-94. In the light of them, the Panel acknowledges that there is a measure of ambiguity in the pertinent provisions of the Bylaws and in their preparatory work.

132. ICANN's officers testified before committees of the U.S. Congress that ICANN had installed provision for appeal to “independent arbitration” (*supra*, paragraph 55). Article IV, Section 3 of ICANN's Bylaws specifies that, “The IRP shall be operated by an international arbitration provider appointed from time to time by ICANN...using arbitrators...nominated by that provider”. The provider so chosen is the American Arbitration Association's International Centre for Dispute Resolution (“ICDR”), whose Rules (at C-11) in Article 27 provide for the making of arbitral awards which “shall be final and binding on the parties. The parties undertake to carry out any such award without delay.” The Rules of the ICDR “govern the arbitration” (Article 1). It is unquestioned that the term, “arbitration” imports production of a binding award (in contrast to conciliation and mediation). Federal and California courts have so held. The Supplementary Procedures adopted to supplement the independent review procedures set forth in ICANN's Bylaws provide that the ICDR's “International Arbitration Rules...will govern the process in combination with these Supplementary Procedures”. (C-12.) They specify

that the Independent Review Panel refers to the neutrals “appointed to decide the issue(s) presented” and further specify that, “DECLARATION refers to the decisions/opinions of the IRP”. “The DECLARATION shall specifically designate the prevailing party.” All of these elements are suggestive of an arbitral process that produces a binding award.

133. But there are other indicia that cut the other way, and more deeply. The authority of the IRP is “to declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws” – to “declare”, not to “decide” or to “determine”. Section 3(8) of the Bylaws continues that the IRP shall have the authority to “recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP”. The IRP cannot “order” interim measures but do no more than “recommend” them, and this until the Board “reviews” and “acts upon the opinion” of the IRP. A board charged with reviewing an opinion is not charged with implementing a binding decision. Moreover, Section 3(15) provides that, “Where feasible, the Board shall consider the IRP declaration at the Board’s next meeting.” This relaxed temporal proviso to do no more than “consider” the IRP declaration, and to do so at the next meeting of the Board “where feasible”, emphasizes that it is not binding. If the IRP’s Declaration were binding, there would be nothing to consider but rather a determination or decision to implement in a timely manner. The Supplementary Procedures adopted for IRP, in the article on “Form and Effect of an IRP Declaration”, significantly omit the provision of Article 27 of the ICDR Rules specifying that award “shall be final and binding on the parties”. (C-12.) Moreover, the preparatory work of the IRP provisions summarized above in paragraph 93 confirms that the intention of the drafters of the IRP process was to put in place a process that produced declarations that would not be binding and that left ultimate decision-making authority in the hands of the Board.

134. In the light of the foregoing considerations, it is concluded that the Panel’s Declaration is not binding, but rather advisory in effect.

*The Standard of Review Applied by the Independent Review Process*

135. For the reasons summarized above in paragraph 56, ICM maintains that this is a *de novo* review in which the decisions of the ICANN Board do not enjoy a deferential standard of review. For the reasons summarized above in paragraphs 100-103, ICANN maintains that the decisions of the Board are entitled to deference by the IRP.



136. The Internet Corporation for Assigned Names and Numbers is a not-for-profit corporation established under the law of the State of California. That law embodies the “business judgment rule”. Section 309 of the California Corporations Code provides that a director must act “in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders...” and shields from liability directors who follow its provisions. However ICANN is no ordinary non-profit California corporation. The Government of the United States vested regulatory authority of vast dimension and pervasive global reach in ICANN. In “recognition of the fact that the Internet is an international network of networks, owned by no single nation, individual or organization” – including ICANN -- ICANN is charged with “promoting the global public interest in the operational stability of the Internet...” ICANN “shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law...” Thus, while a California corporation, it is governed particularly by the terms of its Articles of Incorporation and Bylaws, as the law of California allows. Those Articles and Bylaws, which require ICANN to carry out its activities in conformity with relevant principles of international law, do not specify or imply that the International Review Process provided for shall (or shall not) accord deference to the decisions of the ICANN Board. The fact that the Board is empowered to exercise its judgment in the application of ICANN’s sometimes competing core values does not necessarily import that that judgment must be treated deferentially by the IRP. In the view of the Panel, the judgments of the ICANN Board are to be reviewed and appraised by the Panel objectively, not deferentially. The business judgment rule of the law of California, applicable to directors of California corporations, profit and non-profit, in the case of ICANN is to be treated as a default rule that might be called upon in the absence of relevant provisions of ICANN’s Articles and Bylaws and of specific representations of ICANN – as in the RFP – that bear on the propriety of its conduct. In the instant case, it is those Articles and Bylaws, and those representations, measured against the facts as the Panel finds them, which are determinative.

*The Applicable Law of this Proceeding*

137. The contrasting positions of the parties on the applicable law of this proceeding are summarized above at paragraphs 59-62 and 104-109. Both parties agree that the “local law” referred to in the provision of Article 4 of the Articles of Incorporation – “The Corporation shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international

conventions and local law” – is the law of California. But they differ on what are “relevant principles of international law” and their applicability to the instant dispute.

138. In the view of ICM Registry, principles of international law are applicable; that straightforwardly follows from their specification in the foregoing phrase of Article 4 of the Articles, and from the reasons given in introducing that specification. (*Supra*, paragraphs 53-54.) Principles of international law in ICM’s analysis include the general principles of law recognized as a source of international law in Article 38 of the Statute of the International Court of Justice. Those principles are not confined, as ICANN argues, to the few principles that may be relevant to the interests of Internet stakeholders, such as principles relating to trademark law and freedom of expression. Rather they include international legal principles of general applicability, such as the fundamental principle of good faith and allied principles such as estoppel and abuse of right. ICM’s expert, Professor Goldsmith, observes that there is ample precedent in international contracts and in the holdings of international tribunals for the proposition that non-sovereigns may choose to apply principles of international law to the determination of their rights and to the disposition of their disputes.

139. ICANN and its expert, Professor David Caron, maintain that international law essentially governs relations among sovereign States; and that to the extent that such principles are “relevant” in this case, it is those few principles that are applicable to a private non-profit corporation that bear on the activities of ICANN described in Article 3 of its Articles of Incorporation (*supra*, paragraph 2). General principles of law, such as that of good faith, are not imported by Article 4 of ICANN’s Articles of Incorporation; still less are principles derived from treaties that protect legitimate expectations. Nor is Article 4 of the Articles a choice-of-law provision; in fact, no governing law has been specified by the disputing parties in this case. If ICANN, by reason of its functions, is to be treated as analogous to public international organizations established by treaty (which it clearly is not), then a relevant principle to be extracted and applied from the jurisprudence of their administrative tribunals is that of deference to the discretionary authority of executive organs and of bodies whose decisions are subject to review.

140. In the view of the Panel, ICANN, in carrying out its activities “in conformity with the relevant principles of international law,” is charged with acting consistently with relevant principles of international law, including the general principles of law recognized as a source of international law.

That follows from the terms of Article 4 of its Articles of Incorporation and from the intentions that animated their inclusion in the Articles, an intention that the Panel understands to have been to subject ICANN to relevant international legal principles because of its governance of an intrinsically international resource of immense importance to global communications and economies. Those intentions might not be realized were Article 4 interpreted to exclude the applicability of general principles of law.

141. That said, the differences between the parties on the place of principles of international law in these proceedings are not of material moment to the conclusions that the Panel will reach. The paramount principle in play is agreed by both parties to be that of good faith, which is found in international law, in the general principles that are a source of international law, and in the corporate law of California.

*The Consistency of the Action of the ICANN Board with the Articles of Incorporation and Bylaws*

142. The principal – and difficult – issue that the Panel must resolve is whether the rejection by the ICANN Board of the proposed agreement with ICM Registry and its denial of the application’s request for delegation of the .XXX sTLD was or was not consistent with ICANN’s Articles of Incorporation and Bylaws. The conflicting contentions of the parties on this central issue have been set forth above (paragraphs 63-93, 109-131).

143. The Panel will initially consider the primary questions of whether by adopting the resolutions of June 1, 2005, the ICANN Board determined that the application of ICM Registry met the sponsorship criteria, and, if so, whether that determination was definitive and irrevocable.

144. The parties agree that, pursuant to the RFP, applications for sTLDs were to be dealt with in two stages. First, the Evaluation Panel was to review applications and recommend those that met the selection criteria. Second, those applicants that did meet the selection criteria were to proceed to negotiate commercial and technical terms of a contract with ICANN’s President and General Counsel. If and when those terms were agreed upon, the resultant draft contract was to be submitted to the Board for approval. As it turned out, the Board was not content with the fact that the Evaluation Panel positively recommended only a few applications. Accordingly the Board itself undertook to consider and decide whether the other applications met the selection criteria.

145. In the view of the Panel, which has weighed the diverse evidence with care, the Board did decide by adopting its resolutions of June 1, 2005, that the application of ICM Registry for a sTLD met the selection criteria, in particular the sponsorship criteria. ICM contends that that decision was definitive and irrevocable. ICANN contends that, while negotiating commercial and technical terms of the contract, its Board continued to consider whether or not ICM's application met sponsorship criteria, that it was entitled to do so, and that, in the course of that process, further questions about ICM's application arose that were not limited to matters of sponsorship, which the Board also ultimately determined adversely to ICM's application.

146. The considerations that militate in favor of ICM's position are considerable. They are summarized above in paragraphs 63, 65 and 66. ICM argues that these considerations must prevail because they are sustained by contemporary documentary evidence, whereas the contrary arguments of ICANN are not.

147. The Panel accepts the force of the foregoing argument of ICM insofar as it establishes that the June 1, 2005, resolutions accepted that ICM's application met the sponsorship criteria. The points summarized in subparagraphs (a) through (i) of paragraph 63 above are in the view of the Panel not adequately refuted by the recollections of ICANN's witnesses, distinguished as they are and candid as they were. Their current recollection, the sincerity of which the Panel does not doubt, is that it was their understanding in adopting the June 1, 2005 resolution that the Board was entitled to continue to examine whether ICM's application met the sponsorship criteria, even if it had by adopting that resolution found those criteria to have been provisionally met (which they challenge). While that understanding is not supported by factors (a) through (i) of paragraph 63, it nevertheless can muster substantial support on the question of whether any determination that sponsorship criteria had been met was subject to reconsideration.

148. Support on that aspect of the matter consists of the following:

- (a) The resolutions of June 1, 2005 (*supra*, paragraph 19) make no reference to the satisfaction of sponsorship criteria or to whether that question is definitively resolved.
- (b) Those resolutions however expressly provide that the approval and authorization of the Board is required to enter into an agreement relating to

the delegation of the sTLD; that being so, the Board viewed itself to be entitled to review all elements of the agreement before approving and authorizing it, including whether sponsorship criteria were met.

- (c) At the meeting of the GAC in July, 2005, some six weeks after the adoption by the Board of its resolutions of June 1, in the course of preparing the GAC Communique, the GAC Chair "confirmed that, having consulted the ICANN Legal Counsel, GAC could still advise ICANN about the .xxx proposal, should it decide to do so." (*Supra*, paragraph 24.) Since on the advice of counsel the GAC could still advise ICANN about the .XXX proposal, and since questions had been raised in the GAC about whether ICM's application met sponsorship criteria in the light of the appraisal of the Evaluation Panel, it may seem to follow that that advice could embrace the question of whether sponsorship criteria had been met and whether any such determination was subject to reconsideration. In point of fact, after June 1, 2005, a number of members of the GAC challenged or questioned the desirability of approving the ICM application on a variety of grounds, including sponsorship (*supra*, paragraphs 21-25, 40).

- (d) At its teleconference of September 15, 2005, there was "lengthy discussion involving nearly all of the directors regarding the sponsorship criteria..." (*supra*, paragraph 32). That imports that the members of the Board did not regard the question of sponsorship criteria to have been closed by the adoption of the resolutions of June 1, 2005.

- (e) In a letter of May 4, 2006, the President Twomey wrote the Chairman and Members of the GAC noting

"that the Board decision as to the .XXX application is still pending...the Board voted to authorize staff to enter into contractual negotiations without prejudicing the Board's right to evaluate the resulting contract and to decide whether it meets all of the criteria before the Board including public policy advice such as might be offered by the GAC... Due to the subjective nature of the sponsorship related criteria that were reviewed by the Sponsorship Evaluation Team, additional materials were requested from each applicant to be supplied directly for Board review and consideration...In some instances, such as with .XXX, while the additional materials provided sufficient clarification to proceed with contractual discussions, the Board still expressed concerns about whether the applicant met all of the criteria, but took the view that such concerns could possibly be

addressed by contractual obligations to be stated in a registry agreement." (C-188, and *supra*, paragraph 37.)

- (f) At a Board teleconference of February 12, 2007, ICANN's General Counsel asked the Board to consider "how ICM measures up against the RFP criteria," a request that implies that questions about whether such criteria had been met were not foreclosed. (*Supra*, paragraph 41.)
- (g) ICM provided data to ICANN staff, in the course of the preparation of its successive draft registry agreements, that bore on sponsorship. It has not placed in evidence contemporaneous statements that in its view such data was not relevant to continued consideration of its application on the ground that it had met sponsorship criteria or that the Board's June 1, 2005 resolutions foreclosed further consideration of sponsorship criteria. It is understandable that it did not do so, because it was in the process of endeavoring to respond positively to every request of the ICANN Board and staff that it could meet in the hope of promoting final approval of its application; but nevertheless that ICM took part in a continuing dialogue on sponsorship criteria suggests that it too did not regard, or at any rate, treat, that question as definitively resolved by adopted of the June 1, 2005 resolutions.
- (h) When Rita Rodin, a new member of the Board, raised concerns about ICM's meeting of sponsorship criteria at the Board's teleconference of February 12, 2007, she said that she did "not wish to reopen issues if they have already been decided by the Board" and asked the President and General Counsel to confirm that the question was open for discussion. There was no direct reply but the tenor of the subsequent discussion indicates that the Board did not view the question as closed. (During the Board's debate over adoption of its climactic resolution of March 30, 2007, Susan Crawford said that opposition to ICM's application was not sufficient "to warrant revisiting the question of the sponsorship strength of this TLD which I personally believe to be closed.") (*Supra*, paragraph 52.)

149. While the Panel has concluded that by adopting its resolutions of June 1, 2005, the Board found that ICM's application met financial, technical and sponsorship criteria, less clear is whether that determination was subject to reconsideration. The record is inconclusive, for the conflicting reasons set forth above in paragraphs 63, 65 and 66 (on behalf of ICM) and paragraph 149 (on behalf of ICANN). The Panel nevertheless is charged with arriving at a conclusion on the question. In appraising whether ICANN on this issue "applied documented policies, neutrally and objectively, with integrity and

fairness" (Bylaws, Section 2(8), the Panel finds instructive the documented policy stated in the Board's Carthage resolution of October 31, 2003 on "Finalization of New sTLD RFP," namely, that an agreement "reflecting the commercial and technical terms shall be negotiated upon the successful completion of the sTLD selection process." (C-78, p. 4.) In the Panel's view, the sTLD process was "successfully completed", as that term is used in the Carthage RFP resolution, in the case of ICM Registry with the adoption of the June 1, 2005, resolutions. ICANN should, pursuant to the Carthage documented policy, then have proceeded to conclude an agreement with ICM on commercial and technical terms, without reopening whether ICM's application met sponsorship criteria. As Dr. Williams, chair of the Evaluation Panel, testified, the RFP process did not contemplate that new criteria could be added after the [original] criteria had been satisfied. (Tr. 374: 1719). It is pertinent to observe that the GAC's proposals for new TLDs generally exclude consideration of new criteria (*supra*, paragraph 46).

150. In so concluding, the Panel does not question the integrity of the ICANN Board's disposition of the ICM Registry application, still less that of any of the Board's members. It does find that reconsideration of sponsorship criteria, once the Board had found them to have been met, was not in accord with documented policy. If, by way of analogy, there was a construction contract at issue, the party contracting with the builder could not be heard to argue that specifications and criteria defined in invitations to tender can be freely modified once past the qualification stage; the conditions of any such modifications are carefully circumscribed. Admittedly in the instant case the Board was not operating in a context of established business practice. That fact is extenuating, as are other considerations set out above. The majority of the Board appears to have believed that was acting appropriately in reconsidering the question of sponsorship (although a substantial minority vigorously differed). The Board was pressed to do so by the Government of the United States and by quite a number of other influential governments, and ICANN was bound to "duly take into account" the views of those governments. It is not at fault because it did so. It is not possible to estimate just how influential expressions of governmental positions were. They were undoubtedly very influential but it is not clear that they were decisive. If the Board simply had yielded to governmental pressure, it would have disposed of the ICM application much earlier. The Panel does not conclude that the Board, absent the expression of those governmental positions, would necessarily have arrived at a conclusion favorable to ICM. It accepts the affirmation of members of the Board that they did not vote against acceptance of ICM's application because of governmental pressure. Certainly there are those, including Board members,

who understandably react negatively to pornography, and, in some cases, their reactions may be more visceral than rational. But they may also have had doubts, as did the Board, that ICM would be able successfully to achieve what it claimed .XXX would achieve.

151. The Board's resolution of March 30, 2007, rejecting ICM's proposed agreement and denying its request for delegation of the .XXX sTLD lists four grounds for so holding in addition to failure to meet sponsored community criteria (*supra*, paragraph 47). The essence of these grounds appears to be the Board's understanding that the ICM application "raises significant law enforcement compliance issues ... therefore obligating ICANN to acquire responsibility related to content and conduct ... there are credible scenarios that lead to circumstances in which ICANN would be forced to assume an ongoing management and oversight role regarding Internet content, which is inconsistent with its technical mandate." ICM interprets these grounds, and statements of Dr. Twomey and Dr. Cerf, as seeking to impose on ICM responsibility for "enforcing restrictions around the world on access to illegal and offensive content" (*supra*, paragraph 66-67). ICM avers that it never undertook "to enforce the laws of the world on pornography", an undertaking that it could never discharge. It did undertake, in the event of the approval and activation of .XXX, to install tools that would make it far easier for governments to restrict access to content that they deemed illegal and offensive. ICM argues that its application was rejected in part because of its inability to comply with a contractual undertaking to which it never had agreed in the first place (*supra*, paragraphs 66-71). To the extent that this is so – and the facts and the conclusions drawn from the facts by the ICANN Board in its resolution of March 30, 2007, in this regard are not fully coherent – the Panel finds ground for questioning the neutral and objective performance of the Board, and the consistency of its so doing with its obligation not to single out ICM Registry for disparate treatment.

#### PART FIVE: CONCLUSIONS OF THE INDEPENDENT REVIEW PANEL

152. The Panel concludes, for the reasons stated above, that:

First, the holdings of the Independent Review Panel are advisory in nature; they do not constitute a binding arbitral award.

Second, the actions and decisions of the ICANN Board are not entitled to deference whether by application of the "business judgment" rule or otherwise; they are to be appraised not deferentially but objectively.



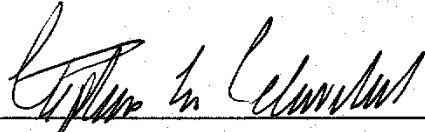
Third, the provision of Article 4 of ICANN's Articles of Incorporation prescribing that ICANN "shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law," requires ICANN to operate in conformity with relevant general principles of law (such as good faith) as well as relevant principles of international law, applicable international conventions, and the law of the State of California.

Fourth, the Board of ICANN in adopting its resolutions of June 1, 2005, found that the application of ICM Registry for the .XXX sTLD met the required sponsorship criteria.

Fifth, the Board's reconsideration of that finding was not consistent with the application of neutral, objective and fair documented policy.

Sixth, in respect of the first foregoing holding, ICANN prevails; in respect of the second foregoing holding, ICM Registry prevails; in respect of the third foregoing holding, ICM Registry prevails; in respect of the fourth foregoing holding, ICM Registry prevails; and in respect of the fifth foregoing holding, ICM Registry prevails. Accordingly, the prevailing party is ICM Registry. It follows that, in pursuance of Article IV, Section 3(12) of the Bylaws, ICANN shall be responsible for bearing all costs of the IRP Provider. Each party shall bear its own attorneys' fees. Therefore, the administrative fees and expenses of the International Centre for Dispute Resolution, totaling \$4,500.00, shall be borne entirely by ICANN, and the compensation and expenses of the Independent Review Panel, totaling \$473,744.91, shall be borne entirely by ICANN. ICANN shall accordingly reimburse ICM Registry with the sum of \$241,372.46, representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by ICM Registry.

Judge Tevrizian is in agreement with the first foregoing conclusion but not the subsequent conclusions. His opinion follows.




**Stephen M. Schwebel**

Date: February 19, 2010



**Jan Paulsson**

Date: 16 February 2010



**Dickran Tevzian**

Date: February 18, 2010

## CONCURRING AND DISSENTING OPINION

I concur and expressly join in the Panel's conclusion that the holdings of the Independent Review Panel are advisory in nature and do not constitute a binding arbitral award. I adopt the rationale and the reasons stated by the Panel on this issue only.

However, I must respectfully dissent from my learned colleagues as to the remainder of their findings. I am afraid that the majority opinion will undermine the governance of the internet community by permitting any disgruntled person, organization or governmental entity to second guess the administration of one of the world's most important technological resources.

### I

#### INTRODUCTION

The Internet Corporation for Assigned Names and Numbers (hereinafter "ICANN") is a uniquely created institution: a global, private, not-for-profit organization incorporated under the laws of the State of California (Calif. Corp. Code 5100, et seq.) exercising plenary control over one of the world's most important technological resources: the Internet Domain Name System or "DNS." The DNS is the gateway to the nearly infinite universe of names and numbers that allow the Internet to function.

ICANN is a public benefit, non-profit corporation that was established under the law of the State of California on September 30, 1998. ICANN's Articles of Incorporation were finalized and adopted on November 21, 1998, and its By-Laws were finalized and adopted on the same day as its Articles of Incorporation.

Article 4 of ICANN's Articles of Incorporation sets forth the standard of conduct under which ICANN is required to carry out its activities and mission to protect the stability, integrity and utility of the Internet Domain Name System on behalf of the global Internet community pursuant to a series of agreements with the United States Department of Commerce. ICANN is headquartered in Marina del Rey, California, U.S.A.

Article 4 of ICANN's Articles of Incorporation specifically provide:

"The Corporation shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law and, to the extent appropriate and consistent with these Articles and its Bylaws, through open and transparent processes that enable competition and open entry in Internet-related markets. To this effect, the Corporation shall cooperate as appropriate with relevant international organizations."

ICANN serves the function as the DNS root zone administrator to ensure and is required by its Articles of Incorporation to be a neutral and open facilitator of Internet coordination. ICANN's function and purpose was never meant to be content driven in any respect.

The Articles of Incorporation provide that ICANN is managed by a Board of Directors ("Board"). The Board consists of 15 voting directors and 6 non-voting liaisons from around the world, "who in the aggregate [are to] display diversity in geography, culture, skills, experience and perspective." (Article VI, § 2). The voting directors are composed of: (1) six representatives of ICANN's Supporting Organizations, which are sub-groups dealing with specific sections of the policies under ICANN's purview; (2) eight independent representatives of the general public interest, currently selected through ICANN's Nominating Committee, in which all the constituencies of ICANN are represented; and (3) the President and CEO, who is appointed by the rest of the Board. Consistent with ICANN's mandate to provide private sector technical leadership in the management of the DNS, "no official of a national government" may serve as a director. (Article VI, § 4). In carrying out its functions, it is obvious that ICANN is expected to solicit and will receive input from a wide variety of Internet stakeholders and participants.

ICANN operates through its Board of Directors, a Staff, An Ombudsman, a Nominating Committee for Directors, three Supporting Organizations, four Advisory Committees and numerous other stakeholders that participate in the unique ICANN process. (By-Laws Articles V through XI).

As was stated earlier, ICANN was formed under the laws of the State of California as a public benefit, non-profit corporation. As such, it would appear that California Corporations Code Section 5100, et seq., together with ICANN's Articles of Incorporation and By-Laws, control its governance and accountability.

In general, a non-profit director's fiduciary duties include the duty of care, which includes an obligation of due inquiry and the duty of loyalty among others. The term "fiduciary" refers to anyone who holds a position requiring trust, confidence and scrupulous exercise of good faith and candor. It includes anyone who has a duty, created by a particular undertaking, to act primarily for the benefit of others in matters connected with the undertaking. A fiduciary relationship is one in which one person reposes trust and confidence in another person, who "must exercise a corresponding degree of fairness and good faith." (Blacks Law Dictionary). The type of persons who are commonly referred to as fiduciaries include corporate directors. The California Corporation's Code makes no distinction between

directors chosen by election and directors chosen by selection or designation in the application of fiduciary duties.

Directors of non-profit corporations in California owe a fiduciary duty to the corporation they serve and to its members, if any. See Raven's Cove Townhomes, Inc. v. Knuppe Dev. Co., (1981) 114 CA3d 783, 799; Burt v. Irvine Co., (1965) 237 CA2d 828, 852. See also, Harvey v. Landing Homeowners Assn., (2008) 162 CA4th 809, 821-822.

The "business judgment rule" is the standard the California courts apply in deciding whether a director, acting without a financial interest in the decision, satisfied the requirements of careful conduct imposed by the California Corporations Code. See Gaillard v. Natomas Co., (1989) 208 CA3d 1250, 1264. The rule remains a creature of common law. Some California courts define it as a standard of reasonable conduct. See Burt v. Irvine Co., (1965) 237 CA2d 828, while others speak of actions taken in good faith. See Marble v. Latchford Glass Co., (1962) 205 CA2d 171. While, still others examine whether the director "rationally believes that the business judgment is in the best interests of the corporation." See Lee v. Interinsurance Exch., (1996) 50 CA4th 694.

The business judgment rule is codified in Section 309 of the California Corporations Code, which provides that a director must act "in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." Cal. Corp. Code § 309(a); see also Lee v. Interinsurance Exch., (1996) 50 CA4th 694, 714. Section 309 shields from liability directors who follow its provisions: "A person who performs the duties of a director in accordance with subdivisions (a) and (b) shall have no liability based upon any alleged failure to discharge the person's obligations as a director." Cal. Corp. Code § 309 (c).

## II

### THE ACTIONS OF THE ICANN BOARD OF DIRECTORS ARE ENTITLED TO SUBSTANTIAL DEFERENCE FROM THE INDEPENDENT REVIEW PANEL

ICANN's By-Laws, specifically Article I, § 2, sets forth 11 core values and concludes as follows:

"These core values are deliberately expressed in very general terms, so that they may provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each new

situation will necessarily depend on many factors that cannot be fully anticipated or enumerated; and because they are statements of principle rather than practice, situations will inevitably arise in which perfect fidelity to all eleven core values simultaneously is not possible. Any ICANN body making a recommendation or decision shall exercise its judgment to determine which core values are most relevant and how they apply to the specific circumstances of the case at hand, and to determine, if necessary, an appropriate and defensible balance among competing values.”

The By-Laws make it clear that the core values must not be construed in a “narrowly prescriptive” manner. To the contrary, Article I, § 2, provides that the ICANN Board is vested with board discretion in implementing its responsibility such as is mentioned in the business judgment rule.

### III

#### PRINCIPLES OF INTERNATIONAL LAW DO NOT APPLY

Article 4 of the ICANN Articles of Incorporation does not preempt the California Corporations Code as a “choice-of-law provision” importing international law into the independent review process. Rather, the substantive provisions of the By-Laws and Articles of Incorporation, as construed in light of the law of California, where ICANN is incorporated as a non-profit entity, should govern the claims before the Independent Review Panel (hereinafter “IRP”).

Professor Caron opined that principles of international law do not apply because, as a private entity, ICANN is not subject to that body of law governing sovereigns. To adopt a more expansive view is tantamount to judicial legislation or mischief.

### IV

#### THE ICANN BOARD OF DIRECTORS DID NOT ACT INCONSISTENTLY WITH ICANN’S ARTICLES OF INCORPORATION AND BY-LAWS IN CONSIDERING AND ULTIMATELY DENYING ICM REGISTRY, LLC’S APPLICATION FOR A SPONSORED TOP LEVEL DOMAIN NAME

On March 30, 2007, the ICANN Board of Directors approved a resolution rejecting the proposed registry agreement and denying the application submitted by ICM Registry, LLC for a sponsored top level domain name. The findings of the Board was that the application was deficient in that the applicant, ICM Registry, LLC, (hereinafter “ICM”), failed to satisfy the

Request For Proposal (“hereinafter “RFP”) posted June 24, 2003, in the following manner:

- “1. ICM’s definition of its sponsored TLD community was not capable of precise or clear definition;
2. ICM’s policies were not primarily in the interests of the sponsored TLD community;
3. ICM’s proposed community did not have needs and interests which are differentiated from those of the general global Internet community;
4. ICM could not demonstrate that it had the requisite community support; and,
5. ICM was not adding new and valuable space to the Internet name space.”

On December 15, 2003, ICANN posted a final RFP for a new round of sponsored Top Level Domain Names (hereinafter “STLD”). On March 16, 2004, ICM submitted its application for the .XXX STLD name. From the inception, ICM knew that its .XXX application would be controversial. From the time that ICM submitted its applications until the application was finally denied on March 30, 2007, ICM never was able to clearly define what the interests of the .XXX community would be or that ICM had adequate support from the community it sought to represent.

ICM has claimed during these proceedings that the RFP posted by ICANN established a non-overlapping two-step procedure for approving new STLDs, under which applications would first be tested for baseline criteria, and only after the applications were finally and irrevocably approved by the ICANN Board could the applications proceed to technical and commercial contract negotiations with ICANN staff. ICM forcefully argues that on June 1, 2005, the ICANN Board irrevocably approved the ICM .XXX STLD application so as to be granted vested rights to enter into registry agreement negotiations dealing with economic issues only. The evidence introduced at the independent review procedure refutes this contention. Nothing contained in the ICANN RFP permits this interpretation.

Before the ICANN Board could approve a STLD application, applicants had to satisfy the baseline selection criteria set forth in the RFP, including the technical, business, financial and sponsorship criteria, and also negotiate an acceptable registry contract with ICANN staff. A review of the relevant documents and testimony admitted into evidence established that the two phases could overlap in time.

The fact that most ICANN Board members expressed significant concerns about ICM’s sponsorship shortcomings after the June 1, 2005,

resolutions negates any notion that the June 1, 2005, resolutions (which do not say that the Board is approving anything and, to the contrary, state clearly that the ICANN Board is not doing so) conclusively determined the sponsorship issue.

The sponsorship issues and shortcomings in ICM's application were also raised by ICANN Board members who joined the ICANN Board after the June 1, 2005, resolutions. Between the June 2005 and February 2007 ICANN Board meetings, there were a total of six new voting Board members (out of a total of fifteen) considering ICM's application.

Both Dr. Cerf and Dr. Pisanty testified during the evidentiary hearing that the ICANN Board's vote on June 1, 2005, made clear that the Board's vote was intended only to permit ICM to proceed with contract negotiations. Under no circumstances was ICANN bound by the vote to award the .XXX STLD to ICM because the resolution that the ICANN Board adopted was not a finding that ICM had satisfied the sponsorship criteria set forth in the Request for Proposal.

By August 9, 2005, ICM's first draft of the proposed .XXX STLD registry agreement was posted on ICANN's website and submitted to the ICANN Board for approval. ICANN's next Board meeting was scheduled for August 16, 2005, at which time the ICANN Board had planned on discussing the proposed agreement.

Within days of ICANN posting the proposed registry agreement, the Government Advisory Committee (hereinafter "GAC") Chairman wrote Dr. Cerf a letter expressing the GAC's diverse and wide ranging" concerns with the .XXX STLD and requesting that the ICANN Board provide additional time for governments to express their public policy concerns before the ICANN Board reached a final decision on the proposed registry agreement.

The GAC's input was significant and proper because the ICANN By-Laws require the ICANN Board to take into account advice from the GAC on public policy matters, both in formulation and adoption of policies. ICANN By-Laws Article XI, § 2.1 (j), provides: "The advice of the Governmental Advisory Committee on public policy matters shall be duly taken into account, both in the formulation and adoption of policies." Where the ICANN Board seeks to take actions that are inconsistent with the GAC's advice, the Board must tell the GAC why. Thus, it was perfectly acceptable, appropriate and fully consistent with the ICANN Articles of Incorporation and By-Laws for the ICANN Board to consider and to address the GAC's concerns.

Further, throughout 2005 and up to the ICANN Board's denial of the ICM .XXX STLD on March 30, 2007, a number of additional continuing concerns and issues appeared beyond those originally voiced by the evaluation panel at the beginning of the review process. Despite the best efforts of many and



numerous opportunities, ICM could not satisfy these additional concerns and, most importantly, could not cure the continuing sponsorship defects.

In all respects, ICANN operated in a fair, transparent and reasoned manner in accordance with its Articles of Incorporation and By-Laws.

## V

### CONCLUSION

For the reasons stated above, I would give substantial deference to the actions of the ICANN Board of Directors taken on March 30, 2007, in approving a resolution rejecting the proposed registry agreement and denying the application submitted by ICM Registry, LLC for a sponsored top level domain name. I specifically reject any notion that there was any sinister motive by any ICANN Director, governmental entity or religious organization to undermine ICM Registry, LLC's application. In my opinion, the application was rejected on the merits in an open and transparent forum. On the basis of that, ICM Registry, LLC never satisfied the sponsorship requirements and criteria for a top level domain name.

The rejection of the business judgment rule will open the floodgates to increased collateral attacks on the decisions of the ICANN Board of Directors and undermine its authority to provide a reliable point of reference to exercise plenary control over the Internet Domain Name System. In addition, it will leave the ICANN Board in a very vulnerable position for politicization of its activities.

The business judgment rule establishes a presumption that the directors' and officers' decisions are based on sound business judgment, and it prohibits courts from interfering in business decisions made by the management in good faith and in the absence of a conflict of interest. *Katz v. Chevron Corp.*, 22 Cal.App.4th 1352. In most cases, "the presumption created by the business judgment rule can be rebutted only by affirmative allegations of facts which, if proven, would establish fraud, bad faith, overreaching or an unreasonable failure to investigate material facts." The record in this case does not support such findings. In addition, interference with the discretion of the directors is not warranted in doubtful cases such as is present here. *Lee v. Interinsurance Exch.*, 50 Cal.App.4th 694.

In *Marble v. Latchford Glass Co.*, 205 Cal.App.2nd 171, the court stated that it would "not substitute its judgment for the business judgment of the board of directors made in good faith." Similarly, in *Eldridge v. Tymshare, Inc.*, 186 Cal.App.3rd 767, the court stated that the business judgment rule "sets up a presumption that directors' decisions are based on sound business judgment. This presumption can be rebutted only by a factual showing of fraud, bad faith or gross overreaching." ICM Registry, LLC has not met the standard articulated by established law.

**In the present case, regardless of how ICM Registry, LLC stylizes its allegations, the business judgment rule poses a substantial hurdle for ICM's effort which I submit was never met by the evidence presented. The evidence presented at the hearing held in this matter disclosed that at every step the decisions made by the ICANN Board were made in good faith, and for the benefit of the continued operation of ICANN in its role as exercising plenary control over one of the world's most important technological resources: the Internet Domain Name System.**

**Simply stated, as long as ICANN is incorporated and domiciled within the State of California, U.S.A., it is the undersigned's opinion that the standard of review to be used by the Independent Review Panel in judging the conduct of the ICANN board, is the abuse of discretion standard, based upon the business judgment rule, and not a de novo review of the evidence.**

**JUDGE DICKRAN TEVRIZIAN (Retired)**

*Dickran Tevrizian*  
*February 18, 2010*

**CLA-004**

**IN THE MATTER OF AN INDEPENDENT REVIEW PROCESS BEFORE THE  
INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION**

Between: )  
)  
Vistaprint Limited )  
)  
*Claimant* )  
)  
v. ) **ICDR Case No. 01-14-0000-6505**  
)  
INTERNET CORPORATION FOR )  
ASSIGNED NAMES AND NUMBERS )  
)  
*Respondent* )  
\_\_\_\_\_ )

**FINAL DECLARATION OF THE INDEPENDENT REVIEW PANEL**

IRP Panel:

Geert Glas  
Siegfried H. Elsing  
Christopher S. Gibson (Chair)

## I. Introduction

1. This Final Declaration (“Declaration”) is issued in this Independent Review Process (“IRP”) pursuant to Article IV, §3 of the Bylaws of the Internet Corporation for Assigned Names and Numbers (“Bylaws”; “ICANN”). In accordance with the Bylaws, the conduct of this IPR is governed by the International Centre for Dispute Resolution’s (“ICDR”) International Dispute Resolution Procedures, amended and effective June 1, 2014 (“ICDR Rules”), as supplemented by the Supplementary Procedures for Internet Corporation for Assigned Names and Numbers Independent Review Process, dated December 21, 2011 (“Supplementary Procedures”).
2. Claimant, Vistaprint Limited (“Vistaprint”), is a limited company established under the laws of Bermuda. Vistaprint describes itself as “an Intellectual Property holding company of the publicly traded company, Vistaprint NV, a large online supplier of printed and promotional material as well as marketing services to micro businesses and consumers. It offers business and consumer marketing and identity products and services worldwide.”<sup>1</sup>
3. Respondent, ICANN, is a California not-for-profit public benefit corporation. As stated in its Bylaws, ICANN’s mission “is to coordinate, at the overall level, the global Internet’s system of unique identifiers, and in particular to ensure the stable and secure operation of the Internet’s unique identifier systems.”<sup>2</sup> In its online Glossary, ICANN describes itself as “an internationally organized, non-profit corporation that has responsibility for Internet Protocol (IP) address space allocation, protocol identifier assignment, generic (gTLD) and country code (ccTLD) Top-Level Domain name system management, and root server system management functions.”<sup>3</sup>
4. As part of this mission, ICANN’s responsibilities include introducing new top-level domains (“TLDs”) to promote consumer choice and competition, while maintaining the stability and security of the domain name system (“DNS”).<sup>4</sup> ICANN has gradually expanded the DNS from the original six generic top-level domains (“gTLDs”)<sup>5</sup> to include 22 gTLDs and over 250 country-code TLDs.<sup>6</sup> However, in June 2008, in a significant step ICANN’s Board of Directors (“Board”) adopted recommendations developed by one of its policy development bodies, the Generic Names Supporting Organization (“GNSO”), for

---

<sup>1</sup> Request for Independent Review Process by Vistaprint Limited dated June 11, 2014 (“Request”), ¶ 12.

<sup>2</sup> ICANN’s Response to Claimant Vistaprint Limited’s Request for Independent Review Process dated July 21, 2014 (“Response”), ¶ 13; Bylaws, Art. I, § 1.

<sup>3</sup> Glossary of commonly used ICANN Terms, at <https://www.icann.org/resources/pages/glossary-2014-02-03-en#i> (last accessed on Sept. 15, 2015).

<sup>4</sup> Affirmation of Commitments by the United States Department of Commerce and the Internet Corporation for Assigned Names and Numbers (“Affirmation of Commitments”), Article 9.3 (Sept. 30, 2009), available at <https://www.icann.org/resources/pages/affirmation-of-commitments-2009-09-30-en> (last accessed on Sept. 15, 2015).

<sup>5</sup> The original six gTLDs consisted of .com; .edu; .gov; .mil; net; and .org.

<sup>6</sup> Request, ¶ 14.

introducing additional new gTLDs.<sup>7</sup> Following further work, ICANN's Board in June 2011 approved the "New gTLD Program" and a corresponding set of guidelines for implementing the Program – the gTLD Applicant Guidebook ("Guidebook").<sup>8</sup> ICANN states that "[t]he New gTLD Program constitutes by far ICANN's most ambitious expansion of the Internet's naming system."<sup>9</sup> The Guidebook is a foundational document providing the terms and conditions for new gTLD applicants, as well as step-by-step instructions and setting out the basis for ICANN's evaluation of these gTLD applications.<sup>10</sup> As described below, it also provides dispute resolution processes for objections relating to new gTLD applications, including the String Confusion Objection procedure ("String Confusion Objection" or "SCO").<sup>11</sup> The window for submitting new gTLD applications opened on January 12, 2012 and closed on May 30, 2012, with ICANN receiving 1930 new gTLD applications.<sup>12</sup> The final version of the Guidebook was made available on June 4, 2012.<sup>13</sup>

5. This dispute concerns alleged conduct by ICANN's Board in relation to Vistaprint's two applications for a new gTLD string, ".WEBS", which were submitted to ICANN under the New gTLD Program. Vistaprint contends that ICANN's Board, through its acts or omissions in relation to Vistaprint's applications, acted in a manner inconsistent with applicable policies, procedures and rules as set out in ICANN's Articles of Incorporation ("Articles") and Bylaws, both of which should be interpreted in light of the Affirmation of Commitments between ICANN and the United States Department of Commerce ("Affirmation of Commitments").<sup>14</sup> Vistaprint also states that because ICANN's Bylaws require ICANN to apply established policies neutrally and fairly, the Panel must consider other ICANN policies relevant to the dispute, in particular, the policies in Module 3 of the Guidebook regarding ICANN's SCO procedures, which Vistaprint claims were violated.<sup>15</sup>
6. Vistaprint requests that the IRP Panel provide the following relief:
  - Find that ICANN breached its Articles, Bylaws, and the Guidebook;
  - Require that ICANN reject the determination of the Third Expert in the String

---

<sup>7</sup> ICANN Board Resolution 2008.06.26.02, at <http://www.icann.org/en/groups/board/documents/resolutions-26jun08-en.htm> (last accessed on Sept. 11, 2015).

<sup>8</sup> ICANN Board Resolution 2011.06.20.01, at <http://www.icann.org/en/groups/board/documents/resolutions-20jun11-en.htm> (last accessed on Sept. 11, 2015). ICANN states that the "Program's goals include enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of new gTLDs." Response, ¶ 16. The Guidebook is available at <http://newgtlds.icann.org/en/applicants/agg> (last accessed on Sept. 13, 2015).

<sup>9</sup> Response, ¶ 16.

<sup>10</sup> Response, ¶ 16.

<sup>11</sup> The Guidebook is organized into Modules. Module 3 (Objection Procedures) is of primary relevance to this IRP case.

<sup>12</sup> Response, ¶ 5; New gTLD Update (May 30, 2012) on the close of the TLD Application system, at <http://newgtlds.icann.org/en/announcements-and-media/announcement-3-30may12-en> (last accessed on Sept. 11, 2015).

<sup>13</sup> gTLD Applicant Guidebook, Version 2012-06-04.

<sup>14</sup> Affirmation of Commitments.

<sup>15</sup> Request, ¶ 58; Vistaprint's First Additional Submission, ¶ 34.

Confusion Objection proceedings involving Vistaprint (“*Vistaprint SCO*”)<sup>16</sup>, which found that the two proposed gTLD strings – .WEBS and .WEB – are confusingly similar, disregard the resulting “Contention Set”, and allow Vistaprint’s applications for .WEBS to proceed on their own merits;

- In the alternative, require that ICANN reject the *Vistaprint SCO* determination and organize a new independent and impartial SCO procedure, according to which a three-member panel re-evaluates the Expert Determination in the *Vistaprint SCO* taking into account (i) the ICANN Board’s resolutions on singular and plural gTLDs<sup>17</sup>, as well as the Board’s resolutions on the DERCars SCO Determination, the United TLD Determination, and the Onlineshopping SCO Determination<sup>18</sup>, and (ii) ICANN’s decisions to delegate the .CAR and .CARS gTLDs, the .AUTO and .AUTOS gTLDs, the .ACCOUNTANT and ACCOUNTANTS gTLDs, the .FAN and .FANS gTLDs, the .GIFT and .GIFTS gTLDs, the .LOAN and .LOANS gTLDs, the .NEW and .NEWS gTLDs and the .WORK and .WORKS gTLDs;
  - Award Vistaprint its costs in this proceeding; and
  - Award such other relief as the Panel may find appropriate or Vistaprint may request.
7. ICANN, on the other hand, contends that it followed its policies and processes at every turn in regards to Vistaprint’s .WEBS gTLD applications, which is all that it is required to do. ICANN states its conduct with respect to Vistaprint’s applications was fully consistent with ICANN’s Articles and Bylaws, and it also followed the procedures in the Guidebook. ICANN stresses that Vistaprint’s IRP Request should be denied.

## II. Factual and Procedural Background

8. This section summarizes basic factual and procedural background in this case, while leaving additional treatment of the facts, arguments and analysis to be addressed in sections III (ICANN’s Articles, Bylaws, and Affirmation of Commitments), IV (Summary of Parties’ Contentions) and V (Analysis and Findings).

### A. Vistaprint’s Application for .WEBS and the String Confusion Objection

9. Vistaprint’s submitted two applications for the .WEBS gTLD string, one a standard application and the other a community-based application.<sup>19</sup> Vistaprint states that it applied to operate the .WEBS gTLD with a view to reinforcing the reputation of its website

---

<sup>16</sup> Request, Annex 24 (Expert Determination in the SCO case *Web.com Group, Inc. v. Vistaprint Limited*, ICDR Consolidated Case Nos. 50 504 T 00221 13 and 50 504 T 00246 13 (Jan. 24, 2014) (“*Vistaprint SCO*”).

<sup>17</sup> ICANN Board Resolution 2013.06.25.NG07.

<sup>18</sup> ICANN Board Resolution 2014.10.12.NG02.

<sup>19</sup> Request, Annex 1 (Application IDs: 1-1033-22687 and 1-1033-73917). A community-based gTLD is a gTLD that is operated for the benefit of a clearly delineated community. An applicant designating its application as community-based must be prepared to substantiate its status as representative of the community it names in the application. A standard application is one that has not been designated as community-based. Response, ¶ 22 n. 22; *see also* Glossary of commonly used terms in the Guidebook, at <http://newgtlds.icann.org/en/applicants/glossary> (last accessed on Sept. 13, 2015).

creation tools and hosting services, known under the identifier “Webs”, and to represent the “Webs” community.<sup>20</sup> The .WEBS gTLD would identify Vistaprint as the Registry Operator, and the products and services under the .WEBS gTLD would be offered by and for the Webs community.<sup>21</sup>

10. Seven other applicants applied for the .WEB gTLD string.<sup>22</sup> Solely from the perspective of spelling, Vistaprint’s proposed .WEBS string differs by the addition of the letter “s” from the .WEB string chosen by these other applicants. On March 13, 2013, one of these applicants, Web.com Group, Inc. (the “Objector”), filed two identical String Confusion Objections as permitted under the Guidebook against Vistaprint’s two applications.<sup>23</sup> The Objector was the only .WEB applicant to file a SCO against Vistaprint’s applications. The Objector argued that the .WEBS and .WEB strings were confusingly similar from a visual, aural and conceptual perspective.<sup>24</sup> Vistaprint claims that the Objector’s “sole motive in filing the objection was to prevent a potential competitor from entering the gTLD market.”<sup>25</sup>

11. As noted above, Module 3 of the Guidebook is relevant to this IRP because it provides the objection procedures for new gTLD applications. Module 3 describes “the purpose of the objection and dispute resolution mechanisms, the grounds for lodging a formal objection to a gTLD application, the general procedures for filing or responding to an objection, and the manner in which dispute resolution proceedings are conducted.”<sup>26</sup> The module also discusses the guiding principles, or standards, that each dispute resolution panel will apply in reaching its expert determination. The Module states that

*“All applicants should be aware of the possibility that a formal objection may be filed against any application, and of the procedures and options available in the event of such an objection.”<sup>27</sup>*

12. Module 3, § 3.2 (Public Objection and Dispute Resolution Process) provides that

*In filing an application for a gTLD, the applicant agrees to accept the applicability of this gTLD dispute resolution process. Similarly, an objector accepts the applicability of this gTLD dispute resolution process by filing its objection.*

13. A formal objection may be filed on any one of four grounds, of which the SCO procedure is relevant to this case:

*String Confusion Objection – The applied-for gTLD string is confusingly similar to an existing TLD*

---

<sup>20</sup> Request, ¶ 5.

<sup>21</sup> Request, ¶ 17. Vistaprint states that the Webs community is predominantly comprised of non-US clients (54% non-US, 46% US).

<sup>22</sup> Request, ¶ 5.

<sup>23</sup> Request, ¶ 32.

<sup>24</sup> Request, ¶ 32.

<sup>25</sup> Request, ¶ 80.

<sup>26</sup> Guidebook, Module 3, p. 3-2. Module 3 also contains an attachment, the New gTLD Dispute Resolution Procedure (“New gTLD Objections Procedure”), which sets out the procedural rules for String Confusion Objections.

<sup>27</sup> Guidebook, Module 3, p. 3-2.



or to another applied-for gTLD string in the same round of applications.<sup>28</sup>

14. According to the Guidebook, the ICDR agreed to serve as the dispute resolution service provider (“DRSP”) to hear String Confusion Objections.<sup>29</sup> On May 6, 2013, the ICDR consolidated the handling of the two SCOs filed by the Objector against Vistaprint’s two .WEBS applications.<sup>30</sup>
15. Section 3.5 (Dispute Resolution Principles) of the Guidebook provides that the “objector bears the burden of proof in each case”<sup>31</sup> and sets out the relevant evaluation criteria to be applied to SCOs:
  - 3.5.1 String Confusion Objection

*A DRSP panel hearing a string confusion objection will consider whether the applied-for gTLD string is likely to result in string confusion. String confusion exists where a string so nearly resembles another that it is likely to deceive or cause confusion. For a likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user. Mere association, in the sense that the string brings another string to mind, is insufficient to find a likelihood of confusion.*
16. On May 23, 2013, Vistaprint filed its responses to the Objector’s String Confusion Objections.
17. On June 28, 2013, the ICDR appointed Steve Y. Koh as the expert to consider the Objections (the “First Expert”). In this IRP Vistaprint objects that this appointment was untimely.<sup>32</sup>
18. On 19 July 2013, the Objector submitted an unsolicited supplemental filing replying to Vistaprint’s response, to which Vistaprint objected.<sup>33</sup> Vistaprint claims that the supplemental submission should not have been accepted by the First Expert as it did not comply the New gTLD Objections Procedure.<sup>34</sup> The First Expert accepted the Objector’s submission and permitted Vistaprint to submit a sur-reply, which Vistaprint claims was subject to unfair conditions imposed by the First Expert.<sup>35</sup> Vistaprint filed its sur-reply on

---

<sup>28</sup> Guidebook, § 3.2.1.

<sup>29</sup> Guidebook, § 3.2.3.

<sup>30</sup> Request, ¶ 23, n. 24. The ICDR consolidated the handling of cases nos. 50 504 T 00221 13 and 50 504 T 00246 13. The Guidebook provides in § 3.4.2 that “[o]nce the DRSP receives and processes all objections, at its discretion the DRSP may elect to consolidate certain objections.”

<sup>31</sup> Guidebook, § 3.5. This standard is repeated in Article 20 of the Objection Procedure, which provides that “[t]he Objector bears the burden of proving that its Objection should be sustained in accordance with the applicable standards.”

<sup>32</sup> Request, ¶ 33.

<sup>33</sup> Response, ¶ 26.

<sup>34</sup> Request, ¶ 42. Article 17 provides that “[t]he Panel may decide whether the parties shall submit any written statements in addition to the Objection and the Response.” Article 18 states that “[i]n order to achieve the goal of resolving disputes over new gTLDs rapidly and at reasonable cost, procedures for the production of documents shall be limited. In exceptional cases, the Panel may require a party to provide additional evidence.”

<sup>35</sup> Vistaprint states that “this surreply was not to exceed 5 pages and was to be submitted within 29 days. This page limit and deadline are in stark contrast with the 58 day period taken by [the Objector] to submit a 6-page (Continued...)”

August 29, 2013.

19. On September 18, 2013 the ICDR informed the parties that the expert determination for the SCO case would be issued on or about October 4, 2013.<sup>36</sup> Vistaprint claims that this extension imposed an unjustified delay beyond the 45-day deadline for rendering a determination.<sup>37</sup>
20. On October 1, 2013, the ICDR removed the First Expert due to a conflict that arose. On October 14, 2013, the ICDR appointed Bruce W. Belding as the new expert (the “Second Expert”).<sup>38</sup> Vistaprint claims that the New gTLD Objections Procedure was violated when the First Expert did not maintain his independence and impartiality and the ICDR failed to react to Vistaprint’s concerns in this regard.<sup>39</sup>
21. On October 24, 2013, the Objector challenged the appointment of the Second Expert, to which Vistaprint responded on October 30, 2013. The challenge was based on the fact that the Second Expert had served as the expert in an unrelated prior string confusion objection, which Vistaprint maintained was not a reason for doubting the impartiality or independence of the Second Expert or accepting the challenge his appointment.<sup>40</sup> On November 4, 2013, the ICDR removed the Second Expert in response to the Objector’s challenge.<sup>41</sup> On November 5, 2013, Vistaprint requested that the ICDR reconsider its decision to accept the challenge to the appointment of the Second Expert. On November 8, 2013, the ICDR denied this request.<sup>42</sup> Vistaprint claims that the unfounded acceptance of the challenge to the Second Expert was a violation of the New gTLD Objections Procedure and the ICDR’s rules. The challenge was either unfounded and the ICDR should have rejected it, or it was founded, which would mean that the ICDR appointed the Second Expert knowing that justifiable doubts existed as to the Expert’s impartiality and independence.<sup>43</sup>
22. On November 20, 2013, the ICDR appointed Professor Ilhyung Lee to serve as the expert (the “Third Expert”) to consider the Objector’s string confusion objection. No party objected to the appointment of Professor Lee.<sup>44</sup>

---

reply with no less than 25 additional annexes. Vistaprint considers that the principle of equality of arms was not respected by this decision.” Request, ¶ 42.

<sup>36</sup> Request, Annex 14.

<sup>37</sup> Request, ¶ 33; *see* New Objections Procedure, Art. 21(a).

<sup>38</sup> Response, ¶ 27; Request, Annexes 15 and 16.

<sup>39</sup> Request, ¶¶ 36 and 43. New Objections Procedure, Art. 13(c).

<sup>40</sup> Request, ¶ 37.

<sup>41</sup> Response, ¶ 28; Request, ¶ 39, Annex 19.

<sup>42</sup> Request, ¶ 39, Annex 21.

<sup>43</sup> Request, ¶¶ 37-40. Vistaprint states that the Objector’s challenge was “based solely on the fact that Mr. Belding had served as the Panel in an unrelated string confusion objection” administered by ICDR. Request, ¶ 37. ICDR “was necessarily aware” that Mr. Belding had served as the Panel in the string confusion objection proceedings. “If [ICDR] was of the opinion that the fact that Mr. Belding served as the Panel in previous proceedings could give rise to justifiable doubts as to the impartiality and independence of the Panel, it should never have appointed him in the case between Web.com and Vistaprint.”

<sup>44</sup> Response, ¶ 28; Request, ¶ 39, Annex 22.

23. On 24 January 2014, the Third Expert issued its determination in favor of the Objector, deciding that the String Confusion Objection should be sustained.<sup>45</sup> The Expert concluded that

*“the <.webs> string so nearly resembles <.web> – visually, aurally and in meaning – that it is likely to cause confusion. A contrary conclusion, the Panel is simply unable to reach.”*<sup>46</sup>

24. Moreover, the Expert found that

*“given the similarity of <.webs> and <.web>..., it is probable, and not merely possible, that confusion will arise in the mind of the average, reasonable Internet user. This is not a case of ‘mere association’.”*<sup>47</sup>

25. Vistaprint claims that the Third Expert failed to comply with ICANN’s policies by (i) unjustifiably accepting additional submissions without making an independent assessment, (ii) making an incorrect application of the burden of proof, and (iii) making an incorrect application of the substantive standard set by ICANN for String Confusion Objections.<sup>48</sup> In particular, Vistaprint claims that ICANN has set a high standard for a finding of confusing similarity between two gTLD strings, and the Third Expert’s determination did not apply this standard and was arbitrary and baseless.<sup>49</sup>

26. Vistaprint concludes that “[i]n sum, the cursory nature of the Decision and the arbitrary and selective discussion of the parties’ arguments by the [Third Expert] show a lack of either independence and impartiality or appropriate qualification.”<sup>50</sup> Vistaprint further states that it took 216 days for the Third Expert to render a decision in a procedure that should have taken a maximum of 45 days.<sup>51</sup>

27. The Guidebook § 3.4.6 provides that:

*The findings of the panel will be considered an expert determination and advice that ICANN will accept within the dispute resolution process.*<sup>52</sup>

28. Vistaprint objects that ICANN simply accepted the Third Expert’s ruling on the String Confusion Objection, without performing any analysis as to whether the ICDR and the Third Expert complied with ICANN’s policies and fundamental principles, and without

---

<sup>45</sup> Request, ¶ 39, Annex 24 (Expert Determination, *Web.com Group, Inc. v. Vistaprint Limited*, ICDR Case Nos. 50 504 221 13 and 50 504 246 13 (Consolidated) (Jan. 24, 2014)).

<sup>46</sup> Request, Annex 24, p. 10.

<sup>47</sup> Request, Annex 24, p. 11.

<sup>48</sup> Request, ¶¶ 44-49.

<sup>49</sup> Vistaprint’s First Additional Submission, ¶¶ 1-2.

<sup>50</sup> Request, ¶ 49.

<sup>51</sup> Request, ¶ 41; see New gTLD Objections Procedure, Art. 21(a).

<sup>52</sup> Guidebook, § 3.4.6. The New gTLD Objections Procedure further provides in Article 2(d) that:

*The ‘Expert Determination’ is the decision upon the merits of the Objection that is rendered by a Panel in a proceeding conducted under this Procedure and the applicable DRSP Rules that are identified in Article 4(b).*

giving any rationale for doing so.<sup>53</sup>

29. Vistaprint contends that ICANN’s Board remains its ultimate decision-making body and that the Board should have intervened and “cannot blindly accept advice by third parties or expert determinations.”<sup>54</sup> In this respect, Vistaprint highlights the Guidebook, which provides in Module 5 (Transition to Delegation) § 1 that:

ICANN’s Board of Directors has ultimate responsibility for the New gTLD Program. The Board reserves the right to individually consider an application for a new gTLD to determine whether approval would be in the best interest of the Internet community. Under exceptional circumstances, the Board may individually consider a gTLD application. For example, the Board might individually consider an application as a result ... the use of an ICANN accountability mechanism.<sup>55</sup>

*[Underlining added]*

30. As a result of the Third Expert sustaining the Objector’s SCO, Vistaprint’s application was placed in a “Contention Set”. The Guidebook in § 3.2.2.1 explains this result:

*In the case where a gTLD applicant successfully asserts string confusion with another applicant, the only possible outcome is for both applicants to be placed in a contention set and to be referred to a contention resolution procedure (refer to Module 4, String Contention Procedures). If an objection by one gTLD applicant to another gTLD application is unsuccessful, the applicants may both move forward in the process without being considered in direct contention with one another.*<sup>56</sup>

## **B. Request for Reconsideration and Cooperative Engagement Process**

31. On February 6, 2014 Vistaprint filed a Request for Reconsideration (“Request for Reconsideration” or “RFR”).<sup>57</sup> According to ICANN’s Bylaws, a RFR is an accountability mechanism which involves a review conducted by the Board Governance Committee (“BGC”), a sub-committee designated by ICANN’s Board to review and consider Reconsideration Requests.<sup>58</sup> A RFR can be submitted by a person or entity that has been “adversely affected” by one or more staff actions or inactions that contradict established ICANN policies.<sup>59</sup>
32. Article IV, §2.15 of ICANN’s Bylaws sets forth the BGC’s authority and powers for handling Reconsideration Requests. The BGC, at its own option, may make a final determination on the RFR or it may make a recommendation to ICANN’s Board for

---

<sup>53</sup> Request, ¶ 50.

<sup>54</sup> Vistaprint’s First Additional Submission, ¶¶ 29-30.

<sup>55</sup> Guidebook, § 5.1.

<sup>56</sup> Guidebook, § 3.2.2.1. Module 4 (String Contention Procedures) provides that “*Contention sets are groups of applications containing identical or similar applied-for gTLD strings.*” Guidebook, § 4.1.1. Parties that are identified as being in contention are encouraged to reach settlement among. Guidebook, § 4.1.3. It is expected that most cases of contention will be resolved through voluntary agreement among the involved applicants or by the community priority evaluation mechanism. Conducting an auction is a tie-breaker mechanism of last resort for resolving string contention, if the contention has not been resolved by other means. Guidebook, § 4.3.

<sup>57</sup> Request, Annex 25.

<sup>58</sup> Response, ¶ 29; Bylaws, Art. IV, § 2.

<sup>59</sup> Bylaws, Art. IV, § 2.2.a.

consideration and action:

*For all Reconsideration Requests brought regarding staff action or inaction, the Board Governance Committee shall be delegated the authority by the Board of Directors to make a final determination and recommendation on the matter. Board consideration of the recommendation is not required. As the Board Governance Committee deems necessary, it may make recommendation to the Board for consideration and action. The Board Governance Committee's determination on staff action or inaction shall be posted on the Website. The Board Governance Committee's determination is final and establishes precedential value.*

33. ICANN has determined that the reconsideration process can be invoked for challenges to expert determinations rendered by panels formed by third party dispute resolution service providers, such as the ICDR, where it can be stated that the panel failed to follow the established policies or processes in reaching the expert determination, or that staff failed to follow its policies or processes in accepting that determination.<sup>60</sup>
34. In its RFR, Vistaprint asked ICANN to reject the Third Expert's decision and to instruct a new expert panel to issue a new decision "that applies the standards defined by ICANN."<sup>61</sup> Vistaprint sought reconsideration of the "various actions and inactions of ICANN staff related to the Expert Determination," claiming that "the decision fails to follow ICANN process for determining string confusion in many aspects."<sup>62</sup> In particular, Vistaprint asserted that the ICDR and the Third Expert violated the applicable New gTLD Objection Procedures concerning:
  - (i) the timely appointment of an expert panel;
  - (ii) the acceptance of additional written submissions;
  - (iii) the timely issuance of an expert determination;
  - (iv) an expert's duty to remain impartial and independent;
  - (v) challenges to experts;
  - (vi) the Objector's burden of proof; and
  - (vii) the standards governing the evaluation of a String Confusion Objection.
35. Vistaprint also argued that the decision was unfair, and accepting it creates disparate treatment without justified cause.<sup>63</sup>
36. The Bylaws provide in Article IV, § 2.3, that the BGC "shall have the authority to":
  - a. evaluate requests for review or reconsideration;
  - b. summarily dismiss insufficient requests;
  - c. evaluate requests for urgent consideration;
  - d. conduct whatever factual investigation is deemed appropriate;
  - e. request additional written submissions from the affected party, or from other parties;
  - f. make a final determination on Reconsideration Requests regarding staff action or inaction, without

---

<sup>60</sup> See BGC Recommendation on Reconsideration Request 14-5 dated February 27, 2014 ("BGC Determination"), at p. 7, n. 7, Request, Annex 26, and available at <https://www.icann.org/en/system/files/files/determination-vistaprint-27feb14-en.pdf> (last accessed on Sept. 14, 2015).

<sup>61</sup> Request, ¶ 51; Annex 25, p.7.

<sup>62</sup> Request, Annex 25, p.2.

<sup>63</sup> Request, Annex 25, p.6.

*reference to the Board of Directors; and*  
*g. make a recommendation to the Board of Directors on the merits of the request, as necessary.*

37. On February 27, 2014 the BGC issued its detailed Recommendation on Reconsideration Request, in which it denied Vistaprint’s reconsideration request finding “no indication that the ICDR or the [Third Expert] violated any policy or process in reaching the Determination.”<sup>64</sup> The BGC concluded that:

*With respect to each claim asserted by the Requester concerning the ICDR’s alleged violations of applicable ICDR procedures concerning experts, there is no evidence that the ICDR deviated from the standards set forth in the Applicant Guidebook, the New gTLD Dispute Resolution Procedure, or the ICDR’s Supplementary Procedures for String Confusion Objections (Rules). The Requester has likewise failed to demonstrate that the Panel applied the wrong standard in contravention of established policy or procedure. Therefore, the BGC concludes that Request 14-5 be denied.*<sup>65</sup>

38. The BGC explained what it considered to be the scope of its review:

*In the context of the New gTLD Program, the reconsideration process does not call for the BGC to perform a substantive review of expert determinations. Accordingly, the BGC is not to evaluate the Panel’s substantive conclusion that the Requester’s applications for .WEBS are confusingly similar to the Requester’s application for .WEB. Rather, the BGC’s review is limited to whether the Panel violated any established policy or process in reaching that Determination.*<sup>66</sup>

39. The BGC also stated that its determination on Vistaprint’s RFR was final:

*In accordance with Article IV, Section 2.15 of the Bylaws, the BGC’s determination on Request 14-5 shall be final and does not require Board (or NGPC<sup>67</sup>) consideration. The Bylaws provide that the BGC is authorized to make a final determination for all Reconsideration Requests brought regarding staff action or inaction and that the BGC’s determination on such matters is final. (Bylaws, Art. IV, § 2.15.) As discussed above, Request 14-5 seeks reconsideration of a staff action or inaction. After consideration of this Request, the BGC concludes that this determination is final and that no further consideration by the Board is warranted.*<sup>68</sup>

40. On March 17, 2014, Vistaprint filed a request for a Cooperative Engagement Process

---

<sup>64</sup> BGC Determination, p. 18, Request, Annex 26.

<sup>65</sup> BGC Determination, p. 2, Request, Annex 26.

<sup>66</sup> BGC Determination, p. 7, Request, Annex 26.

<sup>67</sup> The “NGPC” refers to the New gTLD Program Committee, which is a sub-committee of the Board and “has all the powers of the Board.” See New gTLD Program Committee Charter | As Approved by the ICANN Board of Directors on 10 April 2012, at <https://www.icann.org/resources/pages/charter-2012-04-12-en> (last accessed Sept. 15, 2015).

<sup>68</sup> BGC Determination, p. 19, Request, Annex 26. As noted, the BGC concluded that its determination on Vistaprint’s RFR was final and made no recommendation to ICANN’s Board for consideration and action. Article IV, §2.17 of ICANN’s Bylaws sets out the scope of the Board’s authority for matters in which the BGC decides to make a recommendation to ICANN’s Board:

*The Board shall not be bound to follow the recommendations of the Board Governance Committee. The final decision of the Board shall be made public as part of the preliminary report and minutes of the Board meeting at which action is taken. The Board shall issue its decision on the recommendation of the Board Governance Committee within 60 days of receipt of the Reconsideration Request or as soon thereafter as feasible. Any circumstances that delay the Board from acting within this timeframe must be identified and posted on ICANN’s website. The Board’s decision on the recommendation is final.*

“CEP”) with ICANN.<sup>69</sup> Vistaprint stated in its letter:

*Vistaprint is of the opinion that the Board of Governance Committee’s rejection of Reconsideration Request 14-5 is in violation of various provisions of ICANN’s Bylaws and Articles of Incorporation. In particular, Vistaprint considers this is in violation of Articles I, II(3), III and IV of the ICANN Bylaws as well as Article 4 of ICANN’s Articles of Incorporation. In addition, Vistaprint considers that ICANN has acted in violation of Articles 3, 7 and 9 of ICANN’s Affirmation of Commitment.*<sup>70</sup>

41. The CEP did not lead to a resolution and Vistaprint thereafter commenced this IRP. In this regard, Module 6.6 of the Guidebook provides that an applicant for a new gTLD:

*MAY UTILIZE ANY ACCOUNTABILITY MECHANISM SET FORTH IN ICANN’S BYLAWS FOR PURPOSES OF CHALLENGING ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION.*<sup>71</sup>

### C. Procedures in this Case

42. On June 11, 2014, Vistaprint submitted its Request for Independent Review Process (“Request”) in respect of ICANN’s treatment of Vistaprint’s application for the .WEBS gTLD. On July 21, 2014, ICANN submitted its Response to Vistaprint’s Request (“Response”).
43. On January 13, 2015, the ICDR confirmed that there were no objections to the constitution of the present IRP Panel (“IRP Panel” or “Panel”). The Panel convened a telephonic preliminary hearing with the parties on January 26, 2015 to discuss background and organizational matters in the case. Having heard the parties, the Panel issued Procedural Order No. 1 permitting an additional round of submissions from the parties. The Panel received Vistaprint’s additional submission on March 2, 2015 (Vistaprint’s “First Additional Submission”) and ICANN’s response on April 2, 2015 (ICANN’s “First Additional Response”).
44. The Panel then received further email correspondence from the parties. In particular, Vistaprint requested that the case be suspended pending an upcoming meeting of ICANN’s Board of Directors, which Vistaprint contended would be addressing matters informative for this IRP. Vistaprint also requested that it be permitted to respond to arguments and information submitted by ICANN in ICANN’s First Additional Response. In particular, Vistaprint stated that ICANN had referenced the Final Declaration of March 3, 2015 in the IRP case involving *Booking.com v. ICANN* (the “*Booking.com Final Declaration*”).<sup>72</sup> The *Booking.com Final Declaration* was issued one day after Vistaprint had submitted its First Additional Submission in this case. ICANN objected to Vistaprint’s requests, urging that there was no need for additional briefing and no justification for suspending the case.

---

<sup>69</sup> Request, Annex 27.

<sup>70</sup> Request, Annex 27.

<sup>71</sup> Guidebook, § 6.6.

<sup>72</sup> *Booking.com B.V. v. ICANN*, ICDR Case No. 50-2014-000247 (March 3, 2015) (“*Booking.com Final Declaration*”), at <https://www.icann.org/en/system/files/files/final-declaration-03mar15-en.pdf> (last accessed on Sept. 15, 2015)

45. On April 19, 2015, the Panel issued Procedural Order No. 2, which denied Vistaprint's request that the case be suspended and permitted Vistaprint and ICANN to submit another round of supplemental submissions. Procedural Order No. 2 also proposed two dates for a telephonic hearing with the parties on the substantive issues and the date of May 13, 2015 was subsequently selected. The Panel received Vistaprint's second additional submission on April 24, 2015 (Vistaprint's "Second Additional Submission") and ICANN's response to that submission on May 1, 2015 (ICANN's "Second Additional Response").
46. The Panel then received a letter from Vistaprint dated April 30, 2015 and ICANN's reply of the same date. In its letter, Vistaprint referred to two new developments that it stated were relevant for this IRP case: (i) the Third Declaration on the IRP Procedure, issued April 20, 2015, in the IRP involving *DotConnectAfrica Trust v. ICANN*<sup>73</sup>, and (ii) the ICANN Board of Director's resolution of April 26, 2015 concerning the *Booking.com Final Declaration*. Vistaprint requested that more time be permitted to consider and respond to these new developments, while ICANN responded that the proceedings should not be delayed.
47. Following further communications with the parties, May 28, 2015 was confirmed as the date for a telephonic hearing to receive the parties' oral submissions on the substantive issues in this case. On that date, counsel for the parties were provided with the opportunity to make extensive oral submissions in connection with all of the facts and issues raised in this case and to answer questions from the Panel.<sup>74</sup>
48. Following the May 28, 2015 hear, the Panel held deliberations to consider the issues in this IRP, with further deliberations taking place on subsequent dates. This Final Declaration was provided to the ICDR in draft form on October 5, 2015 for non-substantive comments on the text; it was returned to the Panel on October 8, 2015.

### **III. ICANN's Articles, Bylaws, and Affirmation of Commitments**

49. Vistaprint states that the applicable law for these IRP proceedings is found in ICANN's Articles of Incorporation and Bylaws. Both Vistaprint and ICANN make numerous references to these instruments. This section sets out a number of the key provisions of

---

<sup>73</sup> Third Declaration on the IRP Procedure, *DotConnectAfrica Trust v. ICANN*, ICDR Case No. 50-2013-001083 (April 20, 2015) ("*DCA Third Declaration on IRP Procedure*"), at <https://www.icann.org/en/system/files/files/irp-procedure-declaration-20apr15-en.pdf> (last accessed on Sept. 15, 2015)

<sup>74</sup> The Panel conducted these IRP proceedings relying on email and telephonic communications, with no objections to this approach from either party and in view of ICANN's Bylaws, Article IV, § 3.12 ("*In order to keep the costs and burdens of independent review as low as possible, the IRP Panel should conduct its proceedings by email and otherwise via the Internet to the maximum extent feasible. Where necessary, the IRP Panel may hold meetings by telephone.*").



the Articles and the Bylaws, as they are relied upon by the parties in this IRP.<sup>75</sup> Vistaprint also references the Affirmation of Commitments – relevant provisions of this document are also provided below.

### **A. Articles of Incorporation**

50. Vistaprint refers to the Articles of Incorporation, highlighting Article IV’s references to “relevant principles of international law” and “open and transparent processes”. Article 4 of the Articles provides in relevant part:

*The Corporation shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law and, to the extent appropriate and consistent with these Articles and its Bylaws, through open and transparent processes that enable competition and open entry in Internet-related markets.*

*[Underlining added]*

51. Vistaprint states that general principles of international law – and in particular the obligation of good faith – serve as a prism through which the various obligations imposed on ICANN under its Articles of Incorporation and Bylaws must be interpreted.<sup>76</sup> The general principle of good faith is one of the most basic principles governing the creation and performance of legal obligations, and rules involving transparency, fairness and non-discrimination arise from it.<sup>77</sup> Vistaprint also emphasizes that the principle of good faith includes an obligation to ensure procedural fairness by adhering to substantive and procedural rules, avoiding arbitrary action, and recognizing legitimate expectations.<sup>78</sup> The core elements of transparency include clarity of procedures, the publication and notification of guidelines and applicable rules, and the duty to provide reasons for actions taken.<sup>79</sup>

### **B. Bylaws**

#### **a. Directives to ICANN and its Board**

52. The Bylaws contain provisions that address the role, core values and accountability of ICANN and its Board.
53. Article IV, § 3.2 specifies the right of “any person materially affected” to seek independent review (through the IRP) of a Board action alleged to be a violation of the

---

<sup>75</sup> ICANN’s Articles are available at <https://www.icann.org/resources/pages/governance/articles-en> (last accessed on Sept. 15, 2015). ICANN’s Bylaws are available at <https://www.icann.org/resources/pages/governance/bylaws-en> (last accessed on Sept. 15, 2015).

<sup>76</sup> Request, ¶ 55. Vistaprint also states that “U.S. and California law, like almost all jurisdictions, recognize obligations to act in good faith and ensure procedural fairness. The requirement of procedural fairness has been an established part of the California common law since before the turn of the 19th century.” Request, ¶ 60, n.8.

<sup>77</sup> Request, ¶ 59.

<sup>78</sup> Request, ¶ 60.

<sup>79</sup> Request, ¶ 66.

## Articles or Bylaws:

*Any person materially affected by a decision or action by the Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws may submit a request for independent review of that decision or action. In order to be materially affected, the person must suffer injury or harm that is directly and causally connected to the Board's alleged violation of the Bylaws or the Articles of Incorporation, and not as a result of third parties acting in line with the Board's action.*

54. Vistaprint has relied on certain of ICANN's core values set forth in Article I, § 2 (Core Values) of the Bylaws. The sub-sections underlined below are invoked by Vistaprint as they relate to principles of promoting competition and innovation (Article I § 2.2, 2.5 and 2.6); openness and transparency (Article I § 2.7); neutrality, fairness, integrity and non-discrimination (Article I § 2.8); and accountability (Article I § 2.10). Article I § 2 provides in full:

### *Section 2. Core Values*

*In performing its mission, the following core values should guide the decisions and actions of ICANN:*

*1. Preserving and enhancing the operational stability, reliability, security, and global interoperability of the Internet.*

*2. Respecting the creativity, innovation, and flow of information made possible by the Internet by limiting ICANN's activities to those matters within ICANN's mission requiring or significantly benefiting from global coordination.*

*3. To the extent feasible and appropriate, delegating coordination functions to or recognizing the policy role of other responsible entities that reflect the interests of affected parties.*

*4. Seeking and supporting broad, informed participation reflecting the functional, geographic, and cultural diversity of the Internet at all levels of policy development and decision-making.*

*5. Where feasible and appropriate, depending on market mechanisms to promote and sustain a competitive environment.*

*6. Introducing and promoting competition in the registration of domain names where practicable and beneficial in the public interest.*

*7. Employing open and transparent policy development mechanisms that (i) promote well-informed decisions based on expert advice, and (ii) ensure that those entities most affected can assist in the policy development process.*

*8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.*<sup>80</sup>

*9. Acting with a speed that is responsive to the needs of the Internet while, as part of the decision-making process, obtaining informed input from those entities most affected.*

*10. Remaining accountable to the Internet community through mechanisms that enhance ICANN's effectiveness.*

---

<sup>80</sup> Vistaprint states that “[t]his requirement is also found in applicable California law, which requires that decisions be made according to procedures that are ‘fair and applied uniformly’, and not in an ‘arbitrary and capricious manner.’” Request, ¶ 62, n.9.

11. While remaining rooted in the private sector, recognizing that governments and public authorities are responsible for public policy and duly taking into account governments' or public authorities' recommendations.

*These core values are deliberately expressed in very general terms, so that they may provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each new situation will necessarily depend on many factors that cannot be fully anticipated or enumerated; and because they are statements of principle rather than practice, situations will inevitably arise in which perfect fidelity to all eleven core values simultaneously is not possible. Any ICANN body making a recommendation or decision shall exercise its judgment to determine which core values are most relevant and how they apply to the specific circumstances of the case at hand, and to determine, if necessary, an appropriate and defensible balance among competing values.*

*[Underlining added]*

55. Vistaprint refers to Article II, § 3 in support of its arguments that the Board failed to act fairly and without discrimination as it considered Vistaprint's two .WEBS applications and the outcome of the *Vistaprint SCO* case. Article II, § 3 provides:

*Section 3 (Non-Discriminatory Treatment)*

*ICANN shall not apply its standards, policies, procedures, or practices inequitably or single out any particular party for disparate treatment unless justified by substantial and reasonable cause, such as the promotion of effective competition.*

*[Underlining added]*

56. Vistaprint refers to Article III (Transparency), § 1 of the Bylaws in reference to the principle of transparency:

*Section 1. PURPOSE*

*ICANN and its constituent bodies shall operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness.*

*[Underlining added]*

57. Vistaprint also refers Article IV (Accountability and Review), § 1 as it relates to ICANN's accountability and core values, providing in relevant part:

*In carrying out its mission as set out in these Bylaws, ICANN should be accountable to the community for operating in a manner that is consistent with these Bylaws, and with due regard for the core values set forth in Article I of these Bylaws.*

*[Underlining added]*

**b. Directives for the IRP Panel**

58. ICANN's Bylaws also contain provisions that speak directly to the role and authority of the Panel in this IRP case. In particular, Article IV of the Bylaws creates the IRP as an accountability mechanism, along with two other mechanisms: (i) the RFR process, described above and on which Vistaprint relied, and (ii) an unrelated periodic review of

ICANN's structure and procedures.<sup>81</sup>

59. Article IV, § 1 of the Bylaws emphasizes that the IRP is a mechanism designed to ensure ICANN's accountability:

The provisions of this Article, creating processes for reconsideration and independent review of ICANN actions and periodic review of ICANN's structure and procedures, are intended to reinforce the various accountability mechanisms otherwise set forth in these Bylaws, including the transparency provisions of Article III and the Board and other selection mechanisms set forth throughout these Bylaws.

[Underlining added]

60. In this respect, the IRP Panel provides an independent review and accountability mechanism for ICANN and its Board. Vistaprint urges that IRP is the *only* method established by ICANN for holding itself accountable through independent third-party review of its decisions.<sup>82</sup> The Bylaws in Article IV, § 3.1 provides:

*In addition to the reconsideration process described in Section 2 of this Article, ICANN shall have in place a separate process for independent third-party review of Board actions alleged by an affected party to be inconsistent with the Articles of Incorporation or Bylaws.*

61. ICANN states in its Response that “[t]he IRP Panel is tasked with determining whether the Board’s actions are consistent with ICANN’s Articles and Bylaws.”<sup>83</sup> ICANN also maintains that while the IRP is intended to address challenges to conduct undertaken by ICANN’s Board, it is not available as a mechanism to challenge the actions or inactions of ICANN staff or third parties that may be involved with ICANN’s activities.<sup>84</sup>

62. In line with ICANN’s statement, the Bylaws provide in Article IV, § 3.4, that:

Requests for such independent review shall be referred to an Independent Review Process Panel (“IRP Panel”), which shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws.<sup>85</sup>

[Underlining added]

63. The Bylaws also include a standard of review in Article IV, § 3.4, providing that the Panel:

---

<sup>81</sup> Note that Article V (Ombudsman) of the Bylaws also establishes the Office of Ombudsman to facilitate the fair, impartial, and timely resolution of problems and complaints for those matters where the procedures of the RFR or the IRP have not been invoked.

<sup>82</sup> Request, ¶ 57.

<sup>83</sup> Response, ¶ 33.

<sup>84</sup> Response, ¶ 4.

<sup>85</sup> Bylaws, Art. IV, § 3.4. The reference to “actions” of ICANN’s Board should be read to refer to both “actions or inactions” of the Board. See Bylaws, Art. IV, § 3.11(c) (“The IRP Panel shall have the authority to:...(c) declare whether an *action or inaction* of the Board was inconsistent with the Articles of Incorporation or Bylaws”); see also Supplementary Procedures, which define “Independent Review” as referring

*“to the procedure that takes place upon the filing of a request to review ICANN Board actions or inactions alleged to be inconsistent with ICANN's Bylaws or Articles of Incorporation.*

“must apply a defined standard of review to the IRP request, focusing on:

- a. did the Board act without conflict of interest in taking its decision?;
- b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?<sup>86</sup>

64. The Bylaws in Article IV, § 3.11 set out the IRP Panel’s authority in terms of alternative actions that it may take once it has an IRP case before it:

*The IRP Panel shall have the authority to:*

- a. summarily dismiss requests brought without standing, lacking in substance, or that are frivolous or vexatious;
- b. request additional written submissions from the party seeking review, the Board, the Supporting Organizations, or from other parties;
- c. declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws; and
- d. recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP;
- e. consolidate requests for independent review if the facts and circumstances are sufficiently similar; and
- f. determine the timing for each proceeding.<sup>87</sup>

65. Further, the Bylaws in Article IV, § 3.18 state that

*“[t]he IRP Panel shall make its declaration based solely on the documentation, supporting materials, and arguments submitted by the parties, and in its declaration shall specifically designate the prevailing party.”<sup>88</sup>*

*[Underlining added]*

66. The Bylaws address the steps to be taken after the Panel issues a determination in the IRP. Article IV, § 3.21<sup>89</sup> states that “declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value”:

*Where feasible, the Board shall consider the IRP Panel declaration at the Board’s next meeting. The declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value.*

*[Underlining added]*

### **C. Affirmation of Commitments**

67. Vistaprint claims that ICANN violated the ICANN’s Affirmation of Commitments, in particular Articles 3, 7 and 9. This Affirmation of Commitments is instructive, as it explains ICANN’s obligations in light of its role as regulator of the DNS. Article 3, 7 and 9 are set forth below in relevant part:

---

<sup>86</sup> Bylaws, Art. IV, § 3.4.

<sup>87</sup> Bylaws, Art. IV, § 3.11.

<sup>88</sup> Bylaws, Art. IV, § 3.18.

<sup>89</sup> This section was added by the amendments to the Bylaws on April 11, 2013.

3. This document affirms key commitments by DOC and ICANN, including commitments to: (a) ensure that decisions made related to the global technical coordination of the DNS are made in the public interest and are accountable and transparent; (b) preserve the security, stability and resiliency of the DNS; (c) promote competition, consumer trust, and consumer choice in the DNS marketplace; and (d) facilitate international participation in DNS technical coordination.

\* \* \* \*

7. ICANN commits to adhere to transparent and accountable budgeting processes, fact-based policy development, cross-community deliberations, and responsive consultation procedures that provide detailed explanations of the basis for decisions, including how comments have influenced the development of policy consideration, and to publish each year an annual report that sets out ICANN's progress against ICANN's bylaws, responsibilities, and strategic and operating plans. In addition, ICANN commits to provide a thorough and reasoned explanation of decisions taken, the rationale thereof and the sources of data and information on which ICANN relied.

9. Recognizing that ICANN will evolve and adapt to fulfill its limited, but important technical mission of coordinating the DNS, ICANN further commits to take the following specific actions together with ongoing commitment reviews specified below:

9.1 Ensuring accountability, transparency and the interests of global Internet users: ICANN commits to maintain and improve robust mechanisms for public input, accountability, and transparency so as to ensure that the outcomes of its decision-making will reflect the public interest and be accountable to all stakeholders by: (a) continually assessing and improving ICANN Board of Directors (Board) governance which shall include an ongoing evaluation of Board performance, the Board selection process, the extent to which Board composition meets ICANN's present and future needs, and the consideration of an appeal mechanism for Board decisions; (b) assessing the role and effectiveness of the GAC and its interaction with the Board and making recommendations for improvement to ensure effective consideration by ICANN of GAC input on the public policy aspects of the technical coordination of the DNS; (c) continually assessing and improving the processes by which ICANN receives public input (including adequate explanation of decisions taken and the rationale thereof); (d) continually assessing the extent to which ICANN's decisions are embraced, supported and accepted by the public and the Internet community; and (e) assessing the policy development process to facilitate enhanced cross community deliberations, and effective and timely policy development. ICANN will organize a review of its execution of the above commitments no less frequently than every three years, ..... Each of the foregoing reviews shall consider the extent to which the assessments and actions undertaken by ICANN have been successful in ensuring that ICANN is acting transparently, is accountable for its decision-making, and acts in the public interest. Integral to the foregoing reviews will be assessments of the extent to which the Board and staff have implemented the recommendations arising out of the other commitment reviews enumerated below.

\* \* \* \*

9.3 Promoting competition, consumer trust, and consumer choice: ICANN will ensure that as it contemplates expanding the top-level domain space, the various issues that are involved (including competition, consumer protection, security, stability and resiliency, malicious abuse issues, sovereignty concerns, and rights protection) will be adequately addressed prior to implementation. If and when new gTLDs (whether in ASCII or other language character sets) have been in operation for one year, ICANN will organize a review that will examine the extent to which the introduction or expansion of gTLDs has promoted competition, consumer trust and consumer choice, as well as effectiveness of (a) the application and evaluation process, and (b) safeguards put in place to mitigate issues involved in the introduction or expansion. ICANN will organize a further review of its execution of the above commitments two years after the first review, and then no less frequently than every four years.... Resulting recommendations of the reviews will be provided to the Board and posted for public comment. The Board will take action within six months of receipt of the recommendations.

{Underlining added}

#### IV. Summary of Parties' Contentions

68. This presentation of the parties' contentions is intended to provide a summary to aid in understanding this Final Declaration. It is not an exhaustive recitation of the entirety of the parties' allegations and arguments. Additional references to the parties' assertions are included in sections II (Factual and Procedural Background), III (ICANN's Articles, Bylaws and Affirmation of Commitments) and V (Analysis and Findings).
69. The IRP Panel has organized the parties' contentions into three categories, based on the areas of claim and dispute that have emerged through the exchange of three rounds of submissions between the parties and the Panel. The *first* section relates to the authority of the Panel, while the *second* and *third* sections address the allegations asserted by Vistaprint, which fall into two general areas of claim. In this regard, Vistaprint claims that the ICDR and Third Expert made numerous errors of procedure and substance during the String Confusion Objection proceedings, which resulted in Vistaprint being denied a fair hearing and due process. As a result of the flawed SCO proceedings, Vistaprint alleged that ICANN through its Board (and the BGC), in turn: (i) violated its Articles, Bylaws and the Guidebook (e.g., failed to act in good faith, fairly, non-arbitrarily, with accountability, due diligence, and independent judgment) by accepting the determination in the *Vistaprint SCO* and failing to redress and remedy the numerous alleged process and substantive errors in the SCO proceedings, and (ii) discriminated against Vistaprint, in violation of its Articles and Bylaws, by delaying Vistaprint's .WEBS gTLD applications and putting them into a Contention Set, while allowing other gTLD applications with equally serious string similarity concerns to proceed to delegation, or permitting still other applications that were subject to an adverse SCO determination to go through a separate additional review mechanism.
70. Thus, the three primary areas of contention between the parties are as follows:
- IRP Panel' Authority: The parties have focused on the authority of the IRP Panel, including the *standard of review* to be applied by the Panel, whether the Panel's IRP declaration is *binding* or *non-binding* on ICANN, and, on a very closely related point, whether the Panel has authority to award any *affirmative relief* (as compared to issuing only a declaration as to whether or not ICANN has acted in a manner that is consistent or not with its Articles and Bylaws).
  - SCO Proceedings Claim: Vistaprint claims ICANN's failed to comply with the obligations under its Articles and Bylaws by accepting the Third Expert's SCO determination and failing to provide a remedy or redress in response to numerous alleged errors of process and substance in the *Vistaprint SCO* proceedings. As noted above, Vistaprint claims there were process and substantive violations, which resulted in Vistaprint not being accorded a fair hearing and due process. Vistaprint states that because ICANN's Bylaws require ICANN to apply established policies neutrally and fairly, therefore, the Panel should also consider the policies in Module 3 of the

Guidebook concerning the String Confusion Objection procedures. Vistaprint objects to the policies themselves as well as their implementation through the ICDR and the Third Expert. Vistaprint claims that ICANN’s Board, acting through the BGC or otherwise, should have acted to address these deficiencies and its choice not to intervene violated the Articles and Bylaws.

- Disparate Treatment Claim: Vistaprint claims ICANN discriminated against Vistaprint through ICANN’s (and the BGC’s) acceptance of the Third Expert’s allegedly baseless and arbitrary determination in *Vistaprint SCO*, while allowing other gTLD applications with equally serious string similarity concerns to proceed to delegation, or permitting still other applications that were subject to an adverse SCO determination to go through a separate additional review mechanism.

## A. Vistaprint’s Position

### a. IRP Panel’s Authority

71. Standard of review: Vistaprint emphasizes that ICANN is accountable to the community for operating in a manner that is consistent with the Article and Bylaws, and with due regard for the core values set forth in Article I of the Bylaws. To achieve this required accountability, the IRP Panel is “charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws.”<sup>90</sup> Vistaprint states that the IRP Panel’s fulfillment of this core obligation is crucial to ICANN’s commitment to accountability. The IRP is the only method established by ICANN for holding itself accountable through third-party review of its decisions.<sup>91</sup>
72. Vistaprint contends that ICANN is wrong in stating (in its Response<sup>92</sup>) that a deferential standard of review applies in this case.<sup>93</sup> No such specification is made in ICANN’s Bylaws or elsewhere, and a restrictive interpretation of the standard of review would be inappropriate. It would fail to ensure accountability on the part of ICANN and would be incompatible with ICANN’s commitment to maintain and improve robust mechanisms for accountability, as required by Article 9.1 of ICANN’s Affirmation of Commitments and ICANN’s core values, which require ICANN to “remain accountable to the Internet community through mechanisms that enhance ICANN’s effectiveness”.<sup>94</sup>
73. Vistaprint states further that the most recent version of ICANN’s Bylaws, amended on

---

<sup>90</sup> Request, ¶ 55-56 (citing Bylaws, Art. IV, §§1 & 3.4).

<sup>91</sup> Request, ¶ 57.

<sup>92</sup> Response, ¶ 33.

<sup>93</sup> Vistaprint’s First Additional Submission, ¶ 36.

<sup>94</sup> Vistaprint’s First Additional Submission, ¶¶ 36-37; Request, ¶ 57.



April 11, 2013, require that the IRP Panel focus on whether ICANN's Board was free from conflicts of interest and exercised an appropriate level of due diligence and independent judgment in its decision making.<sup>95</sup> Vistaprint asserts, however, that these issues are mentioned by way of example only. The Bylaws do not restrict the IRP Panel's remit to these issues alone, as the Panel's fundamental task is to determine whether the Board has acted consistently with the Articles and Bylaws<sup>96</sup>

74. IRP declaration binding or non-binding: Vistaprint contends that the outcome of this IRP is binding on ICANN and that any other outcome "would be incompatible with ICANN's obligation to maintain and improve robust mechanisms for accountability."<sup>97</sup>
75. Vistaprint states that since ICANN's amendment of its Bylaws, IRP declarations have precedential value.<sup>98</sup> Vistaprint asserts the precedential value – and binding force – of IRP declarations was confirmed in a recent IRP panel declaration,<sup>99</sup> which itself has precedential value for this case. Vistaprint argues that any other outcome would effectively grant the ICANN Board arbitrary and unfettered discretion, something which was never intended and would be incompatible with ICANN's obligation to maintain and improve robust mechanisms for accountability.<sup>100</sup>
76. Vistaprint contends that the IRP is not a mere "corporate accountability mechanism" aimed at ICANN's internal stakeholders.<sup>101</sup> The IRP is open to any person materially affected by a decision or action of the Board<sup>102</sup> and is specifically available to new gTLD applicants, as stated in the Guidebook, Module 6.4. Vistaprint claims that *internally*, towards its stakeholders, ICANN might be able to argue that its Board retains ultimate decision-making power, subject to its governing principles. *Externally*, however, the ICANN Board's discretionary power is limited, and ICANN and its Board must offer redress when its decisions or actions harm third parties.<sup>103</sup>
77. Vistaprint argues further that the IRP has all the characteristics of an international arbitration.<sup>104</sup> The IRP is conducted pursuant to a set of independently developed

---

<sup>95</sup> Bylaws, Article IV, § 3.4.

<sup>96</sup> Vistaprint's First Additional submission, ¶ 35.

<sup>97</sup> Vistaprint's First Additional Submission, ¶ 37.

<sup>98</sup> Vistaprint's First Additional Submission, ¶ 37 (citing Bylaws, Art. IV § 3.21).

<sup>99</sup> See *DCA Third Declaration on IRP Procedure*, ¶ 131 (the panel ruled that "[b]ased on the foregoing and the language and content of the IRP Procedure, the Panel concludes that this Declaration and its future Declaration on the Merits of this case are binding on the Parties").

<sup>100</sup> Vistaprint's First Additional Submission, ¶ 37.

<sup>101</sup> Vistaprint's Second Additional Submission, ¶ 29.

<sup>102</sup> Bylaws, Article IV § 3.2 ("Any person materially affected by a decision or action by the Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws may submit a request for independent review of that decision or action.").

<sup>103</sup> Vistaprint's Second Additional Submission, ¶ 15.

<sup>104</sup> Vistaprint's Second Additional Submission, ¶ 27.

international arbitration rules: the ICDR Rules, as modified by the Supplementary Procedures. The IRP is administered by the ICDR, which is a provider of international arbitration services. The decision-maker is not ICANN, but a panel of neutral individuals selected by the parties in consultation with the ICDR, and appointed pursuant to the ICDR Rules.

78. Vistaprint provides further detailed argument in its Second Additional Submission that the IRP is binding in view of ICANN's Bylaws, the ICDR Rules and the Supplementary Procedures, and that any ambiguity on this issue should weigh against ICANN as the drafter and architect of the IRP:

*31. As mentioned in Vistaprint's Reply, a previous IRP panel ruled that "[v]arious provisions of ICANN's Bylaws and the Supplementary Procedures support the conclusion that the [IRP] Panel's decisions, opinions and declarations are binding" and that "[t]here is certainly nothing in the Supplementary Rules that renders the decisions, opinions and declarations of the [IRP] Panel either advisory or non-binding" (RM 32, para 98).<sup>105</sup>*

*32. Indeed, as per Article IV(3)(8) of the ICANN Bylaws, the ICANN Board has given its approval to the ICDR to establish a set of operating rules and procedures for the conduct of the IRP. The operating rules and procedures established by the ICDR are the ICDR Rules as referred to in the preamble of the Supplementary Procedures (RM 32, para. 101). The Supplementary Procedures supplement the ICDR Rules (Supplementary Procedures, Preamble and Section 2). The preamble of the ICDR Rules provides that "[a] dispute can be submitted to an arbitral tribunal for a final and binding decision". Article 30 of the ICDR Rules specifies that "[a]wards shall be made in writing by the arbitral tribunal and shall be final and binding on the parties". No provision in the Supplementary Procedures deviates from the rule that the Panel's decisions are binding. On the contrary, Section 1 of the Supplementary Procedures defines an IRP Declaration as a decision/opinion of the IRP Panel. Section 10 of the Supplementary Procedures requires that IRP Declarations i) are made in writing, and ii) specifically designate the prevailing party. Where a decision must specifically designate the prevailing party, it is inherently binding. Moreover the binding nature of IRP Declarations is further supported by the language and spirit of Section 6 of the Supplementary Procedures and Article IV(3)(11)(a) of the ICANN Bylaws. Pursuant to these provisions, the IRP Panel has the authority to summarily dismiss requests brought without standing, lacking in substance, or that are frivolous or vexatious. Surely, such a decision, opinion or declaration on the part of the IRP Panel would not be considered advisory (RM 32, para. 107).*

*33. Finally, even if ICANN's Bylaws and Supplementary Procedures are ambiguous - quod non - on the question of whether or not an IRP Declaration is binding, this ambiguity would weigh against ICANN. The relationship between ICANN and Vistaprint is clearly an adhesive one. In such a situation, the rule of contra proferentem applies. As the drafter and architect of the IRP Procedure, it was possible for ICANN, and clearly within its power, to adopt a procedure that expressly and clearly announced that the decisions, opinions and declarations of IRP Panels were advisory only. ICANN did not adopt such a procedure (RM 32, paras. 108-109).*

79. Finally, Vistaprint contends that ICANN conceived of the IRP as an alternative to dispute

---

<sup>105</sup> Citing *DCA Third Declaration on IRP Procedure*, ¶ 98.

resolution by the courts. To submit a new gTLD application, Vistaprint had to agree to terms and conditions including a waiver of its right to challenge ICANN's decisions on Vistaprint's applications in a court, provided that as an applicant, Vistaprint could use the accountability mechanisms set forth in ICANN's Bylaws. Vistaprint quotes the *DCA Third Declaration on Procedure*, in which the IRP panel stated:

*assuming that the foregoing waiver of any and all judicial remedies is valid and enforceable, the ultimate 'accountability' remedy for [Vistaprint] is the IRP.*<sup>106</sup>

80. Authority to award affirmative relief: Vistaprint makes similar arguments in support of its claim that the IRP Panel has authority to grant affirmative relief. Vistaprint quotes the *Interim Declaration on Emergency Request for Interim Measures of Protection in Gulf Cooperation Council v. ICANN* (“GCC Interim IRP Declaration”),<sup>107</sup> where that panel stated that the right to an independent review is

*a significant and meaningful one under the ICANN's Bylaws. This is so particularly in light of the importance of ICANN's global work in overseeing the DNS for the Internet and also the weight attached by ICANN itself to the principles of accountability and review which underpin the IRP process.*

81. Accordingly, Vistaprint argues that the IRP Panel's authority is not limited to declare that ICANN breached its obligations under the Articles, Bylaws and the Guidebook. To offer effective redress to gTLD applicants, the Panel may indicate what action ICANN must take to cease violating these obligations. The point is all the stronger here, as ICANN conceived the IRP to be the sole independent dispute resolution mechanism available to new gTLD applicants.<sup>108</sup>

#### **b. SCO Proceedings Claim**

82. Vistaprint states that this case relates to ICANN's handling of the determination in the *Vistaprint SCO* proceedings following String Confusion Objections to Vistaprint's .WEBS applications, but does not relate to the merits of that SCO determination.<sup>109</sup>
83. Vistaprint's basic claim here is that given the errors of process and substance in those proceedings, Vistaprint was not given a fair opportunity to present its case. Vistaprint was deprived of procedural fairness and the opportunity to be heard by an independent panel applying the appropriate rules. Further, Vistaprint was not given any meaningful opportunity for remedy or redress once the decision was made, and in this way ICANN's Board allegedly violated its Articles and Bylaws.<sup>110</sup>

---

<sup>106</sup> *DCA Third Declaration on IRP Procedure*, ¶ 40.

<sup>107</sup> *Interim Declaration on Emergency Request for Interim Measures of Protection in Gulf Cooperation Council v. ICANN*, ICDR Case No. 01-14-0002-1065, ¶ 59 (February 12, 2015) (“GCC Interim IRP Declaration”).

<sup>108</sup> Vistaprint's Second Additional Submission, ¶ 24.

<sup>109</sup> Request, ¶ 4.

<sup>110</sup> Request, ¶ 71.

84. Although Vistaprint challenged the SCO decision through ICANN's Request for Reconsideration process, ICANN refused to reconsider the substance of the challenged decision, or to take any action to remedy the lack of due process. In doing so, Vistaprint claims ICANN failed to act in a fair and non-arbitrary manner, with good faith, accountability, due diligence and independent judgment, as required by ICANN's Bylaws and Articles.<sup>111</sup> ICANN's acceptance of the SCO determination and refusal to reverse this decision was an abdication of responsibility and contrary to the evaluation policies ICANN had established in the Guidebook.<sup>112</sup>
85. A number of Vistaprint's contentions regarding the alleged violations of process and substance in SCO proceedings are described in part II.A above addressing Vistaprint's .WEBS applications and the SCO proceedings. Vistaprint's alleges as follows:
- (i) ICDR's appointment of the First Expert was untimely, in violation of Article 13(a) of the New gTLD Objections Procedure<sup>113</sup>;
  - (ii) the First Expert (and Third Expert) improperly accepted and considered unsolicited supplemental filings, violating Articles 17 and 18 of the New gTLD Objections Procedure<sup>114</sup>;
  - (iii) ICDR violated Article 21 of the New gTLD Objections Procedure<sup>115</sup> by failing to ensure the timely issuance of an expert determination in the SCO;
  - (iv) the First Expert failed to maintain independence and impartiality, in violation of Article 13(c) of the New gTLD Objections Procedure<sup>116</sup>;
  - (v) ICDR unjustifiably accepted a challenge to the Second Expert (or created the circumstances for such a challenge), in violation of Article 2 of the ICDR's Supplementary Procedures for String Confusion Objections (Rules);
  - (vi) the Determination of the Third Expert was untimely, in violation of Article 21(a) of the New gTLD Objections Procedure;
  - (vii) the Third Expert incorrectly applied the Objector's burden of proof, in violation of section 3.5 of the Guidebook and Article 20(c) of the New gTLD Objections Procedure, which place the burden of proof on the Objector; and

---

<sup>111</sup> Request, ¶ 71.

<sup>112</sup> Request, ¶ 8.

<sup>113</sup> Article 13(a) of the Procedure provides: "The DRSP shall select and appoint the Panel of Expert(s) within thirty (30) days after receiving the Response."

<sup>114</sup> Request, ¶ 42. Article 17 provides that "[t]he Panel may decide whether the parties shall submit any written statements in addition to the Objection and the Response." Article 18 states that "[i]n order to achieve the goal of resolving disputes over new gTLDs rapidly and at reasonable cost, procedures for the production of documents shall be limited. In exceptional cases, the Panel may require a party to provide additional evidence."

<sup>115</sup> Article 21(a) of the Procedure provides that "[t]he DSRP and the Panel shall make reasonable efforts to ensure that the Expert Determination is rendered within forty-five (45) days of the constitution of the Panel."

<sup>116</sup> Article 13(c) of the New gTLD Objections Procedure provides that "[a]ll Experts acting under this Procedure shall be impartial and independent of the parties." Section 3.4.4 of the Guidebook provides that the ICDR will "follow its adopted procedures for requiring such independence, including procedures for challenging and replacing an expert for lack of independence."

(viii) the Third Expert incorrectly applied ICANN’s substantive standard for evaluation of String Confusion Objections, as set out in Section 3.5.1 of the Guidebook, in particular the standards governing the evaluation of a string confusion objection.

86. Based on these alleged errors in process and substance, Vistaprint concludes in its Request:

*49. In sum, the cursory nature of the Decision and the arbitrary and selective discussion of the parties’ arguments by the Panel show a lack of either independence and impartiality or appropriate qualification on the fact of the Panel. The former is contrary to Article 13 of the Procedure; the latter is contrary to the Applicant Guidebook, Module 3-16, which requires that a panel (ruling on a string confusion or other objection) must consist of “appropriately qualified experts appointed to each proceeding by the designated DRSP”.<sup>117</sup>*

87. Vistaprint states that ICANN’s Board disregarded these accumulated infringements and turned a blind eye to the Third Expert’s lack of independence and impartiality. Vistaprint asserts that ICANN is not entitled to blindly accept expert determinations from SCO cases; it must verify whether or not, by accepting the expert determination and advice, it is acting consistent with its obligations under its Articles, Bylaws and Affirmation of Commitments.<sup>118</sup> Vistaprint further claims ICANN would be in violation of these obligations if it were to accept an expert determination or advice in circumstances where the ICDR and/or the expert had failed to comply with the New gTLD Objections Procedure and/or the ICDR Rules for SCOs, or where a panel – even if it had been correctly appointed – had failed to correctly apply the standard set by ICANN.<sup>119</sup>

88. Vistaprint states that following ICANN’s decision to accept the *Vistaprint SCO* determination, Vistaprint filed its Reconsideration Request detailing how ICANN’s acceptance of the Third Expert’s determination was inconsistent with ICANN’s policy and obligations under its Articles, Bylaws and Affirmation of Commitments. Background on the RFR procedure is provided above in part II.B. Despite this, Vistaprint states that ICANN refused to reverse its decision.

89. The IRP Panel has summarized as follows Vistaprint’s SCO Proceedings Claim concerning ICANN’s alleged breaches of its obligations under the Articles, Bylaws and Affirmation of Commitments:

(1) ICANN failed to comply with its obligation under Article 4 of the Articles and IV § 3.4 of the Bylaws to act in good faith with due diligence and independent judgment by failing to provide due process to Vistaprint’s .WEBS applications.<sup>120</sup> Good faith encompasses the obligation to ensure procedural fairness and due process, including equal and fair treatment of the parties, fair notice, and a fair opportunity to present one’s case. These are more than just formalistic procedural requirements. The opportunity must be meaningful: the party must be given adequate notice of the relevant

---

<sup>117</sup> Request, ¶ 49.

<sup>118</sup> Request, ¶ 6.

<sup>119</sup> Request, ¶ 6.

<sup>120</sup> Request, ¶¶ 69-71.

rules and be given a full and fair opportunity to present its case. And the mechanisms for redress must be both timely and effective.

Vistaprint claims that it was not given a fair opportunity to present its case; was deprived of procedural fairness and the opportunity to be heard by an independent panel applying the appropriate rules; and was not given any meaningful opportunity for remedy or redress once the SCO determination was made, even in the RFR procedure. Thus, ICANN's Board failed to act with due diligence and independent judgment, and to act in good faith as required by ICANN's Bylaws and Articles.

- (2) ICANN failed to comply with its obligation under Article I § 2.8 to neutrally, objectively and fairly apply documented policies as established in the Guidebook and Bylaws.<sup>121</sup> Vistaprint argues that there is no probability of user confusion if both .WEBS and .WEB were delegated as gTLD strings. Vistaprint states expert evidence confirms that there is no risk that Internet users will be confused and the Third Expert could not have reasonably found that the average reasonable Internet user is likely to be confused between the two strings. As confirmed by the Objector,<sup>122</sup> the average reasonable Internet user is used to distinguishing between words (and non-words) that are much more similar than the strings, .WEBS and .WEB. Since these strings cannot be perceived confusingly similar by the average reasonable Internet user, the *Vistaprint SCO* determination that they are confusingly similar is contradictory to ICANN's policy as established in the Guidebook.
- (3) ICANN failed to comply with its obligation to act fairly and with due diligence and independent judgment as called for under Article 4 of the Articles of Incorporation, Articles I § 2.8 and IV § 3.4 of the Bylaws by accepting the SCO determination made by the Third Expert, who was allegedly not independent and impartial.<sup>123</sup> Vistaprint claims that the Third Expert was not independent and impartial and/or is not appropriately qualified. However, Vistaprint claims this did not prevent ICANN from accepting the determination by the Third Expert, without even investigating the dependence and partiality of the Expert when serious concerns were raised to the ICANN Board in the RFR. This is a failure of ICANN to act with due diligence and independent judgment, and to act in good faith as required by ICANN's Bylaws and Articles.
- (4) ICANN failed to comply with its obligations under the Article 4 of the Articles, and Article I §§ 2.7 and 2.8 and Article III § 1 of the Bylaws (and Article 9.1 of the Affirmation of Commitments) to act fairly and transparently by failing to disclose/perform any efforts to optimize the service that the ICDR provides in the New gTLD Program.<sup>124</sup> Vistaprint contends that the BGC's determination on Vistaprint's RFR shows that the BGC made no investigation into Vistaprint's fundamental questions about the Panel's arbitrariness, lack of independence, partiality, inappropriate

---

<sup>121</sup> Request, ¶ 72.

<sup>122</sup> Request, Annex 10.

<sup>123</sup> Request, ¶ 73.

<sup>124</sup> Request, ¶¶ 52 and 77.

qualification. In addition, rather than identifying the nature of the conflict that forced the First Expert to step down, the BGC focused on developing hypotheses of reasons that could have led to this expert to stepping down. According to Vistaprint, this shows that the BGC did not exercise due diligence in making its determination and was looking for unsubstantiated reasons to reject Vistaprint's Reconsideration Request rather than making a fair determination.

In addition, as it is ICANN's responsibility to ensure that its policies and fundamental principles are respected by its third party vendors, ICANN had agreed with the ICDR that they were going to "communicate regularly with each other and seek to optimize the service that the ICDR provides as a DRSP in the New gTLD Program" and that ICANN was going to support the ICDR "to perform its duties...in a timely and efficient manner".<sup>125</sup> However, ICANN has failed to show that it sought in any way to optimize the ICDR's service vis-à-vis Vistaprint or that it performed any due diligence in addressing the concerns raised by Vistaprint. Instead, the BGC denied Vistaprint's RFR without conducting any investigation.

- (5) ICANN failed to comply with its obligation to remain accountable under Articles I § 2.10 and IV § 1 of the Bylaws (and Articles 3(a) and 9.1 of the Affirmation of Commitments) by failing to provide any remedy for its mistreatment of Vistaprint's gTLD applications.<sup>126</sup> Vistaprint claims that because of ICANN's unique history, role and responsibilities, its constituent documents require that it operate with complete accountability. In contrast to this obligation, throughout its treatment of Vistaprint's applications for .WEBS, ICANN has acted as if it and the ICDR are entitled to act with impunity. ICANN adopted the Third Expert's determination without examining whether it was made in accordance with ICANN's policy and fundamental principles under its Articles and Bylaws. When confronted with process violations, ICANN sought to escape its responsibilities by relying on unrealistic hypotheses rather than on facts that should have been verified. Additionally, ICANN has not created any general process for challenging the substance of SCO expert determinations, while acknowledging the need for such a process by taking steps to develop a review process mechanism for certain individual cases involving SCO objections.
- (6) ICANN failed to promote competition and innovation under Articles I § 2.2 (and Article 3(c) of the Affirmation of Commitments) by accepting the Third Expert's determination.<sup>127</sup> Vistaprint's argues that the Objector's sole motive in filing the SCO against Vistaprint was to prevent a potential competitor from entering the gTLD market. This motive is contrary to the purpose of ICANN's New gTLD Program. The Board's acceptance of the determination in the *Vistaprint SCO*, which was filed with an intent contrary to the interests of both competition and consumers, was contrary to ICANN's Bylaws.

### **c. Disparate Treatment Claim**

---

<sup>125</sup> Request, ¶¶ 52.

<sup>126</sup> Request, ¶¶ 78-79.

<sup>127</sup> Request, ¶ 80.

90. Vistaprint claims that ICANN’s Board discriminated against Vistaprint through the Board’s (and the BGC’s) acceptance of the Third Expert’s allegedly baseless and arbitrary determination in the *Vistaprint SCO*, while allowing other gTLD applications with equally serious string similarity concerns to proceed to delegation, or permitting still other applications that were subject to an adverse SCO determination to go through a separate additional review mechanism.
91. Vistaprint states that the “IRP Panel’s mandate includes a review as to whether or not ICANN’s Board discriminates in its interventions on SCO expert determinations,” and contends that “[d]iscriminating between applicants in its interventions on SCO expert determinations is exactly what the Board has done with respect to Vistaprint’s applications.”<sup>128</sup>
92. Vistaprint asserts that in contrast to the handling of other RFRs, the BGC did not give the full ICANN Board the opportunity to consider the *Vistaprint SCO* matter and did not provide detailed minutes of the meeting in which the BGC’s decision was taken.<sup>129</sup> Vistaprint states this is all the more striking as, in other matters related to handling of SCOs with no concerns about the impartiality and independence of the expert or the procedure, the Board considered potential paths forward to address perceived inconsistencies in expert determinations in the SCO process, including implementing a review mechanism. The Board also directed ICANN’s President and CEO, or his designee, to publish this proposed review mechanism for public comment.<sup>130</sup> Vistaprint emphasizes that ICANN’s Board took this decision the day before Vistaprint filed its Reconsideration Request regarding the *Vistaprint SCO*. However, this did not prevent the BGC from rejecting Vistaprint’s RFR without considering whether such a review mechanism might also be appropriate for dealing with the allegedly unfair and erroneous treatment of the SCO related to Vistaprint’s .WEBS applications.<sup>131</sup>
93. The core of Vistaprint’s discrimination and disparate treatment claims is stated in its First Additional Submission:
7. *Other applicants have equally criticized SCO proceedings. In a letter to ICANN’s CEO, United TLD Holdco, Ltd. denounced the process flaws in the SCO proceedings involving the strings .com and .cam. DERCars, LCC filed an RfR, challenging the expert determination in the SCO proceedings relating to the strings .car and .cars. Amazon EU S.a.r.l. filed an RfR, challenging the expert determination in the SCO proceedings relating to the strings .shop and .通販 (which means ‘online shopping’ in Japanese). The ICANN Board took action in each of these matters.*
- *With respect to the Expert Determination finding .cam confusingly similar to .com, the ICANN Board ordered that an appeals process be developed to address the “perceived inconsistent or otherwise unreasonable SCO Expert Determination”.*
  - *With regard to the Expert Determination finding .cars confusingly similar to .car, the ICANN Board ordered its staff to propose a review mechanism. DERCars decided to withdraw its*

---

<sup>128</sup> Vistaprint’s Second Additional Submission, ¶ 20-21.

<sup>129</sup> Request, ¶ 52.

<sup>130</sup> Request, ¶ 52 (referencing NGPC Resolution 2014.02.05.NG02).

<sup>131</sup> Request, ¶ 52.



application for .cars before the review mechanism was implemented. As a result, it was no longer necessary for the ICANN Board to further consider the proposed review process.

- With regard to the Expert Determination finding 通販 confusingly similar to .shop, the ICANN Board ordered that an appeals process be developed to address the “perceived inconsistent or otherwise unreasonable SCO Expert Determination”.

8. While the ICANN Board took action in the above-mentioned matters, it did not do so with respect to the .webs / .web determination. However, the .webs / .web determination was equally unreasonable, and at least equally serious substantive and procedural errors were made in these SCO proceedings. There is no reason for ICANN to treat the .webs / .web determination differently.

\* \* \* \*

12. When there are clear violations of the process and the outcome is highly objectionable (all as listed in detail in the request for IRP), the ICANN Board must intervene, as it has done with regard to other applications. The ICANN Board cannot justify why it intervenes in certain cases (.cars / .car, .cam / .com and 通販 / .shop), but refuses to do so in another case (.webs / .web). This is a clear violation of its Bylaws and Articles of Incorporation. The Panel in the current IRP has authority to order that ICANN must comply with its Bylaws and Articles of Incorporation and must disregard the expert determination in relation to Vistaprint’s .webs applications.<sup>132</sup>

\* \* \* \*

31. When the ICANN Board individually considers an application, it must make sure that it does not treat applicants inequitably and that it does not discriminate among applicants. Article II, Section 3 of ICANN’s Bylaws provides that “ICANN shall not apply its standards, policies, procedures, or practices inequitably or single out any particular party for disparate treatment unless justified by substantial and reasonable cause, such as the promotion of effective competition”. However, with regard to the SCO proceedings, the ICANN Board has done the exact opposite. It created the opportunity for some aggrieved applicants to participate in an appeals process, while denying others.

32. As explained above, there is no justification for this disparate treatment, and the ICANN Board has not given any substantial and reasonable cause that would justify this discrimination.

94. Vistaprint also contends that ICANN cannot justify the disparate treatment:

22. ICANN’s attempt to justify the disparate treatment of Vistaprint’s applications is without merit. ICANN argues that its Board only intervened with respect to specific expert determinations because there had been several expert determinations regarding the same strings that were seemingly inconsistent (fn. omitted). Vistaprint recognizes that the ICANN Board intervened to address “perceived inconsistent or otherwise unreasonable SCO Expert Determinations” (fn. omitted). However, ICANN fails to explain why the SCO Expert Determination on Vistaprint’s .webs applications was not just as unreasonable as the SCO Expert Determinations involving .cars/.car, .cam/.com and 通販 / .shop. Indeed, the determination concerning Vistaprint’s .webs applications expressly relies on the determination concerning .cars/.car, that was considered inconsistent or otherwise unreasonable by the ICANN Board that rejected the reasoning applied in the two other .cars/.car expert determinations (fn. omitted).

23. Therefore, Vistaprint requests the IRP Panel to exercise its control over the ICANN Board and to declare that ICANN discriminated Vistaprint’s applications.

95. Timing: Vistaprint contends that the objections it raises in this IRP concerning the Third Expert’s SCO determination and the Guidebook and its application are timely.<sup>133</sup> While

---

<sup>132</sup> Vistaprint’s First Additional Submission, ¶ 12.

<sup>133</sup> Vistaprint’s Second Additional Submission, ¶¶ 8-12.

ICANN argues that the time for Vistaprint to object to the SCO procedures as established in the Guidebook has long passed,<sup>134</sup> Vistaprint responds that the opportunity to challenge the erroneous application of the Guidebook in violation of ICANN's fundamental principles only arose when the flaws in ICANN's implementation of the Guidebook became apparent. At the time of the adoption of the Guidebook, Vistaprint was effectively barred from challenging it by the fact that it could not – at that time – show any harm. Further, to raise an issue at that time would have required Vistaprint to reveal that it was contemplating making an application for a new gTLD string, which might have encouraged opportunistic applications by others seeking to extract monetary value from Vistaprint. Although the IRP panel in the *Booking.com v. ICANN* IRP raised similar timing concerns, it did not draw the distinction between the adoption of the general principles and their subsequent implementation.

## **B. ICANN's Position**

### **a. IRP Panel's Authority**

96. Standard of review: ICANN describes the IRP as a unique mechanism available under ICANN's Bylaws.<sup>135</sup> The IRP Panel is tasked with determining whether the Board's actions are consistent with ICANN's Articles and Bylaws. ICANN states that its Bylaws specifically identify a deferential standard of review that the IRP Panel must apply when evaluating the actions of the ICANN Board, and the rules are clear that the IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.<sup>136</sup> In particular, ICANN cites to Article IV, § 3.4 of the Bylaws indicating the IRP Panel is to apply a defined standard of review to the IRP Request, focusing on:
- a. did the Board act without conflict of interest in taking its decision?;
  - b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
  - c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?
97. Further, ICANN states that the IRP addresses challenges to conduct undertaken by ICANN's Board of Directors; it is not a mechanism to challenge the actions or inactions of ICANN staff or third parties that may be involved with ICANN's activities.<sup>137</sup> The IRP is also not an appropriate forum to challenge the BGC's ruling on a Reconsideration Request in the absence of some violation by the BGC of ICANN's Articles or Bylaws.<sup>138</sup>
98. IRP Declaration binding or non-binding: ICANN states that the IRP "is conducted pursuant to Article IV, section 3 of ICANN's Bylaws, which creates a non-binding method

---

<sup>134</sup> ICANN's First Additional Response, ¶¶ 28-29.

<sup>135</sup> Response, ¶ 32.

<sup>136</sup> Response, ¶ 33; ICANN's First Additional Response, ¶ 10.

<sup>137</sup> Response, ¶ 4.

<sup>138</sup> Response, ¶ 12.

of evaluating certain actions of ICANN's Board.<sup>139</sup> The Panel has one responsibility – to “declar[e] whether the Board has acted consistently with the provisions of [ICANN's] Articles of Incorporation and Bylaws.”<sup>140</sup> The IRP is not an arbitration process, but rather a means by which entities that participate in ICANN's processes can seek an independent review of decisions made by ICANN's Board.

99. ICANN states that the language of the IRP provisions set forth in Article IV, section 3 of the Bylaws, as well as the drafting history of the development of the IRP provisions, make clear that IRP panel declarations are not binding on ICANN:<sup>141</sup> ICANN explains as follows in its First Additional Response:

*35. First, the Bylaws charge an IRP panel with "comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws." The Board is then obligated to "review[]"<sup>142</sup> and "consider" an IRP panel's declaration at the Board's next meeting "where feasible."<sup>143</sup> The direction to "review" and "consider" an IRP panel's declaration means that the Board has discretion as to whether it should adopt that declaration and whether it should take any action in response to that declaration; if the declaration were binding, there would be nothing to review or consider, only a binding order to implement.*

100. ICANN contends that the IRP Panel's declaration is not binding because the Board is not permitted to outsource its decision-making authority.<sup>144</sup> However, the Board will, of course, give serious consideration to the IRP Panel's declaration and, “where feasible,” shall consider the IRP Panel's declaration at the Board's next meeting.<sup>145</sup>

101. As to the drafting process, ICANN provides the following background in its First Additional Response:

*36. Second, the lengthy drafting history of ICANN's independent review process confirms that IRP panel declarations are not binding. Specifically, the Draft Principles for Independent Review, drafted in 1999, state that "the ICANN Board should retain ultimate authority over ICANN's affairs – after all, it is the Board...that will be chosen by (and is directly accountable to) the membership and supporting organizations (fn. omitted). And when, in 2001, the Committee on ICANN Evolution and Reform (ERC) recommended the creation of an independent review process, it called for the creation of "a process to require non-binding arbitration by an international arbitration body to review any allegation that the Board has acted in conflict with ICANN's Bylaws" (fn. omitted). The individuals who actively participated in the process also agreed that the review process would not be binding. As one participant stated: IRP "decisions will be nonbinding, because the Board will retain final decision-making authority" (fn. omitted).*

---

<sup>139</sup> Response, ¶ 2.

<sup>140</sup> Response, ¶ 2 (quoting Bylaws, Art. IV, § 3.4).

<sup>141</sup> ICANN's First Additional Response, ¶ 34.

<sup>142</sup> ICANN's First Additional Response, ¶ 35 (quoting Bylaws, Art. IV, § 3.11.d).

<sup>143</sup> ICANN's First Additional Response, ¶ 35 (quoting Bylaws, Art. IV, § 3.21).

<sup>144</sup> Response, ¶ 35.

<sup>145</sup> Response, ¶ 35 (quoting Bylaws, Art. IV, § 3.21).

37. In February 2010, the first IRP panel to issue a final declaration, the ICM IRP Panel, unanimously rejected the assertion that IRP panel declarations are binding<sup>146</sup> and recognized that an IRP panel's declaration "is not binding, but rather advisory in effect." Nothing has occurred since the issuance of the ICM IRP Panel's declaration that changes the fact that IRP panel declarations are not binding. To the contrary, in April 2013, following the ICM IRP, in order to clarify even further that IRPs are not binding, all references in the Bylaws to the term "arbitration" were removed as part of the Bylaws revisions. ICM had argued in the IRP that the use of the word "arbitration" in the portion of the Bylaws related to Independent Review indicated that IRPs were binding, and while the ICM IRP Panel rejected that argument, to avoid any lingering doubt, ICANN removed the word "arbitration" in conjunction with the amendments to the Bylaws.

38. The amendments to the Bylaws, which occurred following a community process on proposed IRP revisions, added, among other things, a sentence stating that "declarations of the IRP Panel, and the Board's subsequent action on those declarations, are final and have precedential value" (fn. omitted). Vistaprint argues that this new language, which does not actually use the word "binding," nevertheless provides that IRP panel declarations are binding, trumping years of drafting history, the sworn testimony of those who participated in the drafting process, and the plain text of the Bylaws. This argument is meritless.

39. First, relying on the use of the terms "final" and "precedential" is unavailing – a declaration clearly can be both non-binding and also final and precedential:....

40. Second, the language Vistaprint references was added to ICANN's Bylaws to meet recommendations made by ICANN's Accountability Structures Expert Panel (ASEP). The ASEP was comprised of three world-renowned experts on issues of corporate governance, accountability, and international dispute resolution, and was charged with evaluating ICANN's accountability mechanisms, including the Independent Review process. The ASEP recommended, among other things, that an IRP should not be permitted to proceed on the same issues as presented in a prior IRP. The ASEP's recommendations in this regard were raised in light of the second IRP constituted under ICANN's Bylaws, where the claimant presented claims that would have required the IRP Panel to reevaluate the declaration of the IRP Panel in the ICM IRP. To prevent claimants from challenging Board action taken in direct response to a prior IRP panel declaration, the ASEP recommended that "[t]he declarations of the IRP, and ICANN's subsequent actions on those declarations, should have precedential value" (fn. omitted).

41. The ASEP's recommendations in this regard did not convert IRP panel declarations into binding decisions (fn. omitted). One of the important considerations underlying the ASEP's work was the fact that ICANN, while it operates internationally, is a California non-profit public benefit corporation subject to the statutory law of California as determined by United States courts. As Graham McDonald, one of the three ASEP experts, explained, because California law requires that the board "retain responsibility for decision-making," the Board has "final word" on "any recommendation that ... arises out of [an IRP]" (fn. omitted). The ASEP's recommendations were therefore premised on the understanding that the declaration of an IRP panel is not "binding" on the Board.

102. Authority to award affirmative relief: ICANN contends that any request that the IRP Panel grant affirmative relief goes beyond the Panel's authority.<sup>147</sup> The Panel does not have the authority to award affirmative relief or to require ICANN to undertake specific

---

<sup>146</sup> Declaration of IRP Panel, ICM Registry, LLC v. ICANN, ICDR Case No. 50 117 T 00224 08, ¶ 133 (Feb. 19, 2010) ("ICM Registry Final Declaration").

<sup>147</sup> Response, ¶ 78.

conduct. The Panel is limited to declaring whether an action or inaction of the Board was inconsistent with the Articles or Bylaws, and recommending that the Board stay any action or decision, or take any interim action, until such time as the Board reviews and acts upon the opinion of the Panel.<sup>148</sup> ICANN adds that the IRP panel in *ICM Registry Declaration* found that

*“[t]he IRP cannot ‘order’ interim measures but do no more than ‘recommend’ them, and this until the Board ‘reviews’ and ‘acts upon the opinion’ of the IRP.”*<sup>149</sup>

#### **b. SCO Proceedings Claim**

103. ICANN states that Vistaprint is using this IRP as a means to challenge the merits of the Third Expert’s determination in the *Vistaprint SCO*.<sup>150</sup> As ICANN states in its Response:

*12. Ultimately, Vistaprint has initiated this IRP because Vistaprint disagrees with the Expert Panel’s Determination and the BGC’s finding on Vistaprint’s Reconsideration Request. ICANN understands Vistaprint’s disappointment, but IRPs are not a vehicle by which an Expert Panel’s determination may be challenged because neither the determination, nor ICANN accepting the determination, constitutes an ICANN Board action. Nor is an IRP the appropriate forum to challenge a BGC ruling on a Reconsideration Request in the absence of some violation by the BGC of ICANN’s Articles or Bylaws. Here, ICANN followed its policies and processes at every turn with respect to Vistaprint, which is all it is required to do.*

104. ICANN states that the IRP Panel has one chief responsibility – to “determine whether the Board has acted consistently with the provisions of [ICANN’s] Articles of Incorporation and Bylaws.”<sup>151</sup> With respect to Vistaprint’s claim that ICANN’s Board violated its Articles and Bylaws by “blindly accepting” the Third Expert’s SCO determination without reviewing its analysis or result, ICANN responds that there is no requirement for the Board to conduct such an analysis. “Accepting” or “reviewing” the Expert’s determination is not something the Board was tasked with doing or not doing. Per the Guidebook, the “findings of the panel will be considered an expert determination and advice that ICANN will accept within the dispute resolution process.”<sup>152</sup> The Guidebook further provides that “[i]n a case where a gTLD applicant successfully asserts string confusion with another applicant, the only possible outcome is for both applicants to be placed in a contention set and to be referred to a contention resolution procedure (refer to Module 4, String Contention Procedures).”<sup>153</sup> This step is a result not of any ICANN Board action, but a straightforward application of Guidebook provisions for SCO determinations.

105. ICANN states the Board thus took no action with respect to the Third Expert’s determination upon its initial issuance, because the Guidebook does not call for the Board to take any action and it is not required by any Article or Bylaw provision. Accordingly, it cannot be a violation of ICANN’s Articles or Bylaws for the Board to not conduct a

---

<sup>148</sup> ICANN’s First Additional Response, ¶ 33 (citing Bylaws, Art. IV, §§ 3.4 and 3.11(d)).

<sup>149</sup> *ICM Registry Final Declaration*, ¶ 133.

<sup>150</sup> Response, ¶ 12; ICANN’s First Additional submission, ¶ 4.

<sup>151</sup> Response, ¶ 2 (citing Bylaws, Art. IV, § 3.4).

<sup>152</sup> Response, ¶ 9 (citing Guidebook, § 3.4.6).

<sup>153</sup> Response, ¶ 9 (citing Guidebook, § 3.2.2.1).

substantive review of an expert's SCO determination. And as such, there is no Board action in this regard for the IRP Panel to review.

106. ICANN states that “the sole Board action that Vistaprint has identified in this case is the BGC’s rejection of Vistaprint’s Reconsideration Request. However, ICANN maintains that nothing about the BGC’s handling of the RFR violated ICANN’s Articles or Bylaws.”<sup>154</sup>
107. In this regard, ICANN states that the BGC was not required, as Vistaprint contends, to refer Vistaprint’s Reconsideration Request to the entire ICANN Board.<sup>155</sup> The Bylaws provide that the BGC has the authority to “make a final determination of Reconsideration Requests regarding staff action or inaction, without reference to the Board of Directors.”<sup>156</sup> Because Vistaprint’s Reconsideration Request was a challenge to alleged staff action, the BGC was within its authority, and in compliance with the Bylaws, when it denied Vistaprint’s Reconsideration Request without making a referral to the full Board.
108. ICANN states that the BGC did what it was supposed to do in reviewing Vistaprint’s Reconsideration Request – it reviewed the Third Expert’s and ICANN staff’s compliance with policies and procedures, rather than the substance of the Third Expert’s SCO determination, and found no policy or process violations.<sup>157</sup> ICANN urges that Vistaprint seeks to use the IRP to challenge the substantive decision of the Third Expert in the *Vistaprint SCO*. However, this IRP may only be used to challenge ICANN Board actions on the grounds that they do not comply with the Articles or Bylaws, neither of which is present here.
109. ICANN nevertheless responds to Vistaprint’s allegations regarding errors of process and substance in the SCO proceedings, and contends that the BGC properly handled its review of the *Vistaprint SCO*. ICANN’s specific responses on these points are as follows:
  - (i) As to Vistaprint’s claim that the ICDR’s appointment of the First Expert was untimely, missing the deadline by 5 days, ICANN states that the BGC determined that Vistaprint failed to provide any evidence that it contemporaneously challenged the timeliness of the ICDR’s appointment of the First Expert, and that a Reconsideration Request was not the appropriate mechanism to raise the issue for the first time. In addition, the BGC concluded that Vistaprint had failed to show that it was “materially” and “adversely” affected by the brief delay in appointing the First Expert, rendering reconsideration inappropriate.
  - (ii) Regarding Vistaprint’s claim that the First Expert (and Third Expert) improperly accepted and considered unsolicited supplemental filings, violating Articles 17 and 18 of the New gTLD Objections Procedure, ICANN states that Article 17 provides the

---

<sup>154</sup> ICANN’s First Additional Submission, ¶ 4.

<sup>155</sup> Response, ¶ 43.

<sup>156</sup> Response, ¶ 44 (citing Bylaws, Art. IV, § 2.3(f)).

<sup>157</sup> Response, ¶ 11.

expert panel with the discretion to accept such a filing:<sup>158</sup> “The Panel *may decide* whether the parties shall submit any written statements in addition to the Objection and the Response, and it shall fix time limits for such submissions.”<sup>159</sup> Thus, as the BGC correctly found, it was not the BGC’s place to second-guess the First (or Third) Expert’s exercise of permitted discretion.

- (iii) As to Vistaprint’s claim that the ICDR violated Article 21 of the New gTLD Objections Procedure by failing to ensure the timely issuance of an expert SCO determination, ICANN contends that the BGC properly determined that Vistaprint’s claims in this regard did not support reconsideration for two reasons. First, on October 1, 2013, before the determination was supposed to be issued by the First Expert, the ICDR removed that expert. The BGC therefore could not evaluate whether the First Expert rendered an untimely determination in violation of the Procedure. Second, the BGC correctly noted that 45-day timeline applies to an expert’s submission of the determination “in draft form to the [ICDR’s] scrutiny as to form before it is signed” and the ICDR and the Expert are merely required to exercise “reasonable efforts” to issue a determination within 45 days of the constitution of the Panel.<sup>160</sup>
- (iv) Regarding Vistaprint’s claim that the First Expert failed to maintain independence and impartiality, in violation of Article 13(c) of the New gTLD Objections Procedure, ICANN argues this claim is unsupported.<sup>161</sup> As the BGC noted, Vistaprint provided no evidence demonstrating that the First Expert failed to follow the applicable ICDR procedures for independence and impartiality. Rather, all indications are that the First Expert and the ICDR complied with these rules as to this “new conflict,” which resulted in a removal of the First Expert. Further, Vistaprint presented no evidence of being materially and adversely affected by the First Expert’s removal, which is another justification for the BGC’s denial of the Reconsideration Request.
- (v) Vistaprint claimed that the ICDR unjustifiably accepted a challenge to the Second Expert (or created the circumstances for such a challenge), in violation of Article 2 of the ICDR’s Supplementary Procedures for String Confusion Objections.<sup>162</sup> ICANN contends that the BGC properly determined that this claim did not support reconsideration. The ICDR Rules for SCOs make clear that the ICDR had the “sole discretion” to review and decide challenges to the appointment of expert panelists. While Vistaprint may disagree with the ICDR’s decision to accept the Objector’s challenge, it is not the BGC’s role to second guess the ICDR’s discretion, and it was

---

<sup>158</sup> Response, ¶ 50.

<sup>159</sup> New gTLD Objections Procedure, Art. 17.

<sup>160</sup> Response, ¶ 53, citing New gTLD Objections Procedure, Art. 21(a)-(b).

<sup>161</sup> Response, ¶¶ 54-56.

<sup>162</sup> Article 2, § 3 of the ICDR’s Supplementary Procedures for String Confusion Objections provides that:

*Upon review of the challenge the DRSP in its sole discretion shall make the decision on the challenge and advise the parties of its decision.*  
*[Underlining added]*

not a violation of the Articles or Bylaws for the BGC to deny reconsideration on this ground.

- (vi) Vistaprint claimed that the determination of the Third Expert was untimely, in violation of Article 21(a) of the New gTLD Objections Procedure. ICANN claims that the BGC properly held that this claim did not support reconsideration.<sup>163</sup> On November 20, 2013, the ICDR appointed the Third Expert. Vistaprint claimed in its Reconsideration Request that pursuant to Article 21, the determination therefore “should have been rendered by January 4, 2014,” which was forty-five (45) days after the Panel was constituted. Because “it took this Panel until January 24, 2014 to render the Decision,” Vistaprint contended that the determination was untimely because it was twenty days late. ICANN states that, according to the Procedure, the Expert must exercise “reasonable efforts” to ensure that it submits its determination “in draft form to the DRSP’s scrutiny as to form before it is signed” within forty-five (45) days of the Expert Panel being constituted. As the BGC noted, there is no evidence that the Third Expert failed to comply with this Procedure, and reconsideration was therefore unwarranted on this ground.
- (vii) ICANN responded to Vistaprint’s claim that the Third Expert incorrectly applied the Objector’s burden of proof, in violation of section 3.5 of the Guidebook and Article 20(c) of the New gTLD Objections Procedure (which place the burden on the Objector). Vistaprint claimed that the Third Expert contravened ICANN’s process because the Expert did not give an analysis showing that the Objector had met the burden of proof.<sup>164</sup> ICANN states that the BGC found the Expert extensively detailed support for the conclusion that the .WEBS string so nearly resembles .WEB – visually, aurally and in meaning – that it is likely to cause confusion. The BGC noted that the Expert had adhered to the procedures and standards set forth in the Guidebook relevant to determining string confusion and reconsideration was not warranted on this basis.
- (viii) Finally, as to Vistaprint’s claim that the Third Expert incorrectly applied ICANN’s substantive standard for evaluation of String Confusion Objections (as set out in Section 3.5.1 of the Guidebook), ICANN contends the BGC properly found that reconsideration was not appropriate.<sup>165</sup> Vistaprint contended that the Expert failed to apply the appropriate high standard for assessing likelihood of confusion.<sup>166</sup> ICANN states that Section 3.5.1 of the Guidebook provides that

*“[f]or the likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user.”*

ICANN claims that disagreement as to whether this standard should have resulted in a finding in favor of Vistaprint does not mean that the Third Expert violated any policy or process in reaching his decision. Vistaprint also claimed that the Third

---

<sup>163</sup> Response, ¶¶ 61-62.

<sup>164</sup> Response, ¶¶ 63-64.

<sup>165</sup> Response, ¶¶ 65-68.

<sup>166</sup> Request, ¶ 47.



Expert “failed to apply the burden of proof and the standards imposed by ICANN” because the Expert questioned whether the co-existence between Vistaprint’s domain name, <webs.com>, and the Objector’s domain name, <web.com> for many years without evidence of actual confusion is relevant to his determination. ICANN states that, as the BGC noted, the relevant consideration for the Expert is whether the *applied-for gTLD string* is likely to result in string confusion, not whether there is confusion between second-level domain names. Vistaprint does not cite any provision of the Guidebook, the Procedure, or the Rules that have been contravened in this regard.

110. In sum, ICANN contends that the BGC did its job, which did not include evaluating the merits of Third Expert’s determination, and the BGC followed applicable policies and procedures in considering the RFR.<sup>167</sup>

111. Regarding Vistaprint’s claims of ICANN’s breach of various Articles and Bylaws, ICANN responds as follows in its Response:

*71. First, Vistaprint contends that ICANN failed to comply with the general principle of “good faith.” But the only reason Vistaprint asserts ICANN failed to act in good faith is in “refus[ing] to reconsider the substance” of the Determination or to “act with independent judgment” (fn. omitted). The absence of an appeal mechanism by which Vistaprint might challenge the Determination does not form the basis for an IRP because there is nothing in ICANN’s Bylaws or Articles of Incorporation requiring ICANN to provide one.*

*72. Second, Vistaprint contends that ICANN failed to apply its policies in a neutral manner. Here, Vistaprint complains that other panels let other applications proceed without being placed into a contention set, even though they, in Vistaprint’s opinion, presented “at least equally serious string similarity concerns” as .WEBS/.WEB (fn. omitted). Vistaprint’s claims about ICDR’s treatment of other string similarity disputes cannot be resolved by IRP, as they are even further removed from Board conduct. Different outcomes by different expert panels related to different gTLDs are to be expected. Claiming that other applicants have not suffered adverse determinations does not convert the Expert Panel’s Determination into a “discriminatory ICANN Board act.”*

*73. Third, Vistaprint contends that the ICANN Board violated its obligation to act transparently for not investigating the “impartiality and independence” of the Expert Panel and thereby “did not seek to communicate with [ICDR] to optimize [its] service” (fn. omitted). Aside from the disconnect between the particular Bylaws provision invoked by Vistaprint requiring ICANN’s transparency, and the complaint that the ICDR did not act transparently, Vistaprint fails to identify any procedural deficiency in the ICDR’s actions regarding the removal of the First Expert, as set forth above. Moreover, Vistaprint cites no obligation in the Articles or Bylaws that the ICANN Board affirmatively investigate the impartiality of an Expert Panel, outside of the requirement that the ICDR follow its policies on conflicts, which the ICDR did.*

*74. Fourth, Vistaprint contends that ICANN “has not created any general process for challenging the substance of the so-called expert determination,” and thus has “brashly flouted” its obligation to remain accountable (fn. omitted). But again, Vistaprint does not identify any provision of the Articles or Bylaws that requires ICANN to provide such an appeals process.*

*75. Fifth, Vistaprint “concludes” that the ICANN Board neglected its duty to promote competition and innovation (fn. omitted) when it failed to overturn the Expert Panel’s Determination. Vistaprint claims that the Objector’s “motive in filing the objection was to prevent a potential competitor from entering*

---

<sup>167</sup> Response, ¶ 69.

the gTLD market” and therefore ICANN’s “acceptance” of the objection purportedly contravenes ICANN’s core value of promoting competition. But every objection to a gTLD application by an applicant for the same string seeks to hinder a competitor’s application. By Vistaprint’s logic, ICANN’s commitment to promoting competition requires that no objections ever be sustained and every applicant obtains the gTLD it requests. There is no provision in the Articles or Bylaws that require such an unworkable system.

76. All in all, Vistaprint’s attempt to frame its disappointment with the Expert Panel’s decision as the ICANN Board’s dereliction of duties does not withstand scrutiny.

### c. Disparate Treatment Claim

112. ICANN states that Vistaprint objects to the Board’s exercise of its independent judgement in determining not to intervene further (beyond the review of the BGC) with respect to the Third Expert’s determination in the *Vistaprint SCO*, as the Board did with respect to expert determinations on String Confusion Objections regarding the strings (1) .COM/.CAM, (2) .CAR/.CARS, and (3) .SHOP/.通販 (online shopping in Japanese).<sup>168</sup>
113. ICANN states that the Guidebook provides that in “exceptional circumstances,” such as when accountability mechanisms like RFR or IRP are invoked, “the Board might individually consider an application”<sup>169</sup> and that is precisely what occurred in Vistaprint’s case. Because Vistaprint sought reconsideration, the BGC considered Vistaprint’s Reconsideration Request and concluded that the ICDR and Third Expert had not violated any relevant policy or procedure in rendering the Expert’s determination.
114. ICANN states that the ICANN Board only intervened with respect to these other expert determinations because there had been several independent expert determinations regarding the same strings that were seemingly inconsistent with one another. That is not the case with respect to Vistaprint’s applications – no other expert determinations were issued regarding the similarity of .WEB and .WEBS.<sup>170</sup> “Unlike .WEB/.WEBS, the COM/.CAM, .CAR/.CARS, and .SHOP/.通販 strings were all the subject of several, seemingly inconsistent determinations on string confusion objections by different expert panels. So, for example, while one expert upheld a string confusion objection asserting that .CAM was confusingly similar to .COM, another expert overruled a separate string confusion objection asserting precisely the same thing.”<sup>171</sup>
115. Further, ICANN explains that

16. Given what were viewed by some as inconsistent determinations, the BGC requested that ICANN staff draft a report for the ICANN Board’s New gTLD Program Committee (“NGPC”), “setting out

---

<sup>168</sup> ICANN’s First Additional Submission, ¶ 14.

<sup>169</sup> ICANN’s First Additional Submission, ¶ 5 (citing Guidebook, § 5.1). ICANN quotes the *Booking.com Final Declaration*, where the IRP Panel stated in relation to § 5.1 “the fact that the ICANN Board enjoys such discretion [to individually consider an application for a New gTLD] and may choose to exercise it at any time does not mean that it is bound to exercise it, let alone at the time and in the manner demanded by *Booking.com*.”

<sup>170</sup> ICANN’s First Additional Submission, ¶ 5.

<sup>171</sup> ICANN’s First Additional Submission, ¶ 15.

options for dealing...[with] differing outcomes of the String Confusion Objection Dispute Resolution process in similar disputes...."<sup>172</sup> The NGPC subsequently considered potential approaches to addressing perceived inconsistent determinations on string confusion objections, including possibly implementing a new review mechanism.<sup>173</sup> ICANN staff initiated a public comment period regarding framework principles of a potential such review mechanism.<sup>174</sup> Ultimately, having considered the report drafted by ICANN staff, the public comments received, and the string confusion objection process set forth in the Guidebook, the NGPC determined that the inconsistent expert determinations regarding .COM/.CAM and .SHOP/.通販 were "not[] in the best interest of the New gTLD Program and the Internet community" and directed ICANN staff to establish a process whereby the ICDR would appoint a three-member panel to re-evaluate those expert determinations.<sup>175</sup>

116. ICANN contends that Vistaprint has identified no Articles or Bylaws provision violated by the Board in exercising its independent judgment to intervene with respect to inconsistent determinations in certain SCO cases, but not with respect to the single expert SCO determination regarding .WEBS/.WEB. The Board was justified in exercising its discretion to intervene with respect to the inconsistent expert determinations regarding .COM/.CAM, .CAR/.CARS and .SHOP/.通販 - the Board acted to bring certainty to multiple and differing expert determinations on String Confusion Objections regarding the same strings.<sup>176</sup> That justification was not present with respect to the single *Vistaprint SCO* determination at issue here. Thus, ICANN contends Vistaprint was not treated differently than other similarly-situated gTLD applicants.

117. Timing: Finally, ICANN also states that the time for Vistaprint to challenge the Guidebook and its standards has past. The current version of the Guidebook was published on June 4, 2012 following an extensive review process, including public comment on multiple drafts.<sup>177</sup> Despite having ample opportunity, Vistaprint did not object to the Guidebook at the time it was implemented. If Vistaprint had concerns related to the issues it now raises, it should have pursued them at the time, not years later and only after receiving the determination in the *Vistaprint SCO*. ICANN quotes the *Booking.com Final Declaration*, where the IRP stated,

*"the time has long since passed for Booking.com or any other interested party to ask an IRP panel to review the actions of the ICANN Board in relation to the establishment of the string similarity review process, including Booking.com's claims that specific elements of the process and the Board decisions to implement those elements are inconsistent with ICANN's Articles and Bylaws. Any such claims, even if they had any merit, are long since time-barred by the 30-day limitation period set out in Article IV, Section 3(3) of the Bylaws."*<sup>178</sup>

118. ICANN states that while the Guidebook process at issue in this case is different for the

---

<sup>172</sup> See BGC Determination on Reconsideration Request 13-10, at 11.

<sup>173</sup> See Rationale for NGPC Resolution 2014.02.05.NG02, at <https://www.icann.org/resources/board-material/resolutions-new-gtld-2014-02-05-en> (last accessed Sept. 15, 2015).

<sup>174</sup> See <https://www.icann.org/public-comments/sco-rramework-principles-2014-02-11-en> (last accessed Sept. 15, 2015).

<sup>175</sup> ICANN's First Additional Submission, ¶ 16; see NGPC Resolution 2014.1 0.12.NG02, at <https://www.icann.org/resources/board-material/resolutions-new-gtld-2014-1-0-12-en#2.b> (last accessed Sept. 15, 2015).

<sup>176</sup> ICANN's First Additional Submission, ¶ 18.

<sup>177</sup> ICANN's First Additional Response, ¶ 27.

<sup>178</sup> *Booking.com final Declaration*, ¶ 129.

process at issue in the *Booking.com IRP* – the SCO process rather than the string similarity review process – the Booking.com IRP panel's reasoning applies equally. ICANN argues that because both processes were developed years ago, as part of the development of the Guidebook, challenges to both are time-barred.<sup>179</sup>

## V. Analysis and Findings

### a. IRP Panel's Authority

119. Standard of Review: The IRP Panel has benefited from the parties' submissions on this issue, noting their agreement as to the Panel's primary task: comparing contested actions (or inactions)<sup>180</sup> of ICANN's Board to its Articles and Bylaws and declaring whether the Board has acted consistently with them. Yet when considering this Panel's comparative task, the parties disagree as to the level of deference to be accorded by the Panel in assessing the Board's actions or inactions.

120. Vistaprint has sought independent review through this IRP, claiming that it has been "harmed" (i.e., its .WEBS application has not been allowed to proceed and has been placed in a Contention Set) by the Board's alleged violation of the Articles and Bylaws. In accordance with Article IV, § 3.2 of the Bylaws:

*Any person materially affected by a decision or action by the Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws may submit a request for independent review of that decision or action. In order to be materially affected, the person must suffer injury or harm that is directly and causally connected to the Board's alleged violation of the Bylaws or the Articles of Incorporation, and not as a result of third parties acting in line with the Board's action.*

121. As noted above, Article IV, § 1 of the Bylaws emphasizes that the IRP is an accountability mechanism:

*The provisions of this Article, creating processes for reconsideration and independent review of ICANN actions and periodic review of ICANN's structure and procedures, are intended to reinforce the various accountability mechanisms otherwise set forth in these Bylaws.*

122. The Bylaws in Article IV, § 3.4 detail the IRP Panel's charge and issues to be considered in a defined standard of review:

*Requests for such independent review shall be referred to an Independent Review Process Panel ("IRP Panel"), which shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws. The IRP Panel must apply a defined standard of review to the IRP request, focusing on:*

- a. did the Board act without conflict of interest in taking its decision?;*
- b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and*

---

<sup>179</sup> ICANN's First Additional Submission, ¶ 28.

<sup>180</sup> Bylaws, Art. IV, § 3.11(c) ("The IRP Panel shall have the authority to:...(c) declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws" (underlining added)).

- c. *did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?*<sup>181</sup>

[Underlining added]

123. The Bylaws state the IRP Panel is “*charged*” with “*comparing*” contested actions of the Board to the Articles and Bylaws and “*declaring*” whether the Board has acted consistently with them. The Panel is to focus, in particular, on whether the Board acted without conflict of interest, exercised due diligence and care in having a reasonable amount of facts in front of it, and exercised independent judgment in taking a decision believed to be in the best interests of ICANN. In the IRP Panel’s view this more detailed listing of a defined standard cannot be read to remove from the Panel’s remit the fundamental task of comparing actions or inactions of the Board with the Articles and Bylaws and declaring whether the Board has acted consistently or not. Instead, the defined standard provides a list of questions that can be asked, but not to the exclusion of other potential questions that might arise in a particular case as the Panel goes about its comparative work. For example, the particular circumstances may raise questions whether the Board acted in a transparent or non-discriminatory manner. In this regard, the ICANN Board’s discretion is limited by the Articles and Bylaws, and it is against the provisions of these instruments that the Board’s conduct must be measured.
124. The Panel agrees with ICANN’s statement that the Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board. However, this does not fundamentally alter the lens through which the Panel must view its comparative task. As Vistaprint has urged, the IRP is the only accountability mechanism by which ICANN holds itself accountable through *independent third-party review* of its actions or inactions. Nothing in the Bylaws specifies that the IRP Panel’s review must be founded on a deferential standard, as ICANN has asserted. Such a standard would undermine the Panel’s primary goal of ensuring accountability on the part of ICANN and its Board, and would be incompatible with ICANN’s commitment to maintain and improve robust mechanisms for accountability, as required by ICANN’s Affirmation of Commitments, Bylaws and core values.

---

<sup>181</sup> The Supplementary Rules provide similarly in section 1 that the IRP is designed “to review ICANN Board actions or inactions alleged to be inconsistent with ICANN’s Bylaws or Articles of Incorporation” with the standard of review set forth in section 8:

*8. Standard of Review*

*The IRP is subject to the following standard of review: (i) did the ICANN Board act without conflict of interest in taking its decision; (ii) did the ICANN Board exercise due diligence and care in having sufficient facts in front of them; (iii) did the ICANN Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?*

*If a requestor demonstrates that the ICANN Board did not make a reasonable inquiry to determine it had sufficient facts available, ICANN Board members had a conflict of interest in participating in the decision, or the decision was not an exercise in independent judgment, believed by the ICANN Board to be in the best interests of the company, after taking account of the Internet community and the global public interest, the requestor will have established proper grounds for review.*

125. The IRP Panel is aware that three other IRP panels have considered this issue of standard of review and degree of deference to be accorded, if any, when assessing the conduct of ICANN’s Board. All of them have reached the same conclusion: the Board’s conduct is to be reviewed and appraised by the IRP Panel using an objective and independent standard, without any presumption of correctness.<sup>182</sup> As the IRP Panel reasoned in the *ICM Registry Final Declaration*:

*ICANN is no ordinary non-profit California corporation. The Government of the United States vested regulatory authority of vast dimension and pervasive global reach in ICANN. In “recognition of the fact that the Internet is an international network of networks, owned by no single nation, individual or organization” – including ICANN – ICANN is charged with “promoting the global public interest in the operational stability of the Internet...” ICANN “shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law...” Thus, while a California corporation, it is governed particularly by the terms of its Articles of Incorporation and Bylaws, as the law of California allows. Those Articles and Bylaws, which require ICANN to carry out its activities in conformity with relevant principles of international law, do not specify or imply that the International Review Process provided for shall (or shall not) accord deference to the decisions of the ICANN Board. The fact that the Board is empowered to exercise its judgment in the application of ICANN’s sometimes competing core values does not necessarily import that that judgment must be treated deferentially by the IRP. In the view of the Panel, the judgments of the ICANN Board are to be reviewed and appraised by the Panel objectively, not deferentially. The business judgment rule of the law of California, applicable to directors of California corporations, profit and nonprofit, in the case of ICANN is to be treated as a default rule that might be called upon in the absence of relevant provisions of ICANN’s Articles and Bylaws and of specific representations of ICANN...that bear on the propriety of its conduct. In the instant case, it is those Articles and Bylaws, and those representations, measured against the facts as the Panel finds them, which are determinative.<sup>183</sup>*

126. The IRP Panel here agrees with this analysis. Moreover, Article IV, §3.21 of the Bylaws provides that “declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value” (underlining added). The IRP Panel recognizes that there is unanimity on the issue of degree of deference, as found by the three IRP panels that have previously considered it. The declarations of those panels have precedential value. The Panel considers that the question on this issue is now settled. Therefore, in this IRP the ICANN Board’s conduct is to be reviewed and appraised by this Panel objectively and independently, without any presumption of correctness.

127. On a related point as to the scope of the IRP Panel’s review, the Panel agrees with ICANN’s point of emphasis that, because the Panel’s review is limited to addressing challenges to conduct by ICANN’s Board, the Panel is not tasked with reviewing the

---

<sup>182</sup> *ICM Registry Final Declaration*, ¶ 136 (“the judgments of the ICANN Board are to be reviewed and appraised by the Panel objectively, not deferentially”); *Booking.com final Declaration*, ¶ 111 (“the IRP Panel is charged with ‘objectively’ determining whether or not the Board’s actions are in fact consistent with the Articles, Bylaws and Guidebook, which the Panel understands as requiring that the Board’s conduct be appraised independently, and without any presumption of correctness.”); Final Declaration of the IRP Panel in *DotConnectAfrica Trust v. ICANN*, ICDR Case No. 50-2013-001083, ¶ 76 (July 9, 2015) (“*DCA Final Declaration*”), at <https://www.icann.org/en/system/files/files/final-declaration-2-redacted-09jul15-en.pdf> (last accessed on Sept. 15, 2015) (“The Panel therefore concludes that the “standard of review” in this IRP is a *de novo*, objective and independent one, which does not require any presumption of correctness”).

<sup>183</sup> *ICM Registry Final Declaration*, ¶ 136.

actions or decisions of ICANN staff or other third parties who may be involved in ICANN activities or provide services to ICANN (such as the ICDR or the experts in the *Vistaprint SCO*). With this in mind, and with the focus on the Board, the only *affirmative* action of the Board in relation to Vistaprint's .WEBS gTLD application was through the BGC, which denied Vistaprint's Reconsideration Request.<sup>184</sup> ICANN states that "the sole Board action that Vistaprint has identified in this case is the Board Governance Committee's ('BGC') rejection of Vistaprint's Reconsideration Request, which sought reconsideration of the Expert Determination."<sup>185</sup> It appears that ICANN's focus in this statement is on affirmative action taken by the BGC in rejecting Vistaprint's Reconsideration Request; however, this does not eliminate the IRP Panel's consideration of whether, in the circumstances, inaction (or omission) by the BGC or the full ICANN Board in relation to the issues raised by Vistaprint's application would be considered a potential violation of the Articles or Bylaws.

128. As discussed below, the Panel considers that a significant question in this IRP concerns one of "omission" – the ICANN Board, through the BGC or otherwise, did not provide relief to Vistaprint in the form of an additional review mechanism, as it did to certain other parties who were the subject of an adverse SCO determination.
129. IRP declaration binding or non-binding: As noted above, Vistaprint contends that the outcome of this IRP is binding on ICANN, and that any other result would be incompatible with ICANN's obligation to maintain and improve robust mechanisms for accountability. ICANN, on the other hand, contends that the IRP Panel's declaration is intended to be advisory and non-binding.
130. In analyzing this issue, the IRP Panel has carefully reviewed the three charter instruments that give the Panel its authority to act in this case: the Bylaws, the Supplementary Procedures, and the ICDR Rules. The Panel views that it is important to distinguish between (i) the findings of the Panel on the question of whether the ICANN Board's conduct is consistent (or not) with the Articles and Bylaws, and (ii) any consequent remedial measures to be considered as a result of those findings, at least insofar as those

---

<sup>184</sup> The BGC is a committee of the Board established pursuant to Article XII, § 1 of the Bylaws. Article IV, § 2.3 of the Bylaws provide for the delegation of the Board's authority to the BGC to consider Requests for Reconsideration and indicate that the BGC shall have the authority to:

- a. evaluate requests for review or reconsideration;
- b. summarily dismiss insufficient requests;
- c. evaluate requests for urgent consideration;
- d. conduct whatever factual investigation is deemed appropriate;
- e. request additional written submissions from the affected party, or from other parties;
- f. make a final determination on Reconsideration Requests regarding staff action or inaction, without reference to the Board of Directors; and
- g. make a recommendation to the Board of Directors on the merits of the request, as necessary.

The BGC has discretion to decide whether to issue a final decision or make a recommendation to ICANN's Board. In this case, the BGC decided to make a final determination on Vistaprint's RFR.

<sup>185</sup> ICANN's First Additional Submission, ¶ 4. By contrast to the IRP Panel's focus on the Board's conduct, the BGC in its decision on Vistaprint's Reconsideration request considered the action or inaction of ICANN staff and third parties providing services to ICANN (i.e., the ICDR and SCO experts).

measures would direct the Board to take or not take any action or decision. The Panel considers that, as to the first point, the findings of the Panel on whether the Board has acted in a manner that is consistent (or not) with the Articles or Bylaws is akin to a finding of breach/liability by a court in a contested legal case. This determination by the Panel is “binding” in the sense that ICANN’s Board cannot overrule the Panel’s declaration on this point or later decide for itself that it disagrees with the Panel and that there was no inconsistency with (or violation of) the Articles and Bylaws. However, when it comes to the question of whether or not the IRP Panel can *require* that ICANN’s Board implement any form of redress based on a finding of violation, here, the Panel believes that it can only raise remedial measures to be considered by the Board in an advisory, non-binding manner. The Panel concludes that this distinction – between a “binding” declaration on the violation question and a “non-binding” declaration when it comes to recommending that the Board stay or take any action – is most consistent with the terms and spirit of the charter instruments upon which the Panel’s jurisdiction is based, and avoids conflating these two aspects of the Panel’s role.

131. The IRP Panel shares some of Vistaprint’s concerns about the efficacy of the IRP as an accountability mechanism if any affirmative relief that might be considered appropriate by the Panel is considered non-binding on ICANN’s Board (see discussion below); nevertheless, the Panel determines on the basis of the charter instruments, as well as the drafting history of those documents, that its declaration is binding only with respect to the finding of compliance or not with the Articles and Bylaws, and non-binding with respect to any measures that the Panel might recommend the Board take or refrain from taking. The Panel’s Declaration will have “precedential value” and will possibly be made publicly available on ICANN’s website.<sup>186</sup> Thus, the declaration of violation (or not), even without the ability to order binding relief vis-à-vis ICANN’s Board, will carry more weight than would be the case if the IRP was a confidential procedure with decisions that carried no precedential value.

132. To the extent that there is ambiguity on the nature of the IRP Panel’s declaration (which perhaps could have been avoided in the first place), it is because there is ambiguity and an apparent contradiction created by some of the key terms of the three charter instruments – the Bylaws, the Supplementary Procedures, and the ICDR Rules. In terms of a potential interpretive hierarchy for these documents – to the extent that such hierarchy is relevant – the Bylaws can be said to have created the IRP and its terms of reference: the IRP is established as an accountability mechanism pursuant to the Bylaws, Article IV, § 3 (Independent Review of Board Actions). Article IV, § 3.8 of the Bylaws, in turn, delegates to the “IRP Provider” the task of establishing rules and procedures that are supposed to be consistent with Article IV, § 3:

*Subject to the approval of the Board, the IRP Provider shall establish operating rules and procedures,*

---

<sup>186</sup> The Panel observes the final declarations in all previous IRPs that have gone to decision, as well as declarations concerning procedure and interim relief, have been posted on ICANN’s website. In this respect, Supplementary Procedures, Rule 10(c) provides that a “Declaration may be made public only with the consent of all parties or as required by law”. However, ICANN has also agreed in Rule 10(c) that subject to the redaction of confidential information or unforeseen circumstances, “ICANN will consent to publication of a Declaration if the other party so requests.”



which shall implement and be consistent with this Section 3.

[Underlining added]

133. Thus, the Supplementary Procedures and ICDR Rules were established pursuant to Article IV, § 3.8 of the Bylaws; however, the requirement of consistency as between the texts was imperfectly implemented, at least with respect to the ICDR Rules, as discussed below. As between the Supplementary Procedures and the ICDR Rules, the Supplementary Procedures will control, as provided in Supplementary Rule 2:

*In the event there is any inconsistency between these Supplementary Procedures and the Rules, these Supplementary Procedures will govern.*

134. The Bylaws in Article IV, § 3.4 provide that the Panel *shall* be charged with *comparing* contested actions of the Board to the Articles and Bylaws, and with “*declaring*” whether the Board has acted consistently with them. The IRP panel in the *ICM Registry Final Declaration* stressed that the IRP panel’s task is “to ‘declare’, not to ‘decide’ or to ‘determine’.”<sup>187</sup> However, the word “declare”, alone, does not conclusively answer the question of whether the IRP’s declaration (or any part of it) is binding or not. “To declare” means “*to announce or express something clearly and publicly, especially officially.*”<sup>188</sup> Declarations can and do serve as the predicate for binding or non-binding consequences in different contexts. For example, a declaratory relief action – in which a court resolves legal uncertainty by determining the rights of parties under a contract or statute without ordering anything be done or awarding damages – can have a binding result because it may later preclude a lawsuit by one of the parties to the declaratory lawsuit. Further, in a non-legal context, “declaring” a state of emergency in a particular state or country can have binding consequences. Thus, the word “declare,” in itself, does not answer the issue.

135. Moreover, nothing in the Bylaws, Supplementary Procedures or ICDR Rules suggests that the IRP Panel’s declaration is non-binding with respect to the Panel’s core task of deciding whether the Board did, or did not, comply the Articles or Bylaws. There is no provision that states the ICANN Board can reconsider this independent and important declaration. To the contrary, the ICDR Rules, which apply to the IRP proceedings, can be read to suggest that both the Panel’s finding of compliance (or not) by ICANN’s Board, and the Panel’s possible reference to any remedial measures, are binding on ICANN. As Vistaprint indicates, the preamble of the ICDR Rules provide that “[a] dispute can be submitted to an arbitral tribunal for a final and binding decision,” and Article 30(1) of those Rules specifies that “[a]wards shall be made in writing by the arbitral tribunal and shall be final and binding on the parties” (*emphasis added*).

136. However, these terms in the ICDR Rules arguably contradict specific provisions of the Bylaws and Supplementary Procedures, at least to the extent that they are read to cover any measures that the IRP Panel would direct the ICANN Board to take or not take. In this way, if there is a contradiction between the texts, the Bylaws and Supplemental rules would govern. However, focusing on the relief that the Panel is authorized to grant

---

<sup>187</sup> *ICM Registry Final Declaration*, ¶ 133.

<sup>188</sup> Cambridge English Online Dictionary (United States version).

provides a decisive clue as to the question of whether the IRP declaration, or any part of it, is binding or non-binding, and produces a faithful and harmonized reading of all the texts. While the Bylaws and Supplementary Procedures say nothing to limit the binding effect of the IRP Panel’s “liability” declaration, they both contain provisions that expressly indicate the Panel may only “recommend” that the Board stay or take any action or decision. In particular, the Bylaws in Article IV, § 3.11 sets out the IRP Panel’s authority in terms of alternative actions that it may take once it has an IRP case before it:

*The IRP Panel shall have the authority to:*

- a. summarily dismiss requests brought without standing, lacking in substance, or that are frivolous or vexatious;
- b. request additional written submissions from the party seeking review, the Board, the Supporting Organizations, or from other parties;
- c. declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws; and
- d. recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP;
- e. consolidate requests for independent review if the facts and circumstances are sufficiently similar; and
- f. determine the timing for each proceeding.

*[Underlining added]*<sup>189</sup>

137. Article IV, § 3.11(a) provides that the Panel may summarily dismiss an IRP request in certain circumstances. A fair reading of this term is that an IRP panel’s dismissal of a case pursuant to § 3.11(a) would be a binding decision, both for the party who brought the IRP request and for ICANN. In other words, ICANN could not require that the IRP panel take-up the case again once it has been dismissed by the panel.<sup>190</sup> Further, the IRP panel can “request additional written submissions” from the parties (including the Board) or certain third parties. Here again, a fair reading of this term is that it is not subject to any review by ICANN Board before it can be implemented and is therefore binding on those who receive such a request.

138. By comparison, any form of relief whereby the IRP Panel *would direct the Board* to take, or refrain from taking, any action or decision, as specified in § 3.11(d), must be “recommend[ed]” to the Board, which then “reviews and acts upon the opinion of the IRP.”<sup>191</sup> The Panel’s authority is thus limited (and in this sense non-binding) when it

---

<sup>189</sup> Bylaws, Art. IV, § 3.11.

<sup>190</sup> Supplementary Rule 6 provides similarly that:

*An IRP Panel may summarily dismiss any request for Independent Review where the requestor has not demonstrated that it meets the standing requirements for initiating the Independent Review.*

*Summary dismissal of a request for Independent Review is also appropriate where a prior IRP on the same issue has concluded through Declaration.*

*An IRP Panel may also dismiss a querulous, frivolous or vexatious request for Independent Review.*

<sup>191</sup> Supplementary Rule 7 provides similarly (as regards interim measures of protection) that:

*An IRP Panel may recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the IRP declaration. Where the IRP*

(Continued...)

comes to providing ICANN's Board with potential courses of action or inaction in view of Board's non-compliance with the Articles or Bylaws.<sup>192</sup>

139. Several other provisions of the Bylaws and Supplementary Procedures can be fairly read to relate to decisions of the IRP panel that would be considered binding, even as to ICANN's Board. Article IV, § 3.18 provides “[t]he IRP Panel shall make its declaration based solely on the documentation, supporting materials, and arguments submitted by the parties, and in its declaration shall specifically designate the prevailing party.” There is no mechanism for the Board to overrule the IRP panel's designation as to which party is the prevailing party. Article IV, § 3.20 provides “[t]he IRP Panel may, in its discretion, grant a party's request to keep certain information confidential, such as trade secrets.” A fair reading of this provision is that the IRP panel's decision concerning such questions of confidentiality would be binding on all parties (including ICANN) in the IRP procedure. Consolidating IRP requests and determining the timing for each IRP proceeding are also decisions of the panel that are binding and not subject to review. Finally, Supplemental Procedures, Rule 11, directs that “[t]he IRP Panel shall fix costs in its Declaration.” Here too, this decision of the IRP panel can be fairly read to be binding on the parties, including the Board.

140. Thus, the IRP Panel's authority to render binding or non-binding decisions, orders or relief can be considered in relation to four basic areas:

(i) summary dismissals by the IRP Panel (for different reasons as stated in the Bylaws and Supplementary Procedures) are final and binding on the parties. There is no mechanism for appeal of such dismissals and they have precedential value.

(ii) the designation of prevailing party, fixing costs for the IRP, and other orders in support of the IRP proceedings (e.g., timing of proceedings, confidentiality, requests for additional submissions, consolidation of IRP cases) are binding decisions of the IRP Panel, with no review by the Board or any other body.

(iii) the IRP Panel's declaration of whether or not the Board has acted consistently with the provisions of the Articles and Bylaws is final and binding, in the sense that there is no appeal on this point to ICANN's Board or any other body; it is a final determination and has precedential value.

(iv) any form of relief in which the IRP Panel would direct the Board to take, or refrain from taking, any action or decision is only a recommendation to the Board. In this sense,

---

*Panel is not yet comprised, the Chair of the standing panel may provide a recommendation on the stay of any action or decision*

<sup>192</sup> The word “recommend” is also not free of ambiguity. For example, Article 47 of the ICSID Convention (concerning investor-State arbitration) provides in relevant part that “the Tribunal may, if it considers that the circumstances so require, *recommend* any provisional measures which should be taken to preserve the respective rights of either party” (emphasis added). The use of the word “recommend” in this context may refer to an order of the Tribunal that is intended to be binding on the parties. Nevertheless, in the context of the IRP, the Panel considers that use of the word “recommend” conveys that the Panel's direction of any action or inaction on the part of the Board is a non-binding reference.

such a recommendation is not binding on the Board. The Bylaws and Supplementary Procedures provide specific and detailed guidance in this key area – i.e., relief that would require the Board to take or refraining from taking any action or decision – where the IRP Panel’s decisions would not be binding on the Board, but would serve only as a recommendation to be reviewed and acted upon by the Board.

141. The other decisions of the IRP panel, as outlined above and including the declaration of whether or not the Board violated the Articles and Bylaws, would be binding, consistent with the Bylaws, Supplementary Procedures and ICDR Rule Article 30(1). This approach provides a reading that harmonizes the terms of the three charter instruments. It also provides interpretive context for Article IV, § 3.21 of the Bylaws, providing that “[w]here feasible, the Board shall consider the IRP Panel declaration at the Board’s next meeting.” The IRP panel in the *ICM Registry Final Declaration* stated that “[t]his relaxed temporal proviso to do no more than ‘consider’ the IRP declaration, and to do so at the next meeting of the Board ‘where feasible’, emphasizes that it is not binding.”<sup>193</sup> However, consistent with the analysis above, the IRP Panel here reads this statement in the *ICM Registry Final Declaration* to relate only to an IRP panel’s decision to “recommend” that the Board take, or refrain from taking, any action or decision. It does not relate to the other decisions or duties of the IRP panel, as explained above.
142. Vistaprint contends that the second sentence in Article IV, § 3.21 – providing “[t]he declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value” – which was added in April 2013 after the issuance of *ICM Registry Final Declaration*, was a change that supports the view that the IRP panel’s outcome, including any references to remedial relief, is binding. However, the Panel agrees with ICANN’s view that “a declaration clearly can be both non-binding and also final and precedential.”<sup>194</sup> Further, the preparatory work and drafting history for the relevant provisions of the Bylaws relating to the IRP procedure indicate the intention for a non-binding procedure with respect to the Panel’s authority to advise the Board to take, or refrain from taking, any action or decision. As summarized in ICANN’s contentions above, ICANN has submitted evidence that those who were initially involved in establishing the IRP considered that it should be an advisory, non-binding procedure *in relation to any policies that the Board might be requested to consider and implement by the IRP panel*.<sup>195</sup>
143. Thus, the Bylaws and the Supplementary Procedures draw a line: when the measures that an IRP panel might consider as a result of its core task require that the Board take or refrain from taking any action or decision, the panel may only “recommend” this course of action. On the other hand, if the IRP panel decides that the Board had violated its Articles or Bylaws, or if the panel decides to dismiss the IRP request, designate a prevailing party,

---

<sup>193</sup> *ICM Registry Final Declaration*, ¶ 133.

<sup>194</sup> ICANN’s First Additional Submission, ¶ 39.

<sup>195</sup> ICANN’s First Additional Submission, ¶ 38, n 53 (Vint Cerf, the former Chair of ICANN’s Board, testified in the *ICM IRP* that the independent review panel “is an advisory panel. It makes recommendations to the board but the board has the ultimate responsibility *for deciding policy for ICANN*” (*italics added*)). *ICM v. ICANN*, Hearing Transcript, September 23, 2009, at 592:7-11).

set conditions for confidentiality, consolidate IRP requests, request additional written submissions or fix costs, a fair reading of the Bylaws, Supplementary Procedures and ICDR Rules relevant to these determinations would be that the IRP panel's decisions on these matters are binding on both parties, including ICANN.

144. Finally, in view of Article IV, § 3.21 providing that the declarations of IRP panels are final and *have precedential value*, the IRP Panel here recognizes that, in addition to the *ICM Registry Final Declaration*, two other IRP panels have considered the question of the IRP panel's authority. In the *Booking.com Final Declaration*, the IRP panel focused on the independent and objective standard of review to be applied to the panel's core task of assessing whether the Board's actions were consistent with the Articles, Bylaws and Guidebook.<sup>196</sup> However, the IRP panel in *Booking.com*, as ICANN acknowledges in its Second Additional Response, did not directly address whether an IRP panel may issue a binding declaration (although ICANN contends that the panel implicitly acknowledged that it cannot).<sup>197</sup>
145. In the *DCA Final Declaration*, the IRP panel addressed directly the question of whether or not the panel's declaration was binding. The panel ruled that its declarations, both as to the procedure and the merits of the case, were binding. The IRP panel in that case raised some of the same concerns that Vistaprint has raised here<sup>198</sup>:

*110. ICANN points to the extensive public and expert input that preceded the formulation of the Supplementary Procedures. The Panel would have expected, were a mere advisory decision, opinion or declaration the objective of the IRP, that this intent be clearly articulated somewhere in the Bylaws or the Supplementary Procedures. In the Panel's view, this could have easily been done.*

*111. The force of the foregoing textual and construction considerations as pointing to the binding effect of the Panel's decisions and declarations are reinforced by two factors: 1) the exclusive nature of the IRP whereby the non-binding argument would be clearly in contradiction with such a factor; and, 2) the special, unique, and publicly important function of ICANN. As explained before, ICANN is not an ordinary private non-profit entity deciding for its own sake who it wishes to conduct business with, and who it does not. ICANN rather, is the steward of a highly valuable and important international resource.*

[...]

*115. Moreover, assuming for the sake of argument that it is acceptable for ICANN to adopt a remedial scheme with no teeth, the Panel is of the opinion that, at a minimum, the IRP should forthrightly explain and acknowledge that the process is merely advisory. This would at least let parties know before embarking on a potentially expensive process that a victory before the IRP panel may be ignored by ICANN. And, a straightforward acknowledgment that the IRP process is intended to be merely advisory might lead to a legislative or executive initiative to create a truly independent compulsory process.*

146. The IRP panel in the *DCA Final Declaration* also emphasized that, according to the terms of the Guidebook, applicants for a new gTLD string waive their right to resort to the courts

---

<sup>196</sup> *Booking.com Final Declaration*, ¶¶ 104-115.

<sup>197</sup> ICANN's Second Additional Response, ¶ 29.

<sup>198</sup> *DCA Final Declaration*, ¶ 23 (quoting *DCA Declaration on the IRP Procedure* (Aug. 14, 2014)).

and therefore the IRP serves as the ultimate accountability mechanism for them:<sup>199</sup>

*15. The IRP is the only independent third party process that allows review of board actions to ensure their consistency with the Articles of Incorporation or Bylaws. As already explained in this Panel's 14 August 2014 Declaration on the IRP Procedure ("August 2014 Declaration"), the avenues of accountability for applicants that have disputes with ICANN do not include resort to the courts. Applications for gTLD delegations are governed by ICANN's Guidebook, which provides that applicants waive all right to resort to the courts:*

*"Applicant hereby releases ICANN [...] from any and all claims that arise out of, are based upon, or are in any way related to, any action or failure to act by ICANN [...] in connection with ICANN's review of this application, investigation, or verification, any characterization or description of applicant or the information in this application, any withdrawal of this application or the decision by ICANN to recommend or not to recommend, the approval of applicant's gTLD application. APPLICANT AGREES NOT TO CHALLENGE, IN COURT OR ANY OTHER JUDICIAL FORA, ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION, AND IRREVOCABLY WAIVES ANY RIGHT TO SUE OR PROCEED IN COURT OR ANY OTHER JUDICIAL FORA ON THE BASIS OF ANY OTHER LEGAL CLAIM AGAINST ICANN ON THE BASIS OF ANY OTHER LEGAL CLAIM."*

*Thus, assuming that the foregoing waiver of any and all judicial remedies is valid and enforceable, then the only and ultimate "accountability" remedy for an applicant is the IRP.*

147. The IRP Panel in this case considers that the IRP panel in the *DCA Final Declaration*, and Vistaprint, have made several forceful arguments in favor of why the outcome of the IRP should be considered binding, especially to ensure the efficacy of the IRP as an accountability mechanism. Vistaprint has also urged that the IRP, at least with respect to applicants for new gTLD strings, is not merely a corporate accountability mechanism aimed at *internal* stakeholders, but operates to assess ICANN's responsibilities in relation to *external* third parties. And the outcome of the IRP is binding on these third parties, even if it is not binding on ICANN and its Board. In similar circumstances, it would not be uncommon that individuals, companies or even governments, would agree to participate in dispute resolution processes with third parties that are binding, at least *inter partes*.
148. However, as explained above, the IRP Panel concludes that the distinction between a "binding" declaration on the violation/liability question (and certain other matters as discussed above), on the one hand, and a "non-binding" declaration when it comes to recommending that the Board take or refrain from taking any action or decision, on the other hand, is most faithful to the terms and spirit of the charter instruments upon which the Panel's jurisdiction is based. To the extent that there is any disagreement with this approach, it is for ICANN to consider additional steps to address any ambiguities that might remain concerning the authority of the IRP panel and the legal effect of the IRP declaration.
149. Authority to award affirmative relief: The IRP Panel's analysis on this issue is closely related to, and dependent upon, its analysis of the binding vs. non-binding issue

---

<sup>199</sup> *DCA Final Declaration*, ¶ 38 (quoting *DCA Third Declaration on IRP Procedure*).

immediately above. To the extent that the IRP Panel renders any form of relief whereby the Panel would direct the Board to take, or refrain from taking, any action or decision, that relief must be “recommend[ed]” to the Board, which then “reviews and acts upon the opinion of the IRP,” as specified in § 3.11(d) of the Bylaws. Relatedly, Supplementary Rule 7 provides that an “IRP Panel may recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the IRP declaration.” Consequently, the IRP Panel finds that it does not have authority to render affirmative relief requiring ICANN’s Board to take, or refrain from taking, any action or decision.

#### **b. SCO Proceedings Claim**

150. The IRP Panel has carefully reviewed Vistaprint’s arguments concerning ICANN’s alleged violation of its Articles and Bylaws in relation to this *SCO Proceedings Claim*. However, as stated above, the IRP Panel does not review the actions or inactions of ICANN’s staff or any third parties, such as the ICDR or SCO experts, who provided services to ICANN. Instead, the IRP Panel’s focus is on ICANN’s Board and the BGC, which was delegated responsibility from the full Board to consider Vistaprint’s Request for Reconsideration.<sup>200</sup>
151. The core of Vistaprint *SCO Proceedings Claim* is that ICANN’s Board improperly disregarded accumulated errors made by the ICDR and the SCO experts (especially the Third Expert) during the *Vistaprint SCO* proceedings, and in this way ICANN violated Article IV of the Articles of Incorporation and certain provisions of the Bylaws, as well as the Guidebook.
152. Vistaprint contends that ICANN’s Board must verify whether or not, by accepting the SCO expert determination, it is acting consistent with its obligations under its Articles, Bylaws and Affirmation of Commitments,<sup>201</sup> and that ICANN would be in violation of these obligations if it were to blindly accept an expert determination in circumstances where the ICDR and/or the expert had failed to comply with the Guidebook and the New gTLD Objections Procedure and/or the ICDR Rules for SCOs, or where a panel had failed to correctly apply the standard set by ICANN.<sup>202</sup>
153. The IRP Panel disagrees with Vistaprint’s contention on this point. Although the Guidebook provides in § 5.1 that ICANN’s Board of Directors has ultimate responsibility for the New gTLD Program, there is no affirmative duty stated in the Articles, Bylaws or

---

<sup>200</sup> Article IV, §2.15 of ICANN’s Bylaws provides that:

*For all Reconsideration Requests brought regarding staff action or inaction, the Board Governance Committee shall be delegated the authority by the Board of Directors to make a final determination and recommendation on the matter. Board consideration of the recommendation is not required. As the Board Governance Committee deems necessary, it may make recommendation to the Board for consideration and action. The Board Governance Committee’s determination on staff action or inaction shall be posted on the Website. The Board Governance Committee’s determination is final and establishes precedential value.*

<sup>201</sup> Request, ¶ 6.

<sup>202</sup> Request, ¶ 6.

Guidebook that the Board must to review the result in each and every SCO case. Instead, the Guidebook § 3.4.6 provides that:

*The findings of the [SCO] panel will be considered an expert determination and advice that ICANN will accept within the dispute resolution process.*<sup>203</sup>

[Underlining added]

154. In the case of an adverse SCO determination, the applicant for a new gTLD string is not left without any recourse. Module 6.6 of the Guidebook provides that an applicant “**MAY UTILIZE ANY ACCOUNTABILITY MECHANISM SET FORTH IN ICANN’S BYLAWS FOR PURPOSES OF CHALLENGING ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION**” (no emphasis added).<sup>204</sup>

155. The Reconsideration Request is an “accountability mechanism” that can be invoked by a gTLD applicant, as it was used by Vistaprint, to challenge the result in SCO proceedings. Article IV, § 2.2 of the Bylaws provides that:

*Any person or entity may submit a request for reconsideration or review of an ICANN action or inaction (“Reconsideration Request”) to the extent that he, she, or it have been adversely affected by:*

- a. *one or more staff actions or inactions that contradict established ICANN policy(ies); or*
- b. *one or more actions or inactions of the ICANN Board that have been taken or refused to be taken without consideration of material information, except where the party submitting the request could have submitted, but did not submit, the information for the Board’s consideration at the time of action or refusal to act; or*
- c. *one or more actions or inactions of the ICANN Board that are taken as a result of the Board’s reliance on false or inaccurate material information.*

156. In line with Article IV, § 2.2 of the Bylaws, Vistaprint submitted its Reconsideration Request to challenge actions of the ICDR and SCO experts, claiming their conduct contradicted ICANN policies. While Guidebook, § 5.1 permits ICANN’s Board to individually consider new gTLD applications, such as through the RFR mechanism, it does not require that the Board do so in each and every case, *sua sponte*. The Guidebook, § 5.1, provides in relevant part that:

*ICANN’s Board of Directors has ultimate responsibility for the New gTLD Program. The Board reserves the right to individually consider an application for a new gTLD to determine whether approval would be in the best interest of the Internet community. Under exceptional circumstances, the Board may individually consider a gTLD application. For example, the Board might individually consider an application as a result ... the use of an ICANN accountability mechanism.*<sup>205</sup>

157. The IRP Panel determines that in the absence of a party’s recourse to an accountability

---

<sup>203</sup> Guidebook, § 3.4.6. The New gTLD Objections Procedure further provides in Article 2(d) that:

*The ‘Expert Determination’ is the decision upon the merits of the Objection that is rendered by a Panel in a proceeding conducted under this Procedure and the applicable DRSP Rules that are identified in Article 4(b).*

<sup>204</sup> Guidebook, § 6.6.

<sup>205</sup> Guidebook, § 5.1.



mechanism such as the RFR, the ICANN Board has no affirmative duty to review the result in any particular SCO case.

158. In this case, Vistaprint did submit a Reconsideration Request and the BGC did engage in a detailed review of the alleged errors in process and procedures raised by Vistaprint. The BGC explained what it considered to be the scope of its review, which is consistent with the mandate in Article IV, § 2.2 of the Bylaws for review of “staff actions or inactions that contradict established ICANN policies”:

*In the context of the New gTLD Program, the reconsideration process does not call for the BGC to perform a substantive review of expert determinations. Accordingly, the BGC is not to evaluate the Panel’s substantive conclusion that the Requester’s applications for .WEBS are confusingly similar to the Requester’s application for .WEB. Rather, the BGC’s review is limited to whether the Panel violated any established policy or process in reaching that Determination.*<sup>206</sup>

159. In contrast to Vistaprint’s claim that the BGC failed to perform its task properly and “turned a blind eye to the appointed Panel’s lack of independence and impartiality”, the IRP Panel finds that the BGC provided in its 19-page decision a detailed analysis of (i) the allegations concerning whether the ICDR violated its processes or procedures governing the SCO proceedings and the appointment of, and challenges to, the experts, and (ii) the questions regarding whether the Third Expert properly applied the burden of proof and the substantive standard for evaluating a String Confusion Objection. On these points, the IRP Panel finds that the BGC’s analysis shows serious consideration of the issues raised by Vistaprint and, to an important degree, reflects the IRP Panel’s own analysis.<sup>207</sup>

160. For example, in relation to Vistaprint’s contention that the First Expert failed to maintain independence and impartiality, in violation of Article 13(c) of the New gTLD Objections Procedure, the BGC reasoned:

*The only evidence the [Vistaprint] cites in support of its argument that Mr. Koh failed to maintain his independence during the proceeding is the ICDR’s statement that it had decided to remove Mr. Koh “due to a new conflict.” (Request, Section 10, Pgs. 9-10.) The ICDR did not provide any further information as to the nature of the conflict. Conflicts can take many forms, such as scheduling or personal conflicts unrelated to the proceedings. There is no evidence that the conflict that inflicted*

---

<sup>206</sup> BGC Determination, p. 7, Request, Annex 26.

<sup>207</sup> Vistaprint also asserted that based on the Third Expert’s determination in the *Vistaprint SCO*, the Third Expert lacked impartiality and independence, or alternatively lacked qualification. On a complete review of the entire record in this case, including the SCO proceedings and the Reconsideration Request before the BGC, the IRP Panel has found no foundation for these allegations against the Third Expert, and no violation of ICANN’s Articles or Bylaws in the manner in which the BGC handled these assertions. The BGC found that these assertions were insufficient to merit reconsideration, as stated in its RFR decision, in footnote 10:

*[Vistaprint] concludes with the following claim: “The cursory nature of the Decision and the arbitrary and selective discussion of the parties’ arguments by the Panel show the lack of either the Panel’s independence and impartiality or the Panel’s appropriate qualifications.” (Request, Section 10, Pg. 23.) [Vistaprint’s] assertion is not accompanied by any discussion or further explanation for how ICANN processes were purportedly violated. [Vistaprint’s] summary conclusions are without merit and insufficient to warrant reconsideration. Furthermore, [Vistaprint’s] claim that the Determination was “cursory” and only contained “selective discussion of the parties’ arguments” is unsupported. The Determination was eighteen pages long and contained more than six pages of discussion of the parties’ arguments and evidence.*

*Mr. Koh was related to the instant proceedings or otherwise impacted Mr. Koh's ability to remain impartial and independent.*

*Furthermore, [Vistaprint] neither claims to have been, nor presents any evidence of being, materially and adversely affected by Mr. Koh's removal. Indeed, had [Vistaprint] successfully challenged Mr. Koh for lack of independence at the time he was removed, the remedy under the applicable ICDR procedures would have been the removal of Mr. Koh, which was the result here.<sup>208</sup>*

161. The BGC concluded that Vistaprint provided no evidence of being materially and adversely affected by the First Expert's removal. Moreover, to the extent that there was an impact due to the First Expert stepping down, this conduct was attributable to the First Expert, not to the ICDR. As the BGC states, had there been a concern about the First Expert's lack of independence, the remedy under the applicable ICDR procedures would have been the removal of that expert, which is what actually occurred.

162. Vistaprint also argued that the BGC conducted no investigation as to the nature of the new conflict that confronted the First Expert and instead "developed baseless hypotheses for the other reasons that could have led to this Panel stepping down."<sup>209</sup> In this respect, perhaps the BGC could have sought to develop evidence on this issue by inquiring with the ICDR about the circumstances concerning the First Expert. Article IV, § 2.13 of the Bylaws provides the BGC "may also request information relevant to the request from third parties," but it does not require that the BGC do so. However, it would not have changed the outcome, as noted above. It is also noteworthy that Article IV, § 2.2(b) of the Bylaws provides that a party may submit a Reconsideration Request to the extent that the party has been adversely affected by:

*one or more actions or inactions of the ICANN Board that have been taken or refused to be taken without consideration of material information, except where the party submitting the request could have submitted, but did not submit, the information for the Board's consideration at the time of action or refusal to act.*

163. Here, there was no showing that Vistaprint attempted to develop information concerning how the removal of the First Expert might have had a material and adverse impact on Vistaprint, or information concerning the reasons for the First Expert stepping down.

164. Vistaprint also alleged that the ICDR unjustifiably accepted a challenge to the Second Expert, or created the circumstances for such a challenge. As the BGC noted, the procedure governing challenges to experts is set forth in Article 2 § 3 of the ICDR's New gTLD Objections Procedure, which provides:

*Upon review of the challenge the DRSP in its sole discretion shall make the decision on the challenge and advise the parties of its decision.*

165. The BGC reasoned that while Vistaprint may disagree with the ICDR's decision to accept the challenge to the Second Expert, that decision was in the "sole discretion" of the ICDR and it was not the BGC's role to second guess the ICDR's discretion in this regard.<sup>210</sup> The IRP Panel finds that the BGC violated no Article, Bylaw or the Guidebook by taking this

---

<sup>208</sup> BGC Determination, p. 12, Request, Annex 26.

<sup>209</sup> Request, ¶ 77.

<sup>210</sup> BGC Determination, p. 12, Request, Annex 26.

view. However, it does appear that the ICDR might have avoided the challenge situation in the first place by appointing someone other than the Second Expert – who had served as the expert panel in previous SCO case administered by the ICDR – given that the basis for the challenge against him, which the ICDR accepted, was his involvement in the previous case.

166. Vistaprint also claimed that the Third Expert incorrectly applied both the burden of proof and the substantive criteria for evaluating the String Confusion Objection. The BGC rejected these contentions and the IRP Panel agrees. The BGC’s decision looked closely at the standard to be applied in String Confusion Objection proceedings, as well as how the Third Expert extensively detailed the support for his conclusion that the .WEBS string so nearly resembles .WEB – visually, aurally and in meaning – that it is likely to cause confusion.<sup>211</sup> In this respect, the BGC did not violate ICANN’s Articles or Bylaws by determining that the Third Expert properly applied the relevant Guidebook policy for String Confusion Objections. As the BGC noted,

*The Requester’s disagreement as to whether the standards should have resulted in a finding in favor of Requester’s application does not mean that the panel violated any policy or process in reaching the decision.*<sup>212</sup>

167. The Guidebook provides that the following evaluation standard is to be applied in String Confusion Objection proceedings:

*3.5.1 String Confusion Objection*

*A DRSP panel hearing a string confusion objection will consider whether the applied-for gTLD string is likely to result in string confusion. String confusion exists where a string so nearly resembles another that it is likely to deceive or cause confusion. For a likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user. Mere association, in the sense that the string brings another string to mind, is insufficient to find a likelihood of confusion.*

168. Vistaprint in its Request emphasized that ICANN has indicated that the SCO test sets a high bar<sup>213</sup>:

22. *At various times, ICANN has indicated that the string confusion test sets a high bar:*

- “[T]he standard indicates that confusion must be probable, not merely possible, in order for this sort of harm to arise. Consumers also benefit from competition. For new gTLDs, the similarity test is a high bar, as indicated by the wording of the standard.[...] Therefore, while the objection and dispute resolution process is intended to address all types of similarity, the process is not intended to hobble competition or reserve a broad set of string [sic] for a first mover.” (fn. omitted)

- “Policy discussions indicate that the most important reason to disallow similar strings as top-level domain names is to protect Internet users from the increased exposure to fraud and other risks that could ensue from confusion of one string for another. This reasoning must be balanced against unreasonable exclusion of top-level labels and denial of applications where considerable investment

---

<sup>211</sup> BGC Recommendation, pp. 15-18, Request, Annex 26.

<sup>212</sup> BGC Determination, p. 17, Request, Annex 26.

<sup>213</sup> Request, ¶¶ 22-23.

*has already been made. As the top-level grows in number of registrations, drawing too large a circle of “similarity protection” around each existing string will quickly result in the unnecessary depletion of available names. The unnecessary exclusion of names would also tend to stifle the opportunity of community representation at the top-level and innovation.” (fn. omitted)*

23. ICANN’s high standard for dealing with string confusion objections has been explicitly confirmed by the NGPC, which states that in the Applicant Guidebook ‘similar’ means:

*“strings so similar that they create a probability of user confusion if more than one of the strings is delegated into the root zone. During the policy development and implementation design phases of the New gTLD Program, aural and conceptual string similarities were considered. These types of similarity were discussed at length, yet ultimately not agreed to be used as a basis for the analysis of the string similarity panels’ consideration because on balance, this could have unanticipated results in limiting the expansion of the DNS as well as the reach and utility of the Internet. [...] The NGPC reflected on existing string similarity in the DNS and considered the positive and negative impacts. The NGPC observed that numerous examples of similar strings, including singulars and plurals exist within the DNS at the second level. Many of these are not registered to or operated by the same registrant. There are thousands of examples [...]” (NGPC Resolution 2014.02.056. NG02).*

169. The passages quoted by Vistaprint, referencing ICANN materials and a resolution of the NGPC, arguably provide useful context in applying the test for String Confusion Objections. After citing these passages, however, Vistaprint contends in its Request that

*“[a]s a result, two strings should only be placed in a contention set if they are so similar that they would create a probability of user confusion were both to be delegated into the root zone, and the finding of confusing similarity must be balanced against the risk of unreasonable exclusion of top-level labels and the denial of applications” (no underlining added).<sup>214</sup>*

170. However, the problem with the test as posited by Vistaprint is that it would add a balancing element that is not in the Guidebook’s standard: according to Vistaprint the finding of confusing similarity must be balanced against the risk of unreasonable exclusion of top-level labels and the denial of applications. This part of the standard (as advanced by Vistaprint) is not in the Guidebook, although the concerns it represents were reflected in the other ICANN materials. The Guidebook standard is as follows:

*String confusion exists where a string so nearly resembles another that it is likely to deceive or cause confusion. For a likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user. Mere association, in the sense that the string brings another string to mind, is insufficient to find a likelihood of confusion.*

171. There is no reference in this standard to balancing the likelihood of confusion against the needs to promote competition and to guard against the unreasonable exclusion of top-level strings. While it might be advisable to consider whether the standard for String Confusion Objections should be revised to incorporate such a balancing test, these elements were not in the policy that was applied by the Third Expert. Nor was there a violation, by the BGC or the ICANN Board, of any Articles or Bylaws in formulating the SCO standard as it was formulated (based on community input), and in determining that the Third Expert properly applied this policy.

---

<sup>214</sup> Request, ¶ 24.

172. ICANN has argued that the time for Vistaprint to have objected to the Guidebook and its SCO policy has long since passed. Vistaprint has responded that it contests the *implementation* of the Guidebook and its *policies*, not just the policies themselves. Even assuming that the Guidebook's policies could be challenged at this point, the IRP Panel finds that the relevant policies, such as the standard for evaluating String Confusion Objections, do not violate any of ICANN's Articles or Bylaws reflecting principles such as good faith, fairness, transparency and accountability. However, the Panel does agree with ICANN that the time for challenging the Guidebook's standard for evaluating String Confusion Objections – which was developed in an open process and with extensive input – has passed.
173. Vistaprint has also complained that it was not provided with the opportunity to appeal the Third Expert's decision on the merits, such that the BGC or some other entity would re-evaluate the Expert's string confusion determination. As noted above, the BGC's review focused on whether the ICDR and the Third Expert properly applied the relevant rules and policies, not on whether the BGC, if it had considered the matter *de novo*, would have found string confusion as between the .WEBS and .WEB strings.
174. The IRP Panel finds that the lack of an appeal mechanism to contest the merits of the Third Expert's SCO determination is not, in itself, a violation of ICANN's Articles or Bylaws. ICANN's commitment through its Articles and Bylaws to act in good faith and with accountability and transparency, and to apply documented policies neutrally, objectively and fairly, does not require that it must have designed the SCO mechanism so that the result of a string confusion determination would be subject to a right of appeal. Other significant dispute resolution systems – such as the international legal regime for commercial arbitration regarding awards as final and binding<sup>215</sup> – do not normally provide for a right of appeal on the merits.
175. In respect of Vistaprint's *SCO Proceedings Claim*, the IRP Panel denies each of Vistaprint's claims concerning ICANN's alleged breaches of obligations under the Articles, Bylaws and Affirmation of Commitments, as follows:
- (1) Vistaprint claims that ICANN failed to comply with its obligation under Article 4 of the Articles and IV § 3.4 of the Bylaws to act in good faith with due diligence and independent judgment by failing to provide due process to Vistaprint's .WEBS applications.<sup>216</sup> The IRP Panel denies Vistaprint's claim that Vistaprint was not given a fair opportunity to present its case; was deprived of procedural fairness and the opportunity to be heard by an independent panel applying the appropriate rules; and was not given any meaningful opportunity for remedy or redress once the SCO determination was made, even in the RFR procedure.
  - (2) Vistaprint claims ICANN failed to comply with its obligation under Article I § 2.8 to neutrally, objectively and fairly apply documented policies as established in the

---

<sup>215</sup> See *Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)*.

<sup>216</sup> Request, ¶¶ 69-71.

Guidebook and Bylaws.<sup>217</sup> As discussed above, the IRP Panel rejects Vistaprint's claim that the *Vistaprint SCO* determination – finding that the .WEBS and .WEB gTLD strings are confusingly similar – is contradictory to ICANN's policy for String Confusion Objections as established in the Guidebook.

- (3) Vistaprint claims ICANN failed to comply with its obligation to act fairly and with due diligence and independent judgment as called for under Article 4 of the Articles of Incorporation, Articles I § 2.8 and IV § 3.4 of the Bylaws by accepting the SCO determination made by the Third Expert, who was allegedly not independent and impartial.<sup>218</sup> As noted above, the IRP Panel finds that there was no failure of the BGC to act with due diligence and independent judgment, and to act in good faith as required by ICANN's Bylaws and Articles, when it determined that Vistaprint's claim – that the Third Expert was not independent and impartial and/or was not appropriately qualified – did not merit reconsideration.
- (4) Vistaprint claims that ICANN failed to comply with its obligations under the Article 4 of the Articles, and Article I §§ 2.7 and 2.8 and Article III § 1 of the Bylaws (and Article 9.1 of the Affirmation of Commitments) to act fairly and transparently by failing to disclose/perform any efforts to optimize the service that the ICDR provides in the New gTLD Program.<sup>219</sup> The IRP Panel rejects Vistaprint's contention that the BGC's Reconsideration determination shows that the BGC made no investigation into Vistaprint's fundamental questions about the Third Expert's arbitrariness, lack of independence, partiality, inappropriate qualification, or that the BGC did not exercise due diligence in making its determination on this issue.
- (5) Vistaprint claims ICANN failed to comply with its obligation to remain accountable under Articles I § 2.10 and IV § 1 of the Bylaws (and Articles 3(a) and 9.1 of the Affirmation of Commitments) by failing to provide any remedy for its mistreatment of Vistaprint's gTLD applications.<sup>220</sup> The IRP Panel disagrees with Vistaprint's claim that ICANN's Board and the BGC adopted the Third Expert's SCO determination without examining whether it was made in accordance with ICANN's policy and fundamental principles under its Articles and Bylaws. In particular, as described above, the IRP Panel rejects Vistaprint's claim that the *Vistaprint SCO* determination is contradictory to ICANN's policy as established in the Guidebook and agrees with the BGC's analysis on this issue. Regarding Vistaprint's contention that ICANN should have created a review mechanism for challenging the substance of SCO expert determinations, as discussed above, the IRP Panel finds that the lack of such a general appeal mechanism creates no inconsistency with ICANN's Articles or Bylaws.
- (6) Vistaprint claims ICANN failed to promote competition and innovation under Articles I § 2.2 (and Article 3(c) of the Affirmation of Commitments) by accepting the Third

---

<sup>217</sup> Request, ¶ 72.

<sup>218</sup> Request, ¶ 73.

<sup>219</sup> Request, ¶¶ 52 and 77.

<sup>220</sup> Request, ¶¶ 78-79.

Expert's determination.<sup>221</sup> Finally, the IRP Panel disagrees with Vistaprint's contention that the Board's acceptance of the determination in the *Vistaprint SCO* was contrary to ICANN's Bylaws because it was contrary to the interests of competition and consumers.

### c. Disparate Treatment Claim

176. Vistaprint's final claim is one that raises a close question for this IRP Panel. Vistaprint contends that ICANN's Board discriminated against Vistaprint through the Board's (and the BGC's) acceptance of the Third Expert's determination in the *Vistaprint SCO*, while allowing other gTLD applications with equally serious string similarity concerns to proceed to delegation<sup>222</sup>, or permitting still other applications that were subject to an adverse SCO determination to go through a separate additional review mechanism.

177. The IRP Panel agrees with Vistaprint's statement that the "IRP Panel's mandate includes a review as to whether or not ICANN's Board discriminates in its interventions on SCO expert determinations."<sup>223</sup> As discussed above, in the Guidebook, § 5.1, ICANN has reserved the right to individually consider an application for a new gTLD to determine whether approval would be in the best interest of the Internet community:

*....The Board reserves the right to individually consider an application for a new gTLD to determine whether approval would be in the best interest of the Internet community. Under exceptional circumstances, the Board may individually consider a gTLD application....*<sup>224</sup>

178. However, as a counterbalance against this reserved power to individually consider new gTLD applications, the ICANN Board must also comply with Article II, § 3 of ICANN's Bylaws, providing for non-discriminatory treatment:

#### *Section 3 (Non-Discriminatory Treatment)*

*ICANN shall not apply its standards, policies, procedures, or practices inequitably or single out any particular party for disparate treatment unless justified by substantial and reasonable cause, such as the promotion of effective competition.*

179. As Vistaprint maintains in its First Additional Submission, "[w]hen the ICANN Board individually considers an application, it must make sure that it does not treat applicants inequitably and that it does not discriminate among applicants."<sup>225</sup>

180. As discussed above in relation to standard of review, the IRP Panel considers that the Board's actions or omissions in this area of alleged non-discriminatory treatment bear the scrutiny of independent and objective review, without any presumption of correctness. Moreover, ICANN's Bylaws in Article I, § 2 set out its core values that should guide the

---

<sup>221</sup> Request, ¶ 80.

<sup>222</sup> ICANN has permitted the delegation of the .car and .cars gTLDs, the .auto and .autos gTLDs, the .accountant and .accountants gTLDs, the fan and fans gTLDs, the .gift and .gifts gTLDs, the .loan and .loans gTLDs, the .new and news gTLDs and the .work and .works gTLDs.

<sup>223</sup> Vistaprint's Second Additional Submission, ¶ 20.

<sup>224</sup> Guidebook, § 5.1.

<sup>225</sup> Vistaprint's First Additional Submission, ¶ 31.

decisions and actions of ICANN, including the requirement, when balancing among competing core values, to exercise judgment to determine which core values are the most relevant and how they apply to the specific circumstances at hand. Of particular relevance to Vistaprint's disparate treatment claim are the core values set out in §§ 2.8 and 2.9:

*8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.*

\* \* \* \*

*10. Remaining accountable to the Internet community through mechanisms that enhance ICANN's effectiveness.*

*These core values are deliberately expressed in very general terms, so that they may provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each new situation will necessarily depend on many factors that cannot be fully anticipated or enumerated; and because they are statements of principle rather than practice, situations will inevitably arise in which perfect fidelity to all eleven core values simultaneously is not possible. Any ICANN body making a recommendation or decision shall exercise its judgment to determine which core values are most relevant and how they apply to the specific circumstances of the case at hand, and to determine, if necessary, an appropriate and defensible balance among competing values.*

*[Underlining added]*

181. Vistaprint's disparate treatment claim is based on the following allegations:

- On June 25, 2013, the NGPC, a sub-committee of ICANN's Board, determined in Resolution 2013.06.25.NG07 that no changes were needed to the existing mechanisms in the Guidebook to address potential consumer confusion from allowing singular and plural versions of the same gTLD string. The NGPC had addressed this issue in response to advice from the ICANN's Government Advisory Committee ("GAC") that due to potential consumer confusion, the Board should "reconsider its decision to allow singular and plural version of the same strings."
- On February 5, 2014, the day before Vistaprint submitted its Reconsideration Request to the BGC on February 6, 2014, the NGPC approved Resolution 2014.02.05.NG02, which directed ICANN's President to initiate a public comment period on framework principles of a potential review mechanism to address perceived inconsistent String Confusion Objection expert determinations. The NGPC resolution provides in relevant part:

*Whereas, on 10 October 2013 the Board Governance Committee (BGC) requested staff to draft a report for the NGPC on String Confusion Objections "setting out options for dealing with the situation raised within this Request, namely the differing outcomes of the String Confusion Objection Dispute Resolution process in similar disputes involving Amazon's Applied-for String and TLDH's Applied-for String."*

*Whereas, the NGPC is considering potential paths forward to address the perceived inconsistent Expert Determinations from the New gTLD Program String Confusion Objections process, including implementing a review mechanism. The review will be limited to the String Confusion Objection Expert Determinations for .CAR/.CARS and .CAM/.COM.*

*Whereas, the proposed review mechanism, if implemented, would constitute a change to the current String Confusion Objection process in the New gTLD Applicant Guidebook.*

*Whereas, the NGPC is undertaking this action pursuant to the authority granted to it by the*



Board on 10 April 2012, to exercise the ICANN Board's authority for any and all issues that may arise relating to the New gTLD Program.

Resolved (2014.02.05.NG02), the NGPC directs the President and CEO, or his designee, to publish for public comment the proposed review mechanism for addressing perceived inconsistent Expert Determinations from the New gTLD Program String Confusion Objections process.

[Underlining added]

- Vistaprint emphasizes that ICANN's Board (through the NGPC) took this decision the day before Vistaprint filed its Reconsideration Request; however, this did not prevent the BGC from denying Vistaprint's RFR less than one month later without considering whether such a review mechanism might also be appropriate for dealing with the SCO determination involving .WEBS/.WEB.<sup>226</sup>
- Vistaprint's Reconsideration Request and the BGC's decision on that Request rendered on February 27, 2014 contain no reference to the concerns that had been raised both by the BGC (on October 10, 2013 in a prior RFR determination) and the NGPC in its February 5, 2014 resolution concerning inconsistent expert SCO determinations, some of which involved plural and singular versions of the same gTLD string. Neither Vistaprint nor the BGC raised any discussion of disparate treatment at that time. The BGC's determined that its decision on Vistaprint's Reconsideration Request "shall be final and does not require Board (or NGPC) consideration."<sup>227</sup>
- On October 12, 2014, approximately 8 months after the BGC's decision on Vistaprint's Reconsideration Request, and after Vistaprint had filed its Request in this IRP (in June 2014), the NGPC approved Resolution 2014.10.12.NG02, in which it identified certain SCO expert determinations "as not being in the best interest of the New gTLD Program and the Internet community," and directed ICANN's President to establish processes and procedures to re-evaluate certain previous SCO expert determinations. Resolution 2014.10.12.NG02 also stated in its rationale:

*The NGPC also considered whether there was a reasonable basis for certain perceived inconsistent Expert Determinations to exist, and particularly why the identified Expert Determinations should be sent back to the ICDR while other Expert Determinations should not. The NGPC notes that while on their face some of the Expert Determinations may appear inconsistent, including other SCO Expert Determinations, and Expert Determinations of the Limited Public Interest and Community Objection processes, there are reasonable explanations for these seeming discrepancies, both procedurally and substantively.*

*First, on a procedural level, each expert panel generally rests its Expert Determination on materials presented to it by the parties to that particular objection, and the objector bears the burden of proof. Two panels confronting identical issues could – and if appropriate should – reach different determinations, based on the strength of the materials presented.*

*Second, on a substantive level, certain Expert Determinations highlighted by the community that purportedly resulted in "inconsistent" or "unreasonable" results, presented nuanced distinctions*

---

<sup>226</sup> Request, ¶ 52.

<sup>227</sup> BGC Recommendation, p. 19, Request, Annex 26.

relevant to the particular objection. These nuances should not be ignored simply because a party to the dispute disagrees with the end result. Further, the standard guiding the expert panels involves some degree of subjectivity, and thus independent expert panels would not be expected to reach the same conclusions on every occasion. However, for the identified Expert Determinations, a reasonable explanation for the seeming discrepancies is not as apparent, even taking into account all of the previous explanations about why reasonably "discrepancies" may exist. To allow these Expert Determinations to stand would not be in the best interests of the Internet community.

The NGPC considered whether it was appropriate, as suggested by some commenters, to expand the scope of the proposed review mechanism to include other Expert Determinations, such as some resulting from Community and Limited Public Objections, as well as other String Confusion Objection Expert Determinations, and possibly singular and plural versions of the same string. The NGPC determined that to promote the goals of predictability and fairness, establishing a review mechanism more broadly may be more appropriate as part of future community discussions about subsequent rounds of the New gTLD Program. Applicants have already taken action in reliance on many of the Expert Determinations, including signing Registry Agreements, transitioning to delegation, withdrawing their applications, and requesting refunds. Allowing these actions to be undone now would not only delay consideration of all applications, but would raise issues of unfairness for those that have already acted in reliance on the Applicant Guidebook.

It should also be noted that in response to advice from the Governmental Advisory Committee (GAC), the NGPC previously considered the question of whether consumer confusion may result from allowing singular and plural versions of the same strings. On 25 June 2013, the NGPC adopted a resolution resolving "that no changes [were] needed to the existing mechanisms in the Applicant Guidebook to address potential consumer confusion resulting from allowing singular and plural versions of the same string" <http://www.icann.org/en/groups/board/documents/resolutions-new-gtld-25jun13-en.htm#2.d>. The NGPC again notes that the topic of singular and plural versions of the same string also may be the subject of further community discussion as it relates to future rounds of the New gTLD Program.

The NGPC considered community correspondence on this issue in addition to comments from the community expressed at the ICANN meetings. The concerns raised in the ICANN meetings and in correspondence have been factored into the deliberations on this matter.

- In view of the NGPC's Resolution 2014.10.12.NG02, Vistaprint describes its disparate treatment claim in its First Additional Submission as follows:

13 .... Since the filing of Vistaprint's request for IRP, the ICANN Board clarified how the string similarity standard must be applied. In its resolutions of 12 October 2014, the ICANN Board identified certain SCO determinations "as not being in the best interest of the New gTLD Program and the Internet community" and set out the rules for a re-evaluation of these SCO determinations (fn. omitted):

- A first SCO determination that needed re-evaluation is the SCO determination in which ICDR's expert accepted Verisign Inc.'s objection to United TLD Holdco Ltd. ('United TLD')'s application for .cam. We refer to this SCO determination as the 'United TLD Determination'. In the United TLD Determination, ICDR's appointed expert found United TLD's application for .cam confusingly similar to Verisign Inc. ('Verisign')'s .com gTLD (RM 23). The ICANN Board decided that (i) the United TLD Determination was not in the best interest of the New gTLD Program and the Internet community and (ii) a new three-member panel must be established to re-evaluate the United TLD Determination (fn. omitted).

Verisign had also raised a SCO on the basis of its .com gTLD against the application for .cam by Dot Agency Limited and the application for .cam by AC Webconnecting Holding B.V. In both cases, the appointed experts determined that no confusing similarity existed between the .cam and .com strings (fn. omitted). We refer to these SCO determinations as the 'Related .cam/.com Determinations'. The ICANN Board decided that the Related .cam/.com Determinations need no

re-evaluation. In addition, the ICANN Board recommended that the three-member panel charged with re-evaluating the United TLD Determination must review the Related .cam/.com Determinations as background (fn. omitted).

- Another SCO determination that needed re-evaluation is the determination in which ICDR's appointed expert accepted Commercial Connect LLC's objection to Amazon EU S.à.r.l. ('Amazon')'s application for .通販 (which means .onlineshopping in Japanese) (fn. omitted). We refer to this SCO determination as the 'Onlineshopping Determination'. ICDR's appointed expert found in the Onlineshopping Determination that Amazon's application for .通販 was confusingly similar to Commercial Connect LLC's application for .shop. Commercial Connect LLC also invoked its application for .shop in a SCO against Top Level Domain Holdings Limited's application .购物 (which means 'shop' in Chinese). ICDR's appointed expert rejected the latter SCO (fn. omitted). We refer to this SCO determination as the 'Related shop/.shop Determination'. The ICANN Board decided that a three-member panel needs to re-evaluate the Onlineshopping Determination and that no re-evaluation is needed for the Related shop/.shop Determination. The ICANN Board decided that the Related shop/.shop Determination must be reviewed as background by the three-member panel that is charged with re-evaluating the Onlineshopping Determination (fn. omitted).

14. The ICANN Board's recommendations to the three-member panels charged with the re-evaluation of the United TLD Determination and the Onlineshopping Determination are clear. Related determinations – involving the same gTLD string(s) and finding that there is no confusing similarity – will not be re-evaluated and must be taken into account in the re-evaluations.

15. Upon instigation of the ICANN Board, ICANN had developed the same process for re-evaluating the SCO determination in which ICDR's appointed expert accepted Charleston Road Registry Inc. ('CRR')'s objection to DERCars, LLC's application for .cars. We refer to this SCO determination as the 'DERCars Determination'. In the DERCars Determination, ICDR's appointed expert found DERCars, LLC's application for .cars confusingly similar to CRR's application for .car. CRR had also objected to the applications for .cars by Uniregistry, Corp. and Koko Castle, LLC, claiming confusing similarity with CRR's application for .car. The latter objections by CRR were not successful. ICANN decided that DERCars, LLC should be given the option of having the DERCars Determination reviewed. ICANN was not allowing a review of the other SCO determinations involving .car and .cars (fn. omitted).

16. The above shows that ICANN and its Board have always decided in favor of co-existence of 'similar' strings. The ICANN Board explicitly allowed singular and plural gTLD strings to co-exist (fn. omitted). To support this view, the ICANN Board referred to the existence of thousands of examples of singular and plurals within the DNS at second level, which are not registered to or operated by the same registrant. The ICANN Board inter alia referred to the co-existing car.com and cars.com (fn. omitted).

17. Why did the ICANN Board intervene in the DERCars determination – involving the strings .car and .cars – but refused to intervene in the SCO Determination involving .web and .webs? In view of the small number of SCO Determinations finding confusing similarity between two strings (fn. omitted), it is a true mystery why the ICANN Board intervened in some matters, but refused to do so in the SCO determinations on Vistaprint's applications for .webs.

18. If anything, the .webs/.web string pair is less similar than the .cars/.car string pair. Cars is commonly used as the plural for car. Web, however, commonly refers to the world wide web, and as such, it is not normally a word where the plural form would be used.

182. Vistaprint contends that ICANN cannot justify the disparate treatment described above. While Vistaprint recognizes that ICANN's Board intervened to address perceived inconsistent or otherwise unreasonable SCO expert determinations, ICANN failed to explain why the SCO determination on Vistaprint's .WEBS applications was not just as unreasonable as the SCO expert determinations involving .cars/.car, .cam/.com, and 通販

/.shop.

183. In response to Vistaprint's disparate treatment claim, ICANN contends that ICANN's Board only intervened with respect to certain SCO expert determinations because there had been several independent expert determinations regarding the same strings that were seemingly inconsistent with one another. ICANN states that is not the case with respect to Vistaprint's applications, as no other expert determinations were issued regarding the similarity of .WEB and .WEBS.<sup>228</sup> ICANN further urges that the Board was justified in exercising its discretion to intervene with respect to the inconsistent SCO expert determinations regarding .COM/.CAM, .CAR/.CARS and .SHOP/.通販, because the Board acted to bring certainty to differing SCO expert determinations regarding the same strings.<sup>229</sup> However, this justification was not present with respect to the single *Vistaprint SCO*.
184. Finally, ICANN stated that "Vistaprint has identified no Articles or Bylaws provision violated by the ICANN Board *in exercising its independent judgment to intervene with respect to certain inconsistent expert determinations on string confusion objections unrelated to this matter, but not with respect to the single Expert Determination regarding .WEB/.WEBS*" (italics added).<sup>230</sup>
185. The IRP Panel has considered carefully the parties' contentions regarding Vistaprint's disparate treatment claim. The Panel finds that, contrary to what ICANN has stated above, ICANN's Board did not have an opportunity to "exercise its independent judgment" – in particular, in view of its decisions to implement an additional review mechanism for certain other inconsistent SCO expert determinations – to consider specifically whether it should intervene with respect to the adverse SCO expert determination involving Vistaprint's .WEBS applications.
186. It is clear that ICANN's Board, through the BGC and the NGPC, was aware of the concerns involving inconsistent decisions in SCO proceedings when it decided Vistaprint's Reconsideration Request in February 2014. The NGPC, on the day (February 5, 2014) before Vistaprint filed its Reconsideration Request and in response to a request from the BGC, initiated a public comment period on framework principles for a potential review mechanism to address perceived inconsistent SCO expert determinations. However, the BGC's decision on the Reconsideration Request rendered on February 27, 2014 made no mention of these issues.<sup>231</sup> By comparison, there is no evidence that

---

<sup>228</sup> ICANN's First Additional Submission, ¶ 5.

<sup>229</sup> ICANN's First Additional Submission, ¶ 18.

<sup>230</sup> ICANN's Second Additional submission, ¶ 21.

<sup>231</sup> In this regard, the IRP panel in the *Booking.com final Declaration* (¶ 119) quoted Mr. Sadowsky, a member of the Board's NGPC committee, commenting on the Reconsideration process as follows:

*The reconsideration process is a very narrowly focused instrument, relying solely upon investigating deviations from established and agreed upon process. As such, it can be useful, but it is limited in scope. In particular, it does not address situations where process has in fact been followed, but the results of such process have been regarded, sometimes quite widely, as being contrary to what might be best for significant or all segments of the...community and/or Internet users in general.*

Vistaprint was aware of these issues at the time it filed its Reconsideration Request on February 6, 2014. Vistaprint has raised them for the first time in a timely manner during the pendency of this IRP.

187. In accordance with Article 1, § 2 of the Bylaws, the Board *shall* exercise its judgment to determine which competing core values are most relevant and how they apply to arrive at a defensible balance among those values in relation to the case at hand. Given the timing of Vistaprint’s Reconsideration Request, and the timing of ICANN’s consultation process for potential review mechanisms to address inconsistent SCO expert determinations, this exercise of judgment by the Board has not yet occurred in the case of Vistaprint’s .WEBS gTLD applications.
188. Here, ICANN is subject to the requirements of Article II, § 3 of its Bylaws regarding non-discriminatory treatment, providing that it shall not apply its “standards, policies, procedures, or practices inequitably or single out any particular party for disparate treatment unless justified by substantial and reasonable cause.” ICANN has provided additional relief to certain gTLD applicants who were subject to adverse decisions in String Confusion Objection cases. In those cases, the differences in the gTLD strings at issue were not too dissimilar from the .WEBS/.WEB gTLD strings. One of the cases in which ICANN agreed to provide an additional mechanism for review involved a string confusion objection for the .CAR/.CARS strings, which involve the singular vs. plural of the same string. Meanwhile, many other singular and plural variations of the same gTLD strings have been permitted to proceed to delegation, including AUTO and .AUTOS; .ACCOUNTANT and ACCOUNTANTS; .FAN and .FANS; .GIFT and .GIFTS; .LOAN and .LOANS; .NEW and .NEWS; and .WORK and .WORKS.
189. This IRP Panel, among its three members, could not agree – in regards to the specific circumstances of Vistaprint’s gTLD applications – whether the reasons offered by ICANN in its Resolution 2014.10.12.NG02 for refusing the “to expand the scope of the proposed review mechanism to include other [SCO] Expert Determinations” would meet the standard of non-discrimination imposed by Article II, § 3 of the Bylaws, as well as the relevant core values in Article 1, § 2 of the Bylaws (e.g., applying documented policies neutrally and objectively, with integrity and fairness). For instance, one view is that limiting the additional review mechanism to only those SCO cases in which there were inconsistent decisions is a sufficient reason for intervening in these cases, but not in other SCO cases involving similar singular vs. plural gTLD strings where the applicant received an adverse decision. On the other hand, another view is that the real focus should be on the developments involving single vs. plural gTLDs strings, including the inconsistency of decisions and the offering of additional review mechanism in certain cases, and the delegation of so many other single/plural variations of the same gTLD strings, which are, at least in this way, similarly situated to the circumstances of the .WEBS/.WEB strings.<sup>232</sup>

---

<sup>232</sup> Regarding inconsistent decisions, Vistaprint quoted the statement dated October 8, 2014, of ICANN’s former Chief Strategy Officer and Senior Vice President of Stakeholders Relations, Kurt Pritz, who had apparently been leading the introduction of the New gTLD Program, concerning ICANN’s objection procedure:

(Continued...)

190. The IRP Panel is mindful that it should not substitute its judgment for that of ICANN's Board. The Board has not yet considered Vistaprint's claim of disparate treatment, and the arguments that ICANN makes through its counsel in this IRP do not serve as a substitute for the exercise of independent judgment by the Board. Without the exercise of judgment by ICANN's Board on this question of whether there is any inequitable or disparate treatment regarding Vistaprint's .WEBS gTLD applications, the Board would risk violating its Bylaws, including its core values. As the Emergency IRP Panel found in the *GCC Interim IRP Declaration*:

*The ICANN Board does not have an unfettered discretion in making decisions. In bringing its judgment to bear on an issue for decision, it must assess the applicability of different potentially conflicting core values and identify those which are most important, most relevant to the question to be decided. The balancing of the competing values must be seen as "defensible", that is it should be justified and supported by a reasoned analysis. The decision or action should be based on a reasoned judgment of the Board, not on an arbitrary exercise of discretion.*

*This obligation of the ICANN Board in its decision making is reinforced by the standard of review for the IRP process under Article IV, Section 3.4 of the Bylaws, quoted at paragraph 42 b. above, when the action of the Board is compared to the requirements under the Articles and Bylaws. The standard of review includes a consideration of whether the Board exercised due diligence and care in having a reasonable amount of facts before them and also whether the Board exercised its own independent judgment.*<sup>233</sup>

191. Here, the IRP Panel finds that due to the timing and scope of Vistaprint's Reconsideration Request (and this IRP proceeding), and the timing of ICANN's consultation process and subsequent NGPC resolution authorizing an additional review mechanism for certain gTLD applications that were the subject of adverse SCO decisions, the ICANN Board has not had the opportunity to exercise its judgment on the question of whether, in view of ICANN's Bylaw concerning non-discriminatory treatment and based on the particular

---

*There is no doubt that the New gTLD Program objection results are inconsistent, and not predictable. The fact is most easily demonstrated in the 'string confusion,' objections where challenges to exactly the same strings yielded different results. [...] With globally diverse, multiple panelists invoking untried standards and questions of first impression in an industry with which they were not familiar and had little training, the panelists were bound to deliver inconsistent, unpredictable results. ICANN put no mechanism put [sic] into place to rationalize or normalize the answers. [...] It is my opinion that ICANN, having proven in the initial evaluation context that it could do so, should have implemented measures to create as much consistency as possible on the merits in the objection rulings, requiring DRSPs to educate and train their experts as to the specific (and only) standards to employ, and to review and correct aberrant results. The failure to do so resulted in violation of the overarching policy articulated by the GNSO and adopted by the Board at the outset of the new gTLD Program, as well as policies stated in the Bylaws and Articles of Incorporation concerning on discrimination, application of document policies neutrally, objectively and fairly, promotion of competition, and accountability." (fn. omitted).*

<sup>233</sup> See *GCC Interim IRP Declaration*, ¶¶ 76-77 ("Upon completion of the various procedures for evaluation and for objections under the Guidebook, the question of the approval of the applied for domain still went back to the NGPC, representing the ICANN Board, to make the decision to approve, without being bound by recommendation of the GAC, the Independent Objector or even the Expert Determination. Such a decision would appear to be caught by the requirements of Article 1, Section 2 of the Bylaws requiring the Board or the NGPC to consider and apply the competing values to the facts and to arrive at a defensible balance among those values" ¶ 90 (underlining added).

circumstances and developments noted above, such an additional review mechanism is appropriate following the SCO expert determination involving Vistaprint's .WEBS applications.<sup>234</sup> Accordingly, it follows that in response to Vistaprint's contentions of disparate treatment in this IRP, ICANN's Board – and not this Panel – should exercise its independent judgment on this issue, in light of all of the foregoing considerations.

## VI. Prevailing Party; Costs

192. Article IV, § 3.18 of ICANN's Bylaws requires that the IRP Panel "specifically designate the prevailing party." This designation is relevant to the allocation of costs, given that the same section of the Bylaws provides that the "party not prevailing shall ordinarily be responsible for bearing all costs of the IRP Provider."

193. Article IV, § 3.18 of the Bylaws also states that "in an extraordinary case the IRP Panel may in its declaration allocate up to half of the costs of the IRP Provider to the prevailing party based upon the circumstances, including a consideration of the reasonableness of the parties' positions and their contribution to the public interest. Each party to the IRP proceedings shall bear its own expenses."

194. Similarly, the Supplementary Procedures provide in Rule 11:

*The IRP Panel shall fix costs in its Declaration. The party not prevailing in an IRP shall ordinarily be responsible for bearing all costs of the proceedings, but under extraordinary circumstances the IRP Panel may allocate up to half of the costs to the prevailing party, taking into account the circumstances of the case, including the reasonableness of the parties' positions and their contribution to the public interest.*

*In the event the Requestor has not availed itself, in good faith, of the cooperative engagement or conciliation process, and the requestor is not successful in the Independent Review, the IRP Panel must award ICANN all reasonable fees and costs incurred by ICANN in the IRP, including legal fees.*

195. Here, Vistaprint engaged in the Cooperative Engagement Process, although the process did not resolve the issues between the parties. The "IRP Provider" is the ICDR, and, in accordance with the ICDR Rules, the costs to be allocated between the parties – what the

---

<sup>234</sup> The IRP Panel observes that the NGPC, in its Resolution 2014.10.12.NG02, sought to address the issue of why certain SCO expert determinations should be sent back to the ICDR while others should not. In that resolution, the NGPC determined that to promote the goals of predictability and fairness, establishing a review mechanism more broadly may be appropriate as part of future rounds in the New gTLD Program. The NGPC stated that applicants may have already taken action in reliance on SCO expert determinations, including signing Registry Agreements, transitioning to delegation, withdrawing their applications, and requesting refunds. However, in this case Vistaprint does not fall within the category of applicants who have taken such actions in reliance. Instead, it is still asserting its claims in this IRP proceeding. In accordance with the Bylaws, Vistaprint is entitled to an exercise of the Board's independent judgment to determine, based on the facts of the case at hand and in view of ICANN's Bylaws concerning non-discriminatory treatment and core values, whether Vistaprint should be entitled to the additional review mechanism that was made available to certain other gTLD applicants.

Bylaws call the "costs of the IRP Provider", and the Supplementary Procedures call the "costs of the proceedings" – include the fees and expenses of the IRP Panel members and of the ICDR.

196. ICANN is the prevailing party in this IRP. This designation is confirmed by the Panel's decisions concerning Vistaprint's requests for relief in this IRP:

- Vistaprint requests that the Panel find ICANN breached its Articles, Bylaws, and the Guidebook. The Panel declares that ICANN's Board (including the BGC) did not violate the Articles, Bylaws and Guidebook.
- Vistaprint requests that the Panel require ICANN to reject the Third Expert's determination in the *Vistaprint SCO*, disregard the resulting "Contention Set", and allow Vistaprint's applications for .WEBS to proceed on their merits. The Panel determines that it does not have authority to order the relief requested by Vistaprint. In addition, the Panel declares that the Board (through the BGC) did not violate the Articles, Bylaws and Guidebook in regards to the BGC's handling of Vistaprint's Reconsideration Request.
- Vistaprint requests, in the alternative, that the Panel require ICANN to reject the *Vistaprint SCO* determination and organize a new procedure, in which a three-member panel would re-evaluate the Third Expert's decision taking into account (i) the ICANN Board's resolutions on singular and plural gTLDs, as well as the Board's resolutions on the DERCars SCO Determination, the United TLD Determination, and the Onlineshopping SCO Determination, and (ii) ICANN's decisions to delegate the following gTLDs: .CAR and .CARS; .AUTO and .AUTOS; .ACCOUNTANT and ACCOUNTANTS; .FAN and .FANS; .GIFT and .GIFTS; .LOAN and .LOANS; .NEW and .NEWS; and .WORK and .WORKS. The Panel determines that it does not have authority to order the relief requested by Vistaprint. In addition, the Panel recommends that ICANN's Board exercise its judgment on the question of whether an additional review mechanism is appropriate to re-evaluate the Third Expert's determination in the *Vistaprint SCO*, in view of ICANN's Bylaws concerning core values and non-discriminatory treatment, and based on the particular circumstances and developments noted in this Declaration, including (i) the *Vistaprint SCO* determination involving Vistaprint's .WEBS applications, (ii) the Board's (and NGPC's) resolutions on singular and plural gTLDs, and (iii) the Board's decisions to delegate numerous other singular/plural versions of the same gTLD strings.

197. The IRP Panel also recognizes that Vistaprint, through its Request and submissions, raised certain complex and significant issues and contributed to the "public interest" involving the New gTLD Program and the Independent Review Process. It is therefore appropriate and reasonable to divide the IRP costs over the parties in a 60% (Vistaprint) / 40% (ICANN) proportion.

FOR THE FOREGOING REASONS, the IRP Panel hereby:

- (1) Declares that Vistaprint's IRP Request is denied;
- (2) Designates ICANN as the prevailing party;



(3) Recommends that ICANN's Board exercise its judgment on the question of whether an additional review mechanism is appropriate to re-evaluate the Third Expert's determination in the *Vistaprint SCO*, in view of ICANN's Bylaws concerning core values and non-discriminatory treatment, and based on the particular circumstances and developments noted in this Declaration, including (i) the *Vistaprint SCO* determination involving Vistaprint's .WEBS applications, (ii) the Board's (and NGPC's) resolutions on singular and plural gTLDs, and (iii) the Board's decisions to delegate numerous other singular/plural versions of the same gTLD strings;

(4) In view of the circumstances, Vistaprint shall bear 60% and ICANN shall bear 40% of the costs of the IRP Provider, including the fees and expenses of the IRP Panel members and the fees and expenses of the ICDR. The administrative fees and expenses of the ICDR, totaling US\$4,600.00 as well as the compensation and expenses of the Panelists totaling US\$229,167.70 are to be borne US\$140,260.62 by Vistaprint Limited and US\$93,507.08 by ICANN. Therefore, Vistaprint Limited shall pay to ICANN the amount of US\$21,076.76 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by ICANN upon demonstration that these incurred fees and costs have been paid; and

(5) This Final Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Final Declaration of this IRP Panel.

---

Siegfried H. Elsing  
Date:

---

Geert Glas  
Date:



---

Christopher Gibson  
Chair of the IRP Panel  
Date: 9 Oct. 2015

(3) Recommends that ICANN's Board exercise its judgment on the question of whether an additional review mechanism is appropriate to re-evaluate the Third Expert's determination in the *Vistaprint SCO*, in view of ICANN's Bylaws concerning core values and non-discriminatory treatment, and based on the particular circumstances and developments noted in this Declaration, including (i) the *Vistaprint SCO* determination involving Vistaprint's .WEBS applications, (ii) the Board's (and NGPC's) resolutions on singular and plural gTLDs, and (iii) the Board's decisions to delegate numerous other singular/plural versions of the same gTLD strings;

(4) In view of the circumstances, Vistaprint shall bear 60% and ICANN shall bear 40% of the costs of the IRP Provider, including the fees and expenses of the IRP Panel members and the fees and expenses of the ICDR. The administrative fees and expenses of the ICDR, totaling US\$4,600.00 as well as the compensation and expenses of the Panelists totaling US\$229,167.70 are to be borne US\$140,260.62 by Vistaprint Limited and US\$93,507.08 by ICANN. Therefore, Vistaprint Limited shall pay to ICANN the amount of US\$21,076.76 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by ICANN upon demonstration that these incurred fees and costs have been paid; and

(5) This Final Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Final Declaration of this IRP Panel.



Siegfried H. Elsing  
Date: 9 October 2015

---

Geert Glas  
Date:

---

Christopher Gibson  
Chair of the IRP Panel  
Date:


(3) Recommends that ICANN's Board exercise its judgment on the question of whether an additional review mechanism is appropriate to re-evaluate the Third Expert's determination in the *Vistaprint SCO*, in view of ICANN's Bylaws concerning core values and non-discriminatory treatment, and based on the particular circumstances and developments noted in this Declaration, including (i) the *Vistaprint SCO* determination involving Vistaprint's .WEBS applications, (ii) the Board's (and NGPC's) resolutions on singular and plural gTLDs, and (iii) the Board's decisions to delegate numerous other singular/plural versions of the same gTLD strings;

(4) In view of the circumstances, Vistaprint shall bear 60% and ICANN shall bear 40% of the costs of the IRP Provider, including the fees and expenses of the IRP Panel members and the fees and expenses of the ICDR. The administrative fees and expenses of the ICDR, totaling US\$4,600.00 as well as the compensation and expenses of the Panelists totaling US\$229,167.70 are to be borne US\$140,260.62 by Vistaprint Limited and US\$93,507.08 by ICANN. Therefore, Vistaprint Limited shall pay to ICANN the amount of US\$21,076.76 representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by ICANN upon demonstration that these incurred fees and costs have been paid; and

(5) This Final Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Final Declaration of this IRP Panel.


---

Siegfried H. Elsing  
Date:



---

Geert Glas  
Date: 9 October 2015



---

Christopher Gibson  
Chair of the IRP Panel  
Date: 9 Oct. 2015

**CLA-005**

THE MATTER OF AN INDEPENDENT REVIEW PROCESS  
BEFORE INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

_____ )	
DOTCONNECTAFRICA TRUST, )	
Claimant. )	
v. )	ICDR Case No.
INTERNET CORPORATION FOR )	50 2013 00 1083
ASSIGNED NAMES AND NUMBERS, )	
Respondent. )	
_____ )	

HEARING ON THE MERITS  
BEFORE THE PANEL: PRESIDENT BABAK BARIN,  
HONORABLE JUDGE WILLIAM CAHILL, AND  
PROFESSOR CATHERINE KESSEDJIAN  
Friday, May 22, 2015; 9:09 a.m.

Reported by: Cindy L. Sebo, RMR, CRR, RPR, CSR,  
                    CCR, CLR, RSA, LiveDeposition Authorized Reporter  
Job No.     13828

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

Hearing on the Merits in the above-styled  
manner, held at the offices of:

Jones Day  
51 Louisiana Avenue Northwest  
Washington, D.C. 20001  
202.879.3939

The proceedings having been reported by  
the Registered Merit Real-Time Court Reporter,  
CINDY L. SEBO, RMR, CRR, RPR, CSR, CLR, RSA, and  
LiveDeposition Authorized Reporter.

1 A P P E A R A N C E S :

2

3 Attorneys for Claimant:

4 WEIL, GOTSHAL & MANGES LLP

5 ARIF HYDER ALI, ESQUIRE

6 RICARDO AMPUDIA, ESQUIRE

7 ERIN K. YATES, ESQUIRE

8 1300 Eye Street, Northwest

9 Suite 900

10 Washington, D.C. 20005

11 202.682.7004

12 arif.ali@weil.com

13 ricarado.ampudia@weil.com

14 erin.yates@weil.com

15 -and-

16 WEIL, GOTSHAL & MANGES LLP

17 MEREDITH CRAVEN, ESQUIRE

18 767 Fifth Avenue

19 New York, New York 10153

20 212.310.8067

21 meredith.craven@weil.com

22

23

24

25

1 A P P E A R A N C E S (Continued):

2  
3 Attorneys for Respondents:

4 JONES DAY

5 JEFFREY A. LEVEE, ESQUIRE

6 RACHEL H. ZERNIK, ESQUIRE

7 555 South Flower Street

8 Fiftieth Floor

9 Los Angeles, California 90071

10 213.243.2572

11 jlevee@jonesday.com

12 rzernik@jonesday.com

13  
14  
15  
16  
17 ALSO PRESENT:

18 SOPHIA BEKELE ESHETE, On behalf of the Claimant

19 AMY STATHOS, Deputy General Counsel at  
20 ICANN

21 HEATHER DRYDEN, International  
22 Telecommunications Policy and Coordination  
23 Directorate at the Canadian Department of  
24 Industry

25 CHERINE CHALABY, ICANN Board of Directors



CONTENTS :

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

OPENING STATEMENTS :	PAGE :
BY CLAIMANT	13
BY RESPONDENT	93
EXAMINATION OF CHERINE CHALABY :	PAGE :
By President Barin	171
By Professor Kessedjian	198 , 234 , 268
By Honorable Judge Cahill	228 , 266 , 269
By Mr. Ali	239
By Mr. LeVee	265
EXAMINATION OF HEATHER DRYDEN :	PAGE :
By President Barin	274 , 289 , 308 , 318 , 322
By Professor Kessedjian	287 , 304 , 322
By Honorable Judge Cahill	312 , 320
By Mr. Ali	325 , 389
By Mr. LeVee	385

CONTENTS (CONTINUED):

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

EXAMINATION OF SOPHIA BEKELE ESHETE:	PAGE:
By President Barin	393, 444
By Professor Kessedjian	410
By Honorable Judge Cahill	422
By Mr. LeVee	450
	PAGE:
AFTERNOON SESSION	169

E X H I B I T S  
 (Exhibits Retained by Counsel.)

HEARING EXHIBITS:	MARKED	ADMITTED
Exhibit Number 1	12	---
Exhibit Number 2	12	---

1 P R O C E E D I N G S

2  
3 Washington, D.C.

4 Friday, May 22, 2015; 9:09 a.m.

5  
6 PRESIDENT BARIN: Good morning,  
7 everyone.

8 Welcome to Washington, D.C. Thank  
9 you for joining us this morning.

10 After yesterday's weather, we were  
11 this -- especially for you (indicating),  
12 there's sunshine outside.

13 What we'll do this morning is we'll  
14 start with, I guess, the welcome and the  
15 initial presentations of the Members of  
16 the Panel.

17 I will start to my left,  
18 Professor Kessedjian,  
19 Catherine Kessedjian; to my right,  
20 Retired Judge William Cahill; and myself,  
21 who is President of the Panel,  
22 Babak Barin.

23 I will then ask, if you would,  
24 counsel for each side, to present your  
25 team members and guests that you have in

1 the room for the record.

2 And once we do that, as a roll call,  
3 then we will proceed with looking at the  
4 agenda just to make sure that there's no  
5 issues that we need to deal with on a  
6 preliminary basis and then move forward  
7 with your presentations.

8 Is that okay?

9 So, Mr. Ali.

10 MR. ALI: Thank you, Mr. President.  
11 And good morning.

12 My name is Arif Ali from Weil,  
13 Gotshal & Manges on behalf -- appearing  
14 on behalf of DCA Trust, the Claimant.

15 I'll start at the other end. We  
16 have our client, Ms. Sophia Bekele; then  
17 next to her is my colleague  
18 Meredith Craven; next to her, colleague  
19 Ricardo Ampudia; and to my immediate left  
20 is Erin Yates, all from Weil, Gotshal &  
21 Manges.

22 PRESIDENT BARIN: Thank you.

23 MR. ALI: Thank you.

24 MR. LEVEE: Good morning, Members of  
25 the Panel.

1           My name is Jeff LeVee from  
2 Jones Day. Next to me is my colleague  
3 Rachel Zernik, also from Jones Day.

4           To her right is Amy Stathos. Amy is  
5 the deputy general counsel of ICANN, our  
6 client.

7           Behind me are witnesses you met this  
8 morning: Ms. Heather Dryden, who you met,  
9 and Mr. Cherine Chalaby.

10          Mr. Chalaby is a current member of  
11 ICANN's Board. Ms. Dryden is the former  
12 Chair of the Government Advisory  
13 Committee of ICANN and is employed by the  
14 Respondent, ICANN.

15          I'm sure they will introduce  
16 themselves further given the opportunity  
17 this afternoon.

18          PRESIDENT BARIN: Okay. Thank you.

19          So this is the -- for the record,  
20 this is the merits hearing of the IRP  
21 Panel between DotConnectAfrica Trust and  
22 Internet Corporation for Assigned Names  
23 and Numbers, ICANN. It's the American  
24 Arbitration Association Case Number  
25 50 2013 00 1083.

1           So the Panel sent you a Procedural  
2           Order Number 8, which essentially laid  
3           out, if you will, a proposed timetable  
4           for the conduct of this proceeding. We  
5           suggest that we stick to that. We've  
6           started a few minutes later, but I think  
7           we'll catch up in terms of time.

8           Are there any preliminary issues or  
9           anything that you want to deal with  
10          before we actually go formally into the  
11          agenda this morning, either side?

12          MR. ALI: Just one item from us,  
13          Mr. President.

14          Yesterday evening, based on  
15          communications with -- with ICANN's  
16          counsel, we indicated that we would like  
17          two new documents added to the record.  
18          And we have designated those Hearing  
19          Exhibits 1 and 2.

20          There was no objection from ICANN's  
21          side, and so we have these documents  
22          printed out with sufficient copies.

23          And to the extent that it's  
24          acceptable to the Panel, I'll hand them  
25          out now, as we'll be referring to these

1 in our opening presentation.

2 PRESIDENT BARIN: Sure.

3 Do you have any problem?

4 HONORABLE JUDGE CAHILL: No. Go on.

5 MR. ALI: Thank you.

6 PRESIDENT BARIN: It will just be  
7 important to make sure that we have a  
8 sequential numbering.

9 MR. ALI: Yes.

10 We call them Hearing Exhibit 1 and 2  
11 just so they can be slotted at the back.  
12 And when we come to the appropriate --

13 HONORABLE JUDGE CAHILL: Thank you.

14 MR. ALI: -- slide, we'll refer to  
15 those particular documents as  
16 Hearing Exhibit 1 and 2.

17 PRESIDENT BARIN: Okay. Perfect.  
18 Thank you.

19 MR. ALI: Of course, they could also  
20 get sequential numbers in the overall set  
21 of Claimant exhibits, as you prefer.

22 PRESIDENT BARIN: I think Hearing  
23 Exhibit 1 and 2 is fine.

24

25

1 - - -

2 (Whereupon, Hearing Exhibit Number 1  
3 was marked for identification  
4 purposes.)

5 - - -

6 - - -

7 (Whereupon, Hearing Exhibit Number 2  
8 was marked for identification  
9 purposes.)

10 - - -

11 PRESIDENT BARIN: Okay. Anything  
12 else?

13 PROFESSOR KESSEDJIAN: Do you have  
14 copies?

15 MR. LEVEE: I'm sure they're going  
16 to provide them.

17 (Pause.)

18 MR. LEVEE: Thank you.

19 PRESIDENT BARIN: Anything else,  
20 Mr. LeVee?

21 MR. LEVEE: Nothing from our side.  
22 We're ready to go.

23 MR. ALI: Same.

24 PRESIDENT BARIN: Okay. Good.

25 So I guess the first item on this



1 morning's agenda is the opening  
2 presentations.

3 And, Mr. Ali, for the Claimant, the  
4 floor is yours.

5 We've allocated about an hour, but  
6 I'm sure the Panel's flexible to make  
7 sure that we give you a bit of leeway.

8 MR. ALI: Well, thank you, because  
9 we do have a fair amount to present,  
10 which we'll be splitting up between today  
11 and tomorrow, and between myself and my  
12 colleagues.

13 - - -

14 OPENING STATEMENT ON BEHALF OF CLAIMANT

15 DOTCONNECTAFRICA TRUST

16 - - -

17 MR. ALI: So, once again, good  
18 morning.

19 First of all, I'd like to thank  
20 Jones Day and Mr. LeVee and Ms. Zernik  
21 for all of their hospitality and  
22 graciousness in providing this facility.  
23 It can be quite -- quite a headache in  
24 arbitrations or in any type of noncourt  
25 process where you have to focus on -- on

1 finding the facilities. And these really  
2 are very gracious facilities.

3 It's been a fairly long journey for  
4 to us to get here, certainly about a year  
5 and a half for all of us to convene here  
6 in Washington, but all of -- much longer  
7 for Ms. Sophia Bekele.

8 Now, as you've come to see, and  
9 hopefully learn, from her witness  
10 testimony and will come to appreciate in  
11 the course of the next two days,  
12 Ms. Bekele is a highly intelligent, very  
13 motivated woman with considerable  
14 business experience, someone who has  
15 great ideas, a great vision and the  
16 energy to be able to implement those  
17 ideas.

18 Those ideas and her energy were  
19 reflected in the efforts that went into  
20 the development of the  
21 Applicant Guidebook. That is one of the  
22 documents at the -- that we will be  
23 referring to as a source for the  
24 standards that are applicable.

25 Now, of course, there are others,

1 but please do keep in mind that as this  
2 idea of .africa was germinating, it was  
3 germinating hand-in-hand with the  
4 participation of Ms. Bekele in the  
5 creation of the very standards that would  
6 be applied, someone who believed that as  
7 the standards were being developed, that  
8 those standards would be applied fairly  
9 and equitably and transparently.

10 Now, at bottom, what we have here is  
11 the fact that ICANN simply didn't provide  
12 DCA Trust a fair shake.

13 DCA Trust followed the rules of the  
14 game, rules of the game that were  
15 developed with significant involvement  
16 from the Internet community, rules of the  
17 game that were ultimately developed and  
18 approved by the ICANN Board.

19 And with the approval of those rules  
20 of the game, ICANN, as a  
21 quasiinternational organization -- now,  
22 let's not forget that ICANN, while being  
23 a California corporation, has a very,  
24 very unique role. It is the regulator of  
25 the Internet, a global commons, a global

1 resource.

2 And in that respect, ICANN's Bylaws  
3 and Articles of Incorporation lay out, in  
4 the Articles of Incorporation, a very  
5 significant set of principles relating to  
6 ICANN being required to conduct itself  
7 and its activities in accordance with  
8 local law and principles of international  
9 law.

10 Now, I'm not here to educate the  
11 Panel on what those principles of  
12 international law are, but they -- they  
13 include good faith; they include  
14 transparency; they include fair and  
15 equitable treatment, in essence, imposing  
16 upon the regulator of the Internet, the  
17 party that is going to be administering  
18 the rules, to afford a level playing  
19 field. And that is all that DCA Trust  
20 asked for from the very get-go.

21 Like the other applicants, when it  
22 presented its application together with  
23 \$180,000 fee, all it asked for was Treat my  
24 application fairly; be transparent with me;  
25 give me a fair shake.

1           And ICANN, as the curator of the  
2           process, said, I accept your application,  
3           and I am the caretaker of the level playing  
4           field.

5           But instead, what did ICANN do? ICANN  
6           tilted that playing field in favor of one  
7           of the applicants.

8           And just so we understand who that  
9           other applicant is, it is the African Union  
10          Commission and its agent, UniForum, doing  
11          business as ZACR.

12          HONORABLE JUDGE CAHILL: Doing  
13          business as what?

14          MR. ALI: As ZACR, Z-A-C-R.

15          So what we'd like to do in this  
16          opening presentation is to help you look  
17          at the record. And, ultimately, the  
18          eloquence of advocates provides no  
19          substitute for hard evidence. And that's  
20          all we ask the Panel to do, is to look at  
21          the evidence. And we believe the  
22          evidence makes very clear how that  
23          playing field was tilted in favor of the  
24          AUC and ZACR to DCA Trust's disadvantage.

25          So in that spirit of wanting to be

1 of assistance to you as you make your  
2 decision, what we're going to do in our  
3 presentation this morning is to split it  
4 up.

5 So I'm just going to address the  
6 standard of review, shortly, and then I'm  
7 going to hand over to two members of my  
8 team, Ms. Yates and Ms. Craven, who have  
9 looked at every single piece of paper  
10 that's in the record.

11 So who better than my two colleagues  
12 to assist you in looking at the record,  
13 in understanding the documents and  
14 walking you through the language in  
15 ICANN's production, as well as our own  
16 exhibit.

17 Now, I will say, without wishing to  
18 embarrass them, that this is their first  
19 opportunity to appear before a panel.  
20 And, indeed, they have the great fortune  
21 to appear before such a distinguished one  
22 in such an important proceeding. And I  
23 have absolutely no doubt they will do  
24 incredibly well and be of great  
25 assistance to you.

1           So with that, let me just turn very  
2 briefly to what it is that we claim has  
3 taken place.

4           We can go to the slide with the  
5 breaches.

6           So, for us, ICANN has violated its  
7 articles, i.e., has violated the  
8 principles of international law,  
9 principles that were articulated all too  
10 well in the context of the .xxx case,  
11 which Mr. LeVee and I did -- locked horns  
12 over. I guess that was a couple of years  
13 ago --

14           MR. LEVEE: I think we both had more  
15 hair back then.

16           MR. ALI: I was certainly, I hope,  
17 slimmer.

18           (Laughter.)

19           MR. ALI: -- but the -- but it is  
20 the Articles of Incorporation which set  
21 out the principles of international law.

22           And, please, I ask the Panel not to  
23 give that language short shrift. That  
24 language is there for a purpose. It is a  
25 reflection of who ICANN is, and it is a

1 reflection of what ICANN does.

2 And that language is included in the  
3 Articles of Incorporation for a reason,  
4 and it is language that imposes upon  
5 ICANN certain obligations that arise out  
6 of international law and which echoes in  
7 the Bylaws.

8 When you look at the Bylaws of  
9 ICANN, those Bylaws reflect certain  
10 principles and requirements, such as the  
11 fact that ICANN shall not act  
12 discriminatorily towards a party; that  
13 ICANN will not abuse its regulatory  
14 authority; and that ICANN will act  
15 transparently, objectively, fairly and  
16 equitably.

17 So not only are obligations imposed  
18 as a general proposition in the Articles  
19 of Incorporation, including the  
20 obligation of good faith, but more  
21 specifically in ICANN's Bylaws. And  
22 we've indicated which Bylaws are  
23 associated with which particular breaches  
24 in our Slide Number 8, and they're  
25 reflected also in the



1 Applicant Guidebook.

2 So the construct here, insofar as  
3 the substantive principles that are  
4 applicable, are the Articles of  
5 Incorporation; they're the Bylaws and the  
6 Applicant Guidebook; and, certainly,  
7 obviously, the ICDR rules and the  
8 supplemental procedures.

9 Now, let me turn just very shortly  
10 to the -- the standard of -- of review.  
11 I know that this is a matter of some  
12 interest to the Panel, and I know there's  
13 some controversy associated with what the  
14 standard of review should be.

15 According to ICANN, it's a  
16 deferential standard review, and  
17 according to the Claimant, it is a  
18 standard review that's de novo or,  
19 rather, perhaps, using the words of  
20 Judge Schwebel in the ICM versus ICANN  
21 case, it is an objective standard review.

22 Now, why should it be that? First  
23 of all, ICANN says that in light of the  
24 ICM case, that there were many changes  
25 that were made to the IRP system.

1           I must say I'm glad that we had such  
2           an impact in hopefully improving the  
3           system, but it doesn't seem that there's  
4           greater clarity that has arisen out of  
5           those further amendments.

6           I see nowhere in the standard  
7           review -- in the language, I see nowhere  
8           the word "deferential."

9           Now, if ICANN had intended for  
10          there -- for you to be applying a  
11          deferential standard review, there's no  
12          reason why that word could not have been  
13          put in, is there? But they didn't put  
14          those words in. They didn't say  
15          "deferential standard review."

16          Now, what I think should inform your  
17          decision about an objective standard  
18          review, or what we might call "a de novo  
19          standard review," is the following: This  
20          is the only opportunity that a claimant  
21          has for independent and impartial review  
22          of ICANN's conduct, the only opportunity.  
23          And within the context of that only  
24          opportunity, that sole opportunity,  
25          really, there should be a deferential

1 standard review, deference to the  
2 regulator, whose very conduct is being  
3 questioned. I think that that's wrong.

4 So not only do we not have any  
5 specific language in the revised rules  
6 whereby ICANN had previously argued for a  
7 deferential standard review, the  
8 ICM panel said No. ICANN revised the  
9 rules, but they didn't put in the wording  
10 "deferential."

11 But within the context of this  
12 process -- keeping in mind the litigation  
13 waiver, that all applicants are required  
14 to sign a very broad, very strict  
15 litigation waiver that ICANN constantly  
16 invokes and provides it with a protection  
17 from the public courts, and within the  
18 context of a proceeding that ICANN says  
19 has very limited purpose -- we, of  
20 course, contest that -- they ask you to  
21 apply a deferential standard review.

22 Not only do we, ICANN, develop the  
23 rules, we will interpret those rules, and  
24 we will tell you whether or not we are  
25 going to abide by those rules. We change

1           them when we like, we'll agree to them if  
2           we like, and we will apply them as we  
3           wish -- the regulator of the Internet, a  
4           global commons, a resource that has been  
5           put in the hands of ICANN.

6           So we would submit to you that the  
7           standard review is not one that is in any  
8           way deferential, but one that is de novo  
9           and whereby, we, as the Claimants, have  
10          to establish our case by preponderance of  
11          the evidence.

12          Now, ICANN will turn your attention  
13          to the specific elements of Article IV of  
14          the -- of the -- of the Bylaws -- I'm  
15          sorry -- of the supplemental rules, where  
16          it says, The Panel must focus on whether  
17          the Board acted without conflict of  
18          interest in making its decision, whether  
19          the Board exercised due diligence and  
20          care in having a reasonable amount of  
21          facts in front of them, and whether the  
22          Board members exercised independent  
23          judgment in taking the decision believed  
24          to be in the best interests of the  
25          company.

1           And we're not saying you shouldn't  
2           focus on those items, but that doesn't  
3           mean that those items that are listed in  
4           any way detract from, limit, curtail or  
5           circumscribe the obligations that are  
6           laid out as a result of the Articles of  
7           Incorporation, the Bylaws, the Applicant  
8           Guidebook.

9           And, again, we ask you to look at  
10          the standard of review within the context  
11          of what this proceeding is and what ICANN  
12          has said about this proceeding. And we  
13          ask that you reject their proposition,  
14          their submission that the standard review  
15          should be one that is deferential.

16          And with that, I will turn matters  
17          over to Ms. Craven, and we will start  
18          with, again, this perhaps somewhat  
19          laborious but, we do think, very helpful  
20          exercise of reviewing the evidence.

21          Thank you, Members of the Panel.

22          We should say, please do interrupt  
23          any of us if you have any questions about  
24          any aspect of what we've said. And if  
25          there's a question at this particular

1 point, I'm happy to address it before  
2 turning it over to Ms. Craven.

3 PRESIDENT BARIN: We had said that  
4 we would keep questions, if you will, at  
5 the end, but I'm happy to have my  
6 Panel Members ask any questions.

7 Do you have any --

8 HONORABLE JUDGE CAHILL: So your  
9 authority for the standard review is this  
10 other case, right?

11 MR. ALI: Indeed. In -- in -- in  
12 part, yes, but given ICANN's position,  
13 Judge Cahill, that they modified the  
14 standard review in light of that case,  
15 our submissions are also that the  
16 modification should -- should be looked  
17 at. And the fact that there's nothing  
18 set regarding the deferential standard  
19 review, thereby it's important for the  
20 Panel to take guidance from another IRP  
21 which did look at the standard review.

22 HONORABLE JUDGE CAHILL: Got it.

23 PRESIDENT BARIN: Mr. Ali, before  
24 you go, are we to understand, Mr. Ali,  
25 that what you're submitting to us is that

1 we can actually go beyond, if you will,  
2 what is set out in the supplementary  
3 rules as well as, I guess, the provisions  
4 of Article IV, Section 3 of the Bylaws?

5 Is that what you're saying?

6 MR. ALI: Our position is that the  
7 supplemental rules and the ICDR rules  
8 provide a procedural framework.

9 In terms of the substantive  
10 framework, it's the Articles of  
11 Incorporation, the Bylaws and the  
12 Applicant Guidebook. And those are the  
13 particular standards that we believe  
14 apply for purposes of judging ICANN's  
15 conduct.

16 Now, the supplemental rules and the  
17 ICDR rules that they're intended to  
18 modify seem to get, you know, somewhat  
19 jumbled, but that doesn't mean that that  
20 is not the procedural framework as  
21 opposed to the substantive framework.

22 ICDR rules and the supplemental  
23 rules provide the procedural framework,  
24 and, ultimately, those are the documents  
25 that provide the substantive principles

1 and rules that are applicable.

2 PRESIDENT BARIN: This is an  
3 important point, so allow me to press a  
4 little bit further.

5 MR. ALI: Please.

6 PRESIDENT BARIN: If the Panel was  
7 to look at, by example, one of the items  
8 that it would have to -- has to make a  
9 decision on, and that's, for example,  
10 Section 3, Sub 4a, Did the Board act  
11 without conflict of interest in taking  
12 its decision --

13 MR. ALI: Yes.

14 PRESIDENT BARIN: -- would you  
15 explain to us how the Panel would  
16 consider that in light of the standard  
17 that you're setting, which is that  
18 de novo, if you will, or objective  
19 meaning of what transpired? In other  
20 words, what should this Panel be looking  
21 at in order to do that?

22 MR. ALI: Just so I understand the  
23 question, with respect to the substantive  
24 standards of conflict?

25 PRESIDENT BARIN: Right.



1           In other words, at the end of the  
2           day, we have to come up -- you're looking  
3           for a decision from us.

4           MR. ALI:   Indeed.   With respect to  
5           the issue of a conflict of interest --  
6           now, there has been the ICANN ombudsman's  
7           review of whether or not there's a  
8           conflict of interest or not, applying  
9           standards that, frankly, are not entirely  
10          clear.

11          I think, as in all international  
12          proceedings -- and we can consider this  
13          to be an international proceeding --  
14          question marks, as you know, arise and  
15          have been much -- a source of much  
16          academic debate as to what are the  
17          standards of conflict that should be  
18          applicable.

19          I think that there's a rule of  
20          reason that you would need to apply here,  
21          and that rule of reason needs to be  
22          applied within the context of the process  
23          of the specific -- the specific action  
24          that those who are -- who were supposedly  
25          conflicted were involved in.

1           I don't think that we can look to  
2           any particular rules of ethics. I don't  
3           think that -- rules of ethics that would  
4           apply to counsel or to arbitrators.  
5           Those may be informative in a way, but I  
6           don't think the specifications apply.

7           I do believe, at the end of the day,  
8           you will have to apply rule of reason  
9           that is reflective of the particular  
10          context of the decisions that were being  
11          taken --

12          HONORABLE JUDGE CAHILL: That sounds  
13          like the standard that the ombudsman made  
14          in his decision. He said Not arbitrator,  
15          not judge, that it's a different  
16          standard. It sounds like you don't agree  
17          with that standard.

18          MR. ALI: I think that's right. I  
19          can't disagree, Judge Cahill. I mean, at  
20          the end of the day, since there aren't  
21          any defined standards -- you know,  
22          there's one that the ombudsman applied  
23          within the context of his factual  
24          investigation. There's one that you will  
25          apply within the context of looking at

1           our overall submissions regarding whether  
2           or not ICANN has violated the Articles of  
3           Incorporation and the Applicant  
4           Guidebook --

5                   HONORABLE JUDGE CAHILL: You want us  
6           to make a de novo decision on that? Just  
7           look at it fresh?

8                   MR. ALI: Yes, I think there are two  
9           things you can do: one is to look at that  
10          particular issue of conflict of interest;  
11          and then to look at the -- the  
12          allegations of the conflict of interest  
13          within the overall context of our case,  
14          which is that the playing field was  
15          tilted very heavily in favor of the  
16          African Union Commission.

17                   HONORABLE JUDGE CAHILL: Okay.

18                   PRESIDENT BARIN: Thank you.

19                   MR. ALI: May I turn the podium over  
20          to my colleague?

21                   PRESIDENT BARIN: Sure. We'll  
22          probably come back to this again  
23          afterwards.

24                   MR. ALI: Of course.

25                   MS. CRAVEN: Good morning,

1 Mr. Chairman and Members of the Panel.  
2 My name is Meredith Craven, and I appear  
3 before you on behalf of DotConnectAfrica  
4 Trust.

5 I plan to take you through, in a  
6 little more detail, the chronology which  
7 appears here on the tripod and also as  
8 reproduced on Slide 7 of your packet --

9 HONORABLE JUDGE CAHILL: Don't pay  
10 attention to that man.

11 MS. CRAVEN: I'll do my best. I  
12 hope he enjoys the timeline.

13 As you can see from looking at this  
14 timeline, which, of course, is a little  
15 bit easier to read in your packet, from  
16 the very beginning of the New gTLD  
17 Program, ICANN has shepherded the African  
18 Union Commission towards its desired  
19 goal; namely, ownership and operation of  
20 the New gTLD .africa.

21 In October 2011, the AUC formally  
22 requested in a document titled The Dakar  
23 Communiqué that ICANN reserve .africa and  
24 its French and Arabic equivalents for the  
25 exclusive use of the AUC.

1           Despite the fact that the  
2           application window opened in January 2012  
3           and despite the fact that DCA Trust  
4           submitted a letter in December 2011  
5           requesting that ICANN respond to the  
6           AUC's petition and inform applicants of  
7           the status of .africa, ICANN failed to  
8           respond to the AUC's petition and inform  
9           applicants of that status until  
10          March 8th, 2012, three months into the  
11          application window for new gTLDs, during  
12          which DCA submitted its application for  
13          .africa.

14           In its March 2013 response, ICANN  
15          informed the AUC they could not reserve  
16          .africa as this would violate the  
17          Applicant Guidebook. However, ICANN  
18          advised the AUC that it could use  
19          mechanisms, like ICANN's Governmental  
20          Advisory Committee, or GAC, to play a  
21          prominent role in determining the outcome  
22          of any application to these top-level  
23          domain name strings, .africa and its  
24          French and Arabic equivalents.

25           ICANN advised the AUC that by

1 joining the GAC, the AUC could inform  
2 ICANN that there are concerns with an  
3 application via the GAC Early Warning  
4 notice and provide direct advice to the  
5 ICANN Board on any particular  
6 application.

7 ICANN's advice to the AUC that it  
8 could join the GAC is troubling in that  
9 it was not a foregone conclusion that the  
10 AUC could become a GAC member and have  
11 this status required to issue Early  
12 Warnings or participate in GAC advice.

13 According to the ICANN Bylaws,  
14 membership on the GAC is open to national  
15 governments, and the AUC is not a  
16 national government.

17 The Bylaws go on, as you can see  
18 from the highlighting, to indicate that  
19 distinct economies, as recognized in  
20 international fora, multinational  
21 government organizations and treaty  
22 organizations may also join the GAC but  
23 only upon the invitation of the GAC  
24 through its Chair.

25 Moreover, the GAC operating

1 principles clarify that multinational  
2 governmental organizations and treaty  
3 organizations who are invited to  
4 participate in the GAC by its Chair do so  
5 as observers only.

6 Now, what this means is that they do  
7 not have voting rights; they do not issue  
8 Early Warnings; and they do not  
9 participate in GAC advice.

10 HONORABLE JUDGE CAHILL: That's  
11 observers, right?

12 MS. CRAVEN: As observers, they do  
13 not participate in GAC advice.

14 Indeed, looking at the list of GAC  
15 voting members that are not national  
16 governments, as compared to the  
17 organizations that are observers on the  
18 GAC, it really does appear that the AUC  
19 received special treatment in this case.

20 Organizations that are analogous to  
21 the AUC, like the Council of Europe, the  
22 Organization of American States or the  
23 Pacific Islands Forum, are observers.  
24 They do not have voting rights, and they  
25 do not participate in GAC advice.

1           In fact, the sum total of  
2           nongovernment voting members of the GAC  
3           is the European Commission and the  
4           African Union Commission. However, the  
5           European Commission and the African Union  
6           Commission are treated very differently  
7           outside of the ICANN world.

8           While the AU and the EU are both  
9           very important in the relevant regions,  
10          their powers are different. Their  
11          enforcement capabilities with regard to  
12          their members are different. Their  
13          status on the global stage is very  
14          different.

15          For example, the EU actually has the  
16          authority to regulate and legislate over  
17          the sovereign governments which form part  
18          of the European Union. In addition, the  
19          EU creates EU law and has the ability to  
20          enforce this law upon its members.

21          The EU has the authority to sign  
22          international agreements as the EU, and,  
23          perhaps most importantly for our  
24          purposes, the EU has expanded observer  
25          status in the United Nations. This means



1           that the EU, exclusively of all other  
2           international organizations, has the  
3           authority to speak at the UN General  
4           Assembly meetings. It has the sole --  
5           and it is the sole nonstate party to  
6           numerous United Nations agreements.

7           The African Union does not have this  
8           status. The African Union is an  
9           important political organization with a  
10          mission to promote peace, stability and  
11          security in the African continent, but it  
12          has no regulatory authority over African  
13          states. There is no such thing as AU  
14          law, and there is no mechanism to enforce  
15          AU law.

16          Finally, the African Union is a UN  
17          observer, not an expanded observer, an  
18          observer alongside organizations like the  
19          Council of Europe, the Organization of  
20          American States, and the Pacific Islands  
21          Forum, all of which have observer and  
22          nonmember status on the GAC.

23          Now, ICANN has argued that the AUC's  
24          membership as a voting member on the GAC  
25          was a decision purely within the ambit of

1 the GAC. They have said that it was at  
2 the sole discretion of the GAC for the  
3 AUC to join as a voting member.

4 ICANN has argued that its Board had  
5 absolutely nothing to do with the  
6 decision to give the AUC voting rights;  
7 however, two weeks prior to sending its  
8 March 2013 response to the AUC, advising  
9 the AUC that it could use the GAC to  
10 achieve its ends, ICANN shared the draft  
11 of that letter with the GAC Chair,  
12 Ms. Heather Dryden, requesting that she  
13 review and comment upon the draft, which  
14 indicated the AUC could have voting power  
15 as a GAC member, and used that to have a  
16 prominent impact on the outcome of  
17 .africa.

18 And, in fact, after receiving this  
19 advice in the March 8th, 2013 letter, the  
20 AUC did take steps and became a GAC  
21 member by the Toronto GAC meeting in  
22 June 2013. And in November 2013, the GAC  
23 orchestrated the GAC Early Warnings  
24 against DCA's application containing  
25 exactly the anticompetitive purpose --

1 anticompetitive purpose expressed in The  
2 Dakar Communiqué.

3 As you can see from Slide 16, a GAC  
4 Early Warning is intended to allow a  
5 government to indicate to an applicant  
6 that their gTLD application is seen as  
7 potentially sensitive or problematic. It  
8 is merely a notice; it does not result in  
9 any adverse effect upon the application.

10 A GAC Early Warning is essentially  
11 an invitation to the applicant to work  
12 with the affected government so that  
13 problems with the application don't arise  
14 later on in the process.

15 According to the Application  
16 Guidebook, an Early Warning typically  
17 results from a notice to the GAC by one  
18 or more governments that an application  
19 might be problematic because it violates  
20 national law or raises sensitivities.

21 However, the AU's Early Warning did  
22 not relate to policy issues or  
23 sensitivities; instead, the AU's Early  
24 Warning contained three rationales.

25 First, the AU claimed that DCA's

1 application had a lack of geographic  
2 support. This is not a ground for an  
3 Early Warning. This is not a policy  
4 issue. This is actually a matter for the  
5 Geographic Names Panel, which is the  
6 independent body that ICANN specifically  
7 hired and delegated to determine whether  
8 or not geographic applications have the  
9 requisite support to satisfy the  
10 Applicant Guidebook.

11 Second, the AUC complained that  
12 DCA's application was an unwarranted  
13 intrusion on the AUC's self-awarded  
14 mandate to establish .africa.  
15 Essentially, the AU said it wanted the  
16 string, and it did not want DCA to have  
17 it.

18 Finally, the AUC alleged a string  
19 similarity problem. A "string similarity  
20 problem" essentially means that two  
21 applied-for strings are so similar that  
22 it would confuse the DNS system to have  
23 them both in existence.

24 DCA's application, therefore, was  
25 too similar, because it applied for

1 .africa, to the AUC's application for  
2 .africa; and, therefore, DCA's  
3 application should not go forward.

4 This is not a real string similarity  
5 issue; this is, again, an anticompetitive  
6 aim.

7 Again, however, ICANN employs an  
8 independent panel to evaluate string  
9 similarity. So regardless of the purpose  
10 of this string similarity claim, the GAC  
11 Early Warning need not address it.

12 Furthermore, the Early Warning did  
13 not contain any concerns whatsoever about  
14 the policy behind DCA's application. It  
15 didn't touch upon the viability of the  
16 application, the manner in which DCA  
17 proposed to operate .africa in its  
18 application or the impact upon the  
19 African continent if DCA were to be the  
20 custodian of the string .africa.

21 This GAC Early Warning is not a  
22 matter of public policy, which is the  
23 proper ambit of the GAC; instead, it is  
24 merely an anticompetitive document.

25 The anticompetitive Early Warning,

1           however, then translated into the  
2           anticompetitive GAC advice on April 2013.  
3           Again, the purpose of GAC advice, like a  
4           GAC Early Warning, is to address  
5           applications that potentially violate  
6           national law or raise sensitivities. The  
7           purpose is not to simply object to a  
8           competitor.

9           And it's important to understand  
10          that we're looking at a unique situation  
11          here. In no other instance, that we are  
12          aware of, was there an applicant for a  
13          gTLD that was also a member of the GAC.  
14          In no other instance do we have an  
15          applicant who is also a judge.

16          Now, ICANN has maintained that the  
17          GAC advice in DCA's application was  
18          consensus advice; and, therefore, it was  
19          proper for the Board to accept that  
20          advice.

21          As you can see from the slide, the  
22          Applicant Guidebook provides three types  
23          of GAC advice: first, consensus advice;  
24          second, advice that some members on the  
25          GAC may have concerns about an

1 application; and third, advice that  
2 certain amendments should be made to the  
3 application before it should proceed.

4 Consensus advice creates a strong  
5 presumption that the ICANN Board should  
6 not approve the application; however,  
7 this is a strong presumption. It is not  
8 a mandatory requirement that the Board  
9 accept the GAC's decision. And the  
10 factors here that the Claimant maintains  
11 render this advice not consensus advice  
12 should have, at a minimum, prompted the  
13 ICANN Board to conduct due diligence into  
14 the validity of the anticompetitive GAC  
15 advice.

16 First among these factors, the  
17 advisor from Kenya, Mr. Sammy Buruchara,  
18 specifically informed the GAC Chair and  
19 the ICANN CEO, in advance of the GAC  
20 meeting in Beijing in April 2013, the  
21 meeting which produced the GAC advice at  
22 issue here, that Kenya did not wish to  
23 issue the advice on DCA's application.

24 Two days prior to the GAC meeting  
25 from where the advice issued,

1 Mr. Buruchara wrote directly to the  
2 GAC Chair, Ms. Dryden, and to ICANN's  
3 CEO, Fadi Chehadé, informing them that he  
4 could not attend the GAC meeting in  
5 Beijing but that he had concerns about  
6 certain irregularities that had arisen in  
7 the meetings leading up to the GAC  
8 meeting.

9 He informed Ms. Dryden and  
10 Mr. Chehadé that should anyone raise an  
11 objection against DCA's application  
12 through the GAC advice, Kenya objected to  
13 the GAC advice.

14 Redacted - GAC Designated Confidential Information



1

Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

8

Now, how that turned into advice on

9

DCA's application, we don't know.

10

Somehow, the GAC issued advice based

11

upon the -- the version of text -- or a

12

version of text that included an

13

objection to DCA's application. We have

14

no indication of how this occurred

15

because the GAC meeting was confidential.

16

Apparently, no minutes were taken.

17

No one seems to have a recollection of

18

what happened. Ms. Dryden didn't provide

19

any enlightening information in her

20

statement on what actually happened

21

during that critical meeting from which

22

the GAC advice issued.

23

Nonetheless, all the GAC members

24

through the GAC LISTSERV, the GAC's

25

chairperson and ICANN's CEO were all

1           aware that the Government of Kenya  
2           objected to anticompetitive advice issued  
3           through the GAC.

4           In light of the fact that the advice  
5           was anticompetitive and inconsistent with  
6           the role of the GAC and the purpose of  
7           the GAC advice, in light of the fact that  
8           the Board had notice that Kenya disagreed  
9           with anticompetitive use of the GAC  
10          advice, and in light of the fact that the  
11          GAC Chair, a liaison to the ICANN Board,  
12          had notice that Kenya objected to the  
13          anticompetitive use of the GAC advice,  
14          the NGPC should have at a minimum --  
15          should have considered that this was not  
16          proper consensus advice but, at a  
17          minimum, should have investigated into  
18          the procedural irregularities raised,  
19          particularly because DCA pointed out in  
20          its response, which it was entitled to  
21          send to the NGPC -- in its response to  
22          the GAC advice, submitted on May 8th,  
23          2013, that there were all of these  
24          procedural irregularities and that the  
25          AUC was motivated by political

1           machinations, by an anticompetitive  
2           purpose to acquire this TLD for its own  
3           use, operation and profit.

4           HONORABLE JUDGE CAHILL: I saw in  
5           one of their briefs -- one of ICANN's  
6           briefs that this person from Kenya was --  
7           who was sending e-mails was not the  
8           proper person to vote on or was not in  
9           the right position, and the person who  
10          was in the right position was in Beijing.  
11          And we don't know what happened. We  
12          don't even know if he was in the room.

13          When you say about, you know, Kenya  
14          objecting to -- through someone who has  
15          not the power to do it, I think that's  
16          their point.

17          MS. CRAVEN: You're absolutely right  
18          that Mr. Buruchara was the GAC advisor,  
19          and ICANN maintains that the GAC  
20          representative is the proper person to --  
21          to represent a government.

22          Now, whether or not -- some  
23          countries seem to have advisors only.  
24          Some countries seem to have  
25          representatives only.

1                   I would certainly appreciate some  
2                   enlightening on how the system is  
3                   supposed to work, because the reality of  
4                   who represents governments and the GAC  
5                   operating principles doesn't line up  
6                   precisely.

7                   Redacted - GAC Designated Confidential Information

1           The other thing that I would point  
2           out is -- and we're not here to debate  
3           ICANN's procedures; we're here to --  
4           we're here to address the fact that ICANN  
5           has not followed its procedures.

6           But it does seem somewhat strange  
7           that in a meeting where governments are  
8           supposed to be authorizing their  
9           sovereign authority through their  
10          representatives, no one has a record of  
11          what happened, no one seems to know where  
12          Mr. Katundu was, no one seems to know  
13          when this vote was occurring.

14          I mean, hypothetically, a  
15          representative could be in the room,  
16          leave to take a phone call, and a vote  
17          could occur without them knowing. We  
18          don't even know if there is a distinct  
19          agenda for these meetings.

20          So the prominent point is that  
21          Mr. Katundu was, in fact, onboard with  
22          this -- with this objection to the GAC --  
23          the GAC advice and to the use of the GAC  
24          in this manner; but, in addition, his  
25          whereabouts are somewhat -- it's somewhat

1           questionable as to where he was, why he  
2           wasn't in the room. And the only people  
3           who can enlighten us on that have not.

4           HONORABLE JUDGE CAHILL: The only  
5           evidence I saw was a declaration that  
6           said they couldn't remember whether he  
7           was in the room or not when that  
8           happened.

9           Okay.

10          MS. CRAVEN: That's what we've seen  
11          as well, and we don't have additional  
12          information on that.

13          HONORABLE JUDGE CAHILL: Okay.  
14          Thank you.

15          MS. CRAVEN: Absolutely.

16          Indeed, the NGPC consideration of  
17          .africa, as we discussed, didn't consider  
18          any of those procedural errors or  
19          the -- the questionable use of the AUC  
20          for what was not -- excuse me -- of the  
21          GAC for what was not a public policy  
22          purpose.

23          In fact, the NGPC's consideration,  
24          as reflected in the Board  
25          meeting minutes, is actually just a

1 one-liner. The Board says, The committee  
2 discussed accepting the GAC Advisory  
3 Committee advice regarding the  
4 application for .africa.

5 And that's really it. The rest of  
6 the paragraph discusses the process by  
7 which the NGPC will accept the GAC advice  
8 and remove DCA's application from  
9 contention.

10 There's no actionable diligence  
11 performed in that meeting, as far as we  
12 can tell from the minutes and as far as  
13 we can tell from the public records  
14 surrounding those meeting minutes.

15 In addition, the NGPC scorecard  
16 reveals no additional diligence either.  
17 It simply repeats the fact that the NGPC  
18 directed its staff to accept the GAC  
19 advice and that .africa would not be  
20 approved and would, therefore, be  
21 withdrawn from the process.

22 Meanwhile, the NGPC actually did  
23 have the authority to undertake a  
24 detailed investigation, including, if  
25 necessary, the NGPC had the authority to



1           consult an independent expert on these  
2           complex political machinations that were  
3           in play.

4           In cases where the issues resulting  
5           from GAC advice are pertinent to a formal  
6           objection process, the NGPC may consult  
7           an independent expert.

8           The GAC warning and GAC advice  
9           essentially argue that a substantial  
10          portion of the African continent is  
11          opposed to DCA's application, as  
12          represented by the African Union  
13          Commission.

14          The African Union Commission argues  
15          that this Africa community is targeted by  
16          DCA's application for .africa and that  
17          the support is lacking.

18          These claims are pertinent to a  
19          community objection under the ICANN  
20          Applicant Guidebook. Moreover, in light  
21          of the concerns that we have highlighted  
22          surrounding the advice, the NGPC should  
23          have consulted the independent expert  
24          that it had, under the AGB, the authority  
25          to consult.

1           If the -- if the NGPC was uncertain  
2           as to what independent expert to consult,  
3           it could have, at a minimum, referred to  
4           the Geographic Names Panel, which had  
5           been working on the issue for months.

6           The Geographic Names Panel is the  
7           independent expert that ICANN itself  
8           hired specifically to examine, evaluate  
9           and rule upon exactly the governmental  
10          support concerns that are raised by the  
11          AUC in the Early Warning which led to the  
12          GAC advice.

13          And I would like to turn over to my  
14          colleague Erin Yates to explain a little  
15          bit more about the -- the Geographic  
16          Names Panel itself and ICANN's  
17          relationship with the Geographic Names  
18          Panel throughout this process.

19          However, if the Panel has any  
20          questions, I'm happy to address them  
21          before I do so.

22                 PROFESSOR KESSEDJIAN: None for me.  
23          Thank you.

24                 PRESIDENT BARIN: Thank you.

25                 HONORABLE JUDGE CAHILL: No. Talked

1 all we can.

2 MS. CRAVEN: Thank you very much.

3 MS. YATES: Good morning,

4 Mr. President and Members of the Panel.

5 My name is Erin Yates, and I'm also

6 here on behalf of the Claimant,

7 DotConnectAfrica Trust.

8 This morning, I'll take you through

9 the Geographic Names Panel review that

10 InterConnect Communications performed in

11 coordination with ICANN and demonstrate

12 how ICANN's interference in that process

13 influenced the outcome of the application

14 process for .africa to the benefit of

15 DotConnectAfrica Trust's direct

16 competitor.

17 As you know, the Geographic Names

18 Panel review is part of ICANN's initial

19 evaluation process for applications for

20 geographic strengths. ICANN's gTLD

21 Applicant Guidebook requires applicants

22 for geographic strengths to demonstrate

23 support from at least 60 percent of

24 national governments in their respective

25 region.

1           As shown on the slide in front of  
2           you, ICANN's Applicant Guidebook provides  
3           that the Geographic Names Panel will  
4           determine which governments are relevant  
5           based on the inputs of the applicants,  
6           the governments and its own research and  
7           analysis. Nowhere is there mention of  
8           reference to ICANN Staff, the Board or  
9           other resources.

10           The Geographic Names Panel reviews  
11           the documentation of support or  
12           nonobjection provided by applicants and  
13           accesses its relevance and verifies its  
14           authenticity.

15           The Applicant Guidebook contemplates  
16           that the Geographic Names Panel may  
17           communicate with the entities that sign  
18           letters of support in order to understand  
19           the terms on which the support was  
20           provided.

21           With this in mind and consistent  
22           with ICANN's gTLD Applicant Guidebook,  
23           DotConnectAfrica Trust consulted with the  
24           relevant governments and public  
25           authorities in Africa to enlist their

1 support prior to submitting its  
2 application.

3 As Mr. Ali explained earlier, the  
4 fact that ZACR, DCA's direct competitor,  
5 claimed to have the support of the AU  
6 Commissioner for Infrastructure and  
7 Energy did not mean the DotConnectAfrica  
8 Trust could not pass the Geographic Names  
9 review.

10 The Applicant Guidebook expressly  
11 provides that where there was more than  
12 one application for a geographic string  
13 with requisite government approvals, that  
14 applicants, themselves, must resolve the  
15 contention.

16 Where an applicant has not produced  
17 all of the documentation of support, the  
18 Guidebook provides that the Geographic  
19 Names Panel will contact the applicant  
20 and give the applicant no fewer than  
21 90 days to provide such documentation.

22 That is how the process should have  
23 worked. Instead, ICANN controls every  
24 step of the process. And while this  
25 chronology is a bit busy, we'll walk

1 through these documents together and show  
2 the communications that took place  
3 between ICANN and InterConnect  
4 Communications, because even at the very  
5 early stages of the process, ICANN  
6 directed the Geographic Names Panel on  
7 how to treat support for the .africa  
8 applications.

9 As you can see on Slide 34, an  
10 excerpt of Claimant's Exhibit 110, on  
11 July 10th, 2012, ICANN circulated to the  
12 Geographic Names Panel its preliminary  
13 responses to what appear to be questions  
14 about how to resolve certain issues with  
15 respect to geographic strings.

16 As you can see on Slide 35, one of  
17 those questions was whether letters of  
18 support from the African Union or the  
19 United Nations Economic Commission for  
20 Africa count towards the 60 percent rule.

21 ICANN determined in its preliminary  
22 guidance that such letters would not, and  
23 the letters of support must be obtained  
24 from individual countries.

25 Somewhat strangely, ICANN directed

1 InterConnect to send a clarification  
2 question to the African Union only to  
3 state that its letter was meaningful but  
4 did not count.

5 In the following months, ICANN and  
6 InterConnect engaged in much discussion  
7 and debate over this point.

8 As you can see in the excerpt of  
9 Claimant's Exhibit 69 on Slide 36,  
10 InterConnect recognized that -- the  
11 politically sensitive nature of these  
12 applications within ICANN but also didn't  
13 believe that ICANN should second-guess  
14 its independent panels.

15 InterConnect also expressed concern  
16 to ICANN about the acres of time it was  
17 spending on the .africa applications, in  
18 their words, "way out of proportion to  
19 any other geographic name," and repeated  
20 its recommendation that ICANN meet with  
21 InterConnect to discuss how to handle  
22 these applications.

23 At the time InterConnect completed  
24 its geographic review of the .africa  
25 applications in October 2012, discussions

1           about how to handle the .africa  
2           applications were even taking place at  
3           the executive level within ICANN.

4           At the same time, ICANN was aware  
5           that there were significant problems with  
6           the letters of support submitted by ZACR,  
7           and the many ZACR purported letters of  
8           support would result in what ICANN calls  
9           "clarifying questions."

10          Many of the letters of support ZACR  
11          submitted were based on a template that  
12          InterConnect determined did not satisfy  
13          the criteria in the Guidebook.

14          InterConnect also put ICANN on  
15          notice that if ICANN did not count the  
16          support of the AU, DotConnectAfrica would  
17          not have a chance of passing the  
18          Geographic Names review with no mention  
19          of DotConnectAfrica support from the  
20          United Nations Economic Commission for  
21          Africa.

22          After this e-mail, ICANN and  
23          InterConnect communicated from time to  
24          time about whether ICANN had made a  
25          decision on how to treat support for the



1 .africa applications.

2 InterConnect apparently issued  
3 clarifying questions for every other  
4 geographic name but not for .africa.

5 Several months passed, and while  
6 InterConnect's position did not change,  
7 no clarifying questions were issued for  
8 the .africa applications.

9 And moving ahead to early  
10 March 2013, an ICANN consultant reached  
11 out to InterConnect Communications to ask  
12 for information for an ICANN steering  
13 committee. What committee that is, we're  
14 not sure, but it does not seem proper  
15 that at the ICANN executive level,  
16 conversations were happening about the  
17 work of an independent panel.

18 On March 15th, 2013, as you can see  
19 from the document before you,  
20 InterConnect e-mails ICANN to reiterate  
21 its recommendation that the Geographic  
22 Names Panel issue the clarifying  
23 questions to each of the applicants, just  
24 as InterConnect did for every other  
25 geographic string, to clarify the

1 position on the African Union.

2 As Ms. Craven explained, the  
3 following month, on April 11, 2013, the  
4 GAC issued its purported consensus  
5 objection advice against  
6 DotConnectAfrica's application.  
7 Only days later, ICANN contacted  
8 InterConnect to see whether InterConnect  
9 had begun preparing clarifying questions  
10 for .africa.

11 Although these e-mails before you  
12 show that InterConnect had some informal  
13 discussions before the Beijing meeting,  
14 the meeting at which the GAC advice was  
15 issued against DCA's application, about  
16 how to proceed on these applications,  
17 InterConnect requested, again, formal  
18 instructions from ICANN on how it should  
19 conduct its work.

20 Only at this point, after the  
21 purported consensus objection advice had  
22 been issued against DotConnectAfrica's  
23 application, did ICANN instruct  
24 InterConnect to proceed with preparing  
25 clarifying questions on the .africa

1 applications.

2 As InterConnect began its work, it,  
3 once again, asked ICANN whether to  
4 contact the African Union directly to  
5 resolve the questions about  
6 the African Union support. ICANN again  
7 denied InterConnect's request.

8 ICANN also questioned why  
9 InterConnect would recommend issuing a  
10 clarifying question for the United  
11 Nations Economic Commission for Africa.

12 After months and months of delay, on  
13 May 7th, ICANN begins pushing  
14 InterConnect to issue clarifying  
15 questions for ZACR's application.

16 At this point, InterConnect explains  
17 to ICANN that ICANN has rejected its  
18 proposed approach, the proposed approach  
19 of the independent panel tasked with  
20 verifying and authenticating the letters  
21 of support, and, instead, recommended  
22 issue clarifying questions to every  
23 country and relevant authority.

24 On the same day, in the face of  
25 deadlines to complete the clarifying

1 questions on ZACR's application,  
2 InterConnect reminded ICANN that it had  
3 advised ICANN all the way back in October  
4 of 2012 of the problems that would be  
5 associated with the .africa applications,  
6 and ICANN waited over seven months to  
7 respond.

8 And as you can see in the following  
9 slides, a similar vein of communications  
10 was exchanged between ICANN and  
11 InterConnect on these issues, with  
12 InterConnect remaining steadfast in its  
13 opinion that the African Union is a  
14 relevant authority and that InterConnect  
15 should be able to contact its  
16 representatives.

17 Interconnect stressed to ICANN that  
18 its approach was in conformance with the  
19 Guidebook, deals fairly and reasonably  
20 between the applicants without the risk  
21 of prejudice to one of the -- one or the  
22 other, and is likely to avoid many months  
23 of delay or potential confusion.

24 On May 15th, ICANN again rejected  
25 the approach recommended by its

1 independent panel --

2 PROFESSOR KESSEDJIAN: Could I  
3 interrupt you here? Because you went  
4 very fast on this new exhibit. That is  
5 the first time the Panel is seeing it.

6 MS. YATES: Yes.

7 PROFESSOR KESSEDJIAN: Perhaps you  
8 want to tell us more --

9 MS. YATES: If you could take it  
10 back to the --

11 PROFESSOR KESSEDJIAN: -- so it's  
12 your Slide 46. It's here in Exhibit 2.

13 And so why are we seeing this for  
14 the first time? And what is important in  
15 this exhibit?

16 MS. YATES: Yes. We thought this  
17 helped complete the picture of the  
18 communications that were taking place  
19 between InterConnect and ICANN during  
20 this time. And it is also helpful to  
21 show that ICANN -- or that InterConnect  
22 remained steadfast into its view that  
23 the African Union was a relevant  
24 authority and would, in fact, qualify  
25 under the 60 percent rule.

1           And we also thought it was helpful  
2           in that it showed that ICANN had a strong  
3           preference that its independent panel not  
4           engage directly with the African Union  
5           and, instead, preferred -- prepared these  
6           clarifying questions for other countries  
7           that gave letters of support, despite the  
8           fact that the Guidebook provided that the  
9           independent panel could reach out and  
10          verify and authenticate these letters of  
11          support directly.

12           HONORABLE JUDGE CAHILL:   Who's Emily  
13          Taylor?

14           MS. YATES:   Pardon me?

15           HONORABLE JUDGE CAHILL:   Who is  
16          Emily Taylor?

17           MS. YATES:   She is an InterConnect  
18          employee.   And I believe, if you're  
19          looking at that slide, that she seems to  
20          send an e-mail from a personal e-mail  
21          address where you see the .eu.   But she's  
22          an InterConnect employee.

23           HONORABLE JUDGE CAHILL:   Okay.   I  
24          was just wondering who she was.

25           Okay.

1 MS. YATES: And as you can see on  
2 Slide 49, conversations continue to take  
3 place between ICANN and InterConnect on  
4 these issues.

5 In InterConnect's May 30th, 2013  
6 letter to ICANN, InterConnect explains  
7 that the AU declarations submitted by  
8 ZACR, the ones that Ms. Craven spoke  
9 about, are not, in fact, letters of  
10 support and, therefore, would not get  
11 qualifying -- or clarifying questions.

12 However, InterConnect restated its  
13 believe that the UN Economic Commission  
14 for Africa should get a clarifying  
15 question, as it is an intergovernmental  
16 organization for the region and,  
17 therefore, qualifies as a relevant public  
18 authority.

19 And before any such clarifying  
20 questions were issued, however, the NGPC  
21 accepted the GAC objection advice against  
22 DotConnectAfrica's application.

23 The very same day the NGPC's  
24 decision was announced, Friday, June 7th,  
25 ICANN directed InterConnect to cease work

1 on DotConnectAfrica Trust's application  
2 and directed InterConnect to issue  
3 clarifying questions for ZACR by the  
4 following Tuesday in only four days' time  
5 after months and months and months of  
6 delay.

7 Without DotConnectAfrica Trust in  
8 contention for .africa, ICANN Staff took  
9 the remarkable step of actually drafting  
10 an endorsement letter for the  
11 African Union so they would have the  
12 required documentation to pass the  
13 Geographic Names review.

14 And as you can see in the following  
15 slide, the AUC made only minor  
16 modifications to the letter, copied it  
17 onto its letterhead and submitted it to  
18 ICANN's CEO, Fadi Chehadé, days later.

19 Now, ICANN's contention is that the  
20 AUC did not follow the template  
21 precisely, and it only used it as a guide  
22 and would have done the same thing for  
23 DotConnectAfrica Trust had it asked.  
24 However, as you can see in Slide 54, the  
25 critical portions of the letter were



1           drafted by ICANN.

2                     With DotConnectAfrica Trust's  
3 application out of the way, ICANN now  
4 rushed to pass ZACR's application. And,  
5 unsurprisingly, InterConnect found that  
6 the letter satisfied the Guidebook  
7 criteria.

8                     Finally, ZACR passed the Geographic  
9 Names review on July 9th and an initial  
10 evaluation on July 12th in time to  
11 announce their ICANN 44, Durban,  
12 South Africa.

13                    And unless you have questions for  
14 me, I will pass it back over to Mr. Ali,  
15 who will address the Board's failure to  
16 make an inquiry into all of these serious  
17 issues.

18                    Thank you.

19                    HONORABLE JUDGE CAHILL: Sorry. No  
20 questions.

21                    MR. ALI: As I was listening to my  
22 two colleagues, I was reminded of the  
23 definition of "success." Success is when  
24 you work with the best and replace  
25 yourself. And I certainly feel that my

1 time for being replaced at the head of  
2 the -- of the legal teams that I run is  
3 soon coming.

4 So thank you both very much. And  
5 congratulations on excellent  
6 presentations.

7 What I would just like you to do for  
8 a brief moment is to focus on the  
9 language that we looked at in the  
10 presentation that was made regarding  
11 ICANN's advice with the input of the GAC  
12 to the African Union Commission about the  
13 prominent role that the African Union  
14 could play through the GAC in impacting  
15 the outcome of what is supposed to be a  
16 fair and transparent process, where the  
17 rules of the game should apply equally to  
18 both -- to all applicants, but, here,  
19 we're talking about two applicants.

20 Redacted - GAC Designated Confidential Information

1 Redacted - GAC Designated Confidential Information

2 So just to quickly recap everything  
3 that we've looked at, October 2011, the  
4 AUC writes to ICANN saying we would like  
5 to have this gTLD for Africa, Afrique,  
6 Afrikia, whatever may be the different  
7 sort of languages, reserved for us.

8 ICANN says, No, we can't do that; but  
9 ICANN says, You can use your position in  
10 the GAC.

11 Why did it take five months from the  
12 time of the letter that was sent in  
13 October 2011 by the AUC for ICANN to  
14 respond? What happened in those  
15 five months?

16 We don't know for sure because we  
17 have not -- everything was produced to  
18 us, but we do know that at least one  
19 thing happened, based on the evidence  
20 that's before you, that there was at  
21 least one, possibly more, consultations  
22 between the ICANN Board and ICANN Staff  
23 and the GAC.

24 What else could they have been  
25 discussing other than the AUC's request?

1           Why should the ICANN Board consult  
2           with the GAC when the GAC is supposed to  
3           make an independent determination about  
4           the position that the AUC will occupy  
5           within the GAC?

6           But as we've seen, based on  
7           unconverted evidence, that the GAC,  
8           Ms. Dryden, gives the AUC special status,  
9           which it otherwise is not entitled to  
10          under the rules of the GAC.

11          Why was the AUC granted this special  
12          consideration and given this special  
13          status?

14          There are only two organizations  
15          that have the special status in the GAC:  
16          the European Commission and the AUC.

17          But you would expect that the  
18          Governmental Advisory Committee would at  
19          least do the due diligence that we have  
20          in order to ascertain the difference  
21          between the European Commission and the  
22          AUC, and understand what the role is of  
23          the AUC in respect of the nonvoting  
24          members and have put them in that  
25          category. But they were not.

1 All I can do is rely on the  
2 evidence. I can't rely on supposition.

3 Now, 28th June 2012, the AUC joins  
4 the GAC. And around this time,  
5 June 2012, ZACR puts its application in.

6 July 2012, ICANN distributes the  
7 Geographic Names Panel guidelines to  
8 InterConnect Communications, which, as  
9 you've heard, is the organization that  
10 was the independent organization that is  
11 to evaluate whether or not the criteria  
12 are satisfied, the criteria that are in  
13 the Applicant Guidebook.

14 These guidelines instruct  
15 InterConnect not to apply the  
16 endorsements of regional organizations  
17 towards the 60 percent geographic  
18 requirement that is in the Applicant  
19 Guidebook.

20 So we're in -- right at the  
21 beginning of the process. We're in  
22 July 2012, and ICANN Staff tell  
23 InterConnect that, No, you shouldn't  
24 apply the -- the -- the endorsement of an  
25 international organization as a proxy or

1 substitute for the 60 percent  
2 requirement.

3 Please keep that in mind when you  
4 think about the complete about-face that  
5 is done following the so-called consensus  
6 GAC advice and the approval by the NGPC  
7 of the -- of the -- of the ZACR  
8 application that led to the ICANN Staff  
9 then writing the letter for the AUC.

10 Suddenly, this criterion doesn't  
11 apply anymore. These rules of the game  
12 don't apply anymore, the rules of the  
13 game that the independent Geographic  
14 Names Panel is saying should be applied  
15 equally.

16 Let's just take a quick look back  
17 again at what it is that on May 10th,  
18 2013, the Geographic Names Panel writes  
19 to ICANN and tells them. And, here, I'm  
20 looking at Slide Number 47.

21 HONORABLE JUDGE CAHILL:

22 Forty-seven?

23 MR. ALI: Yes, sir.

24 Given that both applicants rely on  
25 AU support, and the Guidebook foresees

1           that it is possible for a single country  
2           or public authority -- that a single -- a  
3           single country or authority may support  
4           more than one application for the same  
5           string, we strongly recommend, in the  
6           interests of both applicants and of the  
7           gTLD process, that the next step should  
8           be to approach the AU and signal to the  
9           applicants that depending on the outcome,  
10          we may also seek CQs from the remaining  
11          countries and authorities and attached  
12          their respective applications.

13                 I hope that you will give advice  
14                 your careful consideration. It is in  
15                 conformance with the Guidebook, deals  
16                 fairly and reasonably between the  
17                 applicants without the risk of prejudice  
18                 to one or the other, and is likely to  
19                 avoid many months of delay and potential  
20                 confusion.

21                 And what happens? Time and time  
22                 again, ICANN says, No, do not do that.

23                 ICANN even questions the support  
24                 that is granted or given by UNECA to  
25                 DCA Trust. There is -- there is a

1 communication from ICANN to the  
2 independent panel, Geographic Names  
3 Panel, saying, Oh, why do you think that  
4 UNECA is relevant?

5 Well, the Geographic Names Panel  
6 thinks that UNECA is relevant, and they  
7 say so time and time again. But time and  
8 time again, they are told by ICANN, No.

9 So we have the situation now which  
10 continues from June 2012 till June 2013  
11 where ZACR's application does not have  
12 the support -- and if you'd like us to  
13 get more into what supports ZACR's  
14 application, the application that -- that  
15 the AUC has supported and that ICANN has  
16 facilitated has -- we would be happy to  
17 get into it, because ZACR's application  
18 to date does not have the support that  
19 was set forth in the Guidebook and the  
20 criteria that ICANN was applying back in  
21 July of 2012.

22 Had that criteria, the same criteria  
23 that has been applied to ZACR's  
24 application, been applied to DCA's  
25 application, they would be on parity. They



1 would be in direct discussions.

2 But the way the game was played, the  
3 way the referee allowed the game to be  
4 played, the referee facilitated a tilting  
5 of the playing field.

6 So other questions that we'd like you  
7 to keep in mind as you listen to  
8 Mr. LeVee's presentation, What happens at  
9 this executive level meeting? They had an  
10 executive level meeting -- by now, when you  
11 look at all the correspondence -- and by  
12 the way, we apologize for how small this is  
13 in terms of its print.

14 But all of these documents are in the  
15 binder that we've given you. So you can  
16 follow those along, I think, much more  
17 easily in terms of the printout.

18 So we have a -- we have a -- we have  
19 documentation which clearly states that  
20 there's a hot political debate going on  
21 within ICANN, within the Geographic Names  
22 Panel. It says -- it says very clearly  
23 that there is a political struggle that's  
24 going on, that these are politically  
25 complicated applications. The

1 documentation says that.

2 So what happens?

3 On the 25th of October, there's an  
4 executive level meeting at ICANN to discuss  
5 .africa.

6 Do we know anything about what  
7 happened at that executive level meeting?

8 No, because they haven't produced any  
9 documentation to us, and they have no  
10 witnesses to talk about what happened at  
11 that executive level meeting.

12 But there is a meeting --

13 PROFESSOR KESSEDJIAN: What's the  
14 date again?

15 MR. ALI: It's 25th October 2012.

16 -- what they have at that executive  
17 level meeting, what we know is that they  
18 have input from the Geographic Names  
19 Panel. And we have a subsequent set of  
20 communications whereby all sorts of  
21 questions are being raised as a result of  
22 this executive level meeting with  
23 reference to DCA's application, but the  
24 same questions aren't being raised with  
25 respect to -- to -- to -- to the AUC's

1 application.

2 Well, what happens a month later?

3 Well, you've seen that on 20th of  
4 November 2012, the AUC, using its  
5 position on the GAC, the special position  
6 that's been given to it on the GAC with  
7 the facilitation of ICANN, it use its  
8 Early Warning notices.

9 Now --

10 HONORABLE JUDGE CAHILL: AUC does?

11 MR. ALI: The AUC --

12 HONORABLE JUDGE CAHILL: Okay.

13 MR. ALI: -- issues its Early  
14 Warning notice --

15 HONORABLE JUDGE CAHILL: Okay.

16 MR. ALI: -- and some other  
17 governments or part of it issue these  
18 Early Warning notices all pretty much in  
19 the same language.

20 -- now, would it be that difficult  
21 to conclude, again, in the absence of  
22 documentation from the other side, that  
23 if ICANN had guided the AUC as to how it  
24 could participate in the process through  
25 the GAC -- and appreciating that the AUC,

1 so far, has not been a participant in the  
2 fairly complicated world of ICANN  
3 governments -- that the AUC might, in  
4 fact, have sought ICANN's help in  
5 crafting the Early Warning advice.

6 Is that so difficult? They  
7 ultimately helped them draft the letter  
8 that they needed to get the approval,  
9 which they shoehorned, bulldozed.

10 HONORABLE JUDGE CAHILL: I think it  
11 was a form that was created by ICANN, but  
12 people just started using it.

13 MR. ALI: The form is there. The  
14 contents -- the contents of the Early  
15 Warning are something that was created.  
16 The contents are -- the form, maybe. The  
17 contents are very much specific to the  
18 DCA application, applicant and judge.  
19 That's one in the same time --

20 HONORABLE JUDGE CAHILL: Okay.

21 MR. ALI: -- that is just wrong.

22 Anyway. So now we have the  
23 executive meeting. A month later, we  
24 have the -- we have these Early Warning  
25 notices, which, as we've seen, do not fit

1 the criteria of Early Warning notice,  
2 but, nonetheless, they are provided.

3 What we'd also like you to  
4 appreciate is that starting in March  
5 of -- starting in July of 2012 and going  
6 through to March or April of 2013, there  
7 is this dialogue that was very  
8 interesting and which Ms. Craven --  
9 Ms. Yates took you through, but we would  
10 invite you to look at the documentation  
11 in some detail, where the GNP is saying,  
12 Let us do our job. Please let us apply  
13 the Applicant Guidebook. Let us do what  
14 we need to do. And ICANN is saying, No.

15 The GNP says, We need to go to the  
16 AU and ask. ICANN says, No. Why? What  
17 is it that is worrying ICANN so much if  
18 the GNP is to contact the AU or UNECA?

19 They even questioned UNECA. No, no,  
20 you don't need to go back to them.

21 One wonders.

22 Redacted - GAC Designated Confidential Information

1

2

Redacted - GAC Designated Confidential Information

25

But, obviously, we don't know --

1           they haven't provided us with the  
2           information that we requested.  And,  
3           obviously, here, again, as we will make  
4           our submissions tomorrow, there is a very  
5           well-established principle in  
6           international procedure of the drawing of  
7           adverse inferences.  And we believe that  
8           the absence of testimonial evidence or  
9           documentary evidence on the part of ICANN  
10          with respect to these points, adverse  
11          inferences are entirely appropriate.

12                 So I'm also troubled by the fact  
13          that within the context of what were  
14          clearly two red flag applications, two  
15          applications that were -- that were  
16          consuming a lot of resources of the GNP,  
17          as the documentation says, and two  
18          applications that clearly were the  
19          subject of significant internal  
20          discussion, the NGPC simply accepts the  
21          GAC advice.

22                 Perhaps the right course for the  
23          NGPC would have been to let an  
24          independent third-party decision-maker  
25          decide whether or not the criteria

1 satisfied -- they clearly didn't want to  
2 let the GNP, the Geographic Names Panel,  
3 do that.

4 They could have asked -- they could  
5 have retained an independent expert if  
6 they didn't think the GNP was qualified,  
7 for some reason, to do this. But they  
8 didn't do that.

9 They might even have dug in further  
10 themselves, but there's no evidence that  
11 they did that.

12 They summarily accepted the GAC  
13 advice, and they summarily rejected all  
14 the points that were made by DCA Trust as  
15 to why the GAC advice should not have  
16 been accepted.

17 At the end of the day, what ends up  
18 happening following the -- the GAC advice  
19 and the reconsideration requests and what  
20 have you -- by the way, just going back  
21 to this point of deference, we'd like you  
22 to take a look at one of our slides  
23 whereby -- which shows you what happens  
24 within the ICANN process.

25 GAC advice, it's accepted by the



1 NGPC. The NGPC, you then have a request  
2 for reconsideration to the Board  
3 Governance Committee. The Board  
4 Governance Committee accepts what the  
5 NGPC has -- has decided, and it goes back  
6 to the NGPC from the Board so that the  
7 NGPC can accept the recommendation of the  
8 BGC with respect to its original  
9 decision.

10 It seems somewhat incestuous,  
11 particularly when you compare who the  
12 individuals are that are on the NGPC and  
13 the BGC.

14 I implore you, within a system of  
15 control in governance that is reflected  
16 up on the screen, the review cannot be  
17 deferential, particularly in a forum  
18 which is the only forum that is  
19 independent and impartial that an  
20 applicant has to protect its rights. It  
21 cannot be deferential.

22 Anyway. So the last question I'd  
23 leave you with is the following: What is  
24 it that justifies the complete about-face  
25 that takes place in June of 2013

1 following the so-called consensus GAC  
2 advice that warrants the application of  
3 criteria that, only 12 months earlier,  
4 ICANN has said, This does not satisfy the  
5 requirement of the Applicant Guidebook?

6 If you look at what they say in June  
7 of 2012 and you track through the  
8 correspondence that took place with the  
9 Geographic Names Panel and you arrive at  
10 June 7th, 2013, when ICANN Staff, at the  
11 direction of the Board, tells the GNP,  
12 You can stop work, and the GNP, of  
13 course, finally folds its arms and says,  
14 Well, what are we to do? We tried  
15 everything. We tried to be independent.  
16 We tried to apply the Applicant  
17 Guidebook. We tried to give you our  
18 objections. We told you what would be  
19 fair and equitable. We told you what  
20 would be transparent. We told you a lot  
21 of things.

22 And at the end of the day, they fold  
23 their arms and say, Okay, we're doing  
24 what you want us to do. We're going to  
25 approve this letter that you, ICANN,

1           drafted for the AUC.

2                   And there is language in these  
3 e-mails where Mark McFadden throws up his  
4 arms and says, Well, if Sophia wants to  
5 go to an IRP, good luck to her.

6                   And that's why we're here.

7                   We think that the documentation is  
8 clear. We think the evidence supports  
9 every one of the points that we have  
10 made. We think that it speaks for  
11 itself.

12                   It is clear to us that from the very  
13 get-go, ICANN wanted to help the AUC to  
14 achieve an outcome that they couldn't  
15 otherwise, using a process that was not  
16 designed to give the AUC what it was --  
17 what it wanted.

18                   So AUC wanted to use one process.  
19 ICANN says, You can't use that process.  
20 The AUC is put into another process.  
21 ICANN, hand in glove with the AUC, ensure  
22 that DCA doesn't have a fair shot.

23                   This, we submit, based on the  
24 evidence, is an absolute violation of  
25 ICANN's Articles, Bylaws and the

1 Applicant Guidebook.

2 I'm happy to answer any questions.

3 We've presented a lot to you. We do  
4 hope you look at the documentation as you  
5 think about tomorrow. But I can answer  
6 questions now or answer them tomorrow in  
7 the course of our closing.

8 HONORABLE JUDGE CAHILL: You didn't  
9 mention anything about the conflict --  
10 the alleged conflict of the Board members  
11 of ICANN.

12 Is that something that's not  
13 important now?

14 MR. ALI: Well, we believe it is  
15 important, Judge Cahill. Within the  
16 context of the time we had, which I know  
17 we've exceeded already, we had to make  
18 certain choices of what we thought was  
19 going to be the most significant.

20 But that's not to say that we don't  
21 think -- again, if one looks at -- passes  
22 through all the individuals who are  
23 involved, when you look at the AUC  
24 players who were involved and the players  
25 who were involved with ZACR, clearly,

1 conflicts of interest.

2 When you look at who is on the NGPC  
3 and the Board Governance Committee,  
4 clearly a conflict.

5 If you look at the fact that one of  
6 the individuals who had conflict of  
7 interest -- who's charged with having a  
8 conflict of interest is actually the  
9 person who, at the NGPC meeting, is the  
10 individual who directs the discussion  
11 associated with .africa or DCA's  
12 application, and that individual has  
13 financial or business or advisory  
14 interests in support of another  
15 applicant, more reason that just doesn't  
16 seem right to me.

17 A prudent person within the context  
18 of such highly politicized -- or such a  
19 highly politicized debate with two  
20 applicants, who are so legitimate in  
21 their rights within the forum in which  
22 they're playing, prudence would counsel  
23 that you recuse yourself. That didn't  
24 happen.

25 So we hate that -- again, there's so

1 many different ways you can find in our  
2 favor --

3 HONORABLE JUDGE CAHILL: One other  
4 thing -- I hate to take all this time,  
5 but are there 16 voting members on the  
6 ICANN Board, and two of these are the  
7 ones that you're -- that you're concerned  
8 about?

9 MR. ALI: I believe so.

10 Is that correct?

11 (Off-the-record conference with  
12 colleagues.)

13 MR. ALI: Yes.

14 HONORABLE JUDGE CAHILL: Okay.

15 Thanks.

16 PRESIDENT BARIN: Any questions?

17 PROFESSOR KESSEDJIAN: No.

18 HONORABLE JUDGE CAHILL: Sorry.

19 PRESIDENT BARIN: That's all right.

20 HONORABLE JUDGE CAHILL: I'm very  
21 curious.

22 PRESIDENT BARIN: Thank you.

23 MR. ALI: Thank you.

24 PRESIDENT BARIN: You have,  
25 according to my -- we'll give you the

1 same amount of time, Mr. LeVee.

2 MR. LEVEE: I won't need as much.

3 So what I would suggest is we take a  
4 five-minute break. That way we can swap  
5 out the laptop, whichever is operating  
6 the monitors. And when we come back,  
7 I'll get going.

8 PRESIDENT BARIN: I just have a  
9 question for you in terms of the  
10 witnesses that you have.

11 MR. LEVEE: Yes.

12 PRESIDENT BARIN: We had understood  
13 that there was some time constraint in  
14 terms of their availability. If that's  
15 no longer an issue, then --

16 MR. LEVEE: We had asked for  
17 Mr. Chalaby to testify first, because he  
18 does need to leave earlier. But he'll  
19 have ample time after lunch to do his  
20 testimony.

21 PRESIDENT BARIN: Okay. Could we  
22 have an idea of when he needs to leave?

23 MR. LEVEE: Let me consult with him,  
24 and I will let you know.

25 You had estimated 90 minutes. And

1 even if it goes two hours -- which,  
2 candidly, particularly since the Claimant  
3 didn't even raise the issue in the  
4 opening, Mr. Chalaby will answer your  
5 questions -- I'd be stunned if we even  
6 took the 90 minutes --

7 PROFESSOR KESSEDJIAN: Don't bet on  
8 anything.

9 MR. LEVEE: Yes, a good point.

10 But in any case, he will not have a  
11 difficulty. His schedule was a little  
12 bit more complicated than Ms. Dryden's.  
13 That's why we asked Ms. Dryden to go  
14 second.

15 Please don't be concerned. He'll be  
16 here as long as you need him.

17 PRESIDENT BARIN: That's fine.  
18 Thank you.

19 MR. LEVEE: Why don't we adjourn for  
20 a -- why don't we take 10 minutes?

21 HONORABLE JUDGE CAHILL: Fifteen.

22 MR. LEVEE: Going once.

23 MR. ALI: Thank you.

24 - - -

25 (Whereupon, a brief recess was taken



1 from 10:46 a.m. to 11:02 a.m.)

2 - - -

3 - - -

4 OPENING STATEMENT ON BEHALF OF RESPONDENT  
5 INTERNET CORPORATION FOR ASSIGNED NAMES AND NUMBERS

6 - - -

7 MR. LEVEE: Members of the Panel,  
8 thank you this morning. And on behalf of  
9 ICANN, let me share in the welcome  
10 officially this morning to these  
11 Independent Review Proceedings.

12 We're very much looking forward to  
13 today and tomorrow and pleased that we  
14 have reached the merits of this claim  
15 after what has definitely been a longer  
16 road than I think most of us would have  
17 anticipated.

18 Before I begin, let me pause very  
19 briefly to discuss ICANN's participation  
20 in today's hearing.

21 As you know, ICANN argued to the  
22 three of you that the Bylaws prohibit  
23 live testimony during the final argument  
24 in an IRP hearing. This Panel ruled  
25 otherwise. And so ICANN has brought its

1 two Declarants here today so that they  
2 may answer questions from the Panel and  
3 from the parties.

4 Most importantly, ICANN never wanted  
5 to leave the impression that we were  
6 concerned that our witnesses would not  
7 back up their statements in spades, as  
8 they will do this afternoon.

9 So we are confident that at the  
10 close of this proceeding, the Panel will  
11 determine that ICANN's Board acted fully  
12 consistent with its Bylaws, its Articles  
13 and the Applicant Guidebook in  
14 conjunction with DCA's application for  
15 .africa.

16 Let me turn now to the merits.

17 ICANN was incorporated in 1998 as a  
18 not-for-profit benefit -- public benefit  
19 corporation in California. Its focus on  
20 the -- in the early years was on  
21 literally achieving legitimacy and in  
22 taking some small steps to creating  
23 competition within the domain name  
24 system.

25 In terms of competition, the first

1           thing that ICANN did was to increase the  
2           number of Internet registrars. These are  
3           the companies that actually sell domain  
4           names subscriptions to you and me. And  
5           ICANN was incredibly successful in this  
6           regard, accrediting over -- literally  
7           over hundreds of new registrars in the  
8           course of just a few years.

9           The introduction of that competition  
10          caused the price of domain name  
11          registrations to plummet from \$35 for a  
12          name for a year back in 1998 to \$10 or  
13          even less -- sometimes you can get a name  
14          now for free -- saving consumers  
15          literally hundreds of millions of  
16          dollars.

17          ICANN decided to proceed much more  
18          slowly with respect to top-level  
19          domains -- new top-level domains, such as  
20          the program that brings us here today,  
21          because of concerns that new TLDs could  
22          affect the security or the stability of  
23          the Internet.

24          And so ICANN approved seven new TLDs  
25          in the year 2000, including .info and

1 .name, TLDs that are not all that widely  
2 used, candidly, and then a few more in  
3 the year 2004. But these were basically  
4 test cases to make sure that a broader  
5 expansion would not cause any problems.

6 Now, ICANN has a number of  
7 supporting organizations that develop  
8 policy for ICANN. One of them is known  
9 as the Generic Names Supporting  
10 Organization, or GNSO. And the GNSO is  
11 responsible for formulating policy for  
12 the expansion of the name space, the  
13 registry space.

14 In 2007, after years of study and  
15 public comment, the GNSO recommended that  
16 ICANN permit a substantial expansion in  
17 the number of TLDs, so long as there were  
18 carefully crafted rules that accompanied  
19 that expansion.

20 And in 2011, ICANN's Board approved  
21 what we refer to as the "New gTLD  
22 Program" and that, pursuant to which,  
23 ICANN agreed to accept an unlimited  
24 number of applications.

25 Now, concurrently, beginning in

1           2008, ICANN was developing what you've  
2           heard referred to frequently as the  
3           "Guidebook," or the "New gTLD Application  
4           Guidebook." And several drafts of the  
5           Guidebook were published for public  
6           comment, and ICANN received thousands and  
7           thousands of comments.

8           The Guidebook was crafted consistent  
9           with ICANN's Bylaws, and I want to point  
10          out that DotConnectAfrica has never  
11          alleged otherwise.

12          Ultimately, ICANN announced that it  
13          would accept applications for new gTLDs  
14          beginning in January of 2012.

15          Now, I know that you have seen the  
16          Guidebook in an electronic form, but I  
17          don't know if you've actually seen it  
18          printed out. Maybe you have. Maybe  
19          you've printed it yourself --

20                 HONORABLE JUDGE CAHILL: No.

21                 PROFESSOR KESSEDJIAN: Yes.

22                 MR. LEVEE: It's a big thing. I  
23          brought it today just to give you a  
24          sense --

25                 PROFESSOR KESSEDJIAN: And the

1 language is terrible, Mr. LeVee.

2 MR. LEVEE: Yes, it is.

3 I carry it with me. I have it on  
4 every laptop I've ever used, and download  
5 it on every computer. And it is thick.

6 But it is the result of literally  
7 tens of thousands of hours not only of  
8 ICANN, but of members of the community.  
9 And we heard this morning Ms. Bekele was  
10 involved in some fashion in the drafting.  
11 I don't know that, but I don't question  
12 it.

13 Many, many hundreds of people were  
14 involved, and it became, literally, the  
15 Bible of the New gTLD Program. And in  
16 it, ICANN tried to anticipate as many  
17 scenarios as possible.

18 The Guidebook is divided into six  
19 modules, as you probably notice,  
20 addressing the application process, how  
21 the applications would be evaluated from  
22 various perspectives, technical,  
23 financial and otherwise, methods of  
24 objecting to applications and a number of  
25 other features.

1           Now, various industry insiders  
2 predicted that ICANN would receive maybe  
3 a few hundred, maybe even several hundred  
4 applications for new gTLDs. I can tell  
5 you confidently that no one I know  
6 predicted that ICANN would receive 1,930  
7 applications, which was, in fact, the  
8 final tally.

9           Those applications involved  
10 approximately 1,400 separate gTLD  
11 strings. And as of May 1, the most  
12 recent date I could capture, over 900 new  
13 gTLD registry agreements had been signed,  
14 and most of those gTLDs are now live on  
15 the Internet.

16           So you can go get an .xyz domain or  
17 a dot -- you know,  
18 you-can-pick-your-name-practically  
19 domain, to the extent they are not closed  
20 or that you're not a member of the  
21 community that they represent.

22           So I wanted to be clear, ICANN has  
23 already achieved the goal of increasing  
24 competition.

25           We heard a little bit in the opening

1 statement about anticompetitive conduct.  
2 I don't know that the core values refer  
3 to anticompetitive conduct within a  
4 particular gTLD string.

5 The mission of ICANN was to increase  
6 competition in the registry space. And  
7 it has undoubtedly accomplished that.

8 Now, ICANN anticipated that certain  
9 types of gTLD applications would require  
10 special treatment for various sorts of  
11 reasons. I'll give you two examples.

12 ICANN anticipated that it would  
13 receive applications for strings that, in  
14 some fashion, related to trademarked  
15 names. The trademark community was very  
16 concerned about that, so ICANN  
17 established a number of features in the  
18 Guidebook to allow persons and entities  
19 all over the world to attempt to protect  
20 their intellectual property, including a  
21 trademark clearinghouse.

22 Similarly, ICANN anticipated that  
23 certain types of communities that are not  
24 geographic communities but, instead,  
25 communities of persons who might want to



1 operate gTLD strings would come together.  
2 So ICANN has already approved two  
3 communities off the top of my head. One  
4 is .radio and one is .osaka for citizens  
5 in Japan.

6 And ICANN created a process whereby  
7 an applicant could seek community  
8 treatment for its application, and a  
9 third-party vendor would evaluate whether  
10 that applicant should, in fact, be  
11 permitted to operate a string on  
12 behalf -- for the benefit of that  
13 community.

14 Obviously, we have a specific  
15 feature that's relevant here, which is  
16 that the Guidebook contemplated that  
17 applicants might apply for strings that  
18 represented the specific geographic -- a  
19 specific geographic community, such as  
20 the name of a continent. And the  
21 Guidebook contains a number of provisions  
22 addressing those strings, all located in  
23 Module 2.

24 The most important of those  
25 provisions for this proceeding is

1 Section 2.2.1.4.2 -- sorry that it's so  
2 long -- and that section, in and of  
3 itself, covers several pages.

4 So what I've put in the slide is the  
5 portion that I wanted to focus your  
6 attention to.

7 It says, In the case of an  
8 application for a string appearing on  
9 either of the lists above -- and that  
10 includes .africa -- documentation of  
11 support will be required from at least  
12 60 percent of the respective national  
13 governments in the region -- and then  
14 this is also important, and no one's  
15 really focused on this in the briefs --  
16 there may be no more than one written  
17 statement of objection to the application  
18 from relevant governments in the region  
19 and/or public authorities associated with  
20 the continent or the region.

21 Importantly, the applicant was  
22 supposed to demonstrate that requisite  
23 support in the application itself. And  
24 we'll talk about that in a minute.

25 Now, there was great logic in

1           adopting this provision. If an entity  
2           was going to operate a gTLD string not  
3           only for the benefit of a particular  
4           community, but it actually took the name  
5           of that community, it obviously was  
6           critically important that the applicant  
7           have support from the community.

8           So ICANN decided that the support  
9           would have to be measured as 60 percent  
10          of the countries in that region in order  
11          to use the name of that region as the  
12          string.

13          Now, let me pause to note what the  
14          Guidebook does not address. The  
15          Guidebook does not say that governments  
16          or other governmental authorities in a  
17          particular region cannot organize to  
18          apply for a TLD using that region's name.

19          Quite to the contrary, the Guidebook  
20          permits any entity or any government to  
21          apply to operate a gTLD string that uses  
22          the name of a specific region of the  
23          world or to select a company to operate  
24          that string on its behalf.

25          So it is very important to

1 understand that the Guidebook did not  
2 prevent the countries of Africa, much  
3 less the AUC, from determining that they  
4 wanted to operate a TLD and that they  
5 wanted to select a particular registry to  
6 do so.

7 The Guidebook encourages this  
8 result, because such an application would  
9 demonstrate that the countries of the  
10 region truly support the applicant. And  
11 that would be in the public interest.

12 This is critically important  
13 throughout this whole proceeding, because  
14 one of the primary objections that DCA  
15 has asserted to the entire process dating  
16 back to 2012 is that the very decision by  
17 the African Union Commission to select  
18 ZACR and to sponsor ZACR's application  
19 for .africa not only was inappropriate,  
20 but should have disqualified the AUC from  
21 being part of the process at all.

22 Indeed -- and we'll look at a  
23 document in a moment -- DCA asked  
24 ICANN -- or argued that the AUC's role in  
25 conjunction with ZACR's application

1           should have caused ICANN to eliminate the  
2           requirement in the Guidebook that an  
3           applicant have the support of 60 percent  
4           of the governments in the region. But  
5           DCA's contentions were exactly the  
6           opposite of what ICANN had developed in  
7           the Guidebook.

8                     ICANN welcomed the support of  
9           governments and governmental  
10          organizations because the Guidebook  
11          required that support.

12                    HONORABLE JUDGE CAHILL: One of the  
13          issues is there's no definition of  
14          African community.

15                    MR. LEVEE: And we'll come to that,  
16          definitely.

17                    HONORABLE JUDGE CAHILL: All right.

18                    MR. LEVEE: Now, it's also important  
19          to note that the Guidebook did not  
20          restrict the ability of a country to  
21          support more than one application. It  
22          certainly could have happened that two  
23          competing applications each had the  
24          support of the nations in that region.  
25          It's not what happened here, but it could

1 have happened.

2 And, finally, the Guidebook  
3 specifically permitted -- I've quoted in  
4 the slide -- specifically permitted a  
5 government to endorse an applicant and  
6 then change its mind and either support  
7 no applicant or support a different  
8 applicant. And that is what happened  
9 here.

10 DCA --

11 HONORABLE JUDGE CAHILL: What does  
12 "nonobjection" mean in this?

13 MR. LEVEE: What does?

14 HONORABLE JUDGE CAHILL: You can  
15 change your mind if the operator's  
16 deviated from conditions or nonobjection.

17 What does that mean? The last word.

18 Never mind. It's not that  
19 important.

20 MR. LEVEE: Nonobjection might  
21 simply be a statement that they don't  
22 object, as opposed to a statement that  
23 they specifically endorse. That's how I  
24 interpret it.

25 HONORABLE JUDGE CAHILL: Okay. Your

1 point is you can change your mind?

2 MR. LEVEE: Correct.

3 HONORABLE JUDGE CAHILL: Okay.

4 MR. LEVEE: Now, the Panel has also,  
5 obviously, heard a lot about the GAC.  
6 And I won't give all of the background,  
7 but the Governmental Advisory Committee  
8 is the committee where governments across  
9 the world are permitted and able to  
10 participate in the ICANN process. And  
11 both the Guidebook and the Bylaws address  
12 the GAC's participation in some detail.

13 So starting with the Guidebook,  
14 Section 3.1 of the Guidebook permits GAC  
15 members to raise concerns about any  
16 application to the GAC. And the GAC, as  
17 a whole, would consider concerns raised  
18 by GAC members and agree on GAC advice to  
19 forward to the ICANN Board of Directors.

20 Mr. Ali put up a slide showing the  
21 various types of advice, but there's only  
22 one type that is at issue here, which is  
23 the first, that the GAC advises ICANN  
24 that it is the consensus of the GAC that  
25 a particular application should not

1 proceed.

2 And this next sentence is very  
3 important, not mentioned in the opening  
4 of the DCA: This will create a strong  
5 presumption for the ICANN Board that the  
6 application should not be approved.

7 In addition, Guidebook Section 3.1  
8 says, ICANN will consider the GAC advice  
9 on new gTLDs as soon as practicable. The  
10 Board may -- and I've highlighted "may,"  
11 and we'll come back to that in a  
12 minute -- consult with independent  
13 experts, such as those designated to hear  
14 objections, in cases where the issues  
15 raised in the GAC advice are pertinent to  
16 one of the subject matter areas of the  
17 objection procedures.

18 Now, all of this work in the  
19 Guidebook relating to the GAC is actually  
20 derived from -- directly out of the  
21 Bylaws. What I've quoted here on Slide 8  
22 is Article XI, Section 2, Paragraph 1(j),  
23 which says, The advice of the  
24 Governmental Advisory Committee on public  
25 policy matters shall be duly taken into



1 account, both in the formulation and  
2 adoption of policies.

3 And the rest of the quote goes on to  
4 say what happens if the Board decides not  
5 to act consistent with the GAC advice,  
6 although that's not what happened here.

7 So I wanted to provide my own view  
8 of the background in mind, so let me turn  
9 now to DCA's claims.

10 Let me emphasize that the entire  
11 focus of my presentation today and the  
12 entire focus of my closing tomorrow will  
13 be to explain to you that ICANN's conduct  
14 and the conduct in particular of the  
15 ICANN Board was entirely consistent with  
16 the Articles and the Bylaws.

17 We'll discuss during closing  
18 tomorrow exactly what the Panel's mandate  
19 is. And I will respond tomorrow to this  
20 issue of the standard of review. But I  
21 think it's important to remember,  
22 irrespective of the standard of review,  
23 is that the purpose, and only purpose, of  
24 an independent review proceeding is to  
25 test whether the conduct of the Board was

1 consistent with the Articles and the  
2 Bylaws. We believe it was.

3 And I'll put all sorts of slides up  
4 tomorrow talking about the mandate of the  
5 Panel. And I will also, tomorrow, put  
6 before you each and every one of DCA's  
7 allegations from both of its briefs as to  
8 how DCA alleges that the Board violated  
9 its Articles and Bylaws. And we'll go  
10 through those one by one, and I'll  
11 explain how the evidence is to the  
12 contrary.

13 I thought I would focus my opening  
14 actually on the facts --

15 PROFESSOR KESSEDJIAN: Can I  
16 interrupt you?

17 MR. LEVEE: Of course.

18 PROFESSOR KESSEDJIAN: Could you  
19 explain to the Panel what is exactly the  
20 role of ICANN? And if we -- if we  
21 take -- I think it was alluded to in the  
22 opening of -- of DCA, if we take the  
23 example of the UN, let's imagine that  
24 ICANN is for the Internet what the UN is  
25 for peace and security, just for the sake

1 of discussion.

2 MR. LEVEE: Fine.

3 PROFESSOR KESSEDJIAN: Is ICANN the  
4 general assembly, the security council or  
5 the Secretary General of the UN?

6 MR. LEVEE: ICANN is none of those.  
7 And, actually, the parallel to the  
8 United Nations is not apt in ICANN's  
9 mind. And let me flesh that out.

10 Mr. Ali referred to ICANN as a  
11 "regulator." Regulators actually have  
12 specific authority granted to them. A  
13 government or people can get together and  
14 designate people as a regulator.

15 ICANN is not a regulator. It  
16 doesn't have laws. It doesn't even have  
17 rules. It has Bylaws --

18 PROFESSOR KESSEDJIAN: It does have  
19 a Bible.

20 MR. LEVEE: It does have a Bible,  
21 but ICANN is based -- I view ICANN as an  
22 administrator. Its relationships are  
23 governed by contract.

24 This, interestingly enough, is  
25 simply a contract. The applicant

1 promises to pay money and to conduct  
2 itself in a certain way and to submit  
3 certain materials. And in response,  
4 ICANN promises to evaluate the  
5 application pursuant to the Bible and  
6 then to give an answer. ICANN has  
7 reserved rights; the applicant has  
8 reserved rights.

9 The way that ICANN is structured is  
10 very much different from the United  
11 Nations. ICANN is what they like to  
12 refer to as a "bottoms-up organization."  
13 The genesis of policy that ICANN  
14 ultimately adopts is supposed to bubble  
15 up from all of its supporting  
16 organizations.

17 We have the GNSO, which we already  
18 referred to; there's the address  
19 supporting organization; there are  
20 various other supporting organizations  
21 that deal with the names and the numbers,  
22 and they formulate policy.

23 The policy then gurgles up, and  
24 ICANN has a staff. It has a general  
25 counsel's office, it has people who are

1 involved in processing the applications.  
2 Even before the GNSO program -- or the  
3 gTLD program, ICANN had people who  
4 contracted with the registrars that I  
5 referred to before, people who  
6 investigated when the registrars might  
7 not be compliant with their contracts.  
8 ICANN has -- and then, of course, ICANN  
9 has the Governmental Advisory Committee,  
10 which are representatives of government  
11 that meet separately with the GAC.

12 ICANN does not control the GAC.

13 Ms. Dryden, who you will hear from  
14 later this afternoon, was eager to  
15 clarify a lot of the statements that you  
16 heard in the opening about what the GAC  
17 actually does and the nature of their  
18 meetings and so forth. You'll hear from  
19 her and have a chance to evaluate her  
20 testimony.

21 But ICANN is different than any  
22 other organization I'm aware of, and  
23 it -- it specifically did not want to  
24 organize akin to the United Nations. It  
25 certainly did not want to be controlled

1 by governments.

2 So that's why ICANN's relationship  
3 with the Governmental Advisory  
4 Committee --

5 PROFESSOR KESSEDJIAN: That is  
6 clear.

7 MR. LEVEE: -- is a little bit of a  
8 give-and-take relationship.

9 Have I helped?

10 PROFESSOR KESSEDJIAN: Not  
11 entirely, but if -- we'll come back  
12 tomorrow. But I think it's important  
13 that we do understand, because there is a  
14 claim, if I understand correctly, from  
15 the DCA that ICANN should have remained  
16 neutral.

17 So in order to assess that argument,  
18 I, for one -- we have not discussed that  
19 in the Panel, but I, for one, need to  
20 understand what is -- where does that  
21 claim of neutrality come and, you know,  
22 how it plays out in the ICANN's  
23 responsibilities, if you will.

24 MR. LEVEE: I think Mr. Ali would  
25 tell you that the Bylaws require ICANN to

1 be procedurally open, to be transparent.  
2 And perhaps he is reading into the Bylaws  
3 the claim of neutrality.

4 As I develop the facts, I'm going to  
5 try to make it pretty clear that ICANN  
6 was neutral in this matter consistent  
7 with the Guidebook. ICANN had no  
8 obligation to ignore the provisions of  
9 the Guidebook as applied to what happened  
10 here.

11 PROFESSOR KESSEDJIAN: So you don't  
12 contest that ICANN must be neutral  
13 according to the Guidebook?

14 MR. LEVEE: I think that -- to  
15 answer the question, I think that ICANN  
16 tries to be neutral. I don't know that  
17 ICANN has some legal obligation to be  
18 neutral.

19 HONORABLE JUDGE CAHILL: Her analogy  
20 with the United Nations -- my colleague's  
21 analogy, Secretary Generals, I'm not as  
22 familiar as she is with it, but everybody  
23 is supposed to treat everybody the same  
24 way --

25 MR. LEVEE: Yes.

1 HONORABLE JUDGE CAHILL: -- now,  
2 you're telling me ICANN -- and maybe you  
3 are -- that the Bylaws do not require  
4 ICANN to treat all applicants the same  
5 way?

6 MR. LEVEE: I'm telling you that  
7 ICANN did do everything it could to treat  
8 applicants fairly and neutrally in the  
9 same way, however --

10 HONORABLE JUDGE CAHILL: That wasn't  
11 my question.

12 MR. LEVEE: Okay. You're using the  
13 word "neutral." The only problem I have  
14 with the word is that the Guidebook  
15 creates procedures that might alter the  
16 neutrality.

17 So, for example, if an applicant has  
18 support of the representatives of a  
19 continent for a particular name and  
20 another applicant does not have support,  
21 ICANN isn't going to treat those the  
22 same. ICANN is going to --

23 HONORABLE JUDGE CAHILL: That's  
24 fine. Yeah.

25 MR. LEVEE: Okay. But in terms of



1 proceeding on a day-to-day basis,  
2 absolutely, ICANN does everything it can  
3 to be neutral.

4 PRESIDENT BARIN: Just one follow-up  
5 from me.

6 MR. LEVEE: Sure.

7 PRESIDENT BARIN: I would admit that  
8 it is perhaps a loaded question.

9 If ICANN is an administrator, as  
10 you're saying it is, who does ICANN  
11 answer to?

12 MR. LEVEE: Well, it's a complicated  
13 question.

14 As of this moment, on certain  
15 matters relating to what is referred to  
16 as the IANA function, which involves  
17 certain types of registrations, the  
18 United States Government has a  
19 supervisory role vis-a-vis ICANN.

20 There is, literally as we speak, a  
21 proposal from the Obama administration to  
22 have the U.S. Government relinquish that  
23 role, and it has become politicized  
24 within the United States and elsewhere.

25 I don't know what the outcome will

1 be. It's not relevant here, but -- so,  
2 in some senses, ICANN has a relationship  
3 with the United States Government.

4 Otherwise, ICANN's obligation is to the  
5 members of the Internet community, and  
6 its Board is selected from among those  
7 members.

8 PRESIDENT BARIN: If you were to  
9 assume for a moment that -- on a  
10 contractual basis, from a political  
11 perspective, that's fine, but from a  
12 contractual perspective, if, in fact, the  
13 relationship of ICANN is with its  
14 constituents, as you've said, on a  
15 contractual basis --

16 MR. LEVEE: Yes.

17 PRESIDENT BARIN: -- if there is an  
18 issue with ICANN, then who addresses that  
19 issue? In other words, who is ICANN  
20 answering to when an issue comes up?

21 MR. LEVEE: It really depends on the  
22 nature of the issue.

23 PRESIDENT BARIN: Well, the courts  
24 are, I guess, from what I understood, no  
25 longer there, because the applicants are

1           asked to waive that right.

2                     If that's the case, then where do  
3           constituents go to?

4                     MR. LEVEE:  So if you are an  
5           applicant, you have signed the  
6           Applicant Guidebook and, yes, you have  
7           waived your right to sue ICANN.  And you  
8           have agreed that your redress is through  
9           the ICANN accountability measures, which  
10          include reconsideration and independent  
11          review.

12                    So, thus, we are here --

13                    PRESIDENT BARIN:  So here.

14                    MR. LEVEE:  -- if you are not an  
15          applicant, you have not signed away your  
16          right to sue ICANN.  And I -- I can tell  
17          you that I represented ICANN in many U.S.  
18          Court proceedings.

19                    So ICANN is subject to suit on  
20          many -- in many areas, and it just  
21          depends who you are.

22                    If you are a member of the ICANN  
23          community and you have an issue, you can  
24          submit a public comment; you can send  
25          letters; you can attend meetings.  There

1 are multiple ways of being involved in  
2 the ICANN process.

3 For those who are actively involved,  
4 it is extraordinarily time-consuming.  
5 The Board's meetings, which are three  
6 times a year, take place over a two-week  
7 period. It's not just a day. They  
8 literally -- the meetings, themselves,  
9 last two weeks.

10 So there's a number of different  
11 opportunities for people to be heard.

12 If you're asking about the actual  
13 ability to initiate a legal process, if  
14 you're an applicant, you can't sue; but  
15 if you're not an applicant, you can.

16 If you are a registry or a  
17 registrar, you have signed a contract  
18 that provides for an arbitration clause.

19 So it really depends on the nature  
20 of your participation.

21 Is that helpful?

22 PRESIDENT BARIN: Yeah.

23 MR. LEVEE: Okay.

24 HONORABLE JUDGE CAHILL: I mean -- I  
25 forgot what I really wanted to ask here.

1           Other than on the merits, right,  
2           because the example you gave me is maybe  
3           one application doesn't meet the  
4           60 percent or something like that --

5           MR. LEVEE: Yeah.

6           HONORABLE JUDGE CAHILL: -- other  
7           than on the merits, is ICANN's  
8           responsibility to start off treating  
9           everyone the same in a neutral way?

10          MR. LEVEE: Yes, yes.

11          HONORABLE JUDGE CAHILL: Then it  
12          looks at each application on its merits?

13          MR. LEVEE: Correct.

14          HONORABLE JUDGE CAHILL: So what --  
15          okay. All right.

16          MR. LEVEE: Yeah. If I didn't  
17          clarify that previously, I apologize.

18          HONORABLE JUDGE CAHILL: No. No.  
19          Maybe I just didn't hear you right --

20          MR. LEVEE: Yeah.

21          HONORABLE JUDGE CAHILL: -- but it  
22          starts off equal, and then, in the whole  
23          process, it treats everybody equally  
24          until sometime on the merits, one of the  
25          applications becomes better or worse than

1 the other?

2 MR. LEVEE: Pursuant to the terms of  
3 the Guidebook --

4 HONORABLE JUDGE CAHILL: Thank you.

5 MR. LEVEE: -- yes.

6 Okay. Now, what I have done to  
7 address DCA's claims is to lay out what I  
8 believe are the five fundamental  
9 assumptions that DCA has made. And when  
10 you look at each of those assumptions and  
11 conclude that they are wrong factually,  
12 which I will demonstrate, then you can  
13 conclude that all of DCA's claims fail.

14 So the first assumption we've  
15 already addressed a bit. That is that  
16 the AUC's involvement in an application  
17 for .africa should have either  
18 disqualified that application or at least  
19 caused ICANN to eliminate the Guidebook  
20 requirement that each application for a  
21 geographic name have the support of  
22 60 percent of the countries in that  
23 region.

24 And one of the things I wanted to  
25 point out -- these are based on the

1 exact -- on the specific exhibits. So in  
2 your binders, I gave you the slides that  
3 I'm using. And behind those slides are  
4 the actual exhibits that are referenced  
5 in the slides.

6 And so, for example, if you look at  
7 Exhibit C-35, this is the response by DCA  
8 to the Early Warning advice -- by the  
9 way, that advice was issued by 17  
10 different organizations or countries.  
11 The AUC issued one, but 16 other  
12 countries issued that advice.

13 And if you look at -- I highlighted  
14 on Page 5 -- DCA's position is that the  
15 endorsement issue should no longer be  
16 considered as relevant in the evaluation  
17 of the .africa gTLD as a geographic  
18 string. We urge the ICANN Board to waive  
19 this requirement because of the confusing  
20 role that was played by the  
21 African Union.

22 She goes on, It's created huge  
23 problems of legitimacy. And it  
24 concludes, It is our view that the final  
25 decision by ICANN regarding the

1           delegation of the .africa string should  
2           now only be based on the evaluated  
3           technical, operational and financial  
4           criteria, and not on the issue of  
5           endorsement, which has been entirely  
6           politicized.

7           The point here is that DCA has been  
8           arguing throughout that the Guidebook  
9           should be changed for its benefit, not  
10          enforced for the benefit of all. They  
11          were the ones that wanted to be treated  
12          differently.

13          In addition, we heard this  
14          morning -- well, actually, why don't we  
15          do it this way: Again, nothing in the  
16          Guidebook prohibited the AUC, or country  
17          or any group of countries) from applying  
18          for, or sponsoring, a gTLD application  
19          for .africa.

20          The AUC's role was not improper and  
21          certainly was not a basis for ICANN to  
22          eliminate the Guidebook requirement.

23          Inasmuch as no applicant could  
24          prevail without the 60 percent approval,  
25          the AUC's support for an application was



1 extremely valuable (as DCA knew) because  
2 AUC was representative of the entire  
3 continent of the Africa.

4 Also, I mentioned this before --

5 PROFESSOR KESSEDJIAN: Could you  
6 tell us and point out for us to any other  
7 example where an applicant or somebody  
8 interest -- directly interested in  
9 becoming an applicant, directly or  
10 indirectly, is, at the same time, part of  
11 the body, part of the -- of the  
12 institution that is going to advise the  
13 Board? Because that's the position of  
14 the AUC.

15 MR. LEVEE: Yes.

16 So I can give you an example --

17 ARBITRATOR KESSEDJIAN: Another one?

18 MR. LEVEE: -- the facts are very  
19 different because it relates to the only  
20 other intergovernmental authority that  
21 Mr. Ali references, which is the .ec.  
22 And there is a .eu. It's -- it was done  
23 outside of the Applicant Guidebook --

24 PROFESSOR KESSEDJIAN: Yeah, that  
25 has nothing to do --

1           MR. LEVEE:  -- it was done earlier.  
2           But they -- they were the sponsoring  
3           authority --

4           PROFESSOR KESSEDJIAN:  No, no.  In  
5           the current --

6           MR. LEVEE:  -- under this Guidebook,  
7           there is no other situation -- is there?

8           (Off-the-record conference with  
9           colleagues.)

10          MR. LEVEE:  During the break, I'll  
11          get it.

12          There are -- I'm not aware of any  
13          other continents, and that's what I'm  
14          thinking of.  There are examples, I  
15          believe, with cities in particular, but  
16          also regions.

17          And my point was there was nothing  
18          in the Guidebook that said that anyone  
19          couldn't apply for that.

20          PROFESSOR KESSEDJIAN:  It's a  
21          different problem that I have.

22          MR. LEVEE:  Okay.

23          PRESIDENT BARIN:  I have one more  
24          question.

25          MR. LEVEE:  Sure.

1           PRESIDENT BARIN: I'd rather ask now  
2 because it follows up on  
3 Professor Kessedjian's question.

4           If you go to your Slides 4 and 5,  
5 which you referred to earlier.

6           In Slide 4, you refer to  
7 Section 2.2.1.4.2, where you set out  
8 explicitly the requirements of the  
9 Guidebook for the applications.

10          MR. LEVEE: Yes.

11          PRESIDENT BARIN: On Page 5, your  
12 first point is that there are no  
13 restrictions on the ability of  
14 governments or other entities to apply  
15 for a geographic name.

16          MR. LEVEE: Correct.

17          PRESIDENT BARIN: How was that  
18 communicated to the parties?

19          MR. LEVEE: It's just not in the  
20 Guidebook. That was my point.

21          PRESIDENT BARIN: Was there any  
22 communication? Was there anything sent  
23 to people just so that they would know  
24 that that, in fact, is a possibility?

25          MR. LEVEE: Not that I'm aware of,

1 no.

2 And there are -- so many different  
3 types of organizations have applied for  
4 TLDs over the years. And, of course,  
5 governments across the world do operate  
6 what are referred to as "ccTLDs." I  
7 think maybe some of them operate one.  
8 And those are typically operated by  
9 governments, or the government is the  
10 sponsor and there's a specific entity  
11 that operates it on behalf of the  
12 government.

13 So it's not uncommon. It's very --  
14 it's actually common.

15 PRESIDENT BARIN: But is it fair to  
16 say that this was, I guess, ICANN's  
17 interpretation of --

18 MR. LEVEE: Well, you could say  
19 that, but unless there's a prohibition, I  
20 don't know why it would be -- I'm not  
21 trying to spin it. There's nothing in  
22 the Guidebook that says that you can't do  
23 it --

24 PRESIDENT BARIN: That you can't do  
25 it.

1           MR. LEVEE: -- and there are so  
2 many -- it's the practice within ICANN  
3 that there are lots of governments, 250  
4 or so, that do operate their own  
5 top-level domains, including the  
6 United States. Nobody uses .us. It's  
7 operated by the Postal Service, but  
8 it's -- it's -- it would be common.

9           So there wouldn't really have been a  
10 need to spell out who could apply.  
11 Anyone could apply as long as you were an  
12 entity.

13           The only restriction in the  
14 Guidebook on who could apply is an  
15 individual was not eligible to apply.  
16 Any other entity, corporation structure  
17 of any kind, LLP, they're all permitted  
18 to apply.

19           PRESIDENT BARIN: But to follow on  
20 Professor Kessedjian's questions, there  
21 were no other examples that one could  
22 inspire, at least up-front? In other  
23 words, there were no other examples  
24 previously that you could say there was a  
25 support from another?

1           MR. LEVEE: Well, again, just the  
2           .eu example, it's a different -- it was  
3           not done in conjunction with the  
4           Guidebook. It was a heavily politicized  
5           event, but it was the EU that selected a  
6           registry operator and then ultimately got  
7           approval from ICANN to operate the  
8           string.

9           Now, it -- and so that -- that was a  
10          precedent, but it's not -- it's not  
11          really -- it's not under the Guidebook.

12          PROFESSOR KESSEDJIAN: It's a  
13          previous process?

14          MR. LEVEE: Correct.

15          Okay.

16          PRESIDENT BARIN: Thank you.

17          MR. LEVEE: So at the bottom of  
18          Slide 10, the point that I was making is  
19          had any two governments in Africa  
20          objected in writing to ZACR's  
21          application, that application could not  
22          have proceeded either.

23          So we have the situation where  
24          there's some dispute as to which  
25          governments are supporting which

1 applications, but if DCA had had strong  
2 support from two governments, those two  
3 governments could actually have sent a  
4 writing to ICANN objecting to ZACR's  
5 application, and that application would  
6 have failed on that basis.

7 HONORABLE JUDGE CAHILL: And this is  
8 different from the consensus vote in --  
9 in Beijing?

10 MR. LEVEE: Correct. It's outside  
11 of any GAC advice.

12 HONORABLE JUDGE CAHILL: Okay.

13 MR. LEVEE: Now, if you look at  
14 Exhibit C-24, there was a lot of  
15 discussion of it during Mr. Ali's opening  
16 statement and his colleagues'.

17 This is Dr. Crocker's letter. It's  
18 dated March of 2012. It is nine pages  
19 long, and it was written in response to a  
20 communiqué that the AUC issued in October  
21 of 2012.

22 The AUC had made 12 requests of --  
23 of ICANN, and Dr. Crocker, pretty  
24 methodically in this nine-page letter,  
25 responds to each of them.

1           I'm not going to take you through  
2           the whole letter, but in the first  
3           request, the AUC stated it wanted ICANN  
4           to add to ICANN's list of reserve names  
5           the string .africa.

6           Now, ICANN did have a list of  
7           reserve names. In particular, the  
8           Olympics and the Red Cross had asked  
9           ICANN, Don't let anybody take these  
10          names, and ICANN had agreed. So the  
11          Applicant Guidebook reserved those names.

12          The AUC requested similar treatment  
13          for .africa, and Dr. Crocker said, No,  
14          you can't do that.

15          He then went on to explain -- and  
16          we've highlighted on Pages 2 and a little  
17          bit of 3 -- what the Guidebook actually  
18          says about the participation of  
19          governments. He explained that the  
20          Guidebook had protections that would  
21          allow the African Union and its member  
22          states to play a prominent role in  
23          determining the outcome of those strings.

24          By the way, that statement is  
25          100 percent accurate, as were the several



1 next paragraphs that refer to the  
2 protections available for geographic  
3 names, the fact that Africa is a  
4 geographic name, the fact that it would  
5 require support from at least 60 percent  
6 of the national governments.

7 The letter then very briefly goes on  
8 to discuss the GAC, discuss the concept  
9 of Early Warnings and other objection  
10 processes.

11 The letter does not tell the AUC to  
12 go join the GAC. And that's something  
13 that's very separate --

14 PROFESSOR KESSEDJIAN: That is my  
15 question.

16 At that time when the letter is  
17 written, 8 March 2012, is AUC a member of  
18 the GAC?

19 MR. LEVEE: No.

20 PROFESSOR KESSEDJIAN: Okay.

21 MR. LEVEE: And Ms. Dryden is here.  
22 She will tell you -- this was not in her  
23 declaration because it didn't really come  
24 up in the very first briefing that was  
25 submitted -- she will be more than happy

1 to answer questions to you about that  
2 process.

3 But if you ask her the question, Was  
4 ICANN involved or somehow directed the  
5 GAC to accept the AUC as a voting  
6 member --

7 PROFESSOR KESSEDJIAN: You are  
8 making the question and the answer?

9 MR. LEVEE: -- I'm telling you now,  
10 she's going to say, No, ICANN was not  
11 involved.

12 HONORABLE JUDGE CAHILL: We'll see  
13 what happens.

14 MR. LEVEE: We'll see what happens.

15 HONORABLE JUDGE CAHILL: Leading.

16 MR. LEVEE: The most important thing  
17 is that DCA tells you that this letter is  
18 some -- is the genesis of a conspiracy  
19 that is -- it tells the AUC, No worries,  
20 we've got this wired on your behalf.

21 I've read the letter too many times.  
22 You can read the letter. The letter is  
23 fact-based. It tells the AUC nothing  
24 more than, in particularly on the first  
25 page, of what you could read in the

1 Guidebook.

2 There was absolutely nothing  
3 untoward about the letter. It was in  
4 every way appropriate for the Chairman of  
5 the Board of ICANN to send this letter.

6 Now, DCA's second assumption relates  
7 to the GAC. First, we heard extensively  
8 this morning that the Early Warning  
9 notices were improperly issued. And then  
10 we also heard extensively this morning  
11 that the GAC advice that was issued was  
12 not consensus advice, and that the ICANN  
13 Board should have known this and rejected  
14 it.

15 First, this is Section 1.1.2.4 of  
16 the Guidebook. I'll confess, I didn't  
17 have an opportunity to compare the slides  
18 that you were given this morning to the  
19 slides that I have done. But at the  
20 bottom of this paragraph in a sentence  
21 that I think was omitted from DCA's  
22 presentation is the sentence, A GAC Early  
23 Warning may be issued for any reason.

24 It's not a formal objection. It  
25 doesn't lead to a process that can cause

1           disqualification of the application.

2           What it does is it says to the applicant,  
3           You have an issue, and we need to deal  
4           with it. And if we can deal with it, so  
5           be it. And if we can't deal with it, you  
6           are at risk of the GAC issuing advice.

7                     But it can be issued for any reason.

8                     So there was absolutely nothing  
9           improper about the 17 Early Warning  
10          notices. Further, each of the issuing  
11          countries was entitled to issue a warning  
12          notice, and there were 17 of them.

13                    I also want to emphasize -- and  
14          we'll discuss it in a minute -- the  
15          Government of Kenya issued an Early  
16          Warning notice. So even though there's a  
17          lot of discussion that DCA had the  
18          support of the Government of Kenya, it  
19          signed and issued an Early Warning  
20          notice. And we'll talk about the effect  
21          of that later.

22                    Now, DCA was permitted to respond to  
23          those notices, and it did. I've already  
24          mentioned to you that part of its  
25          response was to say, Ah, I don't think

1 the support of the continent should even  
2 be relevant to the outcome.

3 But the point is that the process of  
4 Early Warning notices worked exactly as  
5 it was supposed to work under the  
6 Guidebook. There was nothing untoward  
7 about it. Those notices told the DCA  
8 that it had an issue, and that -- and  
9 that was the full legal effect of them.  
10 There's nothing more.

11 Now, let's talk about the GAC. As  
12 we've heard, the GAC issues consensus  
13 advice where no duly authorized  
14 representative of a country dissents from  
15 the proposed advice at the meeting where  
16 the advice is considered.

17 At the meeting, GAC advice was  
18 proposed against DCA's application.

19 Ms. Dryden will talk to you this  
20 afternoon about that.

21 No country dissented.

22 HONORABLE JUDGE CAHILL: Is there  
23 any record of that?

24 MR. LEVEE: Pardon?

25 HONORABLE JUDGE CAHILL: Is there

1 any record --

2 MR. LEVEE: Ms. Dryden can explain  
3 exactly the details. And she'll also  
4 explain the effect of the e-mail  
5 exchanges that come forward.

6 Now, remember, at the time  
7 Ms. Dryden did her declaration, there  
8 were two things that were true: one was  
9 that she didn't even want to release the  
10 GAC e-mail --

11 HONORABLE JUDGE CAHILL: Right.

12 MR. LEVEE: -- because they were  
13 confidential. And so neither side had  
14 them.

15 And I have no way of knowing what  
16 was in them. She can explain -- and I  
17 don't want to testify for her. I'm  
18 giving comments that I'm doing bad on  
19 that -- she can explain what was  
20 happening in the e-mail and then what  
21 happens at the GAC meeting where a  
22 country says, I propose advice against a  
23 particular application --

24 HONORABLE JUDGE CAHILL: Sure --

25 MR. LEVEE: -- she'll connect those

1 dots for you --

2 HONORABLE JUDGE CAHILL: -- but  
3 there's no sign-in sheet saying who was  
4 there, and there's no minutes that say  
5 that this is what happened?

6 MR. LEVEE: There are sometimes, but  
7 not always. And, again, she can explain  
8 that.

9 HONORABLE JUDGE CAHILL: Okay.

10 MR. LEVEE: Yeah.

11 So we know for sure, because  
12 Ms. Dryden has already said so in her  
13 declaration, no country dissented. What  
14 she couldn't remember was whether  
15 Mr. Katundu was actually in the room.

16 There were a lot of people in the  
17 room, Members of the Panel. It's a big  
18 room. There's a lot of members. There  
19 are advisors, there's representatives,  
20 there's observers. And it's not  
21 surprising that Ms. Dryden cannot  
22 100 percent be certain whether one  
23 particular individual was in the room or  
24 not.

25 She does know for sure that

1 Mr. Buruchara was not, but we already  
2 know that he said he wasn't there.

3 HONORABLE JUDGE CAHILL: Yeah, he  
4 was out of town.

5 MR. LEVEE: The last point I want to  
6 emphasize -- and, again, this is very  
7 important -- if any country from inside  
8 or outside of Africa had opposed the  
9 advice at the meeting, it would not have  
10 been consensus advice.

11 So at the meeting, if Switzerland  
12 had said, You know what, I don't know if  
13 this is right; or if the Government of  
14 China or the Government of Mexico or any  
15 government in Africa had opposed the  
16 advice, it would not have been issued.  
17 That's not what happened.

18 So as we know, the official  
19 representative for Mr. Katundu did not  
20 oppose it.

21 One thing that's important,  
22 Mr. Buruchara, who, I want to remind you,  
23 when we talk about conflicts, he was the  
24 former Chairman of DCA's Strategic  
25 Advisory Board, so not exactly a neutral



1 party here. But more importantly, he was  
2 not the official GAC representative.

3 That's the phrase that is included  
4 in Paragraph 33 of DCA's amended notice  
5 to this Panel. But he was never the  
6 official GAC representative; he was  
7 always only an advisor.

8 But irrespective of his title, the  
9 bottom line is he did not attend the  
10 meeting, and, thus, he could not prevent  
11 the issuance of GAC advice even if he had  
12 wanted to do so, even if he had been  
13 authorized to do so.

14 The other thing is that  
15 Mr. Buruchara knew that the Government of  
16 Kenya had issued an Early Warning -- I  
17 gave that to you in your binder as  
18 Exhibit C-34 -- so he's on thin ground in  
19 all events, even having the e-mail debate  
20 that he had.

21 The complete e-mail thread, which  
22 Mr. Ali took you through -- and I've also  
23 got copies of some of those exhibits in  
24 our binder -- confirms to me that he did  
25 not oppose the issuance of GAC advice, in

1 any event.

2 Now, importantly, DCA initially  
3 presented the Panel with only a very  
4 small snippet of the e-mail thread. I  
5 don't know how much DCA had at the  
6 time -- we'll ask Ms. Bekele when she is  
7 testifying -- but once we got the  
8 complete thread, it demonstrates that  
9 Mr. Buruchara withdrew his opposition to  
10 the issuance of GAC advice because he  
11 specifically says that he supports the  
12 AUC and that they are acting as one.

13 Exhibit C-87 shows that what he  
14 wanted to do was to keep the GAC as  
15 issuing advice and keep ICANN as the  
16 ultimate decision-maker. And that is  
17 what happens: The GAC issues advice;  
18 ICANN is the decision-maker.

19 There would have been no advice for  
20 the GAC to issue that it supports one  
21 application. That apparently is the spin  
22 of what DCA is arguing to the Panel now,  
23 that the advice was just simply, We  
24 support the -- the ZACR application.  
25 That would've said nothing to ICANN.

1 HONORABLE JUDGE CAHILL: Right. But  
2 the only competing one they said couldn't  
3 go forward.

4 MR. LEVEE: Well, that is the GAC  
5 advice that was issued, but I'm saying  
6 that the -- what -- what DCA's arguing to  
7 the Panel this morning is that somehow,  
8 the GAC was supposed to issue advice, We  
9 like ZACR's application, period.

10 HONORABLE JUDGE CAHILL: That's not  
11 what happened, but --

12 MR. LEVEE: It wouldn't have been  
13 GAC advice. The GAC is giving advice  
14 against an application. It doesn't say,  
15 We like this one, but we're not going to  
16 comment on the other. It wouldn't have  
17 had an effect.

18 The purpose of the GAC in this role  
19 is to say when they have a problem with  
20 an application, and that's the advice  
21 that was given.

22 So the summary that I want to leave  
23 you with is two-fold: We have testimony  
24 from Ms. Dryden already in the record.  
25 In Paragraph 11, she's says, By the end

1 of this e-mail exchange, I could not  
2 reasonably conclude that Mr. Buruchara,  
3 on behalf of Kenya, continued to hold a  
4 divergent view from the AUC or its member  
5 states which supported the issuance of  
6 GAC advice in conjunction with DCA's  
7 application for .africa.

8 That paragraph is and was  
9 100 percent accurate. And you'll have  
10 the opportunity to test that this evening  
11 when Ms. Dryden testifies.

12 She's the one that received these  
13 e-mails. She's the one to interpret  
14 them. And then she will tell you what  
15 happens when she gets all these e-mails  
16 and their relevance to what actually  
17 happens in the room when the GAC meets.

18 Finally, we don't have a sworn  
19 statement from Mr. Buruchara. We know  
20 that DCA could have gotten one, but we  
21 don't have his statement. So that is the  
22 missing evidence that perhaps might have  
23 given you an additional piece of evidence  
24 to support DCA's claim.

25 If he actually thought that via

1 e-mail, he could have blocked or did, in  
2 fact, block, he could have put that in a  
3 declaration and told you that, and then  
4 he could have been here today. He  
5 didn't, and he's not here.

6 So the bottom line -- I'm going to  
7 run through this quickly. I know I'm  
8 running out of time -- DCA did not have  
9 the support of a single country on the  
10 Africa continent, and numerous countries  
11 opposed.

12 DCA knew that the AUC support was  
13 critical -- and by the way, DCA went and  
14 got that support. The problem was it got  
15 it in 2009. It then submitted to ICANN a  
16 copy of the support letter that it had  
17 received in 2009.

18 We heard a lot today at the end,  
19 very end of DCA's opening statement about  
20 the struggle that ICANN had with whether  
21 the AUC support was valid, and the  
22 Geo Names and all that.

23 That entire discussion, by the way,  
24 takes a page and a half of DCA's brief.  
25 It took a half an hour this morning.

1           But the reason there was so much  
2           confusion was that DCA had submitted with  
3           its application the letter from  
4           the African Union. And then DCA said,  
5           Well, we're not really sure of the status  
6           of -- of whether this letter actually has  
7           support.

8           I'll tell you what DCA knew. DCA  
9           knew that it had voluntarily refused to  
10          participate in the request for proposal  
11          process and that, as a result, the AUC  
12          had withdrawn its endorsement. And  
13          that's in Exhibit C-R-10 in your book --

14          HONORABLE JUDGE CAHILL: C-R-10?

15          MR. LEVEE: -- in fact, in  
16          Exhibit C-26, DCA begs the AUC, Please  
17          reinstate our endorsement to enable us to  
18          go ahead with our application to ICANN.  
19          But the AUC did not do so.

20          So DCA knew how critical the  
21          endorsement of the African Union  
22          Commission was, and it had gotten that  
23          endorsement. And then the AUC, which was  
24          entitled to withdraw it and change its  
25          mind, did so.

1           In any event, there is no basis for  
2           any request to change the rules in DCA's  
3           favor by modifying the Guidebook to  
4           eliminate the support requirement, much  
5           less, by the way, in the final brief that  
6           DCA submitted, asking the Panel to then  
7           give it 18 more months.

8           That's not how the Guidebook was set  
9           up. That change would be inconsistent  
10          with the Guidebook and the Bylaws, and it  
11          would give DCA an unfair advantage.

12          HONORABLE JUDGE CAHILL: You said  
13          that the AUC withdrew its support because  
14          .africa refused to participate in the  
15          RFP.

16          Is that just because of the -- of  
17          the dates, or is there something that  
18          says --

19          MR. LEVEE: No. I think what  
20          happened was -- and it's in the letter in  
21          the exhibit -- the AUC decided to hold a  
22          request for proposal --

23          HONORABLE JUDGE CAHILL: Right.

24          MR. LEVEE: -- now, we know that DCA  
25          didn't like the terms; they didn't think

1           it was fair; they thought it was wired.  
2           The bottom line is they didn't  
3           participate.

4                   HONORABLE JUDGE CAHILL:   Right.

5                   MR. LEVEE:   But the AUC decided it  
6           would sponsor a registry to apply for  
7           .africa.  It had a right to do that, and  
8           it decided it wanted to.

9                   Previously, it had supported  
10          Ms. Bekele's approach that -- it was  
11          three years before the applications were  
12          due, but they had -- she had gotten the  
13          support, which she knew was very  
14          important.

15                   And then the AUC changes its mind  
16          and says, You know what, we want to be  
17          more influential.  We want to have an  
18          RFP.  The winner of the RFP is going to  
19          have our endorsement, so we withdraw the  
20          previous endorsement given to you.

21                   HONORABLE JUDGE CAHILL:   That's  
22          fair.  Okay.

23                   MR. LEVEE:   Okay.

24                   The bottom line is no applicant for  
25          .africa can (or should) succeed without



1 the support of the countries of Africa.

2 DCA didn't have that support in  
3 2012. It does not have that support  
4 today.

5 So, really, what this is all about  
6 is trying to change the Guidebook so that  
7 DCA can proceed in the face of the lack  
8 of support that it did not have.

9 But does that amount to -- ICANN's  
10 refusal to change the Guidebook, that  
11 obviously doesn't amount to a violation  
12 of its Articles, Bylaws or Guidebook.  
13 We're following the Guidebook, not  
14 modifying it.

15 The next assumption relates to the  
16 conflicts of interests, and Judge Cahill  
17 noted that it was not discussed in the  
18 opening statement of DCA. I'm going to  
19 cover it very briefly.

20 DCA sent letters to the ombudsman,  
21 sent letters to ICANN's CEO saying these  
22 two Board members shouldn't vote. The  
23 ombudsman rejected it. Messrs. Disspain  
24 and Silber twice confirmed that -- that  
25 they did not believe they had a conflict.

1           And then we have ICANN has a  
2           conflicts of interest policy, and it has  
3           a Subcommittee on Ethics and Conflicts.  
4           And the Chairman of that Subcommittee is  
5           here to testify today, and he will tell  
6           you that they followed their process,  
7           what they did. And the Subcommittee  
8           concluded that no conflicts existed.

9           So the mere assertion of a conflict  
10          doesn't mean that a conflict actually  
11          exists. You actually have to go look at  
12          it.

13          The Board conducted itself  
14          consistent with the Bylaws to proceed  
15          when someone has asserted a conflict.

16          And DCA not once, in any of its  
17          papers, ever told the Panel, using a rule  
18          of reason or any other criteria, why the  
19          Board's decision was objectively or even  
20          subjectively wrong.

21          All they've ever told the Panel was  
22          that they made a complaint. They don't  
23          think these two Board members should have  
24          voted.

25          DCA has never explained to you why

1 the Board's internal investigation, which  
2 ultimately concluded that there was no  
3 conflict, was -- how that somehow  
4 violated its Articles or Bylaws.

5 But my last point is, really, the  
6 most important point, I suppose. This  
7 could come in the category of no harm, no  
8 foul. The vote of the committee of the  
9 Board, the NGPC, the New gTLD Program  
10 Committee -- you asked, Judge Cahill, how  
11 many members are on the Board. There's  
12 16.

13 But the Board created a subset of  
14 itself. All Board members who did not  
15 have a conflict relating to the  
16 program -- in other words, there were a  
17 couple of Board members whose companies  
18 were applying for new gTLDs. Those Board  
19 members stepped back when it related to  
20 the gTLD program.

21 And so the Board created the  
22 New gTLD Program Committee, the NGPC, to  
23 rule on all matters relating to the New  
24 gTLD Program. Those Board members were  
25 not conflicted.

1           HONORABLE JUDGE CAHILL:  Were those  
2           two people that were objected to on that  
3           Board?

4           MR. LEVEE:  They were, they were.

5           HONORABLE JUDGE CAHILL:  Okay.

6           MR. LEVEE:  But if you take those  
7           two people off --

8           HONORABLE JUDGE CAHILL:  How many  
9           people are on the committee?  Sorry.

10          MR. LEVEE:  Well, it changed.  
11          Roughly 14-ish; there were 11 at that  
12          time.  It changed -- as Board members'  
13          conflicts were resolved, like, they  
14          withdrew their application, then the  
15          Board -- that Board member would re-join  
16          the committee --

17          HONORABLE JUDGE CAHILL:  That's  
18          fair, yeah.

19          MR. LEVEE:  -- at the time of the  
20          vote, there were 11.

21          If you take the two people away --  
22          nine people attended the meeting.  If you  
23          take those two people away, you've got  
24          seven people voting.  To vote, all you  
25          need is a quorum.  They had a quorum.

1           They had nine out of 14 -- nine out of  
2           11. I'm sorry. They had a quorum.

3                   And once you have a quorum, it's  
4           majority rules.

5                   In this instance, if you take the  
6           two disputed Board members out of the  
7           equation, you have a 7-0 vote.

8                   So it -- it truly just did not  
9           matter whether those Board members voted  
10          or not.

11                   HONORABLE JUDGE CAHILL: I was going  
12          to ask that question before, but I  
13          thought the answer was they're not -- so  
14          the vote -- if they didn't vote, it still  
15          would have passed. But I was  
16          anticipating them saying, but these two  
17          people were there, so they were going to  
18          influence the other seven people. I  
19          think that's what --

20                   MR. LEVEE: I didn't hear that --

21                   HONORABLE JUDGE CAHILL: I didn't  
22          hear that either, but I may well ask the  
23          question --

24                   MR. LEVEE: It may be on --

25                   HONORABLE JUDGE CAHILL: -- yeah,

1 that's usually what the --

2 MR. LEVEE: -- yeah.

3 HONORABLE JUDGE CAHILL: There's  
4 no minutes of this or anything?

5 MR. LEVEE: There are minutes.  
6 We're going to come to that.

7 HONORABLE JUDGE CAHILL: Oh, sorry.

8 MR. LEVEE: The next -- the minutes  
9 are actually in your binder, and I'm  
10 about to get to them.

11 The fourth of five assumptions is  
12 very brief, that ICANN inappropriately  
13 rejected DCA's reconsideration request  
14 for various reasons, including by not  
15 retaining an independent expert.

16 I'm not going to read the whole  
17 Bylaws provision here -- whoops, there I  
18 just took away -- this is the section --  
19 Article IV, Section 2.2 of the Bylaws  
20 tells you what the grounds for  
21 reconsideration could be.

22 And then I gave you Exhibit 47,  
23 which is the Board Governance Committee  
24 recommendation to deny the request. What  
25 it says is that DCA has not demonstrated

1           that the acceptance of the GAC advice  
2           was, quote, without consideration of  
3           material information, except where the  
4           party submitting the request could have  
5           submitted, but did not submit, the  
6           information for the Board's consideration  
7           at the time of the action.

8           The second bullet says that DCA has  
9           not demonstrated that one or more actions  
10          or -- of the Board were taken as a result  
11          of the Board's reliance on false or  
12          inaccurate information.

13          What we know, instead, DCA, in its  
14          paper, say, We have no idea if the NGPC  
15          even saw our response to the GAC advice.  
16          We had a lengthy response to the GAC  
17          advice to tell the Board why they should  
18          ignore it.

19          But if you look at Exhibits R-1 and  
20          Exhibit C-17 [verbatim], those are  
21          the minutes. I think Exhibit R-1 is the  
22          best. And we've highlighted on Page 5  
23          the question at the top. What materials  
24          did the Board review. As part of its  
25          deliberations, the new GPC reviewed the

1 following materials and documents.

2 It reviewed, obviously, the GAC  
3 communiqué, and then it reviewed the  
4 applicant responses, and then it reviewed  
5 the Guidebook.

6 That's all that needed to be  
7 reviewed. And it confirms that the Board  
8 did, in fact, review DCA's objections and  
9 voted to accept the GAC advice,  
10 nevertheless.

11 DCA also says, Well, you know, you  
12 should have hired an expert.

13 The first thing of course, as we've  
14 already seen, there's no requirement to  
15 hire an expert. The Guidebook in  
16 Section 3.1 says that the Board may  
17 consult with experts.

18 At the time that DCA said, You  
19 should hire an expert, there was no  
20 indication of what that expert might have  
21 said. The Board didn't need an expert to  
22 evaluate whether the GAC advice said what  
23 it said. They didn't need an expert to  
24 evaluate whether the GAC's advice was  
25 consensus advice.



1           Ms. Dryden had issued, on behalf of  
2           the GAC, a communiqué which said what it  
3           said. Nothing that an expert would have  
4           said would have changed anything.

5           So we pointed out in the briefs,  
6           Hey, you know, you never said anything  
7           about what the expert might have said.  
8           And in DCA's second brief to the Panel,  
9           again, DCA says nothing. They don't tell  
10          you anything about what an expert might  
11          have said.

12          This morning, we hear that you could  
13          have gotten an expert to deal with Geo  
14          Names and whether the African Union  
15          Commission was or was not authorized to  
16          sponsor a different application.

17          That actually had nothing to do with  
18          the GAC advice. The GAC advice was  
19          specific to DCA's application. And so  
20          there truly was nothing that any,  
21          quote/unquote, expert could have done to  
22          tell the Board what it -- how it should  
23          be voting. The Board was perfectly  
24          capable of understanding the GAC advice.

25          More importantly, the decision

1           whether to retain an expert is  
2           100 percent discretionary. DCA argued in  
3           its reconsideration request that it was  
4           not discretionary, that it was mandatory;  
5           but, in fact, it's very clear that it was  
6           discretionary.

7           Assumption Number 5 -- and I'm  
8           almost done -- is that ICANN's other  
9           conduct in relation to the AUC and ZACR  
10          was inappropriate.

11          And we heard almost half of the  
12          opening statement this morning where it  
13          talked about the dialogue that occurred  
14          between the -- the supporting  
15          organizations and ICANN and within ICANN  
16          as to whether the AUC was or was not --  
17          whether the letter was or was not  
18          supportive and sufficient under the  
19          Guidebook.

20          And I'm going to address that to  
21          some degree. I'll be candid. It was two  
22          pages of the brief, so I had allocated a  
23          similar amount of time in my overall  
24          presentation.

25          I'll spend more time on it tomorrow

1 in my closing.

2 But the main point I want to  
3 emphasize is the oddity. DCA is saying  
4 that although the African Union  
5 Commission signed a letter of support for  
6 ZACR's application, ICANN was struggling  
7 with whether that letter was sufficient  
8 under the terms of the Guidebook.

9 If the process was wired in favor of  
10 the AUC's application with ZACR, ICANN  
11 should have immediately said, Yeah, the  
12 letter looks good to us, you can use it.

13 Instead, the Staff at ICANN kept  
14 questioning, We want to make sure that  
15 the AUC's letter is sufficient.

16 Ultimately, the Staff agreed that a  
17 letter from the AUC would be sufficient,  
18 and at that point, someone says, Well,  
19 maybe you could write a letter. ICANN --  
20 the Guidebook actually has a draft letter  
21 of support. It's not unusual for the  
22 Staff to recommend a draft.

23 So I don't see anything untoward  
24 about the drafting of a letter for the  
25 AUC to meet the terms of the Guidebook.

1 ICANN would have done the same thing for  
2 DCA if DCA had been the winning  
3 applicant. It wasn't.

4 So the fact that ICANN worked with  
5 the AUC to get the letter right, really,  
6 is that the violation of the Guidebook?  
7 Is that the violation of the Bylaws?

8 DCA's application had already been  
9 the subject of GAC advice, and so at that  
10 point, the question was, Was any  
11 application for .africa going to proceed?

12 There is a string of correspondence  
13 that you saw this morning. None of it is  
14 untoward. None of it is conspiratorial.

15 If the Staff of ICANN or the Board  
16 of ICANN was trying to favor ZACR's  
17 application, it did a really bad job  
18 because it kept being very unsure as to  
19 whether the AUC's original letter of  
20 support was sufficient, there was no  
21 preference here.

22 ICANN's Staff did what it was  
23 supposed to do under the Guidebook. It  
24 made sure that the AUC was, in fact,  
25 representative and said so in a properly

1 drafted letter.

2 Finally, as you will also hear from  
3 Ms. Dryden, the AUC did not permit --  
4 ICANN did not permit the AUC to join the  
5 GAC. The GAC regulates its own  
6 membership, and ICANN had no role  
7 whatsoever.

8 ICANN's ultimate decision, based on  
9 the recommendation of InterConnect  
10 Communications, which was its vendor, to  
11 acknowledge the AUC's enforcement of  
12 ZACR, was appropriate and, candidly,  
13 irrelevant to this proceeding. It occurs  
14 after DCA's application has already been  
15 blocked.

16 As I already said, the drafting of  
17 an endorsement letter was both  
18 appropriate -- appropriate and, likewise,  
19 irrelevant. And the Guidebook even has a  
20 sample letter of support.

21 There's no ill-will or  
22 inappropriateness about helping somebody  
23 draft a letter. We didn't hear anything  
24 about it this morning, so I -- sorry,  
25 now, I include -- I included what --

1           one bullet -- a lot of the papers refer  
2           to problems that DCA had with ICANN's  
3           independent objector, but at the end of  
4           the day, the independent objector, who  
5           was -- whose purpose was to file  
6           objections in certain situations when no  
7           one else did -- well, he didn't file an  
8           objection. So I wasn't sure why that was  
9           in DCA's papers, and I didn't know if it  
10          would come up this morning.

11                 But all of these things, which are  
12                 sort of miscellaneous, none of the  
13                 conduct involves a possible violation of  
14                 the Articles, the Bylaws or the  
15                 Guidebook. I don't think there's even  
16                 Board conduct of talking about Staff of  
17                 ICANN assisting in a letter communicating  
18                 with various authorities. These aren't  
19                 decisions that are made by the  
20                 ICANN Board.

21                 HONORABLE JUDGE CAHILL: Are you  
22                 saying we should only look at what the  
23                 Board does?

24                 The reason I'm asking is that your  
25                 the Bylaws say that ICANN and its

1 constituent bodies shall operate, to the  
2 maximum extent feasible, in an open and  
3 transparent manner.

4 Does the constituent bodies include,  
5 I don't know, GAC or anything? What is  
6 "constituent bodies"?

7 MR. LEVEE: Yeah. What I'll talk to  
8 you about tomorrow in closing when I lay  
9 out what an IRP Panel is supposed to  
10 address, the Bylaws are very clear.  
11 Independent Review Proceedings are for  
12 the purpose of testing conduct or  
13 inaction of the ICANN Board. They don't  
14 apply to the GAC. They don't apply to  
15 supporting organizations. They don't  
16 apply to Staff.

17 HONORABLE JUDGE CAHILL: So you  
18 think that the situation is a -- we  
19 shouldn't be looking at what the  
20 constituent -- whatever the constituent  
21 bodies are, even though that's part of  
22 your Bylaws?

23 MR. LEVEE: Well, when I say not --  
24 when you say not looking, part of DCA's  
25 claims that the GAC did something wrong

1 and that ICANN knew that.

2 HONORABLE JUDGE CAHILL: So is GAC a  
3 constituent body?

4 MR. LEVEE: It is a constituent  
5 body, to be clear --

6 HONORABLE JUDGE CAHILL: Yeah.

7 MR. LEVEE: -- whether -- I don't  
8 think an IRP Panel -- if the only thing  
9 that happened here was that the GAC did  
10 something wrong --

11 HONORABLE JUDGE CAHILL: Right.

12 MR. LEVEE: -- an IRP Panel would  
13 not be -- an Independent Review  
14 Proceeding is not supposed to address  
15 that, whether the GAC did something  
16 wrong.

17 Now, if ICANN knew -- the Board knew  
18 that the GAC did something wrong, and  
19 that's how they link it, they say, Look,  
20 the GAC did something wrong, and ICANN  
21 knew it, the Board -- if the Board  
22 actually knew it, then we're dealing with  
23 Board conduct.

24 The Board knew that the GAC did not,  
25 in fact, issue consensus advice. That's



1 the allegation. So it's fair to look at  
2 the GAC's conduct.

3 HONORABLE JUDGE CAHILL: Okay.

4 You think that GACs have actual  
5 notice, but if they should have known,  
6 then they would have constructive notice?

7 Is that -- what do you do with that?

8 MR. LEVEE: I think that possibly  
9 would fall into a Board inaction --

10 HONORABLE JUDGE CAHILL: Okay.

11 MR. LEVEE: -- yeah.

12 I don't want to suggest that -- that  
13 it's so narrow you're only supposed to --

14 HONORABLE JUDGE CAHILL: All you're  
15 doing is just answering the question.

16 MR. LEVEE: Okay.

17 But, certainly, Independent Review  
18 Proceedings, which -- I mean, these are  
19 ICANN's rules. We're here today to --  
20 pursuant to those rules. And we're  
21 really testing the conduct of the Board.  
22 Okay?

23 So let me close.

24 I gave you five assumptions that DCA  
25 made. We believe each of those is false.

1           We believe that the Board conducted  
2           itself consistent with the Articles, the  
3           Bylaws and the Guidebook.

4           Nothing in the Guidebook even hints  
5           at the notion that the AUC's support  
6           created a conflict of interest or  
7           required the Guidebook to be ignored.

8           The Board didn't violate the  
9           Articles or Bylaws by accepting the  
10          consensus advice or by allowing the two  
11          challenged members to vote. Indeed, the  
12          process for evaluating contested  
13          applications for gTLD using the name of a  
14          geographic region worked exactly as it  
15          was supposed to work.

16          And I know that, ultimately, the  
17          argument of counsel to my left is that  
18          the process was unfair. I get that. But  
19          the process also required DCA to have  
20          support of 60 percent of the countries of  
21          the Africa continent. And at the time it  
22          submitted its application, it did not  
23          have the support of any single country,  
24          certainly not 60 percent.

25          And so, fair is following the

1 Guidebook. There are winners and losers  
2 in the gTLD process. It's designed to  
3 work that way. It doesn't mean that the  
4 process was unfair or that the Board  
5 violated its Bylaws.

6 Thank you.

7 HONORABLE JUDGE CAHILL: Thank you.

8 PRESIDENT BARIN: Any questions?

9 HONORABLE JUDGE CAHILL: No. I  
10 talked myself out of questions.

11 MR. LEVEE: I think we're right on  
12 your timeline.

13 So should we take one hour?

14 PRESIDENT BARIN: It's 12:15, so,  
15 yeah, we could take an hour.

16 MR. LEVEE: Come back at 1:20?

17 PRESIDENT BARIN: Yeah.

18 MR. LEVEE: We'll get started with  
19 Mr. Chalaby at 1:20.

20 PRESIDENT BARIN: That's fine.

21 HONORABLE JUDGE CAHILL: How is this  
22 going to go? Are we going to ask him  
23 questions, or is he going to tell us  
24 something?

25 MR. LEVEE: I will play almost no

1           role.

2                   I think we already determined the  
3           Panel will ask its questions first,  
4           followed by counsel, if they have  
5           questions.

6                   PRESIDENT BARIN: I -- I -- we're  
7           advised that the first witness is going  
8           to be Mr. Chalaby --

9                   MR. LEVEE: Correct.

10                  PRESIDENT BARIN: -- right after  
11           lunch?

12                  MR. LEVEE: Yes. Then Ms. Dryden to  
13           follow, and then Ms. Bekele to follow.

14                  PRESIDENT BARIN: Good. So if we  
15           break now and come back by 1:20 --

16                  MR. LEVEE: Fine.

17                  PRESIDENT BARIN: -- that gives us  
18           enough time. And then we'll start.

19                  MR. LEVEE: We should be fine.  
20           Thank you.

21                  PRESIDENT BARIN: Thank you very  
22           much.

23                                   (Whereupon, at 12:21 p.m., a  
24                                   luncheon recess was taken.)

25



1           It's 1:25. Perfectly on time after  
2           the lunch break.

3           The next part of the Hearing, we'll  
4           deal with the presentation of witnesses  
5           and questions by the Panel.

6           The first witness who is up for  
7           questions by the Panel, and then,  
8           subsequently, questions by counsel for  
9           the parties, is Mr. Cherine Chalaby, if I  
10          pronounced that correctly.

11          THE WITNESS: Perfect.

12          MR. LEVEE: Good afternoon,  
13          Mr. Chalaby.

14          THE WITNESS: Good afternoon.

15          MR. LEVEE: First thing we should do  
16          is make sure that you're sworn in.

17                           - - -

18          C H E R I N E   C H A L A B Y,  
19          after having been first duly sworn by  
20          President Barin, was examined and  
21          testified as follows:

22                           - - -

23          PRESIDENT BARIN: The witness is  
24          sworn.

25          Thank you for making yourself

1 available, Mr. Chalaby.

2 What we will do is we'll start with  
3 some questions from me, as Chair, but my  
4 colleagues will also come in and ask you  
5 questions.

6 I ask you to be as -- as forthright  
7 as you can be. And if you obviously  
8 don't know the answer to my question,  
9 simply say you don't know.

10 - - -

11 EXAMINATION ON BEHALF OF THE PANEL

12 BY PRESIDENT BARIN

13 - - -

14 PRESIDENT BARIN: I read in your  
15 statement that you've been a member of  
16 the Board of Directors of ICANN since  
17 2010?

18 THE WITNESS: Correct.

19 PRESIDENT BARIN: And you're  
20 currently still a member of that Board?

21 THE WITNESS: Correct.

22 PRESIDENT BARIN: Can I ask you what  
23 your professional qualifications are?

24 It's -- it wasn't clear from the  
25 statement to what -- what you do.

1 THE WITNESS: Sure.

2 Well, first of all, I -- I have a --  
3 I graduate -- I went to school -- Jesuit  
4 schools in Egypt where I was born. And  
5 then I have a -- a undergraduate degree  
6 in electronic engineering from Cairo  
7 University --

8 ARBITRATOR KESSEDJIAN: Can you  
9 speak a little bit louder? This room --

10 THE WITNESS: Sure. Okay.

11 HONORABLE JUDGE CAHILL: Where was  
12 the graduate degree again?

13 THE WITNESS: So I was born in  
14 Egypt --

15 HONORABLE JUDGE CAHILL: Got that.

16 THE WITNESS: -- I went to the  
17 Jesuit school, the French Jesuits; and  
18 then I went to Cairo University, where I  
19 took a degree in electrical engineering.

20 Then I took a Master's degree in  
21 computing sciences from Imperial College  
22 in London. Then I joined what is known  
23 today as Accenture. In those days, it  
24 was known as Arthur Andersen Consulting  
25 Division and, thereafter,



1 Andersen Consulting. I stayed with them  
2 28 years, 18 of which I was a partner.

3 I had various positions within  
4 Accenture. One of them was global  
5 managing partner for the capital markets  
6 business. I was also the managing  
7 partner for the venture capital business  
8 that Accenture set up for Middle East,  
9 Africa and Europe. And I was on the  
10 executive global committee.

11 In around 2005, I left Accenture  
12 after a career of about 28 years, I'd  
13 say, and I joined an investment bank in  
14 the Middle East as a chairman of that  
15 investment bank.

16 Subsequently, I became chairman of  
17 the supervisory board of the bank, which  
18 was formed after I arrived. And the bank  
19 also acquired a -- a brokerage house in  
20 Egypt, and I became chairman of that  
21 brokerage house.

22 ARBITRATOR KESSEDJIAN: Which bank?

23 THE WITNESS: It's called -- it's an  
24 investment bank called Rasmala,  
25 R-A-S-M-A-L-A.

1           Before joining Rasmala, I was on the  
2           Board of four companies that Accenture  
3           had invested money in.

4           And then I joined ICANN in 2010 on  
5           the Board.

6           And since joining, I became head of  
7           the New gTLD Committee that was referred  
8           to this morning. I'm also head of the  
9           Finance Committee, and I'm a member of  
10          the Board Governance Committee, and also  
11          member of the Subcommittee of that  
12          Governance Committee for Ethics and  
13          Conflicts.

14          ARBITRATOR KESSEDJIAN: Of which  
15          you're the Chair now?

16          THE WITNESS: There is no official  
17          elected Chair; but, by default, it came  
18          to me. It's only a group of three  
19          people, and I've been elected Chair among  
20          that group.

21          PRESIDENT BARIN: As an ad hoc, if  
22          you will, Chair to the Subcommittee, if I  
23          can put it that way --

24          THE WITNESS: I beg your pardon?

25          PRESIDENT BARIN: -- is that

1 correct?

2 As an ad hoc Chair to the  
3 Subcommittee --

4 THE WITNESS: Yes.

5 PRESIDENT BARIN: -- is this what it  
6 is?

7 THE WITNESS: Yeah.

8 PRESIDENT BARIN: Okay. How many  
9 members are there for the -- Board  
10 members are there on the Governance  
11 Committee?

12 THE WITNESS: The Board Governance  
13 Committee?

14 Six -- six members -- five or  
15 four -- I'm not 100 percent sure.

16 Are you talking about the  
17 Subcommittee or --

18 PRESIDENT BARIN: No; the Governance  
19 Committee, not the Subcommittee. Because  
20 the Subcommittee, if I -- if I have it  
21 right, there's a Governance Committee  
22 and, under the Governance Committee,  
23 there's -- there is a Subcommittee on  
24 Ethics and Conflicts?

25 THE WITNESS: Correct.

1 PRESIDENT BARIN: Okay.

2 There's three members on the Ethics  
3 and Conflicts Subcommittee --

4 THE WITNESS: (No audible response.)

5 PRESIDENT BARIN: -- but there are  
6 six members, according to you?

7 THE WITNESS: Correct.

8 PRESIDENT BARIN: Okay. And are you  
9 able to give us just a quick description  
10 of what the backgrounds of those other  
11 six members of the Governance Committee  
12 are?

13 THE WITNESS: Well, they are  
14 directors of the Board. The head of the  
15 Board Governance Committee is the  
16 Vice Chair, and the other members are  
17 the -- they're diverse from different  
18 parts.

19 Mr. -- two of the members that are  
20 discussed this morning are a member of  
21 the Board Governance Committee.

22 PRESIDENT BARIN: Two of the members  
23 that were discussed this morning? By the  
24 two members, you're talking about  
25 Chris Disspain and Mike Silber?

1 THE WITNESS: Yes.

2 PRESIDENT BARIN: So Chris Disspain  
3 and Mike Silber are two other members of  
4 the six-member Board Governance  
5 Committee?

6 THE WITNESS: Yes, indeed.

7 PRESIDENT BARIN: Okay. And are you  
8 able to tell me -- or tell us a little  
9 bit more about their backgrounds? I  
10 mean, are they businesspeople like you  
11 or -- in terms of experience and  
12 background.

13 And -- and if you don't know, that's  
14 fine.

15 THE WITNESS: No. I can -- I can  
16 only say what I know, that most of them  
17 are a member of a community called the  
18 ccTLD community.

19 Mr. Disspain is the CEO of an  
20 organization in Australia, which is  
21 called auDA, AU Domain Registry [sic].  
22 And Mr. Silber is a director of an  
23 organization in -- in South Africa called  
24 ZADNA, which is .za Domain Name  
25 Authority.

1           That's all I can say.

2           PRESIDENT BARIN: And are you able  
3 to give us an idea of how many times the  
4 Committee meets?

5           THE WITNESS: Which committee?

6           PRESIDENT BARIN: The Governance  
7 Committee.

8           And so, for your purposes, if I say  
9 "Subcommittee," I'm talking about the  
10 Ethics Subcommittee. If I talk about the  
11 "Committee," it's with respect to the  
12 Governance Committee.

13          THE WITNESS: Well, we have -- we  
14 have -- ICANN has three public Board  
15 meetings a year. During those public  
16 Board meetings, all committees meet. So,  
17 at minimum, the Board Governance  
18 Committee meet three times.

19          But in addition to that, outside the  
20 Committee, we have a Board workshop. And  
21 we have, I think, about four of those a  
22 year. And also, at each one of those,  
23 every committee meets again. So the BGC  
24 meets again.

25          Outside of that, Board Governance

1           Committee meets whenever there's a  
2           requirement to look at reconsideration  
3           requests or any other matters that it's  
4           required to look into.

5           So it's active and it does what it  
6           has to do when it needs to do it.

7           PRESIDENT BARIN: And does  
8           the -- the Board Committee also  
9           keep minutes or records of its meetings  
10          and take minutes?

11          THE WITNESS: Indeed, it does.

12          PRESIDENT BARIN: Yes.

13          Okay. And are they taken by someone  
14          that sort of consistently takes those  
15          notes and keeps them?

16          THE WITNESS: Yes. I believe  
17          there's a scribe, and there are notes  
18          being taken and minutes published.

19          PRESIDENT BARIN: Let me just, if  
20          you will, take you to a document that I  
21          would like you to take a look at, and  
22          that would be the conflicts of interest  
23          policy --

24          MR. LEVEE: If you can give us the  
25          exhibit number, I can put it on

1 everybody's monitor.

2 PRESIDENT BARIN: It's Exhibit C-52,  
3 if I'm correct.

4 HONORABLE JUDGE CAHILL: It's  
5 coming.

6 MR. LEVEE: You have to let us know  
7 which page you want.

8 PRESIDENT BARIN: I see. That's  
9 fine.

10 MR. LEVEE: Can you see it,  
11 Mr. Chalaby?

12 HONORABLE JUDGE CAHILL: It's too  
13 small to read?

14 THE WITNESS: I can see it, but I  
15 can barely read it.

16 PRESIDENT BARIN: Do you want us to  
17 give you a printed copy?

18 HONORABLE JUDGE CAHILL: They can  
19 blow up the copy.

20 THE WITNESS: It's okay. I can see  
21 it.

22 PRESIDENT BARIN: Well, I may have  
23 to go back and forth, so --

24 THE WITNESS: I can see what's  
25 there, and then we'll see if --



1           ARBITRATOR KESSEDJIAN: That's the  
2 policy -- if I'm not mistaken, that's the  
3 policy of 6 May 2012 that is quoted in  
4 your declaration?

5           THE WITNESS: It is.

6           MR. LEVEE: It is.

7           PRESIDENT BARIN: It's, in fact,  
8 quoted in Paragraph 3.

9           THE WITNESS: Correct.

10          PRESIDENT BARIN: And then just by  
11 way of background, were you -- were you  
12 involved in any way in the drafting or  
13 the preparation of this policy?

14          THE WITNESS: No. No, I was not.

15          PRESIDENT BARIN: It was prepared  
16 before you --

17          THE WITNESS: It was prepared and --  
18 yes, I was not involved in the drafting  
19 of this.

20          PRESIDENT BARIN: Okay. Is this a  
21 policy that you would say that you're  
22 very familiar with in terms of how it's  
23 applied and used in the, I would say,  
24 Governance and particularly the  
25 Subcommittee on Ethics and Conflicts

1 meetings?

2 THE WITNESS: I would say so.

3 PRESIDENT BARIN: Okay. And do you  
4 regularly use this policy in terms of the  
5 work that either the Committee or the  
6 Subcommittee does?

7 THE WITNESS: Yeah, definitely was  
8 the Subcommittee, and all -- all  
9 directors have to, every year, confirm  
10 that they've read it and understood it  
11 and apply it.

12 PRESIDENT BARIN: And I assume, like  
13 most boards, they -- all directors read  
14 it and sign a document that's then filed  
15 with the Board that says they --

16 THE WITNESS: Yes, it's part of the  
17 annual statement they read.

18 PRESIDENT BARIN: Okay. Was this  
19 policy looked at, Mr. Chalaby, when I  
20 would say the issues in relation to  
21 Chris Disspain and Mike Silber were being  
22 considered by, I would say, first, the  
23 Committee and then the Subcommittee?

24 THE WITNESS: We applied this  
25 policy. I don't know if we had the

1 document open in front of us and read  
2 page by page. I don't remember that.  
3 But we certainly applied the policy.

4 PRESIDENT BARIN: And I guess -- by  
5 my question, I don't mean to say that you  
6 sort of applied it on -- on a -- on a  
7 verbatim basis, but was it -- was it  
8 something that the -- I would say, first,  
9 the Board, as well as the Subcommittee  
10 members looked at in order to arrive at  
11 the decisions that they did?

12 THE WITNESS: Absolutely.

13 PRESIDENT BARIN: During that  
14 meeting, I guess, there was -- can you --  
15 can you explain how the -- the process  
16 worked in that -- I assume the question  
17 must have gone to the Board first and  
18 then -- in terms of --

19 THE WITNESS: Which particular  
20 meeting are you referring to, please?

21 PRESIDENT BARIN: To the meeting  
22 where you are looking as a Subcommittee,  
23 if you will --

24 THE WITNESS: Yes.

25 PRESIDENT BARIN: -- as to what is

1 to happen to Chris Disspain and  
2 Mike Silber with respect to their  
3 conflict of interest question.

4 THE WITNESS: Yes.

5 So what typically happens is the  
6 Board Governance Committee requests the  
7 Subcommittee to investigate the matter --

8 PRESIDENT BARIN: Right.

9 THE WITNESS: -- right?

10 So the Board Governance Committee  
11 requests us. So we met, the three  
12 members, of which Disspain or Silber are  
13 not members of the Subcommittee --

14 PRESIDENT BARIN: All right.

15 THE WITNESS: -- okay?

16 At that time when we met, the first  
17 thing we do, we -- we look at all the  
18 information available to us, and we call  
19 people who are -- have an issue. We  
20 explain to them the process.

21 The first thing we explain is the  
22 definition of "conflict," all right? And  
23 we say that conflict is not just actual;  
24 it's also potential and perceived, and  
25 it's very important.

1           And we -- we apply this very much in  
2           everything we do in the discussion. Then  
3           we -- we discuss among ourself, we  
4           interview people, and then we make a  
5           decision at the end, a finding.

6           We then pass the findings to the  
7           BGC, and the BGC sends it to the Board  
8           for edification and . . .

9           PRESIDENT BARIN: In this particular  
10          case, though, I believe it -- it must  
11          have started with, I would say, the  
12          Committee first, because that's where the  
13          issue is laid before --

14          THE WITNESS: Um-hum.

15          PRESIDENT BARIN: -- of which  
16          Mr. Disspain and Mr. Silber are members,  
17          correct?

18          THE WITNESS: Correct.

19          PRESIDENT BARIN: The issue of the  
20          conflict of interest would first be put  
21          to the Board --

22          THE WITNESS: Right.

23          PRESIDENT BARIN: -- to the  
24          Committee -- to the Governance Committee?

25          THE WITNESS: Correct.

1           PRESIDENT BARIN: Then from the  
2           Governance Committee, it would then go to  
3           the Subcommittee?

4           THE WITNESS: Correct.

5           PRESIDENT BARIN: Okay.

6           And in -- in terms of the -- the  
7           process that was followed with the  
8           Governance Committee, of which  
9           Mr. Disspain and Mr. Silber are members,  
10          they were not part of the -- the  
11          decision-making or discussions --

12          THE WITNESS: No, they were not.

13          PRESIDENT BARIN: -- that were  
14          following, I guess, their questions of  
15          the conflict, correct?

16          THE WITNESS: Correct, no, they were  
17          not.

18          PRESIDENT BARIN: And, subsequently,  
19          when the issue was decided or considered  
20          by the Subcommittee, what information was  
21          before you when you made your decision as  
22          a Subcommittee?

23          THE WITNESS: I don't recall  
24          everything that was put forward to us,  
25          but we start with the -- in that

1 particular instance, we started with, of  
2 course, the declaration of the two  
3 directors.

4 But what triggered that meeting is  
5 an event took place in Durban, when ICANN  
6 met, where, at the opening speech, a  
7 member on the outside had thanked a  
8 couple of Board members, and then another  
9 Board member came after that, concerned  
10 about hearing that a couple of members  
11 were thanked, and informed me and  
12 informed counsel.

13 As a result of that, we -- we said  
14 we will look into this again. So the  
15 Committee met again to look into this.  
16 The Committee advised the Board  
17 Governance Committee, and the Board  
18 Governance Committee advised the  
19 Subcommittee to do the investigation.

20 PRESIDENT BARIN: Let me get this  
21 right, because there are two references  
22 in your statement --

23 THE WITNESS: Yeah.

24 PRESIDENT BARIN: -- to an issue of  
25 conflict being raised against Mr. --

1 Mr. Disspain and Silber. One is in  
2 Paragraphs -- one is in Paragraphs 4 and  
3 5, if you will, particularly 5, where, in  
4 October 2012, DCA notifies ICANN's  
5 ombudsman that DCA believes that two of  
6 the members had a conflict of interest.

7 Then there's a second incident, if  
8 I'm correct, or a second time this was  
9 raised in Paragraph 7, Some weeks after  
10 June 4th, 2013, the issue comes up.

11 THE WITNESS: Yes.

12 PRESIDENT BARIN: Okay. And when  
13 you were talking earlier --

14 THE WITNESS: I was talking about  
15 the second one.

16 PRESIDENT BARIN: -- you were  
17 talking about the second one?

18 THE WITNESS: Indeed.

19 PRESIDENT BARIN: I'd like to take  
20 you back to the first one, if you would.

21 THE WITNESS: Yeah.

22 PRESIDENT BARIN: So when the issue  
23 was raised in -- in December, in October  
24 of 2012, do you recall how it came to  
25 you?



1           THE WITNESS: In relation to the  
2           ombudsman statement in Paragraph 5, is  
3           that what you mean?

4           PRESIDENT BARIN: Yes.

5           THE WITNESS: Okay.

6           It didn't come to us at all. So  
7           what typically happened before the  
8           composition of the New gTLD, the  
9           Subcommittee was formed. And we looked  
10          at all of the statements made by  
11          individual Board members to see who was  
12          going to be in the Committee, who's not  
13          going to be in the Committee. And we  
14          applied those three objective criteria,  
15          actual, potential, and perceived, to all  
16          the Board members -- the voting Board  
17          members.

18          And out of the 16, we decided that  
19          five were conflicted in relation to the  
20          New gTLD, all right, and those that were  
21          not conflicted became part of the New  
22          gTLD.

23          Out of the five that were excluded  
24          from the New gTLD was the Chairman of the  
25          Board and the Vice Chairman of the Board,

1           because we took that definition very  
2           strictly and wanted to make sure that the  
3           New gTLD had members that were not  
4           conflicted at all.

5           After that, usually, we -- we --  
6           only when issues come up to the New gTLD  
7           Committee that we discuss it. The issue  
8           about .africa and the issue had not come  
9           to the New gTLD Committee at all or not  
10          even discussed when the letters and the  
11          ombudsman produced his report.

12          And, in fact, in his report, he  
13          said, as quoted here, I consider no  
14          disqualifying conflict.

15          And, in fact, it was sort of  
16          premature, because no issue came to the  
17          New gTLD Committee to discuss in relation  
18          to these two gentlemen.

19          PRESIDENT BARIN: All right.

20          So if -- if I understand the  
21          summary, what you're saying is that in  
22          the first instance, the -- the Committee  
23          didn't really have to deal with that  
24          issue?

25          THE WITNESS: The New gTLD

1 Committee.

2 PRESIDENT BARIN: The New gTLD  
3 Committee?

4 THE WITNESS: Yes.

5 PRESIDENT BARIN: Okay. But once  
6 the -- once the report of the ombudsman  
7 was issued -- and that's the report that  
8 you'll find in C-29?

9 THE WITNESS: Right.

10 PRESIDENT BARIN: I don't know if  
11 you want to put up a copy.

12 MR. LEVEE: Do you want that up?

13 PRESIDENT BARIN: Yes.

14 MR. LEVEE: Of course.

15 PRESIDENT BARIN: I think he's going  
16 to have a tough time reading that.

17 HONORABLE JUDGE CAHILL: Can you  
18 highlight or expand?

19 MR. LEVEE: Can you just tell us  
20 what to highlight?

21 HONORABLE JUDGE CAHILL: Just the  
22 first half there -- I don't know. I'm  
23 not asking the questions. Excuse me.

24 PRESIDENT BARIN: Well, I guess I'll  
25 start with some general questions.

1 THE WITNESS: Okay.

2 PRESIDENT BARIN: You've obviously  
3 seen this report?

4 THE WITNESS: I had to refamiliarize  
5 myself with it as part of this  
6 proceedings, but I don't remember at the  
7 time when and where I have seen it.

8 PRESIDENT BARIN: So was this never  
9 really looked at, if you will, by the  
10 Committee or the Subcommittee subsequent  
11 to it being issued?

12 THE WITNESS: No --

13 PRESIDENT BARIN: Okay.

14 THE WITNESS: -- not that I  
15 remember, to be honest.

16 PRESIDENT BARIN: Okay. And is  
17 there a reason why that, perhaps, either  
18 the Committee or the Subcommittee may not  
19 be, as being ethics or, if you will,  
20 conflicts committees, interested in the  
21 report of the ombudsman?

22 THE WITNESS: There is no action to  
23 be taken as a result of this.

24 PRESIDENT BARIN: Right.

25 If you look at the report -- and I

1 appreciate that you've looked at it  
2 subsequently -- you will see that it  
3 talks about, as you've said yourself, a  
4 situation of actual -- an actual conflict  
5 of interest existing, which the ombudsman  
6 comes to the conclusion that there  
7 wasn't, according to him at the time.

8 What is not clear from the report,  
9 if you will, is whether or not the  
10 ombudsman looked at that second part of  
11 what you were saying that the Board  
12 Subcommittee deals with, which is not  
13 only just the conflict of interest or the  
14 appearance of a conflict of interest.

15 Was that an issue for you, perhaps,  
16 that required --

17 THE WITNESS: Well, we had  
18 previously, if I -- as I mentioned,  
19 earlier in the year, we had looked at all  
20 of the statements made by the Board  
21 members, including Mr. Silber and  
22 Mr. Disspain, and concluded there wasn't  
23 actual, potential, or perceived conflicts  
24 of interest.

25 And until that time, from earlier in

1 the year, I think it was in 2000, until  
2 that time, that matter had not come to  
3 the New gTLD for any discussion. There  
4 was no reason to look into it.

5 PRESIDENT BARIN: Okay.

6 What about subsequently, then, in --  
7 in what you refer to in your statement as  
8 June 4, 2013, because this is the second  
9 time now that the issue is coming up?  
10 Did you do anything different when the  
11 issue came up the second time?

12 THE WITNESS: Before the second  
13 time, remember that the -- both -- all  
14 members have resubmitted again an annual  
15 statement. And both Mr. Disspain and  
16 Mr. Silber had disclosed all of their  
17 professional relationships, and there was  
18 no -- no change in their status --

19 PRESIDENT BARIN: Right.

20 THE WITNESS: -- and, therefore, not  
21 conflicted.

22 PRESIDENT BARIN: I appreciate that  
23 Board members would always file, if you  
24 will, with all Board members on an annual  
25 basis the statement that says, At the

1 time we're signing it, there's no issue.

2 But if and when something does come  
3 up and -- a new issue does come up, would  
4 the Board then not take it upon itself to  
5 examine and perhaps go further into the  
6 issue?

7 THE WITNESS: But it did. So when  
8 it came up, and this is why when -- when  
9 the NGBC [sic] then afterwards had  
10 requested from the BGC to look into the  
11 matter again, just to be extra cautious.

12 PRESIDENT BARIN: Okay. And what --  
13 what exactly -- and this will take me to  
14 Paragraph 7 of your statement -- what  
15 exactly did the Subcommittee do?

16 At the end of your statement on  
17 Paragraph 7, you say, After investigating  
18 the matters, the Subcommittee concluded  
19 that Chris Disspain and Mike Silber did  
20 not have conflict of interest with  
21 respect to DCA's application for .africa.

22 THE WITNESS: Um-hum.

23 PRESIDENT BARIN: I take it from  
24 your statement that you're referring to  
25 both actual as well as an appearance of

1 conflict of interest?

2 THE WITNESS: Actual, potential and  
3 perception.

4 PRESIDENT BARIN: Okay. And so what  
5 did the Committee -- what did the  
6 Subcommittee exactly do to arrive at its  
7 conclusion?

8 THE WITNESS: Well, the Subcommittee  
9 went back and reviewed facts, what's  
10 available in front of them in terms of  
11 information.

12 PRESIDENT BARIN: Can you give us an  
13 idea what those would be, what was  
14 available in front of you?

15 THE WITNESS: Well, for example, the  
16 relationship disclosed, the -- I suppose,  
17 if I remember, the allegations made  
18 against them. And we looked at the  
19 relationship between both of them and  
20 the .africa application, and we found no  
21 reason to -- to conclude that there is,  
22 you know, any real or potential or  
23 perceived conflict.

24 In the case of Mr. Disspain, as  
25 mentioned in my statement, any -- any



1 relationship that happened between one of  
2 the affiliates of auDA -- and which I  
3 think is called AusRegistry -- and  
4 UniForum SA happened so far in the past,  
5 even before the applications were made,  
6 that the situation was so attenuated, in  
7 terms of the nature, in terms of  
8 contents, in terms of financial interests  
9 or anything, that there was no way we --  
10 we -- we could find that Mr. Disspain,  
11 for example, had any potential or -- or  
12 actual or perceived conflict.

13 In the case of Mr. Silber, we looked  
14 at the relationship he had on -- as  
15 member -- nonexecutive member of the  
16 Board of ZADNA, who has an arm's-length  
17 relationship with this organization  
18 called UniForum SA. They -- they provide  
19 services -- that kind of services for  
20 other -- other organization; ZADNA  
21 happened to be one of them. And the fact  
22 that they apply for .africa doesn't  
23 benefit in any way or form or shape,  
24 financially or any way, Mr. Silber.

25 And, therefore, we concluded that



1           during those times when you were with  
2           bank, when you were with the former  
3           entity not called Accenture at the time?

4                     Did you have any experience during  
5           those past jobs with conflict of  
6           interests?

7                     THE WITNESS:   On the Board that I  
8           served on, there was always, you know,  
9           conflicts issue and conflicts interest.  
10          And we all had to conform to make sure  
11          that we were -- that we applied conflict  
12          of interest policies, sure.

13                    ARBITRATOR KESSEDJIAN:   So you have  
14          been participating in analysis of  
15          conflict of interest and investigations,  
16          perhaps, and decisions over potential  
17          conflict of interest, or was, in other  
18          words, your work at ICANN kind of new to  
19          you?

20                    THE WITNESS:   I would not say it's  
21          new, but I cannot recall individual  
22          instances to answer your question very  
23          specifically.  I'm sorry.  It's so far  
24          back.

25                    ARBITRATOR KESSEDJIAN:   Okay.

1           In your statement -- and I come back  
2           to one of the questions that the Chair  
3           asked you. When I read Paragraph 7 and  
4           when I read the word "investigating," to  
5           me -- of course, I'm not an English  
6           speaker -- but, to me, "investigation" is  
7           quite a strong word.

8           So it means, to me, a proactive  
9           activity. So you go out and you find for  
10          yourself.

11          So if I am correct, you answered the  
12          Chair that you didn't ask either  
13          Mr. Disspain nor Mr. Silber to appear  
14          before the Committee?

15          THE WITNESS: I don't recall.

16          ARBITRATOR KESSEDJIAN: You don't  
17          recall?

18          THE WITNESS: I don't recall.

19          ARBITRATOR KESSEDJIAN: Well, if you  
20          had called them in, you would recall, no?

21          THE WITNESS: I don't recall.

22          ARBITRATOR KESSEDJIAN: When was  
23          that? When was the investigation taking  
24          place?

25          THE WITNESS: In 2012.

1           ARBITRATOR KESSEDJIAN: Okay. Three  
2 years ago. That far away.

3           Do you do a lot of conflicts in the  
4 Subcommittee?

5           THE WITNESS: Whenever -- I mean,  
6 what typically happens if -- if a  
7 director of the Board feels that they  
8 have a conflict of interest or disclosed  
9 something, they -- the process is they  
10 disclose it to general counsel, general  
11 counsel then informs the Board Governance  
12 Committee, and the Board Governance  
13 Committee asks us to investigate.

14           So that's -- that's the process.

15           ARBITRATOR KESSEDJIAN: Okay. So,  
16 in other words, the only way in which the  
17 Subcommittee would start an investigation  
18 would be if the person who is supposed to  
19 have a conflict says it is a potential  
20 conflict? So if somebody does not  
21 disclose anything, then nobody does  
22 anything?

23           THE WITNESS: Well, in that case, we  
24 did, because somebody other than the two  
25 has raised the issue, another Board

1 member. So we took it very seriously and  
2 reinvestigated the issue.

3 ARBITRATOR KESSEDJIAN: Um-hum.

4 THE WITNESS: So if any of the Board  
5 members do not declare, then there's no  
6 reason to go and investigate. But if  
7 there's somebody from -- from the Board,  
8 in that case, or there's any issue that  
9 was brought to us, we would investigate.  
10 And in that case, we have.

11 ARBITRATOR KESSEDJIAN: But what did  
12 you do exactly?

13 I'm not entirely satisfied with the  
14 way you described your, quote/unquote,  
15 investigation. Again, investigating  
16 something means really having proactive  
17 activity, which I didn't hear from you  
18 very clearly.

19 THE WITNESS: What we -- what we  
20 normally do is we -- I explained the  
21 process, and I said --

22 ARBITRATOR KESSEDJIAN: But I would  
23 prefer -- I would really prefer you to be  
24 specific on this particular case, because  
25 the general rules we understand. There's

1 the policy, there's the Subcommittee  
2 saying something. Let's be precise on  
3 this particular case.

4 THE WITNESS: Normally, we would  
5 have interviewed them. I can't remember.  
6 That's all. I mean, I'm just really --  
7 really not trying to not answer the  
8 question.

9 ARBITRATOR KESSEDJIAN: Okay. And  
10 you didn't ask Ms. Bekele to come in and  
11 discuss with you?

12 THE WITNESS: No; but we did ask the  
13 Board member who was concerned, who  
14 expressed concern to come, and we  
15 interviewed him. That I remember very  
16 well.

17 ARBITRATOR KESSEDJIAN: Who was  
18 that?

19 THE WITNESS: One of our Board  
20 members. I mentioned earlier that when  
21 we were in Durban, in the opening speech,  
22 a member of .za thanked a couple of  
23 members of the Board for their help.

24 ARBITRATOR KESSEDJIAN: Was it  
25 Disspain and Silber in those thanks?

1 THE WITNESS: No; it was Disspain  
2 and another Board member who has nothing  
3 to do with the issue with .africa.

4 ARBITRATOR KESSEDJIAN: So Disspain  
5 was thanked by --

6 THE WITNESS: Indeed, yes --

7 ARBITRATOR KESSEDJIAN: Okay.

8 THE WITNESS: -- he was thanked.

9 All right?

10 So that Board member said he  
11 remembered the ombudsman report and not  
12 finding conflicted.

13 ARBITRATOR KESSEDJIAN: And Durban  
14 was when?

15 THE WITNESS: Durban was July 15th,  
16 2013.

17 ARBITRATOR KESSEDJIAN: Okay.

18 So that's after what you did -- now,  
19 I'm lost in the dates. Because here, in  
20 your declaration, we only have two dates.  
21 It's October 2012 and 4 June 2013.

22 So Durban is after all of that, but  
23 you don't have any declaration about  
24 that.

25 MR. LEVEE: I'm sorry. It's the



1 next --

2 THE WITNESS: Sorry.

3 Yes, Durban happened after June the  
4 4th.

5 ARBITRATOR KESSEDJIAN: Okay.

6 PRESIDENT BARIN: I guess, in your  
7 statement, Mr. Chalaby, it's Paragraph 7,  
8 was that when you say, Some weeks after  
9 June 4th? Is that -- is that the  
10 reference?

11 THE WITNESS: Yes. Some weeks after  
12 June 4th, NGPC vote accepting GAC  
13 advice the claim of Mike Silber and  
14 Chris Disspain potential conflict of  
15 interest was raised. So this is --

16 PRESIDENT BARIN: That's the second  
17 incident that you were talking about?

18 THE WITNESS: Yes.

19 -- so that was raised in -- in  
20 Durban by a member of the Board who was  
21 concerned that he heard in the opening  
22 speech -- that he originally thought that  
23 in the opening speech -- that person had  
24 thanked both Mike Silber and  
25 Chris Disspain and --

1           ARBITRATOR KESSEDJIAN: Now, the two  
2 of them were mentioned?

3           THE WITNESS: But he was wrong,  
4 because we went to the script, and he  
5 accepted afterwards that Mike Silber was  
6 not mentioned. So he wasn't -- indeed,  
7 it was -- the transcript of the speech  
8 showed that he didn't mention  
9 Mike Silber, okay?

10          ARBITRATOR KESSEDJIAN: Okay.

11          THE WITNESS: So -- so what happened  
12 then is, because of that, we decided,  
13 okay, to do two things: one is to ask  
14 members of the NGPC to reconfirm and  
15 reaffirm that when they voted on the 4th  
16 of June, they had -- they were not  
17 conflicted. Everybody said -- said this,  
18 including Mr. Silber and including  
19 Mr. Disspain.

20                 And in addition to that, we were not  
21 satisfied with the NGPC. We asked our  
22 Governance Committee to go back and  
23 investigate again and look into the facts  
24 again.

25                 The Board Governance Committee

1 investigated and asked the question, Were  
2 they there in the meeting? I do not  
3 remember, but I do remember that we did  
4 ask the Board member who was concerned to  
5 come in, and we discussed with him and  
6 interviewed him and asked him about, you  
7 know, what is his concern.

8 And then we continued our  
9 investigation based on facts available to  
10 us, and we concluded that there was no  
11 new evidence and no new facts for both  
12 Mr. Silber and Mr. Disspain to be either  
13 conflicted or potential or perceived.

14 ARBITRATOR KESSEDJIAN: Okay. So  
15 you can't be more precise than what you  
16 are now, I guess.

17 Okay. So Mr. Silber, what was his  
18 exact position at the time?

19 And you answered one question by the  
20 Chair by saying that they did exactly the  
21 same declarations again, so nothing was  
22 changed.

23 But in between the declarations, the  
24 .africa controversy, if I may take that  
25 word, was blowing up. So, in fact, there

1           were some factual changes between the  
2           different iterations of the Board  
3           members.

4           So perhaps they didn't declare any  
5           different facts on their personal life,  
6           but the .africa -- I'll repeat --  
7           controversy was actually very different  
8           from one declaration to the other.

9           Could that have triggered a  
10          different analysis for their own  
11          position?

12          THE WITNESS: Well, let's look back  
13          on the timing, so make sure we're talking  
14          about exactly the same time.

15          ARBITRATOR KESSEDJIAN: Yeah.

16          THE WITNESS: So the March 12th,  
17          2012, this is when the first summary of  
18          the statement of interest of the Board  
19          was put on the ICANN Web site. And this  
20          is where we've seen the -- anything that  
21          was disclosed by Mr. Disspain and  
22          Mr. Silber, right?

23          After that -- when was it? I'm  
24          looking at some time frames here.

25          In July of that year, right, the

1 letters from Sophia Bekele came, as well  
2 as in October. At that time, the NGPC  
3 had not looked at or had not been  
4 contemplating any discussion on .africa.

5 The ombudsman took the matter, and  
6 the ombudsman concluded there was no  
7 conflict.

8 After the ombudsman concluded that,  
9 there was a second summary of statement,  
10 which had more details in it than the  
11 previous one. And that summary was there  
12 and, frankly, all the details were there,  
13 but none of them showed any difference.  
14 It's just a bit more detail on the  
15 existing one just to -- there was nothing  
16 more than just more detailed explanation  
17 of their position and relationship.

18 ARBITRATOR KESSEDJIAN: Okay. That  
19 I think I understood, and you said it  
20 already --

21 THE WITNESS: Okay.

22 ARBITRATOR KESSEDJIAN: -- and I'm  
23 fine with that --

24 THE WITNESS: Yeah.

25 ARBITRATOR KESSEDJIAN: -- what I'm

1 saying is that when you analyze a  
2 conflict of interest, you don't analyze  
3 the conflict of interest only with what  
4 is declared by the person who is supposed  
5 to be in conflict or who is -- for whom  
6 we are asking whether there is conflict;  
7 you analyze this on the background of  
8 facts.

9 And the facts of the situation with  
10 .africa -- because -- am I correct to  
11 think that the only reason why there was  
12 a question whether some conflict of  
13 interest existed is because there was --  
14 there may have been a link with the  
15 .africa discussion?

16 That's the only reason; is that  
17 correct?

18 THE WITNESS: Possibly, yeah --

19 ARBITRATOR KESSEDJIAN: Yeah.

20 THE WITNESS: -- you talk about  
21 facts. What I'm not -- what has not been  
22 performed --

23 ARBITRATOR KESSEDJIAN: The  
24 circumstances --

25 THE WITNESS: -- but there are no

1 facts. There are no new facts or  
2 additional facts.

3 So I'd like to know what facts has  
4 been brought to the table that both  
5 Silber and Disspain had not disclosed.

6 What are these facts?

7 ARBITRATOR KESSEDJIAN: What I'm  
8 saying to you is that the conflict of  
9 interest must be analyzed on the  
10 background -- I don't know how to say  
11 that. Should I speak French? -- it's on  
12 the background of the situation at the  
13 certain moment.

14 So you -- you have exactly the  
15 same -- you know, I'm  
16 Catherine Kessedjian. I'm a professor at  
17 the University, plus an arbitrator, plus,  
18 plus, plus. This never changes. This is  
19 always the facts concerning me.

20 But my conflict of interest on Day 1  
21 may be completely different with  
22 Day 10, because between Day 1 and Day 10,  
23 there is a string of events that have  
24 occurred. And, therefore, exactly the  
25 same circumstances which are mine, and in

1           that particular case, it's Disspain and  
2           Silber, looked at through the lens of the  
3           change of circumstances may indeed  
4           trigger a different analysis.

5                     Am I more clear?

6                     THE WITNESS: You are clear.

7                     But in that instance, it did not --  
8           it did not trigger a -- different facts.  
9           But I understand your point.

10                    And as a result, because of the  
11           circumstances, when we had an NGPC  
12           meeting after the 4th of June, we brought  
13           the issue to the NGPC and went through  
14           and explained the circumstances, and  
15           asked each Board member to talk again  
16           about their position and whether they are  
17           conflicted and whether they feel, given  
18           the circumstances that you have  
19           mentioned, they are conflicted. But they  
20           were not.

21                    HONORABLE JUDGE CAHILL: Can I  
22           interrupt a little bit here?

23                    ARBITRATOR KESSEDJIAN: Yes, please.

24                    HONORABLE JUDGE CAHILL: Excuse me,  
25           please.



1           There is a new fact. The ombudsman  
2           says it is clearly apparent from the  
3           records examined that the two Board  
4           members have not participated in any  
5           decision-making about .africa. Indeed,  
6           there's been little discussion; is my  
7           view, it's premature, et cetera.

8           Well, the new fact is, now, these  
9           two Board members are participating in  
10          .africa discussions, decisions, right?

11          THE WITNESS: Correct.

12          HONORABLE JUDGE CAHILL: So I'm  
13          wondering why we didn't go back to the  
14          ombudsman.

15          But there is something -- there is  
16          something new that may change the  
17          analysis, isn't there?

18          THE WITNESS: If they had --

19          HONORABLE JUDGE CAHILL: If the  
20          ombudsman -- now, they're participating  
21          in the decision.

22          THE WITNESS: They are  
23          participating. But as far as the -- the  
24          Subcommittee had determined before -- and  
25          I'll go back to the point that they

1 didn't have any potential or perceived  
2 conflict. The fact that --

3 HONORABLE JUDGE CAHILL: The  
4 Subcommittee or the ombudsman?

5 THE WITNESS: The Board Governance  
6 Committee --

7 HONORABLE JUDGE CAHILL: Okay.

8 THE WITNESS: -- had determined  
9 before that they had no conflict.

10 So -- and especially in their second  
11 set of statement after all the letters  
12 that came from Sophia, and the ombudsman  
13 looked at that.

14 So what happened is when the time of  
15 the discussion came for the NGPC, we  
16 looked at the GAC advice; we looked at  
17 the response that DCA has made; we looked  
18 at the module. And I agree with you, we  
19 did not -- in the 4th of June meeting, we  
20 did not discuss or ask anybody to confirm  
21 whether they're conflicted or not.

22 But subsequent to that, in another  
23 meeting just a few weeks later, we had a  
24 meeting, the NGPC, and the issue was  
25 raised. And we said, The circumstances

1 are that there is the following  
2 happening. Could you please go back and  
3 reexamine the situation and please  
4 confirm whether you are conflicted or  
5 not?

6 So everybody confirmed they were not  
7 conflicted, particularly the two  
8 gentlemen. This was not sufficient.

9 We then -- the NGPC asked the Board  
10 Governance Committee and, through it, the  
11 Subcommittee on Ethics to look into the  
12 situation one more time. They looked at  
13 the situation one more time, and there  
14 was nothing -- there were no new facts  
15 other than they were --

16 HONORABLE JUDGE CAHILL: Now,  
17 they're doing something.

18 THE WITNESS: -- no new facts in  
19 terms of their conflict. There was a  
20 fact that they were there when there was  
21 a vote, but given that they're not  
22 conflicted --

23 HONORABLE JUDGE CAHILL: Okay. I  
24 understand.

25 Excuse me.

1 ARBITRATOR KESSEDJIAN: No, no.

2 Thank you, Bill. That's very useful.

3 Am I correct that the Governance  
4 Committee has records and minutes and  
5 everything is published, I guess, on the  
6 Internet, on ICANN Internet? Is that  
7 your answer to the Chair's question  
8 earlier?

9 THE WITNESS: I believe the minutes  
10 of the --

11 ARBITRATOR KESSEDJIAN: The  
12 Governance Committee?

13 THE WITNESS: Yeah, yeah.

14 ARBITRATOR KESSEDJIAN: Now, I'm  
15 asking you for the Subcommittee on  
16 Ethics.

17 Are there records, minutes? Are  
18 they public?

19 THE WITNESS: There are records, but  
20 I don't believe they are public.

21 ARBITRATOR KESSEDJIAN: So ICANN  
22 says in its policy of 2012 -- and I'm  
23 just quoting from memory, because I've  
24 read that several times -- that it is its  
25 objective to actually obey by the highest

1 standards of ethics.

2 But the work of the Subcommittee on  
3 Ethics, which is basically the only  
4 committee dealing with those issues, are  
5 not public; is that correct?

6 THE WITNESS: Well, I need to -- I  
7 mean, all the discussion --

8 ARBITRATOR KESSEDJIAN: In your --

9 THE WITNESS: -- no, no -- the  
10 reason is all the discussion happens  
11 under client-attorney privilege with  
12 lawyers. So I don't know if I can answer  
13 that question in a satisfactory way for  
14 you.

15 I need to ask --

16 ARBITRATOR KESSEDJIAN: Who's client  
17 attorney --

18 THE WITNESS: We had general counsel  
19 in the meeting as the discussions are  
20 held --

21 ARBITRATOR KESSEDJIAN: You mean of  
22 the Subcommittee?

23 THE WITNESS: Of the Subcommittee,  
24 yeah.

25 PRESIDENT BARIN: I guess --

1           MR. LEVEE:  If I could just  
2           explain -- I'm not going to answer  
3           anything for the witness -- I had told  
4           the witness when an issue came up  
5           relating to privilege that he should  
6           identify it.

7           As he just testified, the general  
8           counsel is in these meetings, and that's  
9           the reason that the meeting minutes are  
10          privileged.  So I can't just publish them  
11          because they would otherwise be waiving  
12          --

13          ARBITRATOR KESSEDJIAN:  Let's go  
14          back to you, Mr. Chalaby, please.

15          You said there are three members in  
16          the Subcommittee on Ethics.  So it's  
17          you -- who are the two others?

18          THE WITNESS:  They're not  
19          Chris Disspain or Mike Silber.

20          ARBITRATOR KESSEDJIAN:  I love  
21          you're aware of certain questions.

22          THE WITNESS:  Would you like me --

23          ARBITRATOR KESSEDJIAN:  Could you be  
24          positive?  Tell us the names.

25          Who are the other members, or at

1 that time?

2 THE WITNESS: Ray Plzak and  
3 Bill Graham.

4 ARBITRATOR KESSEDJIAN: And they  
5 were the same two at the time that we are  
6 discussing here, 2012 to 2013?

7 THE WITNESS: I believe so.

8 ARBITRATOR KESSEDJIAN: Okay. Now,  
9 we just learned from the counsel of ICANN  
10 that the general counsel of ICANN attend  
11 your meetings.

12 What's his function there?

13 PRESIDENT BARIN: I guess the  
14 question is he attends -- the general  
15 counsel attends both the Governance  
16 Committee meetings, correct --

17 THE WITNESS: I'm talking about the  
18 Ethics Committee meeting.

19 PRESIDENT BARIN: -- as well as the  
20 Subcommittee --

21 ARBITRATOR KESSEDJIAN: That was my  
22 question, the Subcommittee.

23 THE WITNESS: Yes.

24 ARBITRATOR KESSEDJIAN: But what was  
25 his function? Why does he attend?

1 THE WITNESS: Well, he brings the  
2 facts to us. So . . .

3 ARBITRATOR KESSEDJIAN: I don't  
4 understand.

5 THE WITNESS: So when there is an  
6 issue of conflict, right --

7 ARBITRATOR KESSEDJIAN: So you're  
8 not doing anything yourself. All the  
9 members of the Subcommittee are just  
10 expecting other people to bring things to  
11 you. You're not proactive?

12 THE WITNESS: No. They put the data  
13 in front of us, and then we are proactive  
14 in terms of discussing, analyzing,  
15 investigating -- in many cases, we  
16 question people.

17 In that instance, we questioned one  
18 of the Board members. We looked at the  
19 cross records. We do.

20 PRESIDENT BARIN: I guess the  
21 question is in terms of the -- the work  
22 that the Subcommittee does, it does this  
23 work in the presence of the general  
24 counsel, correct?

25 THE WITNESS: Yes.



1           PRESIDENT BARIN: Is it always the  
2 general counsel?

3           THE WITNESS: Yes.

4           PRESIDENT BARIN: Okay.

5           ARBITRATOR KESSEDJIAN: A person?

6           THE WITNESS: Yes.

7           PRESIDENT BARIN: So I believe what  
8 you also said is that the general counsel  
9 comes to you, which is the Subcommittee  
10 members, with the facts, correct?

11          THE WITNESS: Right.

12          PRESIDENT BARIN: You look at those  
13 facts and you reach your decisions?

14          THE WITNESS: But in addition -- and  
15 I was not able to answer that question in  
16 that particular instance -- we interview  
17 the Board members when there's a conflict  
18 issue.

19          PRESIDENT BARIN: But if I  
20 understand correctly, you didn't  
21 interview either Mr. Disspain or  
22 Mr. Silber in this case.

23                 That's what you told me?

24          THE WITNESS: I said I cannot  
25 recall.

1 ARBITRATOR KESSEDJIAN: Go ahead.

2 PRESIDENT BARIN: Does the general  
3 counsel also get involved in the  
4 discussions that you have in respect to  
5 whether or not there is a conflict?

6 THE WITNESS: No.

7 PRESIDENT BARIN: Does he express  
8 any opinions with respect to --

9 THE WITNESS: No. No.

10 PRESIDENT BARIN: And the facts that  
11 are put before you, do you verify those  
12 facts in any way, other than what is put  
13 before you by the general counsel?

14 THE WITNESS: Well, the only way we  
15 verify them is by asking further  
16 questions of -- of the -- of the  
17 directors who are subject to a conflict.

18 PRESIDENT BARIN: Right.

19 I have one other question for you in  
20 terms of the policy that you use.  
21 Section -- would you show this section to  
22 Mr. Chalaby --

23 MR. LEVEE: Back on conflict policy?

24 PRESIDENT BARIN: Yeah, conflict  
25 policy, Section 1.3.

1 MR. LEVEE: Okay.

2 MS. ZERNIK: Can you give me the  
3 exhibit number --

4 PRESIDENT BARIN: Pardon me?

5 MS. ZERNIK: -- I don't have it.

6 PRESIDENT BARIN: It's C-52 --

7 MS. ZERNIK: Yeah.

8 PRESIDENT BARIN: -- and it's  
9 Section 1.3.

10 ARBITRATOR KESSEDJIAN: Could you  
11 enlarge it a little bit?

12 MR. LEVEE: Yeah, we'll make it  
13 larger.

14 Here you go.

15 PRESIDENT BARIN: Have you seen this  
16 provision before, Mr. Chalaby?

17 THE WITNESS: Yes.

18 PRESIDENT BARIN: Has it ever been  
19 part of any discussions you've had as  
20 part of the -- either the Committee or  
21 the Subcommittee?

22 THE WITNESS: I don't remember. I  
23 can't answer that question.

24 PRESIDENT BARIN: Do you understand  
25 what it says?

1 THE WITNESS: More or less, yes.

2 HONORABLE JUDGE CAHILL: "More or  
3 less." Good question -- good answer.

4 PRESIDENT BARIN: I guess what I  
5 wanted to just sort of get a sense from  
6 you is the section seems to say that the  
7 conflict of interest policy is intended  
8 to supplement but not to replace -- and  
9 now emphasis on "any applicable laws  
10 governing conflict of interest applicable  
11 to ICANN."

12 Do you know what that would be?

13 THE WITNESS: It means what it says,  
14 no?

15 PRESIDENT BARIN: Yes, but --

16 HONORABLE JUDGE CAHILL: That's also  
17 true.

18 PRESIDENT BARIN: -- admittedly, we  
19 have a problem with it, so . . .

20 THE WITNESS: Go ahead.

21 PRESIDENT BARIN: It's a simple  
22 question. If you don't, you don't. I  
23 just wanted to know whether you had been  
24 told or explained what that means; in  
25 other words, the standard against which

1           you are making your decisions?

2           THE WITNESS: Well, the standard  
3           which we're making decisions, as I  
4           mentioned, is possibly the highest  
5           standard, which is actual, potential and  
6           perceived conflict.

7           PRESIDENT BARIN: Right.

8           THE WITNESS: I mean, is there a  
9           higher standard than that?

10          HONORABLE JUDGE CAHILL: I don't  
11          know.

12          PRESIDENT BARIN: I'm not sure I'm  
13          going to get into a debate with you as to  
14          whether or not that is a standard.

15          But I guess the question is, Is that  
16          something that had come up in discussions  
17          with the general counsel? And I  
18          assume --

19          HONORABLE JUDGE CAHILL: Don't waive  
20          the privilege.

21          THE WITNESS: What I do understand  
22          is those three definitions of conflict  
23          are consistent with local laws. I'm not  
24          an expert in local laws, but I understand  
25          that that is the case.

1 PRESIDENT BARIN: Okay.

2 ARBITRATOR KESSEDJIAN: Did you say  
3 "global law" or "local law"?

4 THE WITNESS: Local law.

5 ARBITRATOR KESSEDJIAN: Local law?

6 THE WITNESS: Yeah.

7 PRESIDENT BARIN: As part of the  
8 discussions you had as Subcommittee  
9 members, was there ever an issue or an  
10 item that came up that you required, I  
11 guess, advice from the general counsel?

12 THE WITNESS: As part of the  
13 discussion in the meeting, general  
14 counsel is silent, does not interfere  
15 with the discussion.

16 PRESIDENT BARIN: No. I guess my  
17 question was: Assume for a moment you're  
18 having a meeting and some facts are  
19 presented to you. You look at those  
20 facts, and then a question comes up that  
21 you, as Subcommittee members, do not know  
22 the answer or do not know how to  
23 approach. Perhaps it's a legal question.  
24 Perhaps it has legal issues involved in  
25 it.

1           Would you then ask the general  
2           counsel to -- to advise you on those  
3           questions?

4           THE WITNESS: I don't know if I can  
5           answer that question.

6           MR. LEVEE: Yes, you can.

7           THE WITNESS: The answer is that I'm  
8           trying to remember if there's -- because  
9           the material presented to us is detailed  
10          enough. And then we ask -- we interview  
11          the -- the Board of Directors and we find  
12          out more and more, and we dig and dig and  
13          find out more facts.

14          If there's a question for  
15          clarification rather than opinion,  
16          whether this person's conflicted or not,  
17          we probably would ask. But we will not  
18          ask general counsel his opinion whether  
19          that person's conflicted or not, just  
20          clarification on that particular  
21          relationship or this information, is this  
22          correct, is this not correct.

23          PRESIDENT BARIN: Okay.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

- - -  
EXAMINATION ON BEHALF OF THE PANEL  
BY HONORABLE JUDGE CAHILL  
- - -

HONORABLE JUDGE CAHILL: They've asked all my questions except for a couple.

I'm looking at the ombudsman's reasoning, and he says, There's, of course, an important distinction between actual bias and apparent bias; but underlying this is a need for some action by the members.

Okay. This goes to my other question that there is now action by the members.

What was done to -- from what I read from your declaration, what you've said is that you determined there were no actual conflicts of interest.

What did you do to see if there was any apparent conflicts of interest?

That's always the harder part where I come from.

And so what analysis was done?



1 THE WITNESS: When the Committee  
2 went back, analyzed the relationship that  
3 Mr. Silber and Mr. Disspain had, in terms  
4 of the work and the professional  
5 relationship, and evaluated whether there  
6 is a potential to it .

7 So as I explained, for example, with  
8 Mr. Silber, he's the CEO of auDA. AuDA  
9 has a relationship with AusRegistry in  
10 terms of they license them to run their  
11 operation.

12 They did the consulting work for  
13 UniForum SA in the past, way before the  
14 applications were -- were announced or  
15 applied for. And we investigated the  
16 story and identified that it was so  
17 attenuated that they couldn't possibly  
18 constitute an apparent or a potential --

19 HONORABLE JUDGE CAHILL: It was a  
20 long -- I -- I -- me reading the  
21 briefs --

22 THE WITNESS: I believe so -- sorry?

23 HONORABLE JUDGE CAHILL: -- me  
24 reading the briefs, I understand that the  
25 company that Mr. Silber is treasurer of,

1           their conduct [verbatim] was administered  
2           by UniForum.

3                     Does that make sense to you?

4                     THE WITNESS:  Yes.

5                     HONORABLE JUDGE CAHILL:  Yeah.  If  
6           it's still happening at the time of the  
7           conflict, then if UniForum is  
8           administering the contract, is it  
9           possible that Mr. -- Mike Silber could  
10          have some impact if he votes against  
11          UniForum?

12                    THE WITNESS:  Not in that instance.  
13                    And I'll explain why.

14                    HONORABLE JUDGE CAHILL:  Okay.

15                    THE WITNESS:  He's a nonexecutive  
16          member of the Board of ZADNA.  Like many  
17          what is called "country code  
18          administrators," they don't have the  
19          facility themself to run the computers  
20          and the administer thing, so they  
21          outsource this to other organizations.

22                    There are other organizations that  
23          specialize in that and provide that  
24          service to many others.

25                    So ZADNA has licensed, or given

1 arm's-length contract, to UniForum SA to  
2 do this administration. It just happened  
3 that -- and first of all, it just  
4 happened that the UniForum SA applied for  
5 .africa.

6 That application in no way would  
7 benefit Mr. Disspain at all. And we felt  
8 that because of the arm's-length  
9 relationship, right, that -- that there  
10 was no perception of conflict or a  
11 potential one.

12 So that's our analysis. We went  
13 into this -- a lot of depth and -- and  
14 understood that because of this  
15 arm's-length relationship and because  
16 there's no financial interest at all,  
17 there was no real link between Mr. Silber  
18 and the .africa application.

19 So we reached that conclusion  
20 ourselves.

21 HONORABLE JUDGE CAHILL: Okay. And  
22 on the -- on -- in your declaration, you  
23 say, Some weeks after June 4, 2013, you  
24 learned about another potential  
25 conflict -- or complaint of potential

1 conflict of interest.

2 What did you understand that  
3 complaint to be? Was it or specific or  
4 was it general?

5 THE WITNESS: Excuse me. Which  
6 paragraph?

7 HONORABLE JUDGE CAHILL: I'm looking  
8 at Paragraph 7 --

9 THE WITNESS: Yes, Paragraph 7.

10 HONORABLE JUDGE CAHILL: -- and the  
11 first sentence, Potential conflict of  
12 interest was again raised.

13 Maybe you answered it before, but I  
14 wasn't sure.

15 What -- what was the exact conflict  
16 of interest that was raised?

17 THE WITNESS: I did mention that  
18 while -- when we were -- and ICANN had a  
19 meeting in Durban, South Africa. In the  
20 opening speech, a member -- because we  
21 were hosted by the African community, a  
22 man thanked two members of the Board.  
23 And those two members, one of them was  
24 Mr. Disspain, and the other one was  
25 another Board member, George Sadowsky.

1 HONORABLE JUDGE CAHILL: Okay.

2 THE WITNESS: That Board member  
3 thought that he also mentioned  
4 Mike Silber, but he did not mention  
5 Mike Silber.

6 All right?

7 HONORABLE JUDGE CAHILL: Got that.

8 THE WITNESS: So that Board member  
9 came to me and went to general counsel  
10 and said, Look, I heard -- everybody  
11 heard it in the opening speech. I am  
12 concerned that maybe we ought to look  
13 into this again. And the thing we did is  
14 we looked into this again.

15 HONORABLE JUDGE CAHILL: Okay. The  
16 first time you got the ombudsman  
17 involved.

18 What was the reason you didn't get  
19 the ombudsman involved in the second  
20 conflict?

21 THE WITNESS: Because there were no  
22 suspected -- no new -- other than the  
23 voting, no new data relating to those two  
24 individuals. But we wanted to make sure  
25 to go back and check this.

1 HONORABLE JUDGE CAHILL: Now, we  
2 have two different individuals, though,  
3 you're checking on. You're not checking  
4 on Mr. Silber anymore, because he wasn't  
5 mentioned in the speech --

6 THE WITNESS: No, but we -- we took  
7 extra caution, and we checked him as  
8 well. We checked the two that were  
9 mentioned in the opening speech as well  
10 as Mr. Silber again.

11 HONORABLE JUDGE CAHILL: Okay.

12 That's all I have right now.

13 (Pause.)

14 - - -

15 EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD  
16 BY ARBITRATOR KESSEDJIAN

17 - - -

18 ARBITRATOR KESSEDJIAN: I don't  
19 understand why you have a written  
20 statement -- and perhaps Mr. LeVeé is  
21 going to tell me that I'm wrong -- but  
22 why in your recent -- in your written  
23 statement you don't mention the date when  
24 you reopened the issue after Durban?

25 I don't see anything in your written

1 statement about that.

2 So you are telling us now orally  
3 that you reopened the issue, but -- I  
4 don't know. To me, it's very unclear.  
5 So if you want to clarify anything, I  
6 would be grateful.

7 THE WITNESS: Yes, I'm happy to  
8 clarify.

9 I don't know why the date is not  
10 there. I'm sorry. The date perhaps  
11 should have been there.

12 But the dates are as follows: It's  
13 4th of June, the NGPC met for the advice,  
14 right; then July the 17th -- sorry --  
15 July the 15th in Durban, the Board met --

16 MR. ALI: Excuse me. If I may  
17 interrupt. I'm sorry, Mr. Chalaby.

18 Mr. President, just for our  
19 information, Mr. Chalaby is looking at  
20 some notes, and he seems to have a  
21 document there. If we can --

22 PRESIDENT BARIN: I was going to ask  
23 --

24 THE WITNESS: No problem. It's just  
25 a timeline, the same as you showed this

1 morning, but in my own work. If you want  
2 it, you can put it as an exhibit --

3 HONORABLE JUDGE CAHILL: We don't  
4 need it right now. You can see it at a  
5 break.

6 MR. ALI: I will take a copy later.

7 HONORABLE JUDGE CAHILL: Just make  
8 it available to him at a break.

9 THE WITNESS: Definitely. I was  
10 just going -- I've reconstructed this  
11 from all the documentation here  
12 (indicating), basically, that --

13 HONORABLE JUDGE CAHILL: Okay.

14 THE WITNESS: -- that's all.

15 So if -- let me read from it, and  
16 then you can -- so June the 4th, the NGPC  
17 meeting met and accepted the GAC advice;  
18 June the 14th, the letter from  
19 Sophia Bekele came regarding the NGPC  
20 decision; June the 19th, DCA submits a  
21 reconsideration request; July 15th, in  
22 Durban, the Board member in Durban raised  
23 questions re: the opening remark, which I  
24 mentioned to you; July 15th to July the  
25 17th, the NGPC meeting met, we discussed



1           what happened then, and we asked every  
2           Board member to confirm again, which they  
3           did, the conflict of interest; then in  
4           September 25, the Ethics and Conflicts  
5           Subcommittee met regarding  
6           reinvestigating what was said in -- in --  
7           in Durban.

8                     And not only we investigated that  
9           Mr. Disspain was thanked, but we also  
10          investigated Mike Silber, who was not  
11          thanked in the opening speech.

12                    And then the Subcommittee made a  
13          recommendation to the Board Governance  
14          Committee, and the Board Governance  
15          Committee so asked the NGPC on behalf of  
16          the Board to ratify it.

17                    My apology that it was not in  
18          the -- I -- I did it in the last couple  
19          days, frankly.

20                    PRESIDENT BARIN: Is that the only  
21          document that you have that you've been  
22          referring to?

23                    THE WITNESS: Yeah. I've been  
24          referring to my declaration. And I've  
25          not referred to, although I have it here,

1 is the ICANN Response to DCA Memorial on  
2 the Merits. I have no other documents.

3 PRESIDENT BARIN: That's the only  
4 other document?

5 HONORABLE JUDGE CAHILL: That's the  
6 only new document. We'll get it at a  
7 break. That's fine.

8 PRESIDENT BARIN: So no more  
9 questions at this stage from the Panel.

10 Thank you, Mr. Chalaby.

11 I would suggest, but I'm open to  
12 whichever way you wish to proceed, that  
13 Mr. Ali start, and then you can finish  
14 up. It perhaps makes more sense.

15 So, Mr. Ali, I would ask you to --  
16 if you would, to ensure that we remain  
17 within the confines of what you had  
18 agreed to as counsel and also the  
19 procedural orders that you ask questions  
20 that came out as a result of the  
21 questions that the Panel asks.

22 MR. ALI: Without the benefit of a  
23 LiveNote, I will strain my memory as best  
24 I can to ensure that I stay --

25 PRESIDENT BARIN: If I see that

1           maybe it's going to a place where it  
2           shouldn't, then I will -- I will let you  
3           know.

4           MR. ALI:    Okay.

5           HONORABLE JUDGE CAHILL:  I'm sure  
6           counsel --

7           MR. ALI:  Give me some elasticity.  
8           Your memory is -- there's a number of  
9           interesting issues that have been raised  
10          by Mr. Chalaby.  And I just think that we  
11          ought to get a little bit more in depth  
12          with them.

13                                   - - -

14                   EXAMINATION ON BEHALF OF CLAIMANT

15                                   DOTCONNECTAFRICA TRUST

16                                   - - -

17          BY MR. ALI:

18           Q.       If you would just excuse me just a  
19          second, Mr. Chalaby.  I know this is -- it's rude  
20          for us to look over a computer screen.  So if you  
21          don't mind, let me put this over here.

22           ARBITRATOR KESSEDJIAN:  Could you  
23          put it on the floor?  Because then, I  
24          cannot see him --

25           MR. ALI:  There may be some

1 documents --

2 ARBITRATOR KESSEDJIAN: That's fine,  
3 then. That's fine. It's more important  
4 that you see him than I see him.

5 MR. ALI: I thought it would be a  
6 little bit rude if --

7 PRESIDENT BARIN: I suggest that you  
8 put it down. Just put it down. And  
9 then, if there's any documents that  
10 Mr. Chalaby needs to see, we can show it  
11 to him.

12 BY MR. ALI:

13 Q. Mr. Chalaby, as I understand it from  
14 one of your responses to a question that was just  
15 put to you, you have looked at various documents  
16 in preparing for your testimony which led you to  
17 create that timeline, correct?

18 A. Yes.

19 Q. Okay. And just within the context of  
20 looking at all of those documents, nothing came up  
21 that would have jogged your memory as to whether  
22 or not you did interview Mr. Disspain and Silber?

23 A. As I mentioned, I don't recall that.

24 Q. Okay. Could you just take a look at  
25 Paragraph 7 of your statement?

1 A. Yeah.

2 Q. So here in your statement, it says, In  
3 addition, the NGPC asked the BGC to look into the  
4 issue further.

5 Do you see that?

6 A. Yes.

7 Q. Now, you've been with ICANN since  
8 2010; is that correct?

9 A. Correct.

10 Q. And you've been the head of the  
11 New gTLD Program Committee, NGPC, since then; is  
12 that right?

13 A. Yes.

14 Q. That's correct?

15 A. Yes.

16 Q. Okay. And you've been head of the  
17 Board Governance Committee since 2010 as well; is  
18 that correct?

19 A. No, I'm not head of the Board  
20 Governance Committee.

21 Q. I see.

22 So you're just on the Board Governance  
23 Committee?

24 A. Uh-huh.

25 Q. But you are also on the Ethics

1 Subcommittee?

2 A. Indeed.

3 Q. Okay.

4 Now, when you say, here, The NGPC  
5 asked the BGC, so that means the NGPC,  
6 effectively meaning you, that is -- or it's some  
7 sort of written communication from the NGPC to  
8 the BGC to look into what you describe as the  
9 issue further; namely, this question of conflict  
10 that had been raised?

11 So the NGPC -- how does that happen?

12 A. Well, it happens -- I, on behalf of  
13 the NGPC, would -- would call the Chair of the BGC  
14 and tell him about it --

15 Q. Okay.

16 A. -- and -- yeah, go ahead.

17 Q. And who is that?

18 A. The Vice Chairman of ICANN,  
19 Bruce Tonkin.

20 Q. So on this particular occasion, you  
21 would have -- in your capacity as Chair of the --  
22 head of the NGPC, have contacted Mr. Tonkin by  
23 phone and have told him that there was an issue  
24 regarding a conflict of interest; is that correct?

25 A. We were all, I think, in -- in Durban

1 at the time when the discussion happened then  
2 while -- or it was by phone.

3 Q. So you went to him and said, I think  
4 there is an issue of conflict of interest?

5 A. I think, also, general counsel  
6 probably brought it up to him as well.

7 Q. Okay. And there was nothing put in  
8 writing by you or the general counsel, to the best  
9 of your knowledge?

10 A. In this instance, I believe there was  
11 nothing put in writing.

12 Q. And so you indicated that once the  
13 matter goes from the BGC, it goes to a  
14 subcommittee?

15 A. Yes.

16 Q. And that subcommittee met in Durban?

17 A. No.

18 Q. When did that subcommittee meet?

19 A. It met in September.

20 Q. So the Subcommittee -- so the issue of  
21 the conflict of interest is raised, as you put it,  
22 some weeks after the NGPC's vote accepting the GAC  
23 advice?

24 A. Correct.

25 Q. And then, some weeks after that, the

1 Subcommittee on Conflicts meets? Just so we have  
2 the timeline straight here.

3 A. Would you like a copy of this?

4 Q. Why don't you just tell me?

5 A. Well, I did say it, and I'll repeat it  
6 again.

7 So the -- June the 4th, there was the  
8 NGPC meeting, which is the first line, Some weeks  
9 after. So some weeks after that, the NGPC -- two  
10 things happened: one is the NGPC met in Durban,  
11 right, and in Durban, we asked all the Board  
12 members to reaffirm and reconfirm that they have  
13 no conflict of interest --

14 Q. And this was because of that -- sorry  
15 to interrupt, but just to be clear, this was  
16 because of that event where somebody thanked  
17 somebody?

18 A. Yes, and because a Board member  
19 brought it up and because it's a serious -- when a  
20 Board member brings it up, it's serious. We have  
21 to take -- so we asked the NGPC members to  
22 reconfirm their vote.

23 And then the NGPC --

24 Q. Sorry. To reconfirm their vote? I  
25 thought you had said earlier to reconfirm that



1 they have no conflict.

2 A. Sorry. You're right, to reconfirm  
3 they had no conflict at the time they voted.

4 Okay?

5 Q. Okay.

6 A. And then the NGPC, which is  
7 well-documented, asked the BGC to look into it,  
8 the Board Governance Committee. And the Board  
9 Governance Committee asked the Subcommittee to  
10 please take a look into it. The Subcommittee  
11 looked into it on September the 25th.

12 Q. Okay. Thank you. That's very  
13 helpful.

14 So September 25th, as I understand it,  
15 the Subcommittee, which includes you --

16 A. Um-hum.

17 Q. -- receives information from the  
18 general counsel, John Jeffrey?

19 A. Right.

20 Q. And as you put it, upon reviewing that  
21 information, you dig and dig and dig.

22 So that's what you did on this  
23 occasion as well?

24 A. Yes.

25 Q. Okay. But notwithstanding the fact

1 that you dag and dag and dag, you don't recall  
2 whether or not you interviewed Mr. Silber and  
3 Mr. Disspain?

4 A. No, I don't recall that. I mentioned  
5 this several times.

6 Q. I just want to be clear. Perhaps  
7 something somebody said might have jogged your  
8 memory.

9 A. No.

10 Q. Okay.

11 So you've also testified to the effect  
12 that you believe that the highest standard is  
13 being applied by ICANN, and, to your mind, that  
14 standard is actual, potential, or perceived  
15 conflict.

16 Correct?

17 A. Yes.

18 Q. So could you give me an example of  
19 what would constitute a conflict?

20 A. In those three terms?

21 Q. For each one.

22 Actual?

23 A. If I have a financial interest -- a  
24 personal financial interest or gain in a -- in a  
25 company that is applying for a new gTLD.

1 Q. So if you have an actual financial  
2 interest.

3 What is a potential conflict of  
4 interest?

5 A. If I know that I will become possibly  
6 involved with one of these companies in the future  
7 and I will have a financial interest.

8 Q. Okay. What is a perceived conflict?

9 A. If a perceived conflict of interest  
10 is -- is not actual or potential, but other people  
11 may perceive me as conflicted.

12 Q. Okay. And so these are the standards  
13 that you are telling us were applied in the  
14 context of the discussion that is taking place in  
15 September 17th in the BGC Ethics Subcommittee,  
16 right?

17 A. Yes.

18 Q. Applying those standards, if you had  
19 concluded that there was a conflict of interest,  
20 what effect would that have had on the NGPC vote  
21 to approve the GAC advice?

22 A. It would have no effect.

23 Q. Sorry. Did you say "no effect"?

24 A. Let me explain.

25 Q. Uh-huh.

1           A.     In the NGPC meeting on the 4th of  
2 June, there were nine voting members present. We  
3 only needed seven to form a quorum and only five  
4 to have a major -- a majority decision.

5                     So if even Mr. Disspain and Mr. Silber  
6 were not voting, we will still have a majority  
7 decision, and we still have a quorum.

8           Q.     I see.

9                     So, in effect -- I don't think you  
10 answered my question, but we'll come back to that  
11 in a second.

12                    But as I understand it -- let me ask  
13 the question that is troubling me.

14                    Can you please answer my question,  
15 What would have been the effect, if you had  
16 determined there was a conflict of interest, on  
17 the decision that had been taken on -- on  
18 June 4th with respect to the GAC advice?

19           A.     Can you be more specific?

20           Q.     Well, I think I have been.

21                    HONORABLE JUDGE CAHILL: I think he  
22 answered it.

23                    MR. ALI: I think he did, too. I  
24 just wanted to be sure we got -- that his  
25 answer was the same.

1 HONORABLE JUDGE CAHILL: I think you  
2 said there were seven people there, you  
3 disqualified two, there was still --  
4 there was 11 there -- nine --

5 THE WITNESS: No, the nine --

6 HONORABLE JUDGE CAHILL: -- and then  
7 seven --

8 THE WITNESS: -- and then seven.  
9 And we only needed five for a majority.

10 HONORABLE JUDGE CAHILL: So 7-0. I  
11 think that's what you said.

12 BY MR. ALI:

13 Q. Effectively, what you're telling us is  
14 that this whole digging and digging, and this  
15 discussion that took place with Mr. Tonkin and the  
16 subsequent Subcommittee meeting that took place  
17 several weeks later was essentially irrelevant;  
18 isn't that correct?

19 A. You are saying that -- in my view,  
20 it's not irrelevant to apply the Bylaws, and it's  
21 not irrelevant if a member is conflicted to be  
22 removed from the New gTLD Committee.

23 Q. So that was the purpose? You were  
24 conducting these additional inquiries to make the  
25 determination as to whether or not Mr. Disspain,

1 Mr. Silber or whomever else should be removed from  
2 the Committee?

3 A. Indeed, if they are conflicted, they  
4 should not be on the Committee.

5 Q. Okay. But that was the purpose of the  
6 further inquiry because, otherwise, it didn't  
7 really matter, which is what you just told us,  
8 because of the nine and seven and five members who  
9 would have been available in the quorum, correct?

10 A. At the time we had the discussion, it  
11 was all about applying the conflict of interest  
12 policy and whether they were conflicted or not.

13 Q. But it wouldn't have made any  
14 difference with respect to the vote, correct?

15 A. Now that we look at the arithmetics,  
16 yes; but at the time, it didn't matter. We had to  
17 do the right thing. And if they were conflicted,  
18 they would be removed. And if that had  
19 consequences on the vote, then it had consequences  
20 on the vote.

21 Q. And what would be those consequences?

22 A. As we look at it now, there would not  
23 be. But we did not think -- that did not come in  
24 our thinking at the time.

25 The most important thing was to apply

1 the conflict of interest policy and to make sure  
2 they were not conflicted. And if they were, then  
3 we would ask them not to be in the New gTLD  
4 Committee, as we asked the Chairman and  
5 Vice Chairman before. And we would not shy away  
6 from doing that.

7 Q. But it would not have mattered with  
8 respect to the vote that had already been taken,  
9 correct?

10 A. I think we've gone through this  
11 several times.

12 Q. Would you please answer my question?

13 A. Now that we're doing the math, the  
14 answer is no.

15 Q. I see.

16 At the time, you didn't -- the math  
17 didn't really matter to you?

18 A. The primary objective of that  
19 discussion was to be sure that the conflict of  
20 interest policy is applied, right, which would  
21 lead to those people, full stop.

22 Q. I understand.

23 Let's move on to a different set of  
24 questions.

25 Let's talk a little bit about

1 Mr. Silber, who -- Silber, who you discuss in  
2 Paragraph 8 of your testimony.

3 So you say that Mr. Silber is a  
4 nonexecutive director of the .za domain name  
5 authority.

6 .za or .zed-a is the country code for  
7 South Africa; is that correct?

8 A. Yes.

9 Q. And what does the .za domain name  
10 authority do?

11 A. They administer the .za.

12 Q. They administer the .za.

13 And what does UniForum SA do with  
14 respect to .za?

15 A. They have a contractual relationship  
16 to actually run it, you know, with computers and  
17 with processes, everything that they do.

18 Q. Okay. And do you know if what --  
19 where is UniForum SA based?

20 A. I don't know. I'm not sure I can  
21 answer this question.

22 Q. Because you don't know the nationality  
23 of the company or the nationality of any of the  
24 principals of UniForum SA?

25 A. No.



1 Q. Okay. That's fair enough.

2 So .za Domain Name Authority you  
3 referred to as ZADNA; is that correct?

4 A. Yes.

5 Q. And in the context of your digging  
6 with respect to the conflict of interest that  
7 Mr. Silber and Mr. Disspain might have had, which  
8 you ultimately determined they didn't have, did  
9 you -- did you ascertain whether or not ZADNA had  
10 endorsed the UniForum application for .africa?

11 A. No.

12 Q. Okay. Now, I'm going to -- it's  
13 difficult now that we don't have the screen up  
14 there --

15 ARBITRATOR KESSEDJIAN: We can put  
16 it back if you want.

17 MR. ALI: I just want to look at  
18 C-71. If we could pull that up, please.

19 There may be a couple of others.

20 (Pause.)

21 BY MR. ALI:

22 Q. So can you see C-71, sir?

23 A. Yeah.

24 Q. Okay. The top -- the top line, this  
25 is a document -- this is an e-mail from -- I

1 believe that's Larika Gurnick to Mark McFadden --  
2 sorry -- Larisa Gurnick. And it says, at the top  
3 of the e-mail, Mark, I just learned from Ann that  
4 there is a meeting taking place today at the  
5 executive level to discuss .africa.

6 MS. ZERNIK: Is this C-71?

7 MR. ALI: This is C-71.

8 MR. LEVEE: On the first page?

9 MR. ALI: On the first page of C-71.

10 MR. LEVEE: Not the one we have.

11 MR. ALI: Maybe it's the second  
12 page. I apologize.

13 I'll give you the Bates number.

14 It's 447.

15 MR. LEVEE: It's the second page.

16 MR. ALI: It's the second page.

17 PRESIDENT BARIN: It's the second  
18 page of C-71.

19 BY MR. ALI:

20 Q. It's the second page.

21 But the question really goes to -- to  
22 what I've just read.

23 Do you know what she's referring to  
24 when they say, "at the executive level to discuss  
25 .africa"?

1 A. No.

2 MR. LEVEE: Mr. Chair, this would be  
3 a good opportunity to say that this is  
4 well beyond the scope of the questions.  
5 And, of course, the witness is not copied  
6 or addressed on the e-mail.

7 PRESIDENT BARIN: I think that's a  
8 fair comment.

9 MR. ALI: Okay. If I can just lay a  
10 foundation.

11 PRESIDENT BARIN: Sure.

12 HONORABLE JUDGE CAHILL: Foundation  
13 doesn't go beyond the scope.

14 MR. ALI: Well, he testified to the  
15 fact that he's been with ICANN for  
16 five years. He's been in the ICANN  
17 leadership for five years.

18 I'm just asking him, as a point of  
19 information within the context of his  
20 role within ICANN, if he knows what they  
21 mean by "an executive level" -- what is  
22 the executive level meeting that takes  
23 place. Would that have involved  
24 Mr. Chalaby?

25 And I believe I should be entitled

1 to ask whether or not he was involved  
2 in -- you know, what meetings he was  
3 involved in.

4 MR. LEVEE: Still beyond the scope.

5 MR. ALI: He said he doesn't know,  
6 so I'll leave it at that. But perhaps  
7 the Panel may wish to explore that  
8 further.

9 PRESIDENT BARIN: It's a question,  
10 Mr. LeVee, that, again, the Panel can  
11 come back and ask also. I mean --

12 MR. LEVEE: I have no objection if  
13 the Panel asks.

14 PRESIDENT BARIN: Yeah.

15 So, Mr. Ali, you can ask your  
16 question, but let's try and keep it --

17 MR. ALI: I'll move on.

18 If I may get some clarification from  
19 the President, together with any guidance  
20 that my friend Mr. LeVee would care to  
21 provide.

22 Would it be permissible for me to  
23 ask questions regarding the June 4th  
24 meeting of the NGPC, which is referred to  
25 in his statement?

1           PRESIDENT BARIN: You know, I'm  
2           inclined to say yes, because I don't know  
3           what question you're going to ask --

4           MR. ALI: Fair point.

5           PRESIDENT BARIN: -- so I will say  
6           yes. And if something comes up, then  
7           we'll deal with it.

8           MR. LEVEE: That's where I was  
9           headed.

10          MR. ALI: Sure. Fair enough.

11          BY MR. ALI:

12           Q. Mr. Chalaby, there was -- there's a  
13          meeting on June 4th of the NGPC at which the GAC  
14          advice was unanimously accepted by the NGPC,  
15          right?

16           A. There was a consensus advice by the  
17          GAC, and the NGPC unanimously voted to accept the  
18          GAC advice, yes.

19           Q. Okay. I believe it's disputed whether  
20          it was consensus or not, but --

21           A. It was consensus advice, sir.

22           Q. Okay. That's your view.

23           HONORABLE JUDGE CAHILL: Well,  
24          that's his testimony. So go on.

25          MR. ALI: Right.

1 BY MR. ALI:

2 Q. So did that meeting take place in  
3 person or was it a telephonic meeting?

4 A. The 4th of June? I don't recall.

5 Q. And if there's a telephonic meeting,  
6 is there a recording kept of that?

7 A. There is a scribe, definitely. There  
8 is minutes -- minutes of the meeting.

9 Q. But there's a real-time transcript,  
10 such as the one that's being taken now; is that  
11 correct?

12 A. I suppose so. I'm not sure. But I  
13 know there are minutes, and minutes are published.

14 Q. All right. And would those minutes  
15 reflect who was present at that meeting?

16 A. It would, yeah.

17 Q. Do you recall if Heather Dryden  
18 participated in that meeting?

19 A. Can we put the minutes and see who was  
20 there?

21 You have to remember that we've had,  
22 since the inception of the NGPC, over 70  
23 meetings. I can't recall which individual.

24 But if we bring the minutes up as an  
25 exhibit, then we will know immediately.

1 Q. I'm happy to oblige.

2 MR. ALI: I believe the one that you  
3 need to pull up is C-114.

4 (Pause.)

5 BY MR. ALI:

6 Q. Could you just scroll through that and  
7 see --

8 A. Can you go back?

9 (Whereupon, the witness mumbles under  
10 breath reviewing the material  
11 provided.)

12 BY MR. ALI:

13 Q. Let me just help you out so we can  
14 save some time.

15 What we'll do is --

16 A. Heather Dryden was in attendance as an  
17 observer of the Committee.

18 Q. And that's the role that the Chair of  
19 the GAC plays, correct?

20 A. Yes.

21 Q. Okay. And at this meeting, there was  
22 a discussion, obviously, regarding -- of some sort  
23 regarding the consensus advice, as you put it,  
24 from -- from the GAC, correct?

25 A. Go on.

1 Q. I asked you a question.

2 A. Can you repeat again?

3 Q. My question was, Do you recall whether  
4 there was a discussion in advance of the vote on  
5 whether or not to accept the GAC's consensus  
6 advice?

7 A. Yes.

8 Q. And was this the only meeting at which  
9 the .africa TLD application by DCA Trust was  
10 discussed?

11 A. I don't remember. I know it was  
12 discussed at that meeting, because there was the  
13 GAC advice.

14 As I mentioned, we had over 70  
15 meetings. I can't remember.

16 Q. Okay. Well, I'll just submit to you  
17 that there was another meeting that took place on  
18 the 8th of May -- and I'm happy to show you a  
19 document confirming that -- at which you -- over  
20 which you presided. And Ms. Dryden was also in  
21 attendance as the GAC liaison at that meeting.

22 So there are two separate meetings  
23 during which the DCA application was discussed:  
24 one on 8th of May and the other one on 4th June.

25 Now, do you recall whether, at any



1 time, Ms. Dryden said anything about the DCA  
2 application?

3 A. No, I don't recall.

4 Q. Do you recall whether anyone on  
5 either -- at either meeting raised any questions  
6 or issues about the fact that the AUC was using  
7 the GAC or participating in the GAC in a manner  
8 that would be detrimental to the interests of --  
9 of DCA?

10 A. I don't recall.

11 Q. So you don't recall, but you don't  
12 know whether anybody said anything or not?

13 A. I don't recall.

14 Q. That's good enough for me.

15 But it's certainly not in the minutes,  
16 to the best of your recollection? You can look  
17 at them both, if you like.

18 To the best of your recollection,  
19 they're not -- nothing's said in the minutes?

20 A. Right. If they are in the minutes,  
21 point them out to me.

22 Q. I'm putting to you there's nothing in  
23 the minutes --

24 A. Okay.

25 Q. -- to that effect, so probably nobody

1 raised anything.

2 A. I don't remember.

3 Q. Just going back, one thing that is  
4 sort of puzzling me a little bit -- you talked  
5 about the different standards: actual, potential,  
6 perceived.

7 So if -- if -- and you also told us  
8 that you've held a number of different senior  
9 positions: global executive committee member,  
10 chairman of supervisory board, the board of  
11 various companies.

12 If one of your companies or one of the  
13 companies you were involved in, in an executive  
14 position or even a managerial position, was  
15 applying for a contract, responding to an RFP,  
16 and you learned that the chairman of one of your  
17 competitors or a senior executive of one of your  
18 competitors was part of the review committee, how  
19 would you react?

20 A. Actually, you lost my concentration  
21 while you were speaking.

22 Can you repeat?

23 Q. I accept that. I think my question  
24 wasn't very precise.

25 Let's assume for a second that --

1           A.     Can we talk about the case rather than  
2     hypotheticals, please?

3           Q.     I think we can talk about a  
4     hypothetical.

5                     I'm simply asking you on the basis of  
6     your experience as a senior executive with -- as  
7     a former partner of Accenture and someone who is  
8     clearly a very sophisticated businessman if a  
9     company in which you were involved was applying  
10    for an RFP --

11          A.     A company I was involved? How is my  
12    involvement --

13          Q.     Any involvement.

14          A.     -- what's the involvement? Explain.

15          Q.     You're the executive chairman of that  
16    company. You are a partner of Accenture, and you  
17    are applying for -- you're responding to an RFP.

18                     You've done that many times, correct?

19          A.     I'm responding to an RFP, okay.  
20                     Correct.

21          Q.     You've done that many times?

22          A.     Keep going. Yes.

23          Q.     Okay. And in responding to that RFP,  
24    you learn that a competitor has been awarded the  
25    RFP --

1 A. Um-hum.

2 Q. -- but that a senior executive of that  
3 competitor was on the Board -- the Review Board  
4 for the RFP.

5 What action would you take?

6 A. So that senior executive of that  
7 company was part of the decision to award the  
8 RFP --

9 Q. I don't think it's a very complicated  
10 question, sir. You can just simply answer it.

11 A. So I would think there's a conflict of  
12 interest.

13 Q. Okay. I think we agree.

14 MR. ALI: I have no further  
15 questions.

16 PRESIDENT BARIN: Thank you,  
17 Mr. Ali.

18 MR. LEVEE: I'm going to stand  
19 because I can barely see.

20 PRESIDENT BARIN: Before you do --  
21 would you like to take a little break  
22 before you do that?

23 THE WITNESS: I'm okay. Thanks.

24 MR. LEVEE: I have four questions.

25 THE WITNESS: Okay.

1 HONORABLE JUDGE CAHILL: Okay.

2 - - -

3 EXAMINATION ON BEHALF OF RESPONDENT  
4 INTERNET CORPORATION FOR ASSIGNED NAMES AND NUMBERS

5 - - -

6 BY MR. LEVEE:

7 Q. I know you cannot remember whether you  
8 interviewed Mr. Disspain or Mr. Silber in  
9 conjunction with the Ethics Subcommittee.

10 Was it and has it been the practice of  
11 the Ethics Subcommittee to interview the Board  
12 members who were under discussion?

13 A. Yes.

14 Q. Okay. You have seen, in the course of  
15 preparing for your testimony, that  
16 DotConnectAfrica sent letters to Mr. Chehadé in  
17 the summer of 2012 expressing concern about a  
18 conflict of interest relating to those two  
19 members, correct?

20 A. Yes.

21 Q. Okay. After the NGPC voted or at any  
22 time in the course of 2011, did DCA bring to the  
23 Board's attention any new facts relating to either  
24 Mr. Disspain or Mr. Silber that had not been  
25 included in the previous letters that had been

1 sent to ICANN?

2 A. No.

3 MR. LEVEE: Okay. That's all I  
4 have. Thank you.

5 HONORABLE JUDGE CAHILL: On  
6 the -- where am I?

7 MR. ALI: Just as a point of record,  
8 Judge Cahill -- sorry -- I don't believe  
9 I asked any questions during my  
10 cross-examination with respect to any  
11 letters sent by DCA.

12 So just as a point of information,  
13 if there are rules that apply to me, they  
14 also apply to Mr. LeVee. Thank you.

15 PRESIDENT BARIN: Understood.

16 HONORABLE JUDGE CAHILL: I'm sorry.  
17 You're fine.

18 - - -

19 EXAMINATION ON BEHALF OF THE PANEL

20 BY HONORABLE JUDGE CAHILL

21 - - -

22 HONORABLE JUDGE CAHILL: Well, I'm  
23 looking at your declaration, Paragraph 5  
24 again, and you have the -- I think I know  
25 the answer to this, but I just want to

1 make sure -- you have the -- the Internet  
2 address for the -- for the ombudsman  
3 report.

4 Do you see that there?

5 THE WITNESS: Yes.

6 HONORABLE JUDGE CAHILL: Is that  
7 public that everybody can see? For  
8 instance, would DCA be -- be available  
9 to -- to look at that?

10 THE WITNESS: I believe it was  
11 posted on the Web site.

12 HONORABLE JUDGE CAHILL: But you  
13 don't know for sure?

14 THE WITNESS: I don't know for sure,  
15 but it would be normal practice to post  
16 it.

17 HONORABLE JUDGE CAHILL: Okay.

18 ARBITRATOR KESSEDJIAN: I got it  
19 from the URL that is mentioned here. I  
20 didn't get it from the file, but I  
21 actually typed the URL and I got  
22 the -- but I don't know when it was  
23 posted.

24 HONORABLE JUDGE CAHILL: Well, I  
25 think they responded, but we'll get to

1           that later.

2           Thank you.

3           Okay.

4           PRESIDENT BARIN: Any questions?

5                           - - -

6           EXAMINATION ON BEHALF OF THE PANEL

7                           BY ARBITRATOR KESSEDJIAN

8                           - - -

9           ARBITRATOR KESSEDJIAN: No, but --  
10          perhaps just as a general context, is  
11          your position with ICANN 100 percent job?  
12          Is that -- or are you having other  
13          activities?

14          THE WITNESS: Currently, I don't  
15          have other activities.

16          ARBITRATOR KESSEDJIAN: And you are  
17          based in Los Angeles, no?

18          THE WITNESS: No; I'm based in  
19          London.

20          ARBITRATOR KESSEDJIAN: In London?

21          THE WITNESS: Yeah.

22          ARBITRATOR KESSEDJIAN: So you  
23          travel to all meetings?

24          THE WITNESS: Indeed, I do.

25          ARBITRATOR KESSEDJIAN: And what's



1 the percentage of meetings that are held  
2 via telephone conference or  
3 videoconferencing and in person? Would  
4 you --

5 THE WITNESS: Well, I don't know  
6 about the percentage, but I can tell you  
7 that we have three big ICANN meetings a  
8 year --

9 ARBITRATOR KESSEDJIAN: That's the  
10 public ones, yeah?

11 THE WITNESS: Yeah.

12 -- and we have, I think, four what I  
13 call "Board workshop," and the rest of it  
14 is by telephone.

15 ARBITRATOR KESSEDJIAN: Okay. Thank  
16 you.

17 - - -

18 EXAMINATION ON BEHALF OF THE PANEL

19 BY HONORABLE JUDGE CAHILL

20 - - -

21 HONORABLE JUDGE CAHILL: You say  
22 "currently."

23 You don't have any other --

24 THE WITNESS: Yes.

25 HONORABLE JUDGE CAHILL: -- at the

1 time this was going on, did you have  
2 other responsibilities?

3 THE WITNESS: Yes. I was chairman  
4 of a bank, but we sold that bank, and I'm  
5 no longer a chairman.

6 HONORABLE JUDGE CAHILL: So in  
7 October 2012, you were chairman of the  
8 bank?

9 THE WITNESS: We sold it probably  
10 just before that.

11 HONORABLE JUDGE CAHILL: Okay.  
12 I'm done.

13 PRESIDENT BARIN: Okay.

14 Thank you, Mr. Chalaby --

15 HONORABLE JUDGE CAHILL: Good. Was  
16 that fun?

17 PRESIDENT BARIN: -- we appreciate  
18 you coming and wish you safe travel  
19 wherever you're going.

20 THE WITNESS: Thank you. I answered  
21 to the best of my ability. That's all I  
22 can say.

23 (The witness was excused.)

24 HONORABLE JUDGE CAHILL: Take a  
25 break?

1           PRESIDENT BARIN: Yes. Let's take a  
2 short break. We'll come back, and we'll  
3 start with Ms. Dryden.

4           Let's say a 10-minute break --

5           HONORABLE JUDGE CAHILL: Yeah.

6           PRESIDENT BARIN: -- 10 minutes  
7 back?

8                                 - - -

9                                 (Whereupon, a brief recess was taken  
10                                 from 3:07 p.m. to 3:26 p.m.)

11                                - - -

12           PRESIDENT BARIN: Just a couple of,  
13 perhaps, housekeeping matters before we  
14 start.

15           I'm looking at my watch. It's 3:30.

16           MR. LEVEE: Yeah.

17           PRESIDENT BARIN: We'll obviously  
18 get through Ms. Dryden this afternoon.

19           HONORABLE JUDGE CAHILL: Obviously?

20           PRESIDENT BARIN: The Panel is in  
21 your hands with respect to Ms. Bekele.

22           MR. LEVEE: We spoke, and it's our  
23 preference -- obviously, if it gets out  
24 of hand, we'll speak again, but it would  
25 be our preference to complete the witness

1 testimony today --

2 PRESIDENT BARIN: Okay.

3 MR. LEVEE: -- so that we could  
4 actually have the testimonies in order to  
5 prepare for tomorrow.

6 HONORABLE JUDGE CAHILL: Okay.

7 PRESIDENT BARIN: So that would  
8 require us to sit for however long we  
9 need.

10 MR. LEVEE: It make take us a little  
11 later into the evening than your schedule  
12 had predicted.

13 HONORABLE JUDGE CAHILL: 9:00, I  
14 have to go.

15 MR. LEVEE: Whatever it is, it is.

16 PRESIDENT BARIN: He's still on  
17 California time.

18 HONORABLE JUDGE CAHILL: We're wide  
19 awake. We're ready to go.

20 MR. LEVEE: It's almost time for  
21 lunch.

22 MR. ALI: At 10:00, I nod off in  
23 front of the TV.

24 PRESIDENT BARIN: Okay.

25 So that's -- so let's move on to --

1 HONORABLE JUDGE CAHILL: If you're  
2 from France, you're in real trouble.

3 (Laughter.)

4 ARBITRATOR KESSEDJIAN: They took my  
5 glass.

6 HONORABLE JUDGE CAHILL: They took  
7 the glasses again.

8 You have an efficient firm.

9 PRESIDENT BARIN: Ms. Dryden, good  
10 afternoon.

11 THE WITNESS: Good afternoon.

12 PRESIDENT BARIN: Thank you for  
13 coming to be with us.

14 First things first. I will do what  
15 I did for equality purposes to you as  
16 well as Mr. Chalaby.

17 - - -

18 H E A T H E R D R Y D E N,  
19 after having been first duly sworn by  
20 President Barin, was examined and  
21 testified as follows:

22 - - -

23 PRESIDENT BARIN: So you've been  
24 sworn.

25 Are you satisfied with that as well?

1 THE COURT REPORTER: Thank you.

2 - - -

3 EXAMINATION ON BEHALF OF THE PANEL

4 BY PRESIDENT BARIN

5 - - -

6 PRESIDENT BARIN: Ms. Dryden, I see  
7 from your declaration that you're  
8 currently a senior policy advisor at the  
9 International Telecommunications Policy  
10 and Coordination Directorate at the  
11 Canadian Department of Industry.

12 THE WITNESS: That's correct, yes.

13 PRESIDENT BARIN: And you still hold  
14 that position?

15 THE WITNESS: Yes. I am on  
16 full-time French training currently and  
17 have been since leaving the position of  
18 chairing the GAC. So that's actually  
19 what I am doing presently.

20 PRESIDENT BARIN: Sorry. Full time?

21 THE WITNESS: French training.

22 PRESIDENT BARIN: French training?

23 THE WITNESS: Yes.

24 PRESIDENT BARIN: Great.

25 ARBITRATOR KESSEDJIAN: French

1 training? In the French language?

2 THE WITNESS: Yes.

3 ARBITRATOR KESSEDJIAN: Wow. That's  
4 great.

5 HONORABLE JUDGE CAHILL: Am I the  
6 only one who speaks one language? I bet  
7 everybody speaks more than one language.

8 ARBITRATOR KESSEDJIAN: And for how  
9 long?

10 THE WITNESS: It has been for a  
11 few months, and I have a test next  
12 week -- an exam.

13 PRESIDENT BARIN: I assume the  
14 Government of Canada has other plans for  
15 her.

16 THE WITNESS: We will see. It's --  
17 it's yet to be seen what I will do next.

18 PRESIDENT BARIN: Okay. Would you  
19 be kind enough to let us know what your  
20 professional background is in terms of  
21 what you studied and what you've done?

22 THE WITNESS: Certainly.

23 I've been a Canadian public servant  
24 since 2002, always with the Canadian  
25 Department of Industry.

1           And my educational background is  
2           focused on international politics and  
3           Russian-Area studies.

4           Before joining the department, I had  
5           various roles. I spent some time working  
6           for the NATO Information Office in  
7           Moscow. I taught English in Korea for a  
8           couple of years.

9           So, as I say, I have no idea of  
10          different kinds of experience before  
11          becoming a public servant.

12          For most of the time working at  
13          industry Canada, I've had responsibility  
14          for telecommunications or Internet policy  
15          matters and, in particular, Internet  
16          governance. And my responsibilities have  
17          not been limited only to the roles I have  
18          played within the -- the GAC, as we say,  
19          at ICANN, but -- but includes things like  
20          representing the department on the Board  
21          of the Canadian operator of the country  
22          code for the Internet, which is .ca.

23          I also spent some time as a member  
24          of the UN Internet Governance Forum  
25          Advisory Group. And, again, that was in



1 my capacity as -- as a Canadian public  
2 servant.

3 PRESIDENT BARIN: And how was it  
4 that you found yourself being involved in  
5 ICANN, I believe, as of 2010, correct?

6 THE WITNESS: My experience with the  
7 GAC predates that. I -- my first meeting  
8 was March 2007, and that was as part of  
9 the Canadian representation to the  
10 committee. And then over time, I became  
11 the Canadian representative.

12 And then, as you pointed out, in  
13 June 2010, that's when I was first  
14 elected to serve as interim Chair, and  
15 then I was elected after that for a total  
16 of about four-and-a-half years in the  
17 role of Chair.

18 PRESIDENT BARIN: And I assume that  
19 kind of invitation comes, presumably,  
20 from ICANN as opposed to anything any  
21 particular government puts forward?

22 THE WITNESS: It's entirely down to  
23 the GAC. And so the GAC has its own  
24 procedures for electing its leadership.  
25 There are three Vice Chairs, for example,

1 in addition to the Chair. And -- and  
2 that's certainly the case with the  
3 working methods of the Committee as well.

4 That's very much a decision of the  
5 Committee.

6 PRESIDENT BARIN: And do I  
7 understand correctly that you are still a  
8 nonvoting liaison member to the Board of  
9 Directors of ICANN?

10 THE WITNESS: No. So the October  
11 meeting of 2014 was my last meeting  
12 serving either as the Chair of the GAC or  
13 the other half of that role that comes  
14 along with it, which is the nonvoting  
15 liaison to the Board.

16 So for any Chair of the GAC, as  
17 things stand, it's a dual purpose role.  
18 You're chairing the GAC, but then you're  
19 also serving as the nonvoting liaison  
20 from the GAC to the Board.

21 PRESIDENT BARIN: Okay. And in that  
22 capacity, is it fair to say that you  
23 play, I guess, a hands-on role when it  
24 comes to reporting to the Board? That's  
25 the ICANN Board. If it's not, you can

1 correct me. It was just an expression  
2 that came to my mind.

3 THE WITNESS: The nature of the  
4 role -- clearly, it's nonvoting -- is --  
5 is really -- it allows for the nonvoting  
6 liaisons to attend meetings. You can ask  
7 to speak and contribute and, where  
8 possible, you can clarify matters.

9 But the expectation from the GAC is  
10 that you are there to represent the  
11 collective views of the GAC as a whole.

12 PRESIDENT BARIN: If I can just sort  
13 of probe into that a little bit more.

14 With respect to the incidents  
15 relating to .africa and the claim of  
16 DCA Trust, is that something that you  
17 would have been, I guess, mostly  
18 professionally, intricately involved from  
19 the outset?

20 THE WITNESS: My involvement really  
21 relates to handling the issue within the  
22 GAC --

23 PRESIDENT BARIN: Okay.

24 THE WITNESS: -- so, as you are  
25 aware, the GAC was given a particular

1           role as part of the gtLD program allowing  
2           for particular kinds of advice, including  
3           GAC consensus objections.

4           And so it was my job to oversee that  
5           in the GAC.

6           PRESIDENT BARIN: Let me take you  
7           directly to your statement, a copy of  
8           which you have in front of you, I  
9           believe, correct?

10          THE WITNESS: I do.

11          PRESIDENT BARIN: You don't have  
12          any -- just so we don't go through -- you  
13          don't have any other notes or anything  
14          that you want to refer to that you can  
15          give us copies?

16          THE WITNESS: No.

17          PRESIDENT BARIN: No.

18          So let's go to Paragraph 12.

19          And there are other questions I'm  
20          sure my colleagues will want to ask you,  
21          but I will go directly to the heart of  
22          the issue.

23          In Paragraph 12, you say, In any  
24          event, the dialogue that occurs among GAC  
25          members prior to the particular GAC

1 meeting at which a proposal is supposed  
2 to be decided, one does not bind the GAC  
3 or any of its participating countries.  
4 What matters is what occurs during the  
5 actual decisional GAC meeting. On  
6 10 April 2013, the GAC met in Beijing  
7 specifically to address whether to issue  
8 GAC consensus advice in conjunction with  
9 DCA's application for .africa.

10 During the meeting, an African  
11 country confirmed the DCA's application  
12 should remain on the consensus objection  
13 agenda for consideration and decision by  
14 the GAC.

15 Can you tell me what really happened  
16 in Beijing?

17 THE WITNESS: Yes, I can tell you in  
18 very precise terms as far as the issue of  
19 the decision that was taken regarding  
20 .africa.

21 There was a specific agenda that was  
22 developed to handle consensus objections.  
23 So that particular kind of advice is  
24 identified in the Guidebook.

25 And governments had the opportunity

1 before the meeting to signal that they  
2 wanted to put a particular string or  
3 application for consideration by the GAC  
4 to issue very specific language about  
5 objecting to a particular string or GAC  
6 application.

7 So in that meeting, I was going  
8 through that agenda, and one of the items  
9 on that agenda, of course, was the  
10 application from DCA --

11 PRESIDENT BARIN: Let me -- I don't  
12 mean to interrupt you, but let me just  
13 back up for a minute because you started  
14 with an agenda.

15 THE WITNESS: Yes.

16 PRESIDENT BARIN: So who prepares  
17 the agenda?

18 THE WITNESS: The GAC.

19 PRESIDENT BARIN: The GAC?

20 THE WITNESS: Yes.

21 PRESIDENT BARIN: And are you  
22 involved in the preparation of that  
23 agenda?

24 THE WITNESS: Yes, it's part of my  
25 responsibilities to oversee and help the

1 meetings.

2 PRESIDENT BARIN: Is it fair to say  
3 that it was your agenda?

4 THE WITNESS: It's the GAC's agenda.  
5 It's agreed by the GAC.

6 PRESIDENT BARIN: Right. But as  
7 being the person who was essentially in  
8 charge, you would put the agenda forward?

9 THE WITNESS: The agenda was created  
10 based on requests coming from individual  
11 countries to -- to form that agenda. So  
12 it's the sum of those inputs from  
13 individual members and the GAC.

14 PRESIDENT BARIN: Okay. So then  
15 there's this agenda that's -- that's  
16 prepared and put forward, and then you go  
17 from there.

18 And one of the items on that agenda  
19 was .africa?

20 THE WITNESS: Correct.

21 PRESIDENT BARIN: Okay.

22 HONORABLE JUDGE CAHILL: Does the EU  
23 have input on this agenda?

24 THE WITNESS: The EU -- the European  
25 commission, which I think you're asking

1 about --

2 HONORABLE JUDGE CAHILL: Yeah.

3 THE WITNESS: -- did not.

4 HONORABLE JUDGE CAHILL: How about  
5 the AUC?

6 THE WITNESS: They did not either.

7 HONORABLE JUDGE CAHILL: Excuse me.

8 PRESIDENT BARIN: Okay. So  
9 continue on. You were saying -- you -- I  
10 sort of stopped you from your flow.

11 You were explaining?

12 THE WITNESS: That's fine.

13 So in the decisional meeting, I came  
14 to this item and explained to the room  
15 that we are now considering a consensus  
16 objection to DCA's application. And one  
17 African country confirmed that they did  
18 want to put it to a question.

19 There were instances where a country  
20 might actually decide to remove something  
21 from an agenda and -- and make that kind  
22 of request.

23 Earlier in the week, on the basis of  
24 discussions and so on and so forth --

25 PRESIDENT BARIN: So give us a bit



1 more context. So -- I mean, imagine --  
2 because we know nothing about -- for you,  
3 I'm sure it's sort of routine, but put us  
4 in context as to how these -- how these  
5 meetings operate.

6 Where are you and -- you're in  
7 Beijing?

8 THE WITNESS: Yes.

9 So would you like me to -- to finish  
10 with the -- the decisional point on DCA's  
11 application or speak more generally about  
12 GAC meetings?

13 PRESIDENT BARIN: Well, speak more  
14 generally to put us in the context, but I  
15 do want to get finally to the decision.

16 THE WITNESS: Okay.

17 So --

18 PRESIDENT BARIN: So you have an  
19 agenda -- let me help you -- you have an  
20 agenda; it's prepared in advance; it's  
21 looked at. And then you --

22 THE WITNESS: I think it's going to  
23 be helpful to be specific about the  
24 agenda.

25 So in the past, the GAC has not had

1 a specific role as outlined in the  
2 Guidebook regarding gTLDs. The GAC can  
3 offer advice anytime it wants on any  
4 topic that it chooses to issue advice on;  
5 but in order to address controversial and  
6 sensitive top-level domains, and, in  
7 particular, the point about the ability  
8 to put forward a consensus objection,  
9 there was a specific agenda for that for  
10 the Beijing meeting in order to manage  
11 that -- handle those particular strings  
12 or applications.

13 If you're talking about how GAC  
14 agendas are prepared, generally, or how  
15 we generate advice, generally --

16 PRESIDENT BARIN: No; I'm more  
17 interested in the specific agenda.

18 THE WITNESS: Okay. So as pertains  
19 to this particular application.

20 So as I was saying, one African  
21 country confirmed that they wanted it put  
22 to a question. I asked the question, and  
23 there were no objections in the room.  
24 And the room was so satisfied with this  
25 result that there was unanimous applause.

1 HONORABLE JUDGE CAHILL: How many  
2 countries are in the room?

3 THE WITNESS: I can't tell you  
4 precisely. If you look at the record of  
5 the meeting, which is the communiqué,  
6 those are our official records of  
7 outcomes from any meeting. You can see a  
8 list of countries there. That will give  
9 you an idea of the number.

10 Generally speaking, between 50 and  
11 70 GAC members would -- would attend.

12 Because of the issues we were  
13 dealing with, I think you had a higher  
14 number than usual for this particular  
15 meeting.

16 ARBITRATOR KESSEDJIAN: May I?

17 PRESIDENT BARIN: Yeah, sure.

18 - - -

19 EXAMINATION ON BEHALF OF THE PANEL

20 BY ARBITRATOR KESSEDJIAN

21 - - -

22 ARBITRATOR KESSEDJIAN: Am I correct  
23 to think that the countries are the only  
24 people who can -- people -- sorry -- are  
25 the only entity who can see who is their

1 representative -- by whom they are --  
2 yeah -- represented and so on?

3 THE WITNESS: Absolutely, yeah.

4 ARBITRATOR KESSEDJIAN: So they do  
5 whatever they want in terms of --

6 THE WITNESS: Yes.

7 ARBITRATOR KESSEDJIAN: Okay.

8 And so if we speak about Kenya in  
9 this particular case, because Kenya had a  
10 special role, what do you remember about  
11 that for the Beijing meeting?

12 I know, in your declaration, you say  
13 you don't remember anything -- you don't  
14 remember who was the representative or  
15 who was there or not there for Kenya; is  
16 that correct?

17 THE WITNESS: In terms of who was at  
18 the Beijing GAC meetings, I recall that  
19 Michael Katundu was there.

20 If you're talking about the session  
21 that I referred to here, which was the  
22 decision to take a consensus objection to  
23 the application from DCA, then I don't  
24 recall him being there.

25 ARBITRATOR KESSEDJIAN: Okay. So

1           you make a difference between the meeting  
2           in general and the special session in  
3           which DCA applications was voted on; is  
4           that correct?

5           THE WITNESS: That's correct.

6           And, of course, people can come in  
7           and out, and can be as strategic about  
8           attending a particular discussion or  
9           decision or not attending a particular  
10          discussion or decision. That's entirely  
11          up to a country to determine.

12                                           - - -

13          EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD

14                                           BY PRESIDENT BARIN

15                                           - - -

16          PRESIDENT BARIN: So the context --  
17          I'm just -- I was just trying to get from  
18          you -- is this was on April 10th, 2013,  
19          in Beijing --

20          THE WITNESS: Yes.

21          PRESIDENT BARIN: -- there's a room  
22          then.

23                                           I assume you're chairing the  
24          meeting, right?

25          THE WITNESS: Yes.

1           PRESIDENT BARIN: And so people are  
2           in front of you, you tabled the issues  
3           one by one, that's the general meeting --

4           THE WITNESS: Yes.

5           PRESIDENT BARIN: -- but then, as  
6           part of that general meeting, there's  
7           this very specific point, which is the  
8           DCA .africa --

9           THE WITNESS: Yes.

10          PRESIDENT BARIN: -- point, which  
11          you then table, correct?

12          THE WITNESS: Yes.

13          PRESIDENT BARIN: And you get  
14          participation from the audience?

15          THE WITNESS: Yes.

16          So GAC members request to speak, and  
17          so I acknowledge them. And then they can  
18          make an intervention, and then I can make  
19          a decision when appropriate.

20

21                        Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

16 PRESIDENT BARIN: -- and following  
17 that point, there was nothing else?

18 THE WITNESS: By my recollection,  
19 no.

20 PRESIDENT BARIN: So what happens  
21 just in terms of process, then? You say  
22 Anybody else have any comments, you get  
23 no comments, and --

24 THE WITNESS: Right --

25 PRESIDENT BARIN: -- and then what?

1 THE WITNESS: -- and then I say, I'm  
2 now going to ask the question. I ask the  
3 question. I see no objections. Then I  
4 confirm that I see none, and then I  
5 confirm that we now have a GAC consensus  
6 objection.

7 That was the exchange.

8 PRESIDENT BARIN: And then it's  
9 noted into -- into the record?

10 THE WITNESS: Yes. It went into the  
11 communiqué.

12 ARBITRATOR KESSEDJIAN: So there is  
13 no vote?

14 THE WITNESS: No.

15 PRESIDENT BARIN: As part of the  
16 function that you occupied for GAC, had  
17 you had a similar situation to that ever  
18 occur with respect to any other item?

19 THE WITNESS: Could you clarify what  
20 the similarity is?

21 PRESIDENT BARIN: Well, the  
22 similarity is -- in this case, you have a  
23 specific agenda relating to .africa --

24 THE WITNESS: Yes.

25 PRESIDENT BARIN: -- you had a



1 general meeting, as you said --

2 THE WITNESS: Yes.

3 PRESIDENT BARIN: -- and you had a  
4 specific item on the agenda? The issue  
5 was raised. You had one comment, and  
6 then, essentially, a decision was  
7 reached.

8 THE WITNESS: Yes.

9 PRESIDENT BARIN: Okay. Are  
10 there -- were there -- have you been  
11 involved in any other situations where a  
12 similar decision was -- was reached as  
13 part of your tenure at the GAC?

14 THE WITNESS: Other consensus  
15 objections were issued at that meeting  
16 and at the fall meeting.

17 PRESIDENT BARIN: In exactly the  
18 same way?

19 THE WITNESS: Yes, the exact same  
20 question was asked each time.

21 HONORABLE JUDGE CAHILL: And there  
22 were objections?

23 THE WITNESS: In some cases, there  
24 were objections, in which case, you do  
25 not have a consensus objection. And for

1           one string, I can recall certainly there  
2           was an objection carried.

3           ARBITRATOR KESSEDJIAN: On this very  
4           question, when you said, yes, there were  
5           the same question asked.

6           Do I have to understand that the  
7           "same question" means applications --  
8           objections to applicants, specific  
9           applicants?

10          THE WITNESS: I would ask the room,  
11          Are there any objections to a GAC  
12          consensus objection to the string  
13          ba-ba-ba-ba?

14          And then I would --

15          ARBITRATOR KESSEDJIAN: Which  
16          example did you have before this year's  
17          application --

18          THE WITNESS: So --

19          ARBITRATOR KESSEDJIAN: -- for  
20          example, I mean --

21          THE WITNESS: -- this session was  
22          the first time that we had done that, and  
23          in that session, we agreed to object to  
24          .gcc, as I recall.

25          ARBITRATOR KESSEDJIAN: Dot?

1 THE WITNESS: .gcc.

2 ARBITRATOR KESSEDJIAN: .gcc?

3 THE WITNESS: Yes.

4 HONORABLE JUDGE CAHILL: You agreed  
5 to object or there were objectors to your  
6 consensus objection?

7 THE WITNESS: We agreed to object.

8 There were other strings that were  
9 put forward for consensus objection, and  
10 they were not carried.

11 HONORABLE JUDGE CAHILL: They were  
12 not carried?

13 THE WITNESS: Right. In other  
14 words, countries put up their hands to  
15 object and block it, in effect.

16 ARBITRATOR KESSEDJIAN: Okay. So  
17 Beijing was the first time you ever did  
18 that kind of process?

19 THE WITNESS: To object to a  
20 particular application, yes.

21 ARBITRATOR KESSEDJIAN: Okay. Okay.  
22 So how did you prepare, as the Chair  
23 for this meeting, since you had no  
24 precedent to work out of?

25 THE WITNESS: It was really in the

1 preparation of -- of the agenda. We have  
2 preparatory calls in between meetings,  
3 and we discussed within the Committee,  
4 within the GAC how to proceed.

5 I made it very clear what the  
6 question would be, and then it's the  
7 responsibility of the countries, of  
8 course, to consult at home and come with  
9 positions prepared and ready to engage  
10 with their colleagues if, for example,  
11 they wanted an objection, to -- to gauge  
12 what the other views are of the  
13 colleagues.

14 And -- and in this way, it was clear  
15 for colleagues what to prepare and what  
16 the question would be and how it would be  
17 handled, and when, for that matter.

18 ARBITRATOR KESSEDJIAN: I sense a  
19 kind of contradiction between -- what you  
20 say in your declaration is that all the  
21 exchange of e-mails before the meeting --  
22 and there seem to be substantial amount  
23 of e-mail exchange before the meetings --  
24 before the meetings -- and you say this  
25 does not matter. What matters is what's

1 going on at the meeting.

2 But now you just explained to us  
3 that, basically, at the meeting, happens  
4 nothing. You ask the question and no  
5 discussion almost, one country just write  
6 something -- I'm not entirely sure what  
7 they said -- and then you declare that  
8 there is a consensus.

9 So how do you reconcile that?

10 Because then, you know, in order to get  
11 to that consensus -- I mean, I've been  
12 chairing meetings where consensus was the  
13 rule. You need to do a lot of  
14 preparation in advance and make sure that  
15 the consensus is going to be accepted.

16 So how do you reconcile those two  
17 things?

18 THE WITNESS: A lot happens in the  
19 meetings, and the decisional part is at  
20 the end. So that's when the communiqués  
21 from our meetings are finalized. So  
22 that's at the end.

23 And up until that point, there's a  
24 lot of engagement, most of it taking  
25 place outside the room. Of course, we're

1           having discussions in the room about the  
2           topics that we need to. But that's all  
3           ready to prepare, that moment when you  
4           are going to decide.

5           And, hopefully, you know in advance  
6           what is probably going to happen, simply  
7           because Chairs don't like to be  
8           surprised. But surprises do happen.  
9           And -- and it's really -- really a matter  
10          of -- of the decisional meeting at the  
11          end reflecting the result of the meeting.

12          PRESIDENT BARIN:     So are you  
13          saying -- because I asked you this  
14          question earlier. I'm a little puzzled  
15          now.

16          Are you saying that a lot of the  
17          decision-making process takes place prior  
18          to the meeting and even during to and  
19          leading to the actual decision where  
20          people are outside?

21          THE WITNESS:     None of the GAC  
22          decision-making takes place in any other  
23          form than -- than when the GAC is making  
24          a decision.

25          If -- if colleagues are trying to

1 resolve issues, come up with a way  
2 forward, that's all very much encouraged;  
3 that's -- that's productive. That's more  
4 informal but very much encouraged.

5 PRESIDENT BARIN: But I also  
6 understood you to say that the -- when  
7 the issue was tabled, which is the  
8 .africa to be specific, it didn't take  
9 very long for the decision to be -- to be  
10 made, which is --

11 THE WITNESS: No, not at all, yeah.

12 PRESIDENT BARIN: -- which means  
13 that a lot of this, I guess,  
14 consultation, if I could put it that way,  
15 was happening before?

16 THE WITNESS: That is what -- what I  
17 certainly hoped, as Chair, would happen.  
18 And -- and, as I say, it doesn't always,  
19 but -- but --

20 PRESIDENT BARIN: But be specific in  
21 this case.

22 Is that what happened in the .africa  
23 case?

24 THE WITNESS: The decision was very  
25 quick, and --

1           PRESIDENT BARIN: But what about the  
2 consultations prior? In other words,  
3 were -- were you privy to --

4           THE WITNESS: No. If -- if  
5 colleagues are talking among themselves,  
6 then that's not something that the GAC,  
7 as a whole, is -- is tracking or -- or  
8 involved in.

9           It's really those interested  
10 countries that are.

11          PRESIDENT BARIN: Understood.

12          But I assume -- I also heard you  
13 say, as the Chair, you never want to be  
14 surprised with something that comes up.

15          So you are aware of -- or you were  
16 aware of exactly what was happening?

17          THE WITNESS: No. No. You do want  
18 to have a good sense of where the  
19 problems are, what's going to come  
20 unresolved back to the full GAC meeting,  
21 but that's -- that's the extent of it.  
22 And that's the nature of -- of the  
23 political process.

24                   Redacted - GAC Designated Confidential  
                                  Information



1 Redacted - GAC Designated Confidential  
Information

7 HONORABLE JUDGE CAHILL: Okay.

8 THE WITNESS: -- that question was  
9 addressed via having that meeting.

10 PRESIDENT BARIN: And what's your  
11 understanding of what -- what the  
12 consequence of that decision is or was  
13 when you took it? So what happens from  
14 that moment on?

15 THE WITNESS: It's conveyed to the  
16 Board, so all the results, the agreed  
17 language coming out of GAC is conveyed to  
18 the Board, as was the case with the  
19 communiqué from the Beijing meeting.

20 PRESIDENT BARIN: And how is that  
21 conveyed to the Board?

22 THE WITNESS: Well, it's a written  
23 document, and usually Support Staff are  
24 forwarding it to Board Staff.

25 ARBITRATOR KESSEDJIAN: Could you

1 speak a little bit louder? I don't know  
2 whether I am tired, but I --

3 THE WITNESS: Okay.

4 So as I was saying, the document is  
5 conveyed to the Board once it's  
6 concluded.

7 PRESIDENT BARIN: When you say "the  
8 document," are you referring to the  
9 communiqué?

10 THE WITNESS: Yes.

11 PRESIDENT BARIN: Okay. And there  
12 are no other documents?

13 THE WITNESS: The communiqué --

14 PRESIDENT BARIN: In relation to  
15 .africa. I'm not interested in any  
16 other.

17 THE WITNESS: Yes, it's the  
18 communiqué.

19 PRESIDENT BARIN: And it's prepared  
20 by your staff? You look at it?

21 THE WITNESS: Right --

22 PRESIDENT BARIN: And then it's sent  
23 over to --

24 THE WITNESS: -- right, it's agreed  
25 by the GAC in full, the contents.

1           PRESIDENT BARIN: And then sent over  
2 to the Board?

3           THE WITNESS: And then sent, yes.

4           PRESIDENT BARIN: And what happens  
5 to that communiqué? Does the Board  
6 receive that and say, Ms. Dryden, we have  
7 some questions for you on this, or --

8           THE WITNESS: Not really. If they  
9 have questions for clarification, they  
10 can certainly ask that in a meeting. But  
11 it is for them to receive that and then  
12 interpret it and -- and prepare the Board  
13 for discussion or decision.

14          PRESIDENT BARIN: Okay. And in this  
15 case, you weren't asked any questions or  
16 anything?

17          THE WITNESS: I don't believe so. I  
18 don't recall.

19          PRESIDENT BARIN: Any follow-ups,  
20 right?

21          THE WITNESS: Right.

22          PRESIDENT BARIN: And in the  
23 subsequent meeting, I guess the issue was  
24 tabled. The Board meeting that it was  
25 tabled, were you there?

1 THE WITNESS: Yes. I don't  
2 particularly recall the meeting, but yes.

3 PRESIDENT BARIN: As, again, the  
4 nonliaison?

5 THE WITNESS: As the nonvoting  
6 liaison, correct.

7 PRESIDENT BARIN: The nonvoting  
8 liaison?

9 THE WITNESS: Correct.

10 PRESIDENT BARIN: If there were any  
11 questions by the Board on the particular  
12 issue, you were a nonvoting member?

13 THE WITNESS: Probably, yeah.

14 PRESIDENT BARIN: Okay.

15 - - -

16 EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD  
17 BY ARBITRATOR KESSEDJIAN

18 - - -

19 ARBITRATOR KESSEDJIAN: Can I turn  
20 your attention to Paragraph 5 of your  
21 declaration?

22 Here, you basically repeat what is  
23 in the ICANN Guidebook literature,  
24 whatever. These are the exact words,  
25 actually, that you use in your

1 declaration in terms of why there could  
2 be an objection to an applicant -- to a  
3 specific applicant.

4 And you use three criteria:  
5 problematic, potentially violating  
6 national law, and raise sensitivities.

7 Now, I'd like you to, for us -- for  
8 our benefit, to explain precisely, as  
9 concrete as you can be, what those three  
10 concepts -- how those three concepts  
11 translate in the DCA case. Because this  
12 must have been discussed in order to get  
13 this very quick decision that you are  
14 mentioning.

15 So I'd like to understand, you know,  
16 because these are the criteria -- these  
17 are the three criteria; is that correct?

18 THE WITNESS: That is what the  
19 witness statement says, but the link to  
20 the GAC and the role that I played in  
21 terms of the GAC discussion did not  
22 involve me interpreting those three  
23 things. In fact, the GAC did not provide  
24 rationale for the consensus objection.

25 ARBITRATOR KESSEDJIAN: No.

1           But, I mean, look, the GAC is taking  
2           a decision which -- very quickly -- I'm  
3           using your words, "very quickly" --  
4           erases years and years and years of work,  
5           a lot of effort that have been put by a  
6           single applicant.

7           And the way I understand the rules  
8           is that the -- the GAC advice --  
9           consensus advice against that applicant  
10          are -- is based on those three criteria.

11          Am I wrong in that analysis?

12          THE WITNESS: I'm saying that the  
13          GAC did not identify a rationale for  
14          those governments that put forward a  
15          string or an application for consensus  
16          objection. They might have identified  
17          their reasons, but there was not GAC  
18          agreement about those reasons or -- or --  
19          or -- or rationale for that.

20          We had some discussion earlier about  
21          Early Warnings. So Early Warnings were  
22          issued by individual countries, and they  
23          indicated their rationale. But, again,  
24          that's not a GAC view.

25          ARBITRATOR KESSEDJIAN: So,

1            basically, you're telling us that the GAC  
2            takes a decision to object to an  
3            applicant, and no reasons, no rationale,  
4            no discussion of the concepts that are in  
5            the rules?

6            THE WITNESS: I'm telling you the  
7            GAC did not provide a rationale. And  
8            that was not a requirement for issuing a  
9            GAC --

10           HONORABLE JUDGE CAHILL: But you  
11           also want to check to see if the  
12           countries are following the right --  
13           following the rules, if there are reasons  
14           for rejecting this or it falls within the  
15           three things that my colleague's talking  
16           about.

17           THE WITNESS: The practice among  
18           governments is that governments can  
19           express their view, whatever it may be.  
20           And so there's a deference to that.  
21           That's certainly the case here as well.

22           The -- if a country tells -- tells  
23           the GAC or says it has a concern, that's  
24           not really something that -- that's  
25           evaluated, in the sense you mean, by the

1 other governments. That's not the way  
2 governments work with each other.

3 HONORABLE JUDGE CAHILL: So you  
4 don't go into the reasons at all with  
5 them?

6 THE WITNESS: To issue a consensus  
7 objection, no.

8 HONORABLE JUDGE CAHILL: Okay.

9 - - -

10 EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD

11 BY PRESIDENT BARIN

12 - - -

13 PRESIDENT BARIN: Just a quick  
14 follow-up, and this may be an obvious  
15 answer to the question.

16 Is there a way that you check as to  
17 who is involved in sort of the  
18 participation on the part of the  
19 governments? In other words, do you --  
20 is there a control mechanism that  
21 indicates to you that certain people are  
22 there that should be there?

23 It -- it's a totally innocent  
24 question, if you will.

25 HONORABLE JUDGE CAHILL: It's an



1 arbitrator question.

2 (Laughter.)

3 THE WITNESS: The GAC maintains  
4 records in the sense of needing to -- to  
5 have -- it's useful to have a point of  
6 contact within a particular government,  
7 knowing which part of government is  
8 responsible for GAC, and then having a  
9 specific individual that really all other  
10 questions about who speaks for that  
11 country, who attends a meeting, them  
12 being appointed, just generally, that's  
13 entirely within the purview of that  
14 country.

15 PRESIDENT BARIN: Okay. And I guess  
16 that reinforces the point that you were  
17 making perhaps earlier that by the time  
18 you get to the actual meeting, you pretty  
19 much have an idea. Because if there was  
20 anything that was to be raised by a  
21 particular government, then you would  
22 know because they would have their  
23 official channels and letters and  
24 correspondence and -- to communicate with  
25 you?

1 THE WITNESS: Correct.

2 And if I could add, in the instance  
3 of being in a meeting, when I called upon  
4 someone to speak, if I had incorrectly  
5 named them or -- or if they say  
6 something, to repeat my point earlier,  
7 that -- that doesn't accord with what  
8 that government expects, then it is up to  
9 them to correct that or address that  
10 point. It's . . .

11 PRESIDENT BARIN: I guess it goes  
12 back to the point that my colleague  
13 Professor Kessedjian was making, with  
14 respect to the e-mails and the  
15 correspondence and the communications  
16 beforehand are -- they do play an  
17 important role because you would suspect  
18 that if something big was going to  
19 happen, you would want to hear or you  
20 would hear it or you would have heard  
21 about it prior to getting to the meeting?

22 THE WITNESS: Not necessarily.

23 What I'm describing is a scenario  
24 that's optimal for a Chair to run a  
25 meeting.

1                   Please understand, we had  
2                   controversial strings, like

3                   Redacted - GAC Designated Confidential Information

5                   Understand, there's a lot of activity.

6                   And we are encouraging colleagues to  
7                   please be speaking to each other,  
8                   understand what views are in the room and  
9                   to please reach out. There's really not  
10                  a lot I can do beyond hoping that  
11                  communication is good.

12                  But all of that does not have  
13                  bearing on -- on the validity of the  
14                  final decision. It doesn't diminish the  
15                  validity of a final decision.

16                  PRESIDENT BARIN: Were you,  
17                  yourself, involved in e-mail  
18                  communications with any --

19                  THE WITNESS: No --

20                  PRESIDENT BARIN: -- countries'  
21                  representatives?

22                  No?

23                  THE WITNESS: Regarding the e-mails,  
24                  no.

25                  PRESIDENT BARIN: Okay.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

- - -  
- - -

EXAMINATION ON BEHALF OF THE PANEL  
BY HONORABLE JUDGE CAHILL

HONORABLE JUDGE CAHILL: You may not know this, but how did the AUC become a member of the GAC?

THE WITNESS: As I recall, they would have followed the usual process, which is to send a letter requesting to join. That letter is addressed to the Chair.

HONORABLE JUDGE CAHILL: That is not something that you would be involved in?

THE WITNESS: The letter comes to me, as Chair --

HONORABLE JUDGE CAHILL: So you would be involved?

THE WITNESS: -- in which case, an acknowledgment is sent. If it's a really straightforward request to join, then it's -- it's immediately a letter to confirm.

HONORABLE JUDGE CAHILL: Did it at all concern you that they were one of the

1 two bidders on the .africa?

2 THE WITNESS: That wasn't relevant  
3 at the time --

4 HONORABLE JUDGE CAHILL: It wasn't  
5 what?

6 THE WITNESS: That issue wasn't in  
7 the GAC at the time. I had no insight  
8 into --

9 HONORABLE JUDGE CAHILL: But at the  
10 time of the consensus vote, did it come  
11 up that maybe -- you say in your brief  
12 that Africa -- I'm talking about Early  
13 Warnings. Never mind --

14 THE WITNESS: Early Warnings.

15 HONORABLE JUDGE CAHILL: -- but they  
16 were going to benefit by this vote.

17 THE WITNESS: It's -- it's a  
18 political bucket, the GAC, so it is a  
19 political decision that was taken.  
20 Procedurally, it was very  
21 straightforward.

22 HONORABLE JUDGE CAHILL: Politics  
23 are involved in this? Geez.

24 THE WITNESS: It's all about  
25 politics.

1 HONORABLE JUDGE CAHILL: Did the GAC  
2 ever send out an Early Warning notice in  
3 its own name --

4 THE WITNESS: No.

5 HONORABLE JUDGE CAHILL: -- because  
6 I know there was one that went out for  
7 AUC.

8 Was there another one that went out?  
9 You say in your declaration African Union  
10 and other countries requested GAC  
11 transmit Early Warning notices.

12 Was that -- what were those notices?

13 THE WITNESS: There were a variety  
14 of -- of different notices that were  
15 conveyed.

16 Again, just to be precise, that is  
17 the GAC transmitting those  
18 Early Warnings; it's not the GAC  
19 expressing the view.

20 HONORABLE JUDGE CAHILL: So the GAC  
21 goes ahead and --

22 THE WITNESS: It's to facilitate  
23 those Early Warnings being issued so that  
24 those countries could explain what they  
25 were concerned about and -- and alert the

1 applicants that there could be an issue.

2 HONORABLE JUDGE CAHILL: Did it  
3 raise any concerns that African Union  
4 Commission was going to send out an Early  
5 Warning to its competitor?

6 THE WITNESS: No one raised it in  
7 the GAC.

8 HONORABLE JUDGE CAHILL: No one  
9 raised it. Nobody thought of it either,  
10 I guess --

11 THE WITNESS: No one raised it.

12 HONORABLE JUDGE CAHILL: -- till  
13 now, that's why we're here.

14 ARBITRATOR KESSEDJIAN: I'm not sure  
15 I followed that conversation.

16 Nobody raised what?

17 THE WITNESS: The fact that the AUC  
18 issued the Early Warning notice.

19 HONORABLE JUDGE CAHILL: Where is it  
20 in the rules that you have to be present  
21 in order to vote?

22 You make the point that the Kenyan  
23 official, who you say doesn't have any  
24 authority anyway, but that's my -- but is  
25 there a rule that says you have to be in

1           that room at that time? You can't do it  
2           from outside or . . .

3           THE WITNESS: That is the -- the  
4           practice.

5           So at a decisional meeting, a  
6           government's -- certainly in the case  
7           with the GAC, you need to be present in  
8           order to contribute to that.

9           HONORABLE JUDGE CAHILL: That's the  
10          practice. This was the first time you've  
11          done it this way, so there probably  
12          wasn't a practice before this.

13          THE WITNESS: All of our communiqués  
14          are handled this way. All of our -- our  
15          advice in those communiqués from our  
16          meetings, it's always an in-person  
17          finalization at the end of our -- of our  
18          week or so of meetings.

19          HONORABLE JUDGE CAHILL: It's been  
20          like that forever?

21          THE WITNESS: Yes. For the seven or  
22          so years I've been in the GAC, yes.

23          HONORABLE JUDGE CAHILL: Did  
24          everyone understand that -- well, let  
25          me -- you don't know what other people



1 understood.

2 Do you think you communicated to  
3 other -- everyone that if there was not  
4 an objection to -- if nobody stood up and  
5 said, I object to taking this off  
6 calendar, that then -- then the GAC was  
7 going to send a -- a communiqué to the  
8 ICANN saying that it's our consensus this  
9 be not considered anymore?

10 Does everybody know that was going  
11 to happen?

12 THE WITNESS: All efforts were made  
13 to be clear about the agenda, the  
14 question, how this matter would be  
15 handled.

16 It is the responsibility of  
17 individual GAC members to -- to be  
18 briefed, to be prepared and to know where  
19 they need to be if, in fact, they need to  
20 be there.

21 HONORABLE JUDGE CAHILL: I guess  
22 it's your feeling that all the  
23 communications from the Kenyan member --  
24 the Kenyan person who wasn't there, that  
25 was -- that was communications, but the

1           only thing that counted was what happened  
2           when you asked for the -- for the  
3           consensus vote, right?

4           THE WITNESS: That is the only thing  
5           that counted, yes.

6           HONORABLE JUDGE CAHILL: Okay.

7           I think that's it.

8                           - - -

9           EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD

10                           BY PRESIDENT BARIN

11                           - - -

12           PRESIDENT BARIN: I have one  
13           question for you.

14                   We spent, now, a bit of time or a  
15           considerable amount of time talking to  
16           you about the process, or the procedure  
17           leading to the consensus decision.

18                   Can you tell me what your  
19           understanding is of why the GAC consensus  
20           objection was made finally? In terms of  
21           the substance, what is --

22           THE WITNESS: With .gcc?

23           PRESIDENT BARIN: Yes.

24           THE WITNESS: Again, no rationale  
25           was provided.

1 HONORABLE JUDGE CAHILL: I'm sorry.

2 Say again.

3 THE WITNESS: There was no rationale  
4 echoed by the GAC regarding .gcc.

5 PRESIDENT BARIN: But in terms of  
6 the .africa, the decision -- the issue  
7 came up, the agenda -- the issue came up,  
8 and you made a decision, correct?

9 THE WITNESS: The GAC made a  
10 decision.

11 PRESIDENT BARIN: Right. When I  
12 say "you," I mean the GAC.

13 Do you know -- are you able to  
14 express to us what your understanding of  
15 the substance behind that decision was?  
16 I mean, in other words, we've spent a bit  
17 of time dealing with the process.

18 Can you tell us why the decision  
19 happened?

20 THE WITNESS: The sum of the GAC's  
21 advice is reflected in its written advice  
22 in the communiqué. That is the view to  
23 GAC. That's -- that's --

24 PRESIDENT BARIN: I appreciate that.  
25 I just wanted to get your view, if you

1 can give it to me.

2 THE WITNESS: That is my view in my  
3 capacity as Chair from that time.

4 PRESIDENT BARIN: Yeah, that's fine.  
5 Okay.

6 - - -

7 EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD  
8 BY HONORABLE JUDGE CAHILL

9 - - -

10 HONORABLE JUDGE CAHILL: So who puts  
11 the DCA on the agenda?

12 And I understand that the DCA was on  
13 the agenda, but the -- AUC was not on the  
14 agenda. So there's only one of the two  
15 competing proposals that were on the  
16 agenda.

17 Why would that be?

18 THE WITNESS: So GAC members had the  
19 option, the possibility of requesting to  
20 add a particular string or application to  
21 that agenda for the consensus objections.  
22 Three African countries asked to put that  
23 particular string or application for DCA  
24 on the agenda.

25 If -- if there aren't -- if there

1           isn't the -- the AUC application there,  
2           it's because no one asked to put it  
3           there.

4           HONORABLE JUDGE CAHILL:   So how many  
5           countries need to be asking to be put on  
6           the agenda before --

7           THE WITNESS:   One?

8           HONORABLE JUDGE CAHILL:   One?

9           THE WITNESS:   Yes.

10          HONORABLE JUDGE CAHILL:   So one  
11          country, like Kenyan, can say, I want to  
12          put those on?

13          THE WITNESS:   Right.

14                                   - - -

15          EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD

16                                   BY PRESIDENT BARIN

17                                   - - -

18          PRESIDENT BARIN:   I'll come back  
19          again.  I want to try this one more time.

20                   Are you able to tell us what the  
21          reason behind those three countries  
22          objecting were?  In other words, would  
23          you know what that reason would be, or it  
24          didn't matter for you?

25          THE WITNESS:   It's not germane to my

1           responsibilities in handling that  
2           question.

3                   And if you want to understand the  
4           views, there's no alternative other than  
5           asking them directly.

6                   PRESIDENT BARIN:   Okay.   But I was  
7           just curious to know whether you had an  
8           understanding as to . . .

9                   HONORABLE JUDGE CAHILL:   She  
10          doesn't.

11                   PRESIDENT BARIN:   No.

12                   ARBITRATOR KESSEDJIAN:   I still --  
13          Babak, can I continue on this?

14                   HONORABLE JUDGE CAHILL:   Did we  
15          interrupt you?

16                   ARBITRATOR KESSEDJIAN:   I'm sorry.

17                   HONORABLE JUDGE CAHILL:   We  
18          interrupted you.   I'm sorry.

19                   ARBITRATOR KESSEDJIAN:   No, no.

20                                           - - -

21          EXAMINATION (CONTINUED) ON BEHALF OF THE BOARD

22                                           BY ARBITRATOR KESSEDJIAN

23                                           - - -

24                   ARBITRATOR KESSEDJIAN:   I just want  
25          to come back to the point that I was

1 making earlier.

2 To your Paragraph 5, you said -- you  
3 answered to me saying that is my  
4 declaration, but it was not exactly  
5 what's going on.

6 Now, we are here to -- at least the  
7 way I understand the Panel's mandate, to  
8 make sure that the rules have been obeyed  
9 by, basically. I'm synthesizing.

10 So I don't understand how, as the  
11 Chair of the GAC, you can tell us that,  
12 basically, the rules do not matter --  
13 again, I'm rephrasing what you said, but  
14 I'd like to give you another opportunity  
15 to explain to us why you are mentioning  
16 those criteria in your written  
17 declaration, but, now, you're telling us  
18 this doesn't matter.

19 If you want to read again what you  
20 wrote, or supposedly wrote, it's  
21 Paragraph 5.

22 THE WITNESS: I don't need to read  
23 again my declaration. Thank you.

24 The header for the GAC's discussions  
25 throughout was to refer to strings or

1 applications that were controversial or  
2 sensitive. That's very broad.

3 And --

4 ARBITRATOR KESSEDJIAN: I'm sorry.  
5 You say the rules say problematic,  
6 potentially violate national law, raise  
7 sensitivities.

8 These are precise concepts.

9 THE WITNESS: Problematic, violate  
10 national law -- there are a lot of  
11 laws -- and sensitivities does strike me  
12 as being quite broad.

13 HONORABLE JUDGE CAHILL:  
14 Sensitivities especially?

15 THE WITNESS: Yes, I would have to  
16 agree, yeah.

17 ARBITRATOR KESSEDJIAN: Okay. So we  
18 are left with what? No rules?

19 THE WITNESS: No rationale with the  
20 consensus objections. That's the -- the  
21 effect.

22 ARBITRATOR KESSEDJIAN: I'm done.

23 HONORABLE JUDGE CAHILL: I'm done.

24 PRESIDENT BARIN: So am I.

25 Would you like to take a little -- a



1           few minutes before we continue on? Are  
2           you okay?

3           THE WITNESS: I'm okay.

4           PRESIDENT BARIN: Okay.

5           THE WITNESS: Thank you.

6           HONORABLE JUDGE CAHILL: Don't be  
7           shy.

8           PRESIDENT BARIN: Mr. LeVee, we'll  
9           follow the same --

10          MR. LEVEE: Absolutely. It's --  
11          Mr. Ali should go first.

12          PRESIDENT BARIN: So the same?

13          MR. ALI: Yes.

14                                   - - -

15                   EXAMINATION ON BEHALF OF CLAIMANT

16                                   DOTCONNECTAFRICA TRUST

17                                   - - -

18          BY MR. ALI:

19           Q.       As you know, I'm Arif Ali. I have  
20           some questions and follow up on what it is that  
21           the Panel has been asking about on various topics.  
22           And if I stray, I will go back to the right path.

23                   So just so I understand one part of  
24           your testimony regarding what you knew at the  
25           time that the AUC applied to join the GAC.

1           Do you recall when you got the request  
2           from the AUC to join the GAC?

3           A.     No, I don't.

4           Q.     Okay.  So do you recall when the AUC  
5           was approved to join the GAC?

6           A.     It would be via letter when they  
7           joined.

8           Q.     As I understand, it would have been by  
9           the end of June 2012, but I stand to be corrected  
10          if there's other correspondence that makes it more  
11          specific as to when they were formally approved.

12          So if -- with that date in mind, does  
13          that trigger anything, any recollection as to  
14          when they put their application in?

15          A.     I believe the June 2012 date followed  
16          a further discussion about the status of -- of the  
17          AUC within the GAC.  They were accepted earlier  
18          than that and accepted as an observer.

19          So by my recollection, the letter you  
20          saw, if it was addressing the point about them  
21          becoming a member listed along with other members  
22          that were governments in GAC records, then, I --  
23          I think that might be the reason you see a letter  
24          from that time.

25          Q.     Okay.  So they -- so the AUC initially

1 joined the GAC as an observer?

2 A. Correct.

3 Q. Nonvoting?

4 A. Correct.

5 Q. Do you recall when that happened?

6 A. I don't. I don't.

7 Q. How would I find out when that  
8 happened?

9 A. Through -- there is usually an  
10 exchange of letters. The letters might be  
11 published on the GAC Web site. They might be  
12 available to you directly.

13 Also, the GAC would list in its  
14 communiqués when they were new members during  
15 that time. So that would be a possible source.

16 Q. So you were here during our opening  
17 presentations, right?

18 A. (No audible response.)

19 Q. And you heard me and my colleagues  
20 make mention to the draft of the communiqué that  
21 was initially sent by Mr. Crocker sometime in  
22 March of 2012. And that particular letter that  
23 was sent by Mr. Crocker was sent to you to review.

24 Do you recall that part of my  
25 presentation?

1           A.     I do, yes.

2           Q.     Okay.  And do you recall having seen  
3 the draft letter that was sent by ICANN Staff of  
4 BGC to you for comment?

5           A.     I don't recall it.

6           Q.     Have you subsequently seen the draft  
7 that was sent to you?

8           A.     Not since -- since it would have been  
9 issued, no, I have not.

10          Q.     Okay.  So you have not seen a copy of  
11 this letter?

12          A.     Not since it would have been sent, no.

13          Q.     Okay.  And insofar as applications  
14 for -- do you recall -- sorry.  Strike that.

15                 Do you recall whether the AUC was  
16 already a -- an observer on the GAC prior to  
17 February 2012?

18          A.     I don't.

19          Q.     Insofar as other requests are  
20 concerned for a country or an international  
21 organization to join the GAC, is it common that  
22 you would receive a communication from ICANN Staff  
23 beforehand?

24          A.     No.  It's entirely a GAC decision.

25          Q.     So in this instance, on 24th of

1 February 2012, you were sent a communication by  
2 ICANN Staff which had been drafted with the  
3 involvement of the BGC to provide comments on the  
4 letter that was going to be going to the AUC.

5 So that was unusual?

6 MR. LEVEE: Could I just interject?

7 Counsel is not showing the witness  
8 the letter. The letter doesn't say  
9 anything about joining the GAC.

10 If counsel wants to say that the  
11 letter does reference it, then he should  
12 show it to the witness.

13 MR. ALI: Fair point. Let me  
14 rephrase.

15 BY MR. ALI:

16 Q. And I'm happy to -- to -- to show you  
17 the letter. It's fairly long.

18 MS. ZERNIK: If you give me an  
19 exhibit number, I can get it.

20 BY MR. ALI:

21 Q. And there's a binder right there if  
22 you want to find the document if you want to see.

23 HONORABLE JUDGE CAHILL: What's the  
24 document?

25 MR. ALI: It is --

1 HONORABLE JUDGE CAHILL: She doesn't  
2 have a screen, so that doesn't help.

3 MS. ZERNIK: Right.

4 MR. ALI: If you look under the tab  
5 that says --

6 MS. CRAVEN: It's in the middle  
7 section, which is the section entitled  
8 GAC e-mails. And it is Tab --

9 MS. ZERNIK: I believe it's  
10 Exhibit C. I have 24 --

11 ARBITRATOR KESSEDJIAN: C-24 is  
12 ICANN letter of March 8th.

13 MR. ALI: That's what I'm referring  
14 to, because we don't --

15 ARBITRATOR KESSEDJIAN: Okay. So  
16 it's C-24.

17 MR. ALI: Yes.

18 -- they didn't produce the other  
19 communications, so we don't know when  
20 the -- when the AUC applied to become a  
21 member in observer status. We don't know  
22 when they -- when they were removed from  
23 observer status to voting status.

24 And that's what we're trying to  
25 establish, if we can create some sort of

1 time markers here as to what happened  
2 when.

3 THE WITNESS: I don't have the  
4 document.

5 ARBITRATOR KESSEDJIAN: C-24. It's  
6 a long letter. It's a cover letter.

7 BY MR. ALI:

8 Q. Just to -- this document references  
9 what the AUC could achieve through the GAC. And I  
10 think that's a fair characterization of what the  
11 letter states in March --

12 PRESIDENT BARIN: Let's start, to be  
13 fair, have you seen this letter before,  
14 Ms. Dryden?

15 THE WITNESS: It's something that I  
16 would have been copied on or been aware  
17 of at the time. The content of it I  
18 don't -- I don't recall.

19 HONORABLE JUDGE CAHILL: Do you  
20 remember seeing it, though, before?

21 THE WITNESS: Before it was sent?

22 HONORABLE JUDGE CAHILL: No --  
23 well --

24 THE WITNESS: As a matter of -- of  
25 practice, this is the kind of letter that

1 would have been --

2 HONORABLE JUDGE CAHILL: Okay.

3 PRESIDENT BARIN: Can you tell us  
4 what the practice is?

5 THE WITNESS: These letters are  
6 sometimes shared on the Board list. And  
7 I'm on the Board list as a nonvoting  
8 liaison, so --

9 PRESIDENT BARIN: So you would see  
10 it before it goes in?

11 THE WITNESS: Yes, or sometimes,  
12 because I'm the Chair of the GAC and we  
13 represent governments and organizations,  
14 plus this relates to ICANN documents,  
15 it's a courtesy, if nothing else.

16 MR. ALI: Could we pull up C-113,  
17 please?

18 HONORABLE JUDGE CAHILL: C what?

19 MR. ALI: 113.

20 MR. LEVEE: Do you have a copy of  
21 that binder for us?

22 MR. ALI: I believe one was provided  
23 to you.

24 I apologize for the confusion of the  
25 binders.



1 MR. LEVEE: I don't have one.

2 MS. CRAVEN: I think it's actually  
3 underneath the one that's next to yours.

4 MR. ALI: Why don't you just put the  
5 screen up so she can see?

6 MR. LEVEE: Is it this (indicating)?

7 MS. CRAVEN: It's that. This  
8 document is not in that.

9 PRESIDENT BARIN: C-113 is the  
10 e-mail from Jamie Hedlund, right?

11 MR. ALI: Sorry?

12 PRESIDENT BARIN: Is that the e-mail  
13 from Jamie Hedlund?

14 MR. ALI: That is an e-mail from  
15 Chris Mondini dated 24 February 2012 --

16 PRESIDENT BARIN: Okay.

17 MR. ALI: -- to Heather Dryden at  
18 Heather.Dryden@ic.gc.ca, copying  
19 Jamie Hedlund and Anne-Rachel Inné and  
20 Diane Schroeder. And it says, Draft  
21 response to AU Communiqué.

22 BY MR. ALI:

23 Q. Do you have that document in front of  
24 you, Ms. Dryden?

25 A. No, I don't.

1 Q. Okay.

2 MR. ALI: You don't have that up on  
3 the screen?

4 MR. LEVEE: We can't find it, so  
5 we're still looking.

6 MR. ALI: You can't find it on --

7 MS. ZERNIK: C-113.

8 MR. ALI: Exhibit C-113-001.

9 (Pause.)

10 MR. ALI: Got it?

11 MR. LEVEE: I do have it. And for  
12 what it's worth, it's well beyond the  
13 scope of the Panel's questions.

14 MR. ALI: I don't believe so --

15 PRESIDENT BARIN: Let's hear the  
16 question --

17 MR. ALI: -- I don't believe so.

18 And I think that it's entirely

19 appropriate in light of --

20 HONORABLE JUDGE CAHILL: You already  
21 won.

22 MR. ALI: -- the Panel's  
23 questioning -- excuse me?

24 HONORABLE JUDGE CAHILL: You already  
25 won.

1 MR. ALI: Thank you.

2 Sometimes the pugilist comes out,  
3 and one never figures out if one is  
4 actually winning or not. Many a knockout  
5 has happened as a result.

6 HONORABLE JUDGE CAHILL: No, no.

7 BY MR. ALI:

8 Q. So, Ms. Dryden, let's try this again.

9 C-113, is that up on the screen or do  
10 you have that in front of you?

11 A. I have it in front of me.

12 Q. Thank you.

13 And just to be clear, do we have --  
14 it's an e-mail from Chris Mondini to  
15 Heather Dryden, Jamie Hedlund and  
16 Anne-Rachel Inné, Diane Schroeder, and the  
17 subject is Draft response to AU Communiqué.

18 Are we looking at the same document?

19 A. Yes.

20 Q. Okay. Who is Jamie Hedlund?

21 A. He's an employee of ICANN.

22 Q. Who's Anne-Rachel Inné?

23 A. She's also an employee of ICANN?

24 Q. And Diane Schroeder?

25 A. Also an employee of ICANN.

1 Q. Okay. And Chris Mondini?

2 A. An employee of ICANN.

3 Q. Okay. This letter -- or this e-mail  
4 says, Dear Heather, The attached draft response is  
5 the combined effort of a number of staff members  
6 as well as members of the BGRC. It will be sent  
7 in the form of a letter from Steve Crocker on  
8 behalf of the Board.

9 I'm sending it for your review, and  
10 welcome any comments or advice before we send it  
11 out next week.

12 And the subject is Draft response to  
13 AU Communiqué.

14 Do you recall having received this  
15 e-mail and having reviewed the draft response to  
16 the AU communiqué?

17 A. I don't recall this specific e-mail or  
18 providing comments.

19 But I would like to explain that  
20 there's nothing unusual about this kind of desire  
21 to be diplomatic with -- with government  
22 colleagues and -- and to communicate with them.

23 So it's -- it's not unusual.

24 Q. Sorry. I didn't understand that  
25 response.

1           Diplomatic on the part of whom with  
2       respect to which government colleagues?

3           A.       Governments generally.  So in the GAC,  
4       of course, it's comprised of governments, and they  
5       would be receiving this communication.  So . . .

6           Q.       Thank you for that clarification.

7                    But what I'm just trying to understand  
8       is why ICANN Staff, on this particular occasion,  
9       are sending you a draft of a communication that  
10      they're sending to the AUC.

11          A.       Because they're wanting to provide  
12      that opportunity to provide comments if they  
13      deemed it beneficial to their draft.  But that's  
14      really an aid of having positive communications  
15      with governments, generally.

16                    Obviously, the GAC is a major  
17      component of -- of that activity within the ICANN  
18      structure.

19          Q.       So is it your testimony that the ICANN  
20      Staff here are communicating with you in your  
21      capacity as a Canadian Government representative  
22      or Chair of GAC?

23          A.       They're communicating with me because  
24      I'm the Chair of the GAC.

25          Q.       I see.

1           So -- and the idea here is that  
2       they're looking for your implemental or input  
3       with respect to the communication that will be  
4       sent to the AUC having obtained your views  
5       with -- from the perspective of -- as GAC Chair;  
6       is that correct?

7           A.     It's quite clear, I think, from what's  
8       written here, it's simply providing an  
9       opportunity, if I wish to take it, if it was  
10      appropriate to do so, to communicate.

11          Q.     Okay. And do you recall if you took  
12      it?

13          A.     I don't.

14                MR. LEVEE: Heather, speak up a  
15      little bit.

16                THE WITNESS: Sorry.

17                I don't recall.

18      BY MR. ALI:

19          Q.     So you don't recall whether you  
20      commented on the draft that had been sent to you  
21      by ICANN Staff?

22          A.     Correct.

23                PRESIDENT BARIN: May I?

24                Is this the kind of, sort of, draft  
25      letter that you would get from your

1 colleagues on other issues as well? In  
2 other words, is it -- was it frequent for  
3 you to get letters in draft for you to  
4 comment on and . . .

5 THE WITNESS: When the Board was  
6 communicating with governments, I think  
7 there were circumstances where those  
8 letters would be circulated via  
9 the -- the Board list, which I mentioned  
10 I was a part of as a nonvoting liaison to  
11 the Board --

12 PRESIDENT BARIN: But this is not  
13 one of them. This is -- as I understood  
14 you said, these are letters that are --  
15 these are employees of -- of ICANN.  
16 These are not Board members.

17 THE WITNESS: But the signatory on  
18 the letter is -- is ICANN's leadership,  
19 the Chair of the Board.

20 So staff are facilitating that  
21 activity.

22 PRESIDENT BARIN: Okay.

23 I guess my question is, There must  
24 have been other letters like this that  
25 these staff members perhaps prepared

1 for -- I don't know -- I guess, other  
2 communiqués, or is this the only one?

3 THE WITNESS: In terms of the  
4 letters that come from the Board, then  
5 the Board would be better able to respond  
6 to the kinds of letters that they would  
7 send to -- to -- to governments, which  
8 is, I think, what you're -- how you're  
9 categorizing this type of letter.

10 PRESIDENT BARIN: Okay.

11 ARBITRATOR KESSEDJIAN: May I  
12 continue on this question?

13 How many times do you recall having  
14 been asked to review these types of  
15 letters and -- was that often?

16 THE WITNESS: No, no, but not  
17 unusual either.

18 ARBITRATOR KESSEDJIAN: And for what  
19 kind of matters would you be asked to  
20 review documents and letters?

21 THE WITNESS: It was really from the  
22 view of maintaining positive relations  
23 with -- with government stakeholders.

24 There are programs in place at ICANN  
25 to deal with other stakeholder groups as



1 well and look at those relational  
2 aspects. So this is a component of that  
3 --

4 ARBITRATOR KESSEDJIAN: Thank you.

5 THE WITNESS: -- that's my  
6 understanding.

7 MR. ALI: Thank you.

8 BY MR. ALI:

9 Q. Just staying with -- just staying with  
10 the -- with this letter, could you turn, please,  
11 to -- if you could pull up C-24, which is the  
12 actual letter that Mr. Crocker said and which,  
13 presumably, you reviewed a draft of at the time.

14 Can you see that -- do you have it?

15 A. Yes. Yes.

16 Q. You have it, C-24?

17 A. Yes.

18 Q. This is a letter that is from  
19 Stephen D. Crocker to Elham Ibrahim on 8th of  
20 March 2012. And I'd like you to just turn over to  
21 the second page, please.

22 On the second page, in bold, it says,  
23 Request 1: Include (.africa, Afrique, et cetera.

24 It says, Response to Request 1.

25 And I'm going to go to the last

1 sentence of the first paragraph. If you would  
2 just follow along with me, please.

3 ICANN does wish to explain, however,  
4 that protections exist that allow the  
5 African Union and its member states to play a  
6 prominent role in determining the outcome of any  
7 application for these top-level domain name  
8 strings.

9 We'll stop.

10 So please feel free to take a look at  
11 the paragraphs preceding -- or the language  
12 preceding the language I just read and following  
13 that, so you get some context.

14 And my question to you, Ms. Dryden,  
15 is, Could you explain to us what it is that you  
16 understand Mr. Crocker to be saying in the  
17 sentence I've just read out?

18 A. I believe he is referring to this  
19 particular role that was given to the GAC as part  
20 of the Guidebook rules to explain to the AUC that  
21 this is one of the -- the options available to  
22 them if they did wish to raise concerns.

23 Q. What do you believe he means by "to  
24 play a prominent role"? What would have been your  
25 understanding of that language when you read the

1 draft back in February of 2012?

2 A. It was to point to the fact that  
3 governments were given a specific role as part of  
4 this program, to -- to advise on -- on new gTLDs.

5 Q. Does that mean, at this particular  
6 point in time, that the AUC was already a voting  
7 member of the GAC?

8 A. Offhand, I don't know, but I do not  
9 link those two things.

10 Q. I see.

11 But if they weren't, if they were only  
12 in observer status, they wouldn't have been able  
13 to play a prominent role in determining the  
14 outcome of any applications; isn't that correct?

15 A. No, it's not correct.

16 So members and observers can come and  
17 contribute to discussions in the GAC and to the  
18 development of advice. And, for example,  
19 observers that have expertise, a particular  
20 expertise -- and WIPO is a member, so if we're  
21 talking about trademark-related issues, they may  
22 have useful input to provide to that.

23 So, again, it's really about this  
24 particular role being given as part of the gTLD  
25 program, which hadn't existed in the past for the

1 GAC.

2 Q. Okay. And so, just to be clear,  
3 you're saying -- you're telling us that a -- a --  
4 a member of the GAC that is there in observer  
5 status can issue Early Warning advice?

6 A. No, that's not what I said --

7 Q. I'm sorry.

8 A. -- as far as the -- the link between  
9 observers and members and what specific actions  
10 they can take generally or with regard to Early  
11 Warnings or something else is not -- is not  
12 entirely -- it's not something that can be  
13 summarized very quickly, or there may be existing  
14 lack of clarity today about some of those  
15 questions.

16 It's -- it's -- not everything has  
17 been tested adequately to an absolute answer.

18 As far as Early Warnings were  
19 concerned, the -- the -- there was no particular  
20 constraint on issuing those Early Warnings.

21 Q. So an observer could issue an Early  
22 Warning?

23 A. I can't tell you that, because none  
24 did.

25 Q. It's a simple yes or no.

1 A. I can't tell you that, so --

2 Q. Yes or no.

3 HONORABLE JUDGE CAHILL: Wait, wait.

4 Don't argue with her.

5 Why can't you tell him that?

6 PRESIDENT BARIN: Let her answer.

7 THE WITNESS: None -- none -- other  
8 than those that did issue Early Warnings  
9 provoked an actual discussion or anyone  
10 raising concerns about who issued an  
11 Early Warning. So that wasn't a barrier  
12 up-front.

13 BY MR. ALI:

14 Q. So I understand what -- your testimony  
15 to be that an observer can issue an Early Warning,  
16 but it doesn't really matter?

17 A. That's not how I would sum up my  
18 comments at all.

19 Q. How would you?

20 HONORABLE JUDGE CAHILL: Why can't  
21 you say yes or no? Is that because you  
22 don't know the rules or there were no  
23 rules? What is the reason? Or you can't  
24 tell us because it's secret or something?

25 THE WITNESS: To deal with the Early

1           Warnings specifically, there wasn't  
2           adequate clarity beforehand about that.  
3           It happens that none that are currently  
4           classified as observers issued an Early  
5           Warning to any applicant. And so, for  
6           that reason, it's -- it's not possible to  
7           draw the kind of conclusion that I'm  
8           being asked to.

9           BY MR. ALI:

10           Q.       Well, let's just continue with this,  
11           then.

12                     In terms of -- so in terms of the AUC  
13           joining the GAC as an observer, that request  
14           would come to you?

15           A.       Yes. That's the process.

16           Q.       Do you recall whether that particular  
17           request came to you?

18           A.       I don't specifically recall a request,  
19           but that is the process. So . . .

20           Q.       Okay. So, presumably, it came to you?

21           A.       Yes.

22           Q.       Thank you.

23                     And the movement --

24                     PRESIDENT BARIN: If I may

25                     interrupt --

1 MR. ALI: Yes.

2 PRESIDENT BARIN: -- the AUC request  
3 was not a typical request, was it? In  
4 other words, the request for --

5 THE WITNESS: For which request?

6 PRESIDENT BARIN: For the observer  
7 status that Mr. Ali was just referring  
8 to.

9 THE WITNESS: To become a member?

10 PRESIDENT BARIN: Yeah.

11 THE WITNESS: It's not common, no.

12 PRESIDENT BARIN: Okay. So when you  
13 receive an uncommon request, what -- what  
14 do you usually do? Is that something you  
15 decide? Is that something you consult  
16 on? Is that something you pass on to  
17 somebody else?

18 THE WITNESS: So the -- the only  
19 time that I have to deal with the issue  
20 of someone that was an observer becoming  
21 a member was in the case of the AUC while  
22 I was Chair.

23 And so when that request was made,  
24 there was a discussion in -- in the  
25 meetings. It would have been the Prague

1 meetings, I believe.

2 ARBITRATOR KESSEDJIAN: And when was  
3 that?

4 THE WITNESS: Prague?

5 ARBITRATOR KESSEDJIAN: Can we find  
6 it on the Internet?

7 THE WITNESS: Oh, certainly, I think  
8 we can.

9 MR. LEVEE: We can figure it out.

10 ARBITRATOR KESSEDJIAN: Okay.

11 BY MR. ALI:

12 Q. So there's a discussion --

13 MR. ALI: I apologize.

14 PRESIDENT BARIN: No, no. That's  
15 okay.

16 BY MR. ALI:

17 Q. -- so there's a discussion -- so a  
18 request comes from ICANN or the request comes from  
19 the AUC that the AUC should move from observer  
20 status to voting member status?

21 A. The requests never come from ICANN.  
22 If they did, they shouldn't.

23 So it would have come via the usual  
24 process when they asked to become an observer.  
25 And then -- because they were already in the GAC,



1 then they made a request at a meeting to be  
2 considered or to ask why they're not a member and  
3 to -- to explore that point.

4 So that resulted in a discussion at  
5 the following meeting of the GAC, which, as I  
6 say, I believe was the Prague meeting where the  
7 AUC was accepted as a member.

8 Q. So I'm being told that the Prague  
9 meeting was in June 2012. So, presumably, it was  
10 sometime after June 2012 or at the Prague meeting  
11 June 2012 when the AUC was moved from a nonvoting  
12 to voting.

13 A. The distinction isn't voting to  
14 nonvoting.

15 As I mentioned earlier, there isn't  
16 enough experience with -- with voting in the GAC  
17 to actually have clarity on that point.  
18 The -- the GAC is a consensus-based committee and  
19 is always working towards consensus as a general  
20 practice.

21 The -- the consensus objection  
22 mechanism that was part of gTLDs, that was the  
23 first time we had done anything like that, and we  
24 didn't refer to it as a vote --

25 Q. I see.

1           A.     -- so I can understand why some might  
2     construe it.

3           Q.     That's helpful.

4                     But what was the purpose of the  
5     discussion at the Prague meeting with respect to  
6     AUC?  If there really is no difference or  
7     distinction between voting/nonvoting, observer or  
8     whatever might be the opposite of observer, or  
9     the proper terminology, what was -- what was the  
10    point?

11          A.     I didn't say there was no difference.

12                     The issue is that there isn't GAC  
13    agreement about what are the -- the rights, if  
14    you will, of -- of entities like the AUC.  And  
15    there might be in some limited circumstances, but  
16    it's also an extremely sensitive issue.  And so  
17    not all countries have a shared view about what  
18    those -- those entities, like the AUC, should be  
19    able to do.

20          Q.     So not all countries share the same  
21    view as to what entities, such as the AUC, should  
22    be able to do.

23                     Is that what you said?  I'm sorry.  I  
24    didn't --

25          A.     Right, because that would only get

1 clarified if there is a circumstance where that  
2 link is forced.

3 In our business, we talk about  
4 creative ambiguity. We leave things unclear so  
5 we don't have conflict.

6 ARBITRATOR KESSEDJIAN: This is  
7 beautiful. I love it.

8 MR. ALI: I'll take that.

9 BY MR. ALI:

10 Q. Thank you. I understand.

11 So -- but -- let's just leave it in  
12 your world --

13 PRESIDENT BARIN: Can I just follow  
14 up on it for a second, then?

15 MR. ALI: I was kind of hoping you  
16 wouldn't.

17 HONORABLE JUDGE CAHILL: No; he gets  
18 to.

19 PRESIDENT BARIN: Is it possible,  
20 then, that certain countries would have  
21 had a different view of whether AUC  
22 should have been a member or not?

23 THE WITNESS: That -- that agreement  
24 to list them as a member along with other  
25 governments described as members in the

1 GAC's records, the GAC agreed to do that.

2 As to which part of the operating  
3 principles they might have referred to or  
4 national policy or positions on the  
5 matter they might have referred to, that  
6 will vary.

7 And so the only way to test that is  
8 if you have one particular question or  
9 situation where -- where that is brought  
10 to light. And it's actually -- when you  
11 get into the specifics of -- of -- of how  
12 that should work, it is very delicate.

13 HONORABLE JUDGE CAHILL: Why would  
14 ASU [verbatim] be a member? You know, it  
15 seems like it's so unusual -- I don't  
16 mean to give -- it's not a leading  
17 question, but it seems like -- why --  
18 what were the considerations to letting  
19 them become a member? I understand why  
20 the EU would be there, but the ASU [sic]  
21 is something different, isn't it?

22 THE WITNESS: The considerations are  
23 always going to be political, at least to  
24 some degree. They tend to be primarily  
25 political in the GAC.

1           So it's very difficult for me,  
2           again, to go beyond that -- that decision  
3           that was recorded in the communiqué or  
4           that would have been recorded in the  
5           communiqué at the end of that meeting to  
6           say that we're now being welcomed as a  
7           member.

8           PRESIDENT BARIN: In terms of the  
9           AUC becoming a member, the buck stops  
10          with the GAC? The GAC makes that  
11          decision?

12          THE WITNESS: Absolutely.

13          PRESIDENT BARIN: Okay. It doesn't  
14          have to explain itself as to why it's  
15          making that decision or on what basis?  
16          It can just simply make it, is what  
17          you're saying?

18          THE WITNESS: Right. And it refers  
19          to its own guidance and rules. And  
20          members have particular views on that,  
21          yes.

22          PRESIDENT BARIN: Let me just follow  
23          up.

24          When you say members may have  
25          particular views on it -- earlier, I

1 think I understood correctly, you said  
2 some members may -- may be for it, some  
3 may be against it, but at the end of the  
4 day, it doesn't really matter, because  
5 GAC decides if they become a member or  
6 not.

7 Or am I mistaken?

8 THE WITNESS: Yes, the -- so -- so  
9 it has to be a GAC decision. And,  
10 certainly, on a question like this, it's  
11 brought to the full GAC. It was a  
12 discussion of the full GAC.

13 And the main consideration is  
14 respective powers and influence, and it's  
15 always that way between governments. So  
16 does that mean one region gets more  
17 represented than another? Does it mean  
18 that a particular region end up with more  
19 votes if we were to vote? That --

20 HONORABLE JUDGE CAHILL: The GAC  
21 could have said no to this, right, the  
22 application?

23 THE WITNESS: Yes.

24 HONORABLE JUDGE CAHILL: And it  
25 didn't take into consideration that

1 .africa was -- I don't know. I imagine  
2 it was one of the biggest things you guys  
3 were all dealing with.

4 THE WITNESS: Not that I recall.

5 It was really about the -- the  
6 guidance we had from our operating  
7 principles, national positions  
8 governments have used about what you  
9 might call the additionality for regional  
10 organizations like the AUC or others.  
11 And that all had to be worked through in  
12 that exchange.

13 BY MR. ALI:

14 Q. Ms. Dryden, you talked about the GAC  
15 governing principles. Perhaps we could go to  
16 Exhibit 44.

17 PRESIDENT BARIN: Is that C-44,  
18 Mr. Ali?

19 MR. ALI: It's C-44 and Page 3 of  
20 C-44.

21 BY MR. ALI:

22 Q. My colleagues will help you find the  
23 document.

24 (Pause.)

25

1 BY MR. ALI:

2 Q. Are you there?

3 A. Yes.

4 Q. Okay. Thank you.

5 Principle 15, Membership is open to  
6 all national governments. Membership is also  
7 open to distinct economies as recognized in  
8 international fora. Multinational governmental  
9 organizations and treaty organizations may also  
10 participate as observers on the invitation of the  
11 GAC through the Chair.

12 So based on Principle 15, the  
13 limitations of the AUC would have come from you  
14 or there would have been a request by the AUC.  
15 And in your sole discretion, the AUC would have  
16 joined the GAC.

17 Is that correct -- sorry.

18 Which is it of those various scenarios  
19 that I just put to you?

20 A. So the communication comes to the  
21 GAC Chair, and if I confirm them as -- as an  
22 observer, then that is on behalf of the GAC.

23 Q. So then Principle 16 -- and you  
24 would -- before we go to Principle 16, you would  
25 put the AUC into the category of a multinational



1 governmental organization or treaty organization,  
2 correct?

3 A. That is what I did.

4 Q. Okay. And so then we go to the next,  
5 which is Principle 16. Accredited representatives  
6 of governments and other public authorities,  
7 members of GAC, have voting rights. Accredited  
8 representatives of international organizations and  
9 entities other than public authorities participate  
10 fully in the GAC and its committees and working  
11 groups, as observers, but do not have voting  
12 rights.

13 As I take it, Principle 16 does make  
14 the distinction between voting rights and  
15 nonvoting rights.

16 Could you explain that to us in terms  
17 of what that -- what the practical implications  
18 are and how that applies to the AUC?

19 A. So, as I commented earlier, these  
20 principles are subject to interpretation by GAC  
21 members. And so they would read different parts  
22 of it and understand it in a way that the -- that  
23 accords with their -- their view. And they would  
24 come to a GAC discussion about this based on -- on  
25 a national view about how observers and members

1 and so on should be participating in the  
2 Committee.

3 So unless there's a GAC decision  
4 elaborating -- so in the case of the -- the AUC  
5 becoming a member, there was no clarity  
6 deliberately about the -- the -- the GAC's  
7 understanding of what the full implications were  
8 of them joining as member.

9 PRESIDENT BARIN: Sorry. What do  
10 you mean by that? Deliberately -- there  
11 was no clarity?

12 THE WITNESS: So some GAC members  
13 found, in the part of the operating  
14 principles, that they liked a way to be  
15 flexible and arrive at a consensus to  
16 accept the AUC as a member, but leaving  
17 the -- the specifics unclear.

18 PRESIDENT BARIN: But correct me if  
19 I'm wrong, but if I understand it  
20 correctly, it doesn't really matter  
21 because, at the end of the day, they  
22 become a member, and that's because GAC  
23 decides they become a member.

24 THE WITNESS: They became listed as  
25 a member along with other governments

1           also described as members in the GAC's  
2           records. That, I can tell you.

3           ARBITRATOR KESSEDJIAN: What is very  
4           strange is we are talking about a  
5           commission which is the kind of  
6           Secretariat to an organization and not  
7           the organization itself. You know, I  
8           could have understood the AU,  
9           the African Union, would have become a  
10          member, but the AUC, the Commission  
11          itself, I have a hard time understanding  
12          that.

13          Do you see the difference? I mean,  
14          the Commission is not an organization;  
15          the Commission is a Secretariat to an  
16          organization.

17          So why was the AUC becoming a member  
18          and not the African Union?

19          HONORABLE JUDGE CAHILL: Good point.

20          THE WITNESS: So I have the record  
21          of the result of the GAC accepting them  
22          to become a member without further  
23          clarification. They invited me to  
24          comment on things that -- colleagues in  
25          the GAC will have to give their

1 individual perspectives on -- you would  
2 have to ask them.

3 PRESIDENT BARIN: I guess, as the  
4 person who was responsible for that  
5 position at the time, would you have, I  
6 guess, no power or requirement or  
7 obligation to raise any questions, such  
8 as the one that my colleague just asked  
9 you? In other words, if something didn't  
10 seem right to you, could you not question  
11 that?

12 THE WITNESS: As far as the running  
13 of the GAC, as part of my  
14 responsibilities, yes, I may have  
15 questions or -- but --

16 PRESIDENT BARIN: But in this case,  
17 did you not have any questions or do you  
18 not remember, or . . .

19 THE WITNESS: As Chair, my concern  
20 was around the longer-term challenge of  
21 having observers -- as described now on  
22 the list of observers, those  
23 organizations, having a greater role than  
24 they do now and how that would impact the  
25 Committee.

1           PRESIDENT BARIN: Okay. So you're  
2 saying you were sort of focused on the  
3 more big picture thing as to why a  
4 particular case -- I'm not trying to put  
5 words in your mouth. I'm just trying to  
6 get a sense of what --

7           THE WITNESS: Yes, that was my -- my  
8 concern.

9           HONORABLE JUDGE CAHILL: Why didn't  
10 the membership meet the requirements of  
11 your organization? Because it looks  
12 like -- if you just read the words, they  
13 don't quite fit with the AUC.

14          THE WITNESS: As I say, the -- the  
15 operating principles are -- are guidance  
16 to us, they're principles. And  
17 governments have national positions that  
18 they bring to any discussion and have the  
19 right to --

20          HONORABLE JUDGE CAHILL: It's hard  
21 to say no to governments who want to do  
22 what they want to do?

23          THE WITNESS: Yes. They can express  
24 their view however they want.

25          HONORABLE JUDGE CAHILL: Okay.

1 BY MR. ALI:

2 Q. I guess what I've taken away from this  
3 discussion -- by the way, please do indicate if  
4 you need a break, because you're getting questions  
5 from the Panel, from me. And I can appreciate  
6 that that's not the easiest to deal with.

7 So that is not by any means  
8 gratuitous, so do let me know.

9 PRESIDENT BARIN: Would you like to  
10 take a break?

11 THE WITNESS: Will this go much  
12 longer?

13 MR. ALI: I probably have another  
14 hour, 45 minutes --

15 PRESIDENT BARIN: I don't --

16 MR. ALI: -- at least.

17 PRESIDENT BARIN: -- I frankly don't  
18 think so, but --

19 MR. LEVEE: I will go for about two  
20 minutes.

21 MR. ALI: I do have some questions  
22 associated with what happened prior to  
23 this advice.

24 HONORABLE JUDGE CAHILL: Do it after  
25 the break.

1           PRESIDENT BARIN:    Let's take a  
2           few minutes to give her a chance to . . .

3                                 - - -

4                                 (Whereupon, a brief recess was taken  
5                                 from 4:58 p.m. to 5:10 p.m.)

6                                 - - -

7           PRESIDENT BARIN:    We're back on the  
8           record.

9                                 Mr. Ali, I request that we move  
10           along as efficiently and as quickly as we  
11           can.

12                                MR. ALI:    I will do my best.

13                                HONORABLE JUDGE CAHILL:   He told me  
14           not to ask any more questions, so . . .

15                                MR. ALI:    Well, I will try and stop  
16           before I receive the same instruction.

17   BY MR. ALI:

18           Q.    Let's go to a different topic.

19                                Before we do that, just to confirm, my  
20           final understanding is that this -- there is  
21           discretion in the GAC Chair to -- with respect to  
22           who is invited to join the GAC.

23                                What is the scope of your discretion?

24           A.    So anything that I would do is in,  
25           obviously, this -- within the capacity of -- of

1 Chair on behalf of the GAC.

2 Q. I understand.

3 It sort of sounds a little bit like  
4 you're trying to herd sheep within the context of  
5 a political -- very politicized environment from  
6 what you were telling us earlier.

7 Would that be a colloquial and  
8 colorful but fair -- fair description?

9 A. You're speaking generally about --  
10 about the GAC?

11 Q. Yes.

12 A. So it is only the GAC that can make  
13 decisions. I can confirm them and identify where  
14 there is consensus or where we have concluded a  
15 negotiation on something.

16 Q. Thank you. I think I asked a  
17 different question, and you answered a different  
18 one. But let's leave it at that.

19 Let's move on to what happened on  
20 June 4th when the NGPC -- sorry -- when the GAC  
21 consensus advice was issued -- I may have the  
22 date there wrong --

23 MR. LEVEE: April 10th.

24 MR. ALI: April 10. Thank you,

25 Jeff.



1 HONORABLE JUDGE CAHILL: April

2 10th, right.

3 BY MR. ALI:

4 Q. -- April 10th when the so-called

5 consensus advice was -- was issued.

6 Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

11 BY MR. ALI:

12 Q. While they're doing that, let me ask  
13 you the following question: When is the agenda  
14 developed?

15 And I should say that we don't have  
16 the agenda on record, so we don't really know  
17 what it says. So we're going to ask you to help  
18 us with that.

19 A. Right.

20 So the agenda for the consensus  
21 objection agenda was -- was not published. It's  
22 confidential as some meetings of the Committee  
23 are closed. And related materials also are not  
24 publicly published.

25 So that was the case with this

1 consensus objection agenda. It's not something  
2 that has been published.

3 Q. So it was -- when was it developed?

4 A. It was developed in advance of the  
5 meetings. There was a deadline for countries  
6 to -- to request that a particular application be  
7 placed on that agenda.

8 Q. So this would have happened three days  
9 before, four days before, a week before, two weeks  
10 before April 10th?

11 A. I don't recall precisely, but the  
12 deadline would have been around three weeks or so.  
13 Because governments need time to -- to consult  
14 nationally to prepare for a meeting, so you're  
15 always wanting to give them adequate notice  
16 regarding the -- an issue, whether it's this  
17 agenda or any other issue under consideration in  
18 the GAC.

19 Some of their internal processes are  
20 lengthy, and they need approvals and so on and so  
21 forth. So that's the reasoning.

22 Q. I follow you. Indeed.

23 So --

24 PRESIDENT BARIN: Sorry.

25 Who decides if it's confidential

1 or if it gets published or not?

2 THE WITNESS: The GAC does.

3 HONORABLE JUDGE CAHILL: Is that  
4 you?

5 THE WITNESS: The GAC does, as a  
6 whole.

7 In this case, the -- the current --  
8 well, the practice up until I was --  
9 until I left the role was to have most of  
10 the meetings open, except for the  
11 decisional portions.

12 In Beijing, we had more closed  
13 meetings than usual because the issues  
14 were so sensitive for governments. And  
15 we were doing something -- we needed a  
16 new capacity, and so the -- the GAC took  
17 that decision to -- to close the meetings  
18 that they did.

19 BY MR. ALI:

20 Q. So two to three weeks before the  
21 meeting, you set a deadline for governments to  
22 provide agenda items; is that correct?

23 A. Yes.

24 Q. Okay. And then, with those agenda  
25 items, two to three weeks before the meeting, you

1 circulate a draft agenda to all governments?

2 A. That's right. So there's an agenda  
3 that is a compilation of all the requests.

4 Q. From all of the different governments?

5 A. Governments.

6 Q. And how many are there again?

7 A. How many governments in the GAC?

8 Q. Yes.

9 A. About 150.

10 Q. So -- I see.

11 So it's 150 governments that decide  
12 that it's going to be confidential or not?

13 A. Not all of them will weigh in, but it  
14 has the effect of being the full GAC.

15 Q. Okay. And how does that happen?

16 A. In this case, there was a discussion  
17 beforehand on GAC calls and some requests to close  
18 the meeting. And I believe, at the beginning of  
19 our meetings in Beijing, it was further clarified.

20 Q. I think I'm talking about the agenda.

21 So with respect to the -- to the  
22 agenda being confidential, you propose it or  
23 somebody proposes it or it's presumptively  
24 confidential?

25 A. It's not presumptive, but these --

1 these issues are discussed either, as I say, on  
2 the preparatory teleconferences we have, we might  
3 receive requests. In this case, we received  
4 requests from some -- some in the GAC expressing  
5 the desire to have the discussions be closed.

6 And then it's confirmed again when we  
7 begin our meetings to -- on the basis of -- of  
8 people making requests, if necessary, if they  
9 feel something should be closed.

10 Q. So it just takes the request of one  
11 government in order for the agenda to be kept  
12 confidential?

13 A. No. If other governments said they  
14 really thought it should be open, and we discussed  
15 it and it turned out one government wasn't going  
16 to continue to -- to persist to ask that the  
17 meetings be closed, then maybe they would still be  
18 open --

19 Q. So in this instance --

20 A. -- it's an exchange.

21 Q. I apologize. I didn't mean to  
22 interrupt.

23 But in this particular instance,  
24 they -- do you recall whether there was any  
25 objection as to the confidentiality of the

1 agenda?

2 A. I recall one country did say that they  
3 thought all the meetings should be open --

4 Q. Okay.

5 A. -- and that wasn't enough to result in  
6 opening up the meetings.

7 Q. Okay. And how many items ended up on  
8 the agenda?

9 A. Offhand, I don't recall. I would say,  
10 roughly, 20.

11 Q. Okay. And with respect to those 20  
12 items, how was the item relating to DCA Trust  
13 described?

14 A. It was just the -- listing the  
15 countries that had asked it to be and naming the  
16 string and the application; a simple list.

17 Q. So it just says .africa?

18 A. Essentially, yes. In the application  
19 numbers we were wanting to try --

20 PRESIDENT BARIN: I'm going to ask  
21 that we sort of --

22 MR. ALI: Mr. President, we don't  
23 have this agenda. It's fairly important.  
24 What we have here is -- and just to  
25 shortcut this, because I don't need to

1           elicit testimony when we have the  
2           documents -- we have now been told that  
3           there was an agenda circulated three  
4           weeks beforehand, that this agenda has  
5           been kept confidential.

6                     This agenda has not been produced.  
7           This agenda apparently says nothing but  
8           .africa and an application number.  
9           This -- this agenda does not include the  
10          ZACR application for purposes of any kind  
11          of discussion.

12                    We understand that may be because  
13          nobody asked that the ZACR application be  
14          put on this undisclosed agenda.

15                    Now, what we do know is that a --

16  
17                                 Redacted - GAC Designated Confidential Information



1 Redacted - GAC Designated Confidential Information

1

2

3

Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

25

But we do now know, based on her

1 testimony, that there's an agenda that's  
2 not been disclosed to us but that  
3 reflected an item that we have been told  
4 is somehow an objection agenda -- or  
5 objection advice agenda.

6 Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential  
Information

8

PRESIDENT BARIN: And I have no  
9 problem, Mr. Ali, looking at these  
10 tomorrow if you wish and going through  
11 them, but if you have a question, in all  
12 fairness to Ms. Dryden, then let's get  
13 those questions out.

14

I'm happy to and I'm sure the rest  
15 of the Panel is happy to hear that.

16

MR. LEVEE: I also state this is the  
17 second time that counsel has stated that  
18 there's an agenda that somehow I hid from  
19 the Panel.

20

There was no request for any agendas  
21 to me at any time. The request that came  
22 through was for the e-mail in reference  
23 to Ms. Dryden's declaration, and those  
24 were produced.

25

PRESIDENT BARIN: Understood.

1           And I think, frankly, the way I  
2 understood was that this is an issue that  
3 came up during the testimony of  
4 Ms. Dryden --

5           HONORABLE JUDGE CAHILL: That was  
6 going to be a question I asked.

7           Did you ask for it or --

8           MR. LEVEE: It was not requested.

9           And the only other point I want to  
10 make, given the hour, I have no problems  
11 with questions about this. The parties  
12 raised these e-mails in her opening  
13 statement. We're going to discuss them  
14 tomorrow.

15           What I would prefer or hope for is  
16 if there are factually based questions  
17 that Mr. Ali wants to ask the witness,  
18 fine. If he wants to make his closing  
19 argument, let him do it in the morning.

20           PRESIDENT BARIN: That was the point  
21 that I just made as well.

22           MR. LEVEE: Thank you.

23           MR. ALI: Thank you. Thank you for  
24 the guidance, Judge.

25

1

2

Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information



1

2

Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

1 Redacted - GAC Designated Confidential Information

7 Q. I see.

8 And what's the appropriate amount of  
9 time?

10 A. Well, if there are no raised hands and  
11 several moments pass, then we have a consensus.  
12 Silence is agreement.

13 PRESIDENT BARIN: Enough for you to  
14 look around the room to see if  
15 anybody else --

16 THE WITNESS: Absolutely.

17 BY MR. ALI:

18 Q. Silence is agreement?

19 A. In -- in that case, yes.

20 Q. I see.

21 Consensus by acquiescence?

22 A. It is a very important tool in -- in  
23 the tool kit for governments, yes.

24 Q. I see.

25 So consensus by -- well, I

1 participated in many UN meetings and many  
2 international organization meetings and, frankly,  
3 I don't believe that I've ever seen a  
4 situation --

5 PRESIDENT BARIN: Mr. Ali --

6 HONORABLE JUDGE CAHILL: That's  
7 tomorrow.

8 PRESIDENT BARIN: -- let's ask  
9 questions, please.

10 MR. ALI: I apologize. That was  
11 uncordial.

12 BY MR. ALI:

13 Q. So consensus by acquiescence, by  
14 silence.

15 So what's the consequence in this  
16 instance of GAC consensus advice?

17 A. You would need to ask the Board. It's  
18 their responsibility to interpret.

19 PRESIDENT BARIN: Frankly, Mr. Ali,  
20 I asked her that question, and she  
21 responded by saying the same thing. So  
22 it may not be a satisfactory answer --

23 MR. ALI: It's not.

24 BY MR. ALI:

25 Q. I would like to know what it is that

1 you, as the GAC Chair, understand to be the  
2 consequences of the actions that the GAC will take  
3 --

4 HONORABLE JUDGE CAHILL: The GAC  
5 will take?

6 BY MR. ALI:

7 Q. -- the GAC will take -- the  
8 consequences of the actions taken by the GAC, such  
9 as consensus advice?

10 HONORABLE JUDGE CAHILL: There you  
11 go.

12 THE WITNESS: That isn't my concern  
13 as the Chair. It's really for the Board  
14 to interpret the outputs coming from the  
15 GAC.

16 BY MR. ALI:

17 Q. Okay. I'll take that.

18 MR. ALI: And I have no further  
19 questions. Thank you.

20 PRESIDENT BARIN: Thank you.

21 Mr. LeVee.

22 MR. LEVEE: I'll be very brief.

23 - - -

24

25

1 EXAMINATION ON BEHALF OF RESPONDENT  
2 INTERNET CORPORATION FOR ASSIGNED NAMES AND NUMBERS

3 - - -

4

5 Redacted - GAC Designated Confidential Information

24 MR. LEVEE: Thank you.

25 HONORABLE JUDGE CAHILL: How did

1           that happen? Did somebody call you or  
2           got a note?

3                    THE WITNESS: There were deadlines  
4           issued, communications coming out from  
5           GAC Support Staff to the membership about  
6           how to signal that they would like this  
7           added to that agenda. The process laid  
8           out deadlines, and then those are  
9           compiled and communicated to the GAC.

10          BY MR. LEVEE:

11                Q.     So to clarify, the AUC did not ask for  
12          this to be placed on the agenda?

13                A.     Correct.

14                Q.     Okay.

15                    And the AUC did not -- at the meeting  
16          that we're talking about on April 10th, the AUC  
17          did not speak?

18                A.     Correct.

19                                Redacted - GAC Designated Confidential Information

22                Q.     Okay. And you said something before,  
23          and it got swallowed up, I think, in the  
24          questioning.

25                    When you announced that the GAC had

1 achieved consensus with respect to DCA's  
2 application, what happened next?

3 A. Applause, unanimous applause.

4 Q. So the room broke out into applause?

5 A. Yes.

6 PRESIDENT BARIN: Is that usual,  
7 Ms. Dryden?

8 THE WITNESS: In those situations,  
9 yes, if it's a particularly difficult  
10 discussion. The -- the agenda was, of  
11 course, sensitive and delicate. I don't  
12 want it to sound like I'm contradicting  
13 with my description of the discussion  
14 being very quick and straightforward. It  
15 was.

16 But then colleagues are very keen  
17 to -- to show comity and that we have  
18 reached agreement on something.

19 PRESIDENT BARIN: Let me just  
20 finish.

21 To be precise, this was in relation  
22 to the DCA Trust application?

23 THE WITNESS: Right, directly after  
24 and before we went to the next --

25 PRESIDENT BARIN: To the next item?



1 THE WITNESS: Yes.

2 MR. LEVEE: Those are all the  
3 questions I have.

4 MR. ALI: I have one follow-up  
5 question, if I may.

6 PRESIDENT BARIN: Okay.

7 Redacted - GAC Designated Confidential  
Information

15 - - -

16 EXAMINATION (CONTINUED) ON BEHALF OF CLAIMANT

17 DOTCONNECTAFRICA TRUST

18 - - -

19 BY MR. ALI:

20 Q. So just maybe one, perhaps two  
21 questions very quickly on that.

22 Do you recall who the Kenyan  
23 representative was at the time when the agenda  
24 was developed?

25 A. It would have been Michael Katundu.

1 Q. It would have been Michael Katundu?  
2 You're sure of that?

3 A. He's been the representative for  
4 many years. He's been in the GAC longer than I  
5 have. And my first meeting was 2007, so . . .

6 Q. Okay.

7 PRESIDENT BARIN: Can you be more  
8 precise when you say "would have been"?  
9 Was it?

10 THE WITNESS: Yes.

11 HONORABLE JUDGE CAHILL: How are you  
12 so sure? Did you talk to him or get a  
13 note or see something?

14 THE WITNESS: I'm quite good at  
15 knowing who's who. It's part of the job  
16 knowing who the people are and which part  
17 of government is responsible and what --

18 HONORABLE JUDGE CAHILL: Sure.  
19 How do you know he's the one who did  
20 it?

21 THE WITNESS: It's in the GAC  
22 records that he would be the  
23 representative.

24 As to how Support Staff would have  
25 handled the details, I don't know

1           precisely how they administered --

2                   HONORABLE JUDGE CAHILL: That's not  
3 consistent with some of these other  
4 e-mails from --

5                   THE WITNESS: GAC preparations are  
6 handled by Support Staff.

7                   HONORABLE JUDGE CAHILL: Okay.

8                   MR. ALI: I said one, and that's  
9 one.

10                  PRESIDENT BARIN: Okay.

11                   Professor Kessedjian?

12                   No?

13                  HONORABLE JUDGE CAHILL: No, I'm  
14 fine.

15                  PRESIDENT BARIN: Thank you,  
16 Ms. Dryden. I appreciate your help and  
17 your time.

18                  THE WITNESS: Okay. All right.  
19 Good luck.

20                  PRESIDENT BARIN: Have a safe flight  
21 back home.

22                  THE WITNESS: Thank you.

23                   (The witness was excused.)

24                  MR. LEVEE: With the Panel's  
25 permission, I would just avoid a break at

1           this point and just go straight into  
2           the -- actually, to the next witness. We  
3           just broke 15 minutes ago.

4                       (Pause.)

5           PRESIDENT BARIN: Good evening,  
6           Ms. Bekele. I realize it's 20 to 6:00.  
7           It's been a long day --

8           MS. BEKELE: Yes.

9           PRESIDENT BARIN: -- so we'll have  
10          this go forward as -- as long as we can.  
11          And hopefully we'll finish it tonight.

12          But if -- at whatever point you feel  
13          that it's time and you want to stop, then  
14          we can consider that as well.

15          MS. BEKELE: Sure.

16          PRESIDENT BARIN: Okay. As I did  
17          with the other witnesses, we'll swear you  
18          in.

19                               - - -

20          S O P H I A   B E K E L E   E S H E T E,  
21          after having been first duly sworn by  
22          President Barin, was examined and  
23          testified as follows:

24                               - - -

25          PRESIDENT BARIN: Thank you.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

- - -  
EXAMINATION ON BEHALF OF THE PANEL  
BY PRESIDENT BARIN  
- - -

PRESIDENT BARIN: So you are sworn in. And I'm not going to start asking you the same background questions that I began with the other witnesses because your detailed statement does spell out what your background is and what you've done.

I'm going to start with referring you to Page 23 of your statement, which you have.

And you don't have any other notes or anything that you want to refer to or that you're using other than your statement?

THE WITNESS: No.

PRESIDENT BARIN: Okay. The question I have for you, it somewhat, if you will, resonants throughout the statement that you prepared. You will find as a background Paragraph 51 and 52 of your statement. If you take a look at

1           it.

2                    So you've given us the background.  
3           And the title is The AUC's Purported  
4           Withdrawal for its Support for DCA.

5                    You say, Whilst in the middle of  
6           collecting individual endorsements and  
7           making announcements through our public  
8           relations campaign, you learned that the  
9           AUC had e-mailed you in a letter dated  
10          April 16th, stating that they no longer  
11          endorsed the individual initiatives for  
12          Africa.

13                   And then you go on to say this was  
14          shocking to you.

15                   Did you know that that was coming?

16                   THE WITNESS: No, not at all.

17                   PRESIDENT BARIN: So what is the  
18          background of what this e-mail is there?

19                   THE WITNESS: Okay. So after we've  
20          been endorsed by AUC in 2009 and, prior  
21          to that, another organization called  
22          UNECA, U-N-E-C-A, in 2008, we proceeded  
23          with collecting individual endorsements  
24          from different African governments, as  
25          well as starting our awareness to the

1 African campaign to raise awareness for  
2 the gTLD in Africa.

3 In the midst of that, we received  
4 this letter.

5 So I went back to the AUC to  
6 reconcile what happened, and what they  
7 told me was that ICANN Staff has come a  
8 few weeks before and has presented a  
9 .africa presentation for them. And they  
10 going through a regulatory framework, and  
11 they will be working with ICANN and the  
12 African community and perhaps private  
13 sector to coordinate what is best suited  
14 for .africa for Africa.

15 PRESIDENT BARIN: Are you saying  
16 that prior to this, if you will, contact,  
17 you were totally in the dark as far as --

18 THE WITNESS: Absolutely. No, I'm  
19 not aware.

20 PRESIDENT BARIN: Okay. And so what  
21 else were you told by AUC about the  
22 presentation by ICANN?

23 THE WITNESS: What else was I told?

24 PRESIDENT BARIN: Yes.

25 THE WITNESS: It was a brief

1 meeting. They --

2 PRESIDENT BARIN: Put it in context,  
3 if you will, just so we have a better --

4 THE WITNESS: Who was the contact  
5 there?

6 PRESIDENT BARIN: Who was the  
7 contact, when was it, where were -- you  
8 know -- yeah. Let me finish the  
9 question, and then you can -- because,  
10 otherwise, we're going to -- she's going  
11 to have a problem.

12 So I just asked if you could put it  
13 in context so that we could better  
14 understand how this -- this news is  
15 coming to -- to --

16 THE WITNESS: You want to know the  
17 contact?

18 PRESIDENT BARIN: The context.

19 THE WITNESS: Oh, the context. Oh,  
20 I'm sorry. I thought you said "contact."

21 The context of how this news came  
22 about. As I said, it came through  
23 e-mail --

24 PRESIDENT BARIN: Right.

25 THE WITNESS: -- so it was a



1 shocking surprise to me.

2 And so I had contacted the  
3 African Union headquarters when we  
4 received the -- the original endorsement,  
5 which is from the Chairman's office.

6 So the Chairman's office facilitated  
7 the Chief of Staff, and I went to meet  
8 with the Chief of Staff at the time to  
9 request. And he's the one that told me  
10 this particular presentation was made  
11 and -- by an ICANN Staff, and they're  
12 very -- they're going to start working  
13 with ICANN.

14 And as the letter strictly says, it  
15 says it would coordinate with ICANN, the  
16 African community and the private sector  
17 to -- to -- they didn't even say endorse  
18 to come up with what's best for Africa.

19 So what that means is it's not that  
20 they withdrew our letter; they were just  
21 saying there's another alternative way of  
22 coming up with the regulatory framework.

23 PRESIDENT BARIN: Did he tell you  
24 who at ICANN had visited?

25 THE WITNESS: Yeah. Anne-Rachel,

1           which is the ICANN Staff -- the Africa  
2           ICANN Staff.

3           So I thought it was very  
4           inappropriate for ICANN Staff to come and  
5           do a presentation for Africa, because I  
6           thought a bidding party, like ICANN, who  
7           develops an RFP, should be independent  
8           and should not be working with  
9           stakeholder organization. They're not  
10          certainly working with DCA to assist how  
11          to go about .africa.

12          So I brought it to the attention of  
13          the general counsel; I brought it to the  
14          attention of the ombudsman; and I brought  
15          it to the attention of the Chairman at  
16          the time --

17          PRESIDENT BARIN: Okay.

18          THE WITNESS: -- and, somehow, I  
19          think the ombudsman did not feel that was  
20          irregular; however, the Chairman of ICANN  
21          at the time informed me that they have  
22          reprimanded her and not to do that any  
23          more.

24          PRESIDENT BARIN: Did you have any  
25          other reaction from ICANN as a result of

1 your --

2 THE WITNESS: No. That was it. I  
3 was expecting after that there's not  
4 going to be much contact between ICANN  
5 and the AUC.

6 PRESIDENT BARIN: Okay. So can you  
7 then move forward and tell us what  
8 happens with --

9 THE WITNESS: So after that, we just  
10 continued the campaign. Obviously, we  
11 have an endorsement and support from  
12 UNECA, which is a equivalent organization  
13 to AUC, what we believe. And according  
14 to the Guidebook, it's a legitimate  
15 endorsing entity. So we moved on with  
16 our -- with our campaign.

17 What's important for us was to  
18 create that awareness within the  
19 governments and within the stakeholders  
20 in Africa to sensitize them to what the  
21 gTLD is, because it's the first gTLD  
22 entry for Africa.

23 And then we started preparing for --  
24 for our application upcoming. And then  
25 what we found as a result, there was a

1           Dakar meeting, ICANN meeting, and we  
2           found out that sort of regulatory  
3           framework that the Chief of Staff  
4           mentioned turned out to be an AU reserve  
5           name agenda.

6           So what that means is they -- AUC  
7           and ICANN had consulted to reserve the  
8           name, in my opinion, to -- for the three  
9           names, .afrique, the Arabic, and  
10          .afrikia, the French; and .africa, to be  
11          a reserve for AUC under special  
12          legislation.

13          So that request was made in Dakar.  
14          And DCA -- I stood up in front of the  
15          Board and say that's against the  
16          guidelines of the gTLD procedure. It's  
17          anticompetitive. Had we known that was  
18          an arrangement that AUC would have  
19          requested, then we would not have spent  
20          all this time and monies.

21          And -- and ICANN knows that gTLD has  
22          led the process for a very long time  
23          before that. We had sponsored ICANN  
24          meetings. I have announced my intention  
25          to run for the gTLD at Board meetings,

1 public meetings. So the ICANN is very  
2 much aware of it.

3 So we were kind of surprised that  
4 occurred in Dakar. But in any case,  
5 after a while, ICANN, I think maybe  
6 three months later -- Dakar was like  
7 five minutes before the application  
8 started -- they -- they wrote a letter to  
9 AUC confirming that they would not  
10 reserve that name or the gTLD after the  
11 application process started.

12 So we submitted our application with  
13 the current support that we've collected  
14 from various governments and the AUC and  
15 as well as the UNECA. And we proceeded  
16 with our application.

17 PRESIDENT BARIN: Okay. And when  
18 was it that you found out that the AUC  
19 was going to be a member now of -- of --  
20 of ICANN?

21 THE WITNESS: The -- the Prague  
22 meeting, which is --

23 PRESIDENT BARIN: Can you just -- I  
24 don't mean to interrupt you, but --

25 THE WITNESS: -- that was after the

1 application process.

2 PRESIDENT BARIN: Right. So give  
3 the Panel the context.

4 THE WITNESS: So around March was  
5 the application process, and June -- 2013  
6 March, the application opened, and the  
7 Prague meeting, which was about  
8 June 2013, it was announced that AUC was  
9 going to be a member of GAC.

10 PRESIDENT BARIN: Okay. And your  
11 reaction to that was --

12 THE WITNESS: Very shocked, myself  
13 and many --

14 HONORABLE JUDGE CAHILL: You've got  
15 to let him finish his question.

16 THE WITNESS: Oh, I'm sorry.

17 PRESIDENT BARIN: That's okay.

18 So you were shocked?

19 THE WITNESS: Yes.

20 PRESIDENT BARIN: And what did you  
21 do after you got over being shocked?

22 THE WITNESS: I think we -- we wrote  
23 to ICANN, because there was the AUC in  
24 the African community and ZACR, they had  
25 a meeting with the new CEO. The new CEO

1           joined ICANN at about that time. And  
2           they had a presentation, and they came up  
3           with what's called ICANN Africa Strategy.

4           And we were not included. We were  
5           not invited to the meeting. So we wrote  
6           a letter to ICANN stating that DCA has  
7           been included -- excluded from this  
8           meeting, while AUC and the rest of the  
9           supporters of the AUC application held a  
10          meeting jointly to pursue an ICANN  
11          African strategy.

12          PRESIDENT BARIN: That's why I asked  
13          you the question.

14          Why do you think you were excluded  
15          from the meeting?

16          THE WITNESS: Because we are not --  
17          there was sort of -- we felt there was  
18          always a divide as to who the group  
19          that -- the group that actually is  
20          coordinated with AUC and the group that's  
21          not part of AUC.

22          And so we are competitors, in a  
23          sense. So the competitors of the AUC are  
24          not privy to what's going on with that.  
25          So . . .

1           PRESIDENT BARIN: So, initially, you  
2           were actually on the same side as AUC?  
3           Is that -- is that a fair description?  
4           And thing changed?

5           THE WITNESS: "Same side" means,  
6           like, when they endorse --

7           PRESIDENT BARIN: The same team, if  
8           you will, because you just described as  
9           there being two camps --

10          THE WITNESS: Yes, there has been  
11          two camps because of the .africa -- two  
12          .africa applications.

13          PRESIDENT BARIN: Right.

14          But, initially, I think you just  
15          told us you did have a rapport with the  
16          AUC and things were going forward the  
17          way, perhaps, you initially anticipated.

18          But then, subsequently, that  
19          changed?

20          THE WITNESS: Yes. What's the  
21          point --

22          PRESIDENT BARIN: Pardon me?

23          THE WITNESS: I'm not sure.

24          PRESIDENT BARIN: What was that?

25          THE WITNESS: I was saying, as was



1           pointed -- I'm asking a question, which I  
2           shouldn't. I'm sorry.

3           PRESIDENT BARIN: So my question to  
4           you is, What -- why -- why do you think  
5           the change was there?

6           THE WITNESS: Oh, the change  
7           occurred when AUC was introduced and was  
8           told they could have the reserve name to  
9           themselves. And there was a consultation  
10          by the -- by ICANN and the vested group  
11          of community that wants to have our  
12          competition, who would like to have AU  
13          endorsements so they can proceed with  
14          their own application.

15          PRESIDENT BARIN: So who would you  
16          say would be -- in your own words, who  
17          would you say is responsible for --

18          THE WITNESS: Well, I think,  
19          initially, if AUC did not get the support  
20          of ICANN, I would not think that -- I  
21          mean, AUC had no idea of applying for --  
22          for a gTLD when I went to them. They  
23          supported our efforts. I made various  
24          presentations with the relevant bodies.

25          And I went -- finally, after it's

1           been approved, like almost a year's worth  
2           of communication with AUC, e-mails and  
3           correspondences and presentations on  
4           .africa initiatives. So they had no  
5           idea, and they were not interested in  
6           applying for .africa until the incident  
7           happened where they were advised,  
8           obviously, that they could reserve the  
9           name and/or, you know, buy.

10                   And we totally feel responsible that  
11           ICANN approach to .africa had an  
12           influence in it.

13                   PRESIDENT BARIN: Okay. But is it  
14           fair to say or ask -- I mean, AUC could  
15           have also changed its mind?

16                   THE WITNESS: Obviously, if it  
17           consulted, it would change its mind.

18                   HONORABLE JUDGE CAHILL: I'm sorry.  
19           Say it again.

20                   THE WITNESS: If it's consulted,  
21           there's another approach to .africa, it  
22           will change its mind.

23                   ARBITRATOR KESSEDJIAN: It would  
24           change its mind again, you mean?

25                   THE WITNESS: No, no. At the time,

1 after they've given us endorsements,  
2 right, if they think that they could have  
3 it to themselves or work with another  
4 organization to have it to themselves,  
5 definitely, they would have changed their  
6 mind. That's all I'm saying.

7 They become the competitor, right,  
8 to have the same thing that we're going  
9 after.

10 HONORABLE JUDGE CAHILL: You think,  
11 as a competitor, they took your idea?

12 THE WITNESS: They took our idea  
13 because the whole proposal that we  
14 submitted for 18 months going back and  
15 forth and -- and -- and even the  
16 endorsement they collected from the other  
17 governments, and what they showed to them  
18 was our idea, our proposal.

19 So -- but we didn't have a problem  
20 with the competition, in a sense, because  
21 the ICANN gTLD, you know, it allows for  
22 competition. But when your endorser  
23 becomes a competition and they're trained  
24 after that, how they went about it and  
25 the GAC advice and how they came through

1 GAC to stop our application completely,  
2 it was -- it was not a competition; it  
3 was more like --

4 PRESIDENT BARIN: I want to come to  
5 that in a minute.

6 But when you say -- but do you  
7 attribute that to, if you will -- and I  
8 think you alluded to it earlier, that the  
9 meeting with the ICANN representative, is  
10 that -- is that --

11 THE WITNESS: That's very key --  
12 that's a very key meeting.

13 PRESIDENT BARIN: But a key I can  
14 understand. But the point was made, I  
15 guess -- and you heard it this morning,  
16 submissions by ICANN -- that they could  
17 have changed their mind. AUC could have  
18 changed its mind at any time they wanted  
19 to.

20 THE WITNESS: But I was told by the  
21 Chief of Staff exactly what happened,  
22 right, so they didn't tell me that  
23 they --

24 PRESIDENT BARIN: What were you  
25 told?

1           THE WITNESS: They said the ICANN  
2           representative came and made a .africa  
3           presentation, and they're going to come  
4           up with the regulatory framework.  
5           Obviously, they do not understand the  
6           language of what the reserve name is  
7           really what happened with the regulatory  
8           framework.

9           When you think about it, they're  
10          trying to say it's -- there's a way to  
11          govern the gTLD to the benefits of the --  
12          of Africa. So the regulatory framework  
13          is what they're told. And so that really  
14          turned out in the card to me, the reserve  
15          name directly to the AUC.

16          PRESIDENT BARIN: If I can perhaps  
17          summarize, what you're saying is AUC  
18          found out through, according to you, the  
19          presentation that ICANN made to them that  
20          they no longer really needed you; they  
21          could do it themselves?

22          THE WITNESS: Exactly. That's what  
23          they have on their letter. That's what  
24          the letter says. It does not withdraw  
25          our application. It says, In

1 coordination with ICANN and the  
2 stakeholder community, we will identify  
3 what's best for Africa.

4 So it's very clear.

5 - - -

6 EXAMINATION ON BEHALF OF THE PANEL

7 BY ARBITRATOR KESSEDJIAN

8 - - -

9 ARBITRATOR KESSEDJIAN: Ms. Bekele,  
10 I have a -- the first question for you,  
11 and it concerns the -- what you mentioned  
12 Page 30, Paragraph 66 of your written  
13 statement, that's the request for  
14 proposal that was issued by AUC.

15 You heard this morning in the  
16 opening statement, I think it was from  
17 ICANN, that you refused -- and correct me  
18 if my recollection is not correct -- that  
19 you refused, quote/unquote, to  
20 participate in this request for proposals  
21 that AUC has put out.

22 Could you explain to us what --  
23 first of all, can you confirm that you  
24 refused, and if you do confirm that you  
25 refused, can you confirm why you did

1 refuse?

2 THE WITNESS: Sure thing.

3 We made a strong point as to our  
4 refusal and communicated it to ICANN --  
5 to ICANN as well as AUC executives about  
6 it. And the point being this RFP was  
7 issued right after Dakar when ICANN could  
8 not reserve the name for -- for AUC, when  
9 that was known.

10 And so, therefore, the first point  
11 of -- the first step that AUC took was to  
12 directly appoint ZACR as -- as a registry  
13 operator on behalf of AUC. And then we  
14 fought that, and we explained to AUC  
15 saying that it's only ICANN who has a  
16 mandate to appoint a registry. AUC  
17 cannot do that.

18 At that point, then they turned that  
19 appointment to an RFP, and then they  
20 issued the RFP with certain conditions.  
21 And, primarily, the people behind -- they  
22 put together an African Union Task Force,  
23 which is a task force made up of all the  
24 people within the African community that  
25 has vested interests in .africa.

1           And some of the members of the  
2           .africa -- this task force, in fact, have  
3           failed to get a direct endorsement from  
4           AUC in competition to us, even after we  
5           got endorsement. So these are sort of  
6           vested group that went and, on behalf of  
7           AUC, was executing the RFP.

8           So that was one of the biggest  
9           problems we have.

10          But when we saw the RFP  
11          requirements, it was extraordinarily  
12          different from the ICANN RFP. So one --  
13          for example, one is -- first of all, it  
14          says, Take a geographic name and apply it  
15          for a community.

16          So that means that per -- the  
17          application that's going to be endorsed  
18          is going to have to apply on behalf of  
19          the African community. And we felt that  
20          that's irregular, because the .africa  
21          gTLD is not a community gTLD; it's a  
22          standard gTLD.

23          So that's one constraint we saw.

24          And then the second we saw was that  
25          it required ccTL- -- alignment with the



1 ccTLDs -- African ccTLDs. And that's not  
2 something that the main ICANN RFP  
3 requires. So we didn't have to go with  
4 some extraordinary request again.

5 So we felt like there's no need to  
6 do that. But the other competition does  
7 have already an existing relationship  
8 with the ccTLDs. So we felt like it's  
9 going to favor them.

10 So the whole thing was, we felt  
11 like, contrived by that -- that task  
12 force to favor a particular group and  
13 come up -- come out with a predetermined  
14 outcome.

15 And also, the fact that it's not in  
16 compliance with the -- with an  
17 ICANN-regulated gTLD, which we've come up  
18 with six years of requirements now has  
19 changed with a different kind of  
20 requirement where we're forced to  
21 participate, and we probably will not  
22 even win it. And then, when we go to  
23 ICANN, it's just a contrary to the RFP.

24 And two things I forgot in there,  
25 actually, is that the con- -- the

1 confidentiality of our proposal, because  
2 it requires the financial and the  
3 technical and all the application  
4 proposal they had asked us to submit,  
5 which means we're exposing that to our  
6 competitors as well, who will have --  
7 who, again, are the vested group, as well  
8 as the other competition.

9 So we didn't feel like that should  
10 be given at the AUC level; it should be  
11 given at the ICANN level.

12 Okay. So there many, many reasons.

13 I mean, I have -- my organization  
14 has bid in international bids for a long  
15 time, my private organizations and so  
16 forth. We have experience in  
17 administering bids. So we thought that  
18 the whole thing is irregular in terms of  
19 how they came about it.

20 And, also, one more point on this is  
21 that the ICANN RFP, as you know, it's  
22 taking, like, six, seven, eight months to  
23 evaluate the whole technical, financial  
24 application. You know, it's an extensive  
25 process that requires expertise,

1 independent evaluators and so forth.

2 The AU RFP was extremely simple, and  
3 it required us to give all this  
4 information, but the award is going to be  
5 given in seven days. So it's just -- you  
6 know it was predetermined outcome.

7 So we didn't want to be falling a  
8 victim to something that's extraordinary.  
9 That was not part of the ICANN rules.

10 ARBITRATOR KESSEDJIAN: You are  
11 saying a lot of things at the same time,  
12 so I'm trying to understand the main  
13 points.

14 Are you saying that because AUC was  
15 requiring a filing -- an open filing of  
16 everything, contrary to what ICANN  
17 does -- ICANN has some parts which are  
18 confidential in the applications and  
19 other parts which are public -- are you  
20 saying that AUC was asking you to  
21 basically give to the open public and  
22 to -- therefore, to the competition all  
23 of your application?

24 Is that -- is that what you said?

25 THE WITNESS: No.

1           Let me clarify. What I'm saying is  
2 when you actually submit a bid for any  
3 RFP, right, you have to -- there's a  
4 requirement, which is the financial,  
5 technical and whatever requirement they  
6 would ask.

7           So that would be -- the  
8 confidentiality of that data would fall  
9 on the evaluators. And the evaluators of  
10 that RFP was our competition.

11           So it would not be fair to give all  
12 of our confidential information to them  
13 and then we go apply again as a  
14 confidential in ICANN as well.

15           So it's like double exposure. Yeah.

16           ARBITRATOR KESSEDJIAN: Now, I don't  
17 know whether, in your opinion, the fact  
18 that you refused to participate for the  
19 reasons you just explained basically made  
20 you an opponent to whoever was in power  
21 to decide at the AUC what they were going  
22 to do next.

23           So the call was actually a difficult  
24 call?

25           THE WITNESS: It was an extremely

1           difficult call. Also, the fact that --  
2           the major issue is that AUC wanted that  
3           applicant -- the successful applicant to  
4           apply on behalf of the community.

5           And this is not a community  
6           application; this is a gTLD standard  
7           application. So the -- our opponents'  
8           differentiation strategy from ours was to  
9           apply on behalf of a community. And,  
10          even so, they did not apply at ICANN on  
11          behalf of the community. That was their  
12          differentiation strategy.

13          And we couldn't participate in that  
14          process because we would not know the  
15          impact of getting an endorsement under --  
16          being a successful applicant to apply on  
17          behalf of the community, how it would  
18          affect us on the ICANN level, because  
19          it's ultra contrary to the RFP of ICANN.

20                 ARBITRATOR KESSEDJIAN: Okay. My  
21          second question goes to the processes  
22          that you describe in your -- in your  
23          written statement.

24                 And, in fact, at several moments in  
25          your written statement -- I'm not going

1 to cite them, but you cite names of  
2 people who we have no idea basically who  
3 they are. And I'm just taking an  
4 example, this Pierre Dandjinou.

5 THE WITNESS: Um-hum.

6 ARBITRATOR KESSEDJIAN: So you go  
7 for quite a long time in your statement,  
8 probably several paragraphs, at least the  
9 ones that I have here, Page 33,  
10 explaining what he did and so on.

11 But why is it -- I have to ask the  
12 question -- why is Mr. Dandjinou not  
13 here? I mean, if he's that important  
14 that you really spend so much time  
15 explaining to us what he has done so  
16 wrong, why aren't we, you know, listening  
17 to him?

18 Can you explain that? What's  
19 the --

20 THE WITNESS: I don't know. He's  
21 currently an ICANN employee, so I'm not  
22 sure exactly. I'm not the one calling  
23 the witnesses, so why he's not here --

24 ARBITRATOR KESSEDJIAN: Okay. Fine.

25 THE WITNESS: -- but just to briefly

1 describe the relationship, that, you  
2 know, the gentleman was the head of the  
3 ICANN Task Force -- I mean, the African  
4 Union Task Force during the time the RFP  
5 was being administered.

6 So we thought there was a conflict  
7 of interest because he's one of the  
8 vested groups of .africa that wanted the  
9 community to own, the current ones.

10 So the reason we mention him all  
11 over is because there is sort of an  
12 incestuous relationship with this African  
13 community and ICANN and the .africa gTLD  
14 in general. And we felt like there's a  
15 huge amount of conflicts of interests  
16 that are not resolved.

17 ARBITRATOR KESSEDJIAN: Let's be  
18 precise for a minute about this conflict  
19 of interest. I mean, you, yourself, have  
20 been involved in ICANN. So it seems like  
21 in the Internet community, there's a lot  
22 of going back and forth.

23 I mean, at some stage, you know, you  
24 are -- and I guess in this country, in  
25 the U.S. -- and that's why ICANN has this

1 kind of special status in a way -- there  
2 is -- I mean, for a French person, I can  
3 tell you it's more -- more shocking  
4 that -- and we have actually an  
5 expression which is "pantouflage."

6 You know, pantouflage is really bad.  
7 It's really bad, because that means  
8 you're using your contacts that you have  
9 been -- you know, your network that you  
10 have been crafting at the time you were  
11 in an institution for private interests.  
12 But it seems that the Internet community,  
13 it happens all the time.

14 Would you agree with me?

15 THE WITNESS: I completely agree.

16 ARBITRATOR KESSEDJIAN: But then how  
17 does that influence the analysis that we  
18 have to have on the conflict of interest  
19 that you are raising? You are raising --  
20 you know, your case is based partly on  
21 the conflict of interest. That is  
22 very common.

23 If the going back and forth from  
24 public to private, from ICANN to other  
25 institutions, is pretty common, what is



1 the conclusion for us or what is the  
2 analysis for us?

3 I mean, you may not want to answer  
4 the question. I don't know. But, you  
5 know, this is something that is important  
6 for us.

7 THE WITNESS: Well, there could be a  
8 measure of response. I mean, I was at  
9 ICANN since 2005. I'm very familiar with  
10 the environment.

11 When we were given the opinion of  
12 gTLDs, a consideration of conflict of  
13 interest came in fact and was prevalent  
14 while -- during the final stages of the  
15 gTLD, I would say. That's why we have  
16 about, I think -- maybe I could confirm  
17 that -- but maybe about 18 out of 18  
18 Board of Directors. About 16 have  
19 recused themselves, so that process went  
20 in place.

21 And that's why you start identifying  
22 people to curtail perceptions of  
23 interest -- of -- of -- the thing we were  
24 talking about all day today, the  
25 perceived conflict versus the actual

1 conflict and so forth.

2 So it's very normal to report it to  
3 the upper management of the ICANN Board,  
4 and it's within the integrity of the  
5 person to step down and recuse themselves  
6 so they are not perceived as that. And  
7 the consequences are up to the person, I  
8 would believe.

9 So . . .

10 ARBITRATOR KESSEDJIAN: Okay. Thank  
11 you.

12 - - -

13 EXAMINATION ON BEHALF OF THE PANEL  
14 BY HONORABLE JUDGE CAHILL

15 - - -

16 HONORABLE JUDGE CAHILL: Do you  
17 under -- do you agree you need the  
18 support of the 60 percent of the African  
19 countries to --

20 THE WITNESS: Yes.

21 HONORABLE JUDGE CAHILL: And you --  
22 you knew it before you got the warning  
23 letters?

24 THE WITNESS: Sure.

25 HONORABLE JUDGE CAHILL: And did you

1 ever get 60 percent?

2 THE WITNESS: We have, according to  
3 the Guidebook, almost 100 percent, right,  
4 because we have the AUC -- in our  
5 opinion, it's not withdrawn -- and also  
6 UNECA, which is another equivalent  
7 organization.

8 So the point of the 60 percent was  
9 not determined, in fact, until the  
10 Dakar -- the Dakar meeting, where I  
11 remember we had a discussion with some of  
12 the Board members saying, Sophia, in  
13 fact, the 60 percent might imply that it  
14 would be about 36 governments, instead  
15 of, like, a blanket 60 percent -- a  
16 blanket endorsement.

17 So there was a tiptoeing about  
18 exactly the interpretation of that, what  
19 that 60 percent was. But irrelevant to  
20 that, when we developed the Guidebook, it  
21 was very clear that geographic name  
22 applicants -- it's not only .africa --  
23 they could come in with the current  
24 endorsement they have.

25 And at the end, after the

1 independent evaluators look at them,  
2 there is a 90-day period where we can --  
3 again, if the -- if the -- the  
4 application is viable.

5 Because the application I know we  
6 focused here --

7 HONORABLE JUDGE CAHILL: What  
8 application is viable?

9 THE WITNESS: The application being  
10 viable means the --

11 HONORABLE JUDGE CAHILL: You mean  
12 the AUC --

13 THE WITNESS: -- no, no, the  
14 actual -- the registry application that  
15 you put --

16 HONORABLE JUDGE CAHILL: Okay.

17 THE WITNESS: Yeah.

18 -- so I know we focused a lot --  
19 because of the GAC advice, we focused a  
20 lot on the merits of .africa on -- on the  
21 support.

22 But the merits of an application,  
23 really, according to the gTLD Guidebook,  
24 is the successful applicants should pass  
25 technical, financial and support,

1 obviously, for -- for geographic name.

2 So most people, you know, you may  
3 not have -- you may have a viable  
4 application and not the support. So the  
5 gTLD Guidebook says that, you know, if  
6 your application is viable, you can go  
7 get support. You have 30 days to go get  
8 support.

9 So we -- we are counting on the gTLD  
10 system to work as it's constructed.

11 So when we apply -- when we went in  
12 there, we had already the -- the current  
13 endorsements that we had in our hands,  
14 but if our application -- that's what we  
15 were hoping, that when the two applicants  
16 were going -- being evaluated, the  
17 applicant who successfully evaluated  
18 could go back to the AUC or go back to  
19 the African countries to get  
20 endorsements. And we had no problem to  
21 get them.

22 HONORABLE JUDGE CAHILL: Okay. You  
23 said the AUC endorsement, as far as  
24 you're concerned, is not withdrawn?

25 THE WITNESS: No.

1 HONORABLE JUDGE CAHILL: Why do you  
2 say that?

3 THE WITNESS: Because it was not  
4 withdrawn. They did not say we did not  
5 withdraw your application. They just  
6 said we will work with a framework with  
7 ICANN and --

8 HONORABLE JUDGE CAHILL: I thought  
9 they did withdraw.

10 You don't think they withdrew their  
11 application?

12 THE WITNESS: We don't think they  
13 withdraw it.

14 HONORABLE JUDGE CAHILL: You don't  
15 think they changed their mind --

16 THE WITNESS: They changed their  
17 mind in the way it's implemented -- they  
18 want it implemented.

19 HONORABLE JUDGE CAHILL: Are they  
20 still endorsing you, even though you're a  
21 competitor?

22 THE WITNESS: They did not say  
23 withdraw. We didn't see it as a legal  
24 withdraw.

25 HONORABLE JUDGE CAHILL: Okay.

1 THE WITNESS: Yeah. But we have the  
2 UNECA, so, for us, it's equivalent. So  
3 if we're competitors, then we will  
4 compete with each other on that.

5 But the point is the successful  
6 evaluate -- the person -- the applicant  
7 who is going to be successfully  
8 evaluated, at the end, we still have  
9 three months to get endorsements.

10 And what we are saying to ICANN is,  
11 The GAC advice somehow has stopped us  
12 from participating further, so we don't  
13 even know -- go to that.

14 HONORABLE JUDGE CAHILL: You had 17  
15 countries give you Early Warnings, and  
16 one of the -- I think most of them, not  
17 all of them, said you need 18  
18 countries --

19 THE WITNESS: There are 17, yes.

20 HONORABLE JUDGE CAHILL: Yeah.

21 So what did you do when you got that

22 --

23 THE WITNESS: Okay. Again --

24 HONORABLE JUDGE CAHILL: -- those  
25 complaints are invalid or --

1 THE WITNESS: -- the specifics of  
2 that says that you didn't have support.  
3 But the 17 countries had no idea of our  
4 submission of application. We already  
5 have support.

6 So how could they come in and say  
7 You don't have support? It's their own  
8 perception of what AUC --

9 HONORABLE JUDGE CAHILL: Did you  
10 respond and say, Look, I do have support?  
11 I have AUC --

12 THE WITNESS: Yes, in our early GAC  
13 response -- actually, we should not be  
14 discussing because, obviously, ICANN did  
15 not put even that as a con- -- you know,  
16 the endorsements, they are not in public  
17 domain.

18 So that's -- the discussion was not  
19 if we had support; the discussion is that  
20 they -- their response to us was not  
21 legitimate. Their objection to us was  
22 not legitimate without them knowing that,  
23 if we have support or not. Because  
24 they're acquiescing to the AUC statement.

25 HONORABLE JUDGE CAHILL: There's a



1 writing somewhere where you write back  
2 and you go, Wait a minute, I don't need  
3 18, I've got enough already?

4 THE WITNESS: We did say that, and  
5 we also said, Your supported applicant  
6 does not also have the proper  
7 endorsements, so why are we evaluated  
8 differently?

9 HONORABLE JUDGE CAHILL: Whether or  
10 not AUC's endorsement program is proper  
11 or not, that's not really before us --

12 THE WITNESS: I understand.

13 HONORABLE JUDGE CAHILL: -- what's,  
14 really, kind of before us is the action  
15 of the GAC to stop your application,  
16 right?

17 THE WITNESS: Right.

18 HONORABLE JUDGE CAHILL: Did you  
19 know before the Beijing meeting that that  
20 was on the agenda --

21 THE WITNESS: No.

22 HONORABLE JUDGE CAHILL: -- that one  
23 of the things was to stop your -- going  
24 forward?

25 THE WITNESS: No.

1 HONORABLE JUDGE CAHILL: You didn't  
2 know that?

3 THE WITNESS: No. We only know  
4 about the Early Warning, which could  
5 potentially lead to us --

6 Redacted - GAC Designated Confidential  
Information

1 Redacted - GAC Designated Confidential  
Information

5 HONORABLE JUDGE CAHILL: But you had  
6 no idea that there was going to be  
7 anything consensus -- consensus request  
8 at the Beijing meeting?

9 THE WITNESS: Obviously, once we got  
10 there, we --

11 HONORABLE JUDGE CAHILL: You were  
12 there?

13 THE WITNESS: Yeah, I was there --

14 HONORABLE JUDGE CAHILL: You were  
15 there?

16 THE WITNESS: -- yes.

17 HONORABLE JUDGE CAHILL: Oh.

18 THE WITNESS: I was not at the GAC  
19 meeting, but I was at the meeting for  
20 ICANN.

21 HONORABLE JUDGE CAHILL: Okay. Did  
22 you talk to anybody to try to get  
23 support?

24 THE WITNESS: Yeah. We have intel  
25 after -- over there with the government?

1 No.

2 HONORABLE JUDGE CAHILL: No, not  
3 with the Beijing government.

4 What I'm hearing is everybody's  
5 walking around all this talking --

6 THE WITNESS: We do that, yeah.

7 HONORABLE JUDGE CAHILL: -- and you  
8 needed -- according to the testimony, you  
9 needed only one country to stand up and  
10 say, Don't take this off the agenda or  
11 don't adopt this opinion?

12 THE WITNESS: Kenya objected --

13 HONORABLE JUDGE CAHILL: Who?

14 THE WITNESS: -- Kenya objected.

15 That's what --

16 HONORABLE JUDGE CAHILL: Kenya  
17 objected on the e-mails?

18 THE WITNESS: Yes.

19 HONORABLE JUDGE CAHILL: Did you  
20 know that you had to be present --  
21 present in the room?

22 THE WITNESS: No. The actual GAC  
23 principle says that a member country can  
24 send an e-mail when they are not present.  
25 We put that as part of our GAC response

1 to ICANN.

2 HONORABLE JUDGE CAHILL: Did you  
3 know the position of the -- of GAC, that  
4 the person who is sending e-mails is not  
5 even the proper person to make the  
6 objection?

7 THE WITNESS: That's not still,  
8 again, what is the GAC principles. There  
9 is no clarity on that. It's only the  
10 GAC Chair that says that.

11 So as to who is the one that's  
12 supposed to send an objection, a  
13 representative versus advisor, it's not  
14 in the GAC -- it's not clearly stated in  
15 the GAC principle.

16 HONORABLE JUDGE CAHILL: When you  
17 got all the Early Warnings, did you think  
18 that those countries were going to oppose  
19 your -- your --

20 THE WITNESS: We still had like,  
21 according to the GAC principles, that  
22 unless it's a policy advice or .africa,  
23 they cannot hijack it, the Geographic's  
24 Name objection, which is supposed to be  
25 done by an independent group, and just

1 stop our application. We thought it was  
2 not right. It was very wrongful for  
3 ICANN to accept that as advice.

4 If we didn't count on the  
5 governments, which I think a lot of  
6 confusion is there -- as we say, they can  
7 say whatever they like about an  
8 applicant, if they don't like the  
9 applicant, but it's up to the Board, we  
10 think, that should be determining if this  
11 is the right sacrifice or not.

12 And we expected the Board to know  
13 that Geographic Names Panel would be  
14 responsible for objections over --  
15 over -- over endorsements and not GAC.

16 So, yeah.

17 HONORABLE JUDGE CAHILL: Okay.

18 So on Paragraph 101 of your  
19 declaration on 46 -- Page 46 --

20 PRESIDENT BARIN: Which paragraph?

21 HONORABLE JUDGE CAHILL: I'm sorry.  
22 Page 46 -- Page 46, Paragraph 101.

23 PRESIDENT BARIN: Page 46,  
24 Paragraph 101.

25

1 HONORABLE JUDGE CAHILL: Right.

2 The second-to-last sentence, you  
3 say, AUC used its position on the GAC to  
4 persuade GAC members to advise the Board  
5 that DCA's application should not  
6 proceed.

7 Why did you -- what facts do you  
8 have to support that?

9 THE WITNESS: Which one is that --

10 HONORABLE JUDGE CAHILL: I'm  
11 sorry --

12 THE WITNESS: -- it's 46, Page 101?

13 HONORABLE JUDGE CAHILL: Page -- no.  
14 Page 46 --

15 THE WITNESS: Yeah.

16 HONORABLE JUDGE CAHILL: --  
17 Paragraph 101.

18 THE WITNESS: Yeah.

19 HONORABLE JUDGE CAHILL: You can  
20 read the whole paragraph.

21 The second-to-last sentence says,  
22 Instead, the AUC used its position on the  
23 GAC to persuade GAC members to advise the  
24 Board that DCA's application should not  
25 proceed.

1           What facts do you have that support  
2           that?

3           THE WITNESS: Because I believe the  
4           Early Warning was coordinated by AUC  
5           assistant. So, obviously --

6           HONORABLE JUDGE CAHILL: You believe  
7           that? Does anybody ever tell you that  
8           or --

9           THE WITNESS: No. The AUC has  
10          submitted an Early Warning --

11          HONORABLE JUDGE CAHILL: The AUC  
12          did, yes, that's true.

13          THE WITNESS: -- for the Early  
14          Warning, so why wouldn't they submit --

15          HONORABLE JUDGE CAHILL: Why what?

16          THE WITNESS: -- it's very natural  
17          to actually coordinate further on the GAC  
18          advice as well, yeah.

19          HONORABLE JUDGE CAHILL: And then,  
20          in Paragraph 102, you say, ICANN allowed  
21          the AUC to circumvent the formal  
22          objection process.

23          Why do you say that?

24          THE WITNESS: Because the formal  
25          objection process for ICANN gTLD requires



1 four different kinds of objection  
2 criteria, and one is that -- that of a  
3 community.

4 And, unfortunately, the AUC and  
5 the -- the successful applicant that they  
6 endorsed and should have applied on  
7 behalf of the community did not apply on  
8 behalf of the community. But they were  
9 very unsuccessful in objecting many of  
10 our application, including at the IO  
11 level, the independent objector, and so  
12 forth on a community ground.

13 So it's known that the community --  
14 the community want -- if an applicant  
15 does not apply as a community, since --  
16 it's known that they will not pass the  
17 evaluation; so, therefore, the only way  
18 they could -- they could formally object  
19 to us is through the GAC means, because  
20 that's the only power that they have to  
21 object.

22 Because the legal objection criteria  
23 that's listed under the -- the -- the  
24 Guidebook will not apply. So that advice  
25 that was given by ICANN in Dakar to tell

1           them to use the GAC as a way of objecting  
2           or -- or as a way of prevailing in the  
3           applications to the -- to the desired  
4           outcome of AUC as another way of saying  
5           circumventing them.

6           HONORABLE JUDGE CAHILL: Let me go  
7           back to Beijing a second.

8           So when they had the meeting where  
9           they had the consensus -- what they say  
10          is consensus. I know you dispute that --

11          THE WITNESS: Right.

12          HONORABLE JUDGE CAHILL: -- did you  
13          know that was going to happen during that  
14          meeting, that they were going to go  
15          through that?

16          THE WITNESS: No, I did not know.  
17          There may be an exchange of e-mails, but  
18          we did not anticipate it.

19          HONORABLE JUDGE CAHILL: When did  
20          you find out for the first time when --

21          THE WITNESS: When it was announced  
22          at the GAC -- at the public meeting.  
23          Yeah.

24          HONORABLE JUDGE CAHILL: Now,  
25          what -- you have two people you say have

1 conflicts.

2 THE WITNESS: Yeah.

3 HONORABLE JUDGE CAHILL: Yeah. And  
4 Mr. Disspain, I understand -- what  
5 exactly is the conflict?

6 THE WITNESS: For --

7 HONORABLE JUDGE CAHILL: He's the  
8 one from South Africa, I think --

9 THE WITNESS: Yeah.

10 HONORABLE JUDGE CAHILL: -- no.  
11 He's the one from Australia. Sorry, got  
12 the wrong guy.

13 THE WITNESS: -- he sits on --  
14 and -- on the .au, which is Australian  
15 ccTLD, and the -- the .au is affiliated  
16 with dot -- I mean -- the ARI Registry  
17 Services, which is the registry services  
18 that provided ZACR with the registry  
19 software.

20 So they've consulted with ZACR. And  
21 so by way of business affiliation, we  
22 didn't feel it's comfortable that is --

23 HONORABLE JUDGE CAHILL: Why would  
24 they object? Would there be an economic  
25 or otherwise advantage to them?

1 THE WITNESS: It's always economic  
2 advantage during -- with the registries  
3 and the consultancy to provide and so  
4 forth. There's always a relationship  
5 between -- that's why a lot of the Board  
6 members recuse themselves.

7 HONORABLE JUDGE CAHILL: So if  
8 Mr. Disspain voted against your proposal,  
9 he would gain how economically?

10 THE WITNESS: Well, I don't know the  
11 direct -- the direct financial gain he  
12 would have, but they have a business  
13 relationship with ARI, which is --  
14 supplies software for ZADNA.

15 Usually, when the back-end registry  
16 supplies software for you, it depends --  
17 I don't know their contractual  
18 relationship, but there could be --

19 HONORABLE JUDGE CAHILL: They could  
20 use something -- they could lose  
21 something, right?

22 THE WITNESS: Yeah, there's  
23 always --

24 HONORABLE JUDGE CAHILL: Mr.  
25 Silber -- you heard me say that maybe

1 Mr. Silber was --

2 THE WITNESS: Yes, Mr. Silber is a  
3 South African national. He sits on the  
4 dot -- he is a treasurer on the .z- --  
5 ZADNA, which is a regulator of the .za,  
6 which is the country code for  
7 South Africa.

8 So .za is managed by UniForum, and  
9 UniForum applied for, obviously, the  
10 .africa TLD, and they were the ones that  
11 are endorsed. And the .za general  
12 manager is Vika Mpisane, South African  
13 national, and she is also the Chairman of  
14 the African ccTLDs that have aligned  
15 themselves with ZACR's application.

16 And Mr. -- Vika recommended UniForum  
17 to AUC to be endorsed. So, again, there  
18 is that very, very close relationship of  
19 Mike Silber being a treasurer and -- and  
20 ZADNA endorsing UniForum as part of the  
21 "dotAfrica Initiative." It's a public  
22 record, that they openly endorse them.

23 So I don't know about financial  
24 trail, but all I can say is there's a  
25 very close working relationship of

1           approvals.

2                   HONORABLE JUDGE CAHILL:  It wouldn't  
3           be an independent vote?

4                   THE WITNESS:  I cannot see that.

5                   HONORABLE JUDGE CAHILL:  Okay.  What  
6           else?

7                   Did you see the ombudsman report  
8           when it came out that says there's no  
9           conflict?

10                  THE WITNESS:  Yes.

11                  HONORABLE JUDGE CAHILL:  It was very  
12           narrow.  It just said, No conflict right  
13           now because there's never been any  
14           discussion.

15                  Is that right?

16                  THE WITNESS:  Right.  It was a point  
17           in time, like an audit.

18                  HONORABLE JUDGE CAHILL:  A point in  
19           time.

20                  Did you ever renew that later when  
21           it was obvious -- well, did you ever  
22           review it later -- did you ever renew  
23           your objection to the conflict?

24                  THE WITNESS:  No.

25                  What happened was, during that

1 investigation, the ombudsman, in fact,  
2 consulted with ICANN Internet counsel,  
3 and then he consulted with the two Board  
4 members before he actually decided to  
5 go --

6 HONORABLE JUDGE CAHILL: Right.

7 THE WITNESS: -- so we felt that  
8 was -- the whole threesome relationship  
9 was not independent to begin with.

10 But after -- right after that, that  
11 advice came from DCA. The two Board  
12 members, in fact, published their -- or  
13 updated their statements of interest  
14 publicly, which means disclosure, they  
15 did the disclosure.

16 After that, we did not submit any  
17 other update.

18 HONORABLE JUDGE CAHILL: When I was  
19 asking questions earlier, there was a new  
20 fact. And then, as they started, you  
21 know -- they say there's never been any  
22 votes or any discussion, according to the  
23 ombudsman; therefore, at that point in  
24 time, there's no conflict. But later,  
25 there was.

1 I don't know who's supposed to  
2 rejuvenate that. Maybe ICANN --

3 THE WITNESS: ICANN -- sorry.

4 HONORABLE JUDGE CAHILL: -- maybe  
5 ICANN can.

6 THE WITNESS: ICANN Board is what he  
7 was saying, right, and Mr. Chalaby. The  
8 ICANN Board brought it to their attention  
9 because of --

10 HONORABLE JUDGE CAHILL: That was  
11 the second one.

12 THE WITNESS: Right.

13 HONORABLE JUDGE CAHILL: I'm fine.  
14 I understand the answer. I think I'm  
15 done.

16 - - -

17 EXAMINATION ON BEHALF OF THE PANEL

18 BY PRESIDENT BARIN

19 - - -

20 PRESIDENT BARIN: I have one quick  
21 question for you, and then we'll move on.

22 Did I understand correctly that you  
23 said that, in your view, the way the  
24 process should work -- the gTLD  
25 process -- ICANN should evaluate the



1 technical and financial capabilities of  
2 Africans and that the political support  
3 should then be left to the applicant and  
4 the runnerup, or whoever it is, to then  
5 deal within a certain period of time -- I  
6 think you said it was 30 days or --

7 THE WITNESS: Ninety.

8 PRESIDENT BARIN: -- 90 days -- is  
9 that -- is that what your position is?

10 THE WITNESS: Right. That's why  
11 it's on the gTLD Guidebook so you can  
12 collect endorsement at any time  
13 throughout. Even if you don't submit  
14 your application without endorsement, you  
15 can still collect endorsements. You have  
16 90 days after you're approved as a viable  
17 applicant, you can collect endorsements.

18 PRESIDENT BARIN: So are the -- are  
19 you separating the political issue and  
20 the evaluation of technical and financial  
21 capability?

22 THE WITNESS: Yeah. We don't  
23 consider endorsement as a political; we  
24 consider it as -- as a requirement to  
25 fulfill, like any other. So -- it only

1 gets political if there's a yes or no.

2 For example -- for example, just let  
3 me say -- the -- the Guidebook allows an  
4 entity to endorse two applicants, right?  
5 That's apolitical. That means the  
6 organization is neutral and independent.

7 So the predetermination of something  
8 that's political endorsement is political  
9 is incorrect. It's only -- ours just  
10 only got political because the competitor  
11 wanted the same thing -- the AUC wanted  
12 to be the competitor, they endorsed an  
13 application.

14 PRESIDENT BARIN: So if we were to  
15 turn the clock back and -- and have  
16 you -- that's DCA -- and ZACR go forward  
17 together, the evaluation then would be  
18 one of financial and technical  
19 capabilities?

20 THE WITNESS: Um-hum.

21 PRESIDENT BARIN: And then there  
22 would be a period, as you said, 90 days  
23 for --

24 THE WITNESS: Right.

25 PRESIDENT BARIN: -- either one of

1 the two --

2 THE WITNESS: Right.

3 PRESIDENT BARIN: -- to go out and  
4 get endorsements, as you said, or  
5 support?

6 THE WITNESS: Right.

7 If I may add to this, that is what  
8 we recommended for ICANN. Knowing that  
9 the ZACR application did not satisfy  
10 the -- the endorsement requirement as  
11 well, we thought that ICANN was at a  
12 crossroad of not knowing what to do.

13 And that is why we responded to our  
14 Early Warnings when we say, you know,  
15 waive the endorsements. This is not to  
16 the benefit of DCA; it was to the benefit  
17 of .africa gTLD, because we wanted to  
18 make sure at least we saved .africa.  
19 It's been -- a lot of work has been gone  
20 through it.

21 So that was the recommendation we  
22 make, because we knew -- we have  
23 intelligence that the ZACR application  
24 did not have endorsement either. And  
25 because the endorsement has not been made

1 public by ICANN, which I do not  
2 understand why, because during the  
3 application -- during the RFP period,  
4 when we did that, there was no reason  
5 that endorsement should not be public.

6 Because if it was public, we would  
7 not have gone through this step of, you  
8 know, issues. People would have known if  
9 that endorsement by AUC was legitimate or  
10 not, because all those endorsements that  
11 was collected were on behalf of a reserve  
12 name for AUC, and it wasn't a proper  
13 endorsement.

14 So had that been disclosed at the  
15 beginning of the application, then we  
16 would all know what to do for the next  
17 nine months trying to see -- consult with  
18 AUC or authorities or governments to do  
19 the right thing.

20 But the nondisclosure of that has  
21 caused a lot of confusion.

22 PRESIDENT BARIN: Thank you.

23 HONORABLE JUDGE CAHILL: I'm done.

24 PRESIDENT BARIN: So in the normal  
25 course, that's you, Mr. LeVee.

1                   Is there a need for a very punctual  
2 short break?

3                   MR. LEVEE: Not for me, but if  
4 Ms. Bekele wants a break, she can take  
5 one.

6                   THE WITNESS: It's okay.

7                   PRESIDENT BARIN: Are you okay?

8                   THE WITNESS: Yeah.

9                   PRESIDENT BARIN: How much time do  
10 you think you'll need?

11                   MR. LEVEE: I'm very cognizant of  
12 the hour --

13                   PRESIDENT BARIN: It's fine --

14                   MR. LEVEE: -- I'll be much shorter  
15 than the cross-examination.

16                   HONORABLE JUDGE CAHILL: That  
17 doesn't help.

18                   MR. LEVEE: What I'm handing to  
19 Ms. Bekele, just so you know, is the  
20 binder that has my opening statement  
21 slides and exhibits, because there are a  
22 couple of exhibits that I'd like to turn  
23 to.

24

25

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

- - -

EXAMINATION ON BEHALF OF RESPONDENT  
INTERNET CORPORATION FOR ASSIGNED NAMES AND NUMBERS  
BY MR. LEVEE:

Q. The exhibit number that I started with, Ms. Bekele, is Exhibit C-R-10.

Do you see that in front of you?

A. Um-hum.

PRESIDENT BARIN: I don't mean to interrupt you before you even get started.

Are you able to give me an idea, because I need, personally, a nature break.

MR. LEVEE: If you need a break, then you should take one.

HONORABLE JUDGE CAHILL: Right now?

PRESIDENT BARIN: I'd rather take it now, maybe five minutes, if that's okay?

MR. LEVEE: Five minutes is good. I won't even leave the room.

- - -

(Whereupon, a brief recess was taken from 6:36 p.m. to 6:41 p.m.)

- - -

1                   PRESIDENT BARIN: We're back on the  
2                   record.

3                   Mr. LeVee.

4                   MR. LEVEE: Thank you, Mr. Chairman.

5                   BY MR. LEVEE:

6                   Q.     Ms. Bekele, you understood when you  
7                   submitted your application to ICANN that you were  
8                   supposed to submit with the application whatever  
9                   governmental support you had at that time, right?

10                  A.     Yes.

11                  Q.     So when you -- you submitted your  
12                  application in the spring or so, March of 2012?

13                  A.     Yes.

14                  Q.     And you attached the letter that you  
15                  had received from the AUC in 2009, correct?

16                  A.     Correct.

17                  Q.     And you characterized that as the AUC  
18                  supporting your application, right?

19                  A.     Correct.

20                  Q.     Okay.

21                         So let me ask you to look at -- it was  
22                         the page -- when I gave you the binder, it was  
23                         the page that was open -- Exhibit C-R-10.

24                         So this is a letter dated April 16th,  
25                         2010, correct?

1 A. Correct.

2 Q. And it's written by the Deputy Chair  
3 of the African Union Commission., correct?

4 A. Yes.

5 Q. And it says, The African -- and it's  
6 addressed to you, right?

7 A. Correct.

8 Q. Okay. And it says, The African Union  
9 Commission has reconsidered its approach in  
10 implementing the subject Internet domain name  
11 (.africa) and no longer endorses individual  
12 initiatives in coordination with Member states  
13 continental.

14 You see that, right?

15 A. Correct.

16 Q. You were pretty unhappy by that,  
17 right?

18 A. Surprised.

19 Q. Okay. And you knew that this letter  
20 was the withdrawal of the support that you had  
21 worked so hard to earn?

22 A. No.

23 Q. Okay. Well, let's test that.

24 Why don't you look, then, at

25 Exhibit C-26 at the beginning of the binder?



1                   You tell me when you're there.

2                   Are you with me?

3           A.       Yes.

4           Q.       Okay.  If you look at the second page,  
5 that's your computer-generated signature, correct?

6           A.       Yes.

7           Q.       And this is your letter to the Chief  
8 of Staff of the African Union Commission, right?

9           A.       Correct.

10          Q.       And in that, you say, quote, We have  
11 been waiting patiently for the past several months  
12 to receive an official response from your office  
13 regarding the need to properly redress our wishes  
14 as conveyed at different times for the official  
15 reinstatement of our earlier endorsement received  
16 from the AU for the .africa gTLD and registry.

17                   Now, you wrote that, right?

18          A.       Correct.

19          Q.       So you knew what you were asking for  
20 was to be reinstated, right?

21          A.       A confirmation.

22          Q.       Well, that's not how I read it.

23                   It looks to me that you knew that your  
24 support from the African Union Commission had  
25 been withdrawn by the exhibit we just looked, and

1 you were asking for it to be reinstated.

2 You weren't asking for a confirmation,  
3 right?

4 A. We did not say anything about  
5 withdrawal, though.

6 HONORABLE JUDGE CAHILL: I'm sorry.

7 Say what?

8 THE WITNESS: We did not say  
9 anything about withdrawal; we just say  
10 reinstated. We wanted to make sure that  
11 they confirm what they already have.

12 BY MR. LEVEE:

13 Q. Well, let's look at the next page.  
14 There's a lot in the middle here.

15 And -- and in the middle -- well, hold  
16 on. Let's stay with the first page.

17 You referred to the fact that DCA had  
18 received an endorsement as early as 2009, which  
19 it was believed was valid at the time. And in  
20 the subsequent months thereafter, the issues  
21 became controversial.

22 You see that, right?

23 A. Um-hum.

24 Q. And then, a couple of paragraphs down,  
25 you say, We wish to inform our willingness --

1 unwillingness, I should say, to participate in the  
2 new AU RFP process.

3           So this was the letter where you  
4 informed the AUC that you were not going to  
5 submit an RFP response, correct?

6           A.     (No audible response.)

7           Q.     So, here, we've got the AUC, and it  
8 has announced that it's going for an RFP process,  
9 correct?

10          A.     (No audible response.)

11          Q.     You need to answer audibly so the  
12 court reporter can type something down.

13          A.     Yes.

14          Q.     Okay. And you knew that ZACR was  
15 going to apply, correct?

16          A.     At that time, it was UniForum, yes.

17          Q.     So you knew UniForum was going to  
18 apply?

19          A.     We don't know who is going to apply.

20          Q.     Well, you said earlier that you  
21 thought the whole thing was wired for UniForum.  
22 You expected them --

23          A.     For a predetermined outcome. And it  
24 was UniForum, but then it became ZACR, right? So  
25 we really don't know which organization in name

1 that's going to be endorsed, but we know it's the  
2 one associated with the group that has vested  
3 interest in it. That's it.

4 Q. But you knew, whichever group it was,  
5 ZACR or UniForum, or somebody else that might have  
6 won the RFP, they were going to get the  
7 endorsement of the AUC?

8 A. Certainly not us.

9 Q. Yes.

10 But even so, if you turn to the second  
11 page, you say, you know what, I don't like this  
12 RFP project, right?

13 You didn't think it was fair, right?

14 A. We thought it was an extraordinary  
15 process.

16 Q. Okay.

17 And then you say, In conclusion -- and  
18 this is highlighted so you can see it -- In  
19 conclusion, we think it would be good for the AU  
20 leadership to do what is right and, just in the  
21 present circumstances, redress our case  
22 satisfactorily and reinstate our endorsements to  
23 enable us to go ahead with our application to  
24 ICANN.

25 You said that, right?

1 A. Sure.

2 Q. Those are your words?

3 A. Sure.

4 Q. What you're saying is you weren't  
5 asking for a reinstatement; you were actually  
6 asking for something -- a further endorsement?

7 A. Okay. Mr. LeVee, by the time you have  
8 started the very beginning and the highlight and  
9 then the end, you missed the whole redress points  
10 that were, like, five points in there that we  
11 wanted them to redress.

12 So we thought the whole exercise of  
13 creating an extraordinary process on the gTLD and  
14 creating a parallel policy process, like ICANN --  
15 sort of parallel policy process, like ICANN, and  
16 extraordinary process of RFP was unfair.

17 And in the process, we're trying to  
18 educate them. They did not do the right thing.

19 Q. I know you didn't think they did the  
20 right thing --

21 A. Right.

22 Q. -- but my point is you knew that the  
23 AUC was no longer endorsing your application. You  
24 knew they had pulled their endorsement.

25 A. They have re- -- as they state in that

1 letter, they have reconsidered on the  
2 implementation plan.

3 Q. And they -- you knew that they were no  
4 longer endorsing you?

5 I'm just trying to get a yes or no.

6 A. Support.

7 Q. You knew that they were no longer  
8 supporting you?

9 A. We had the endorsement, but we didn't  
10 have support.

11 Q. So you had a piece of paper, right?  
12 That was the endorsement?

13 A. We didn't have political support.  
14 That's the difference.

15 Q. What you had was a piece of paper from  
16 2009 --

17 A. That was called an endorsement, yes.

18 Q. Okay. And you had another piece of  
19 paper written in 2010 saying that the earlier  
20 piece of paper was no longer valid, right?

21 A. (No audible response.)

22 Q. You have to answer audibly for the  
23 court reporter.

24 A. The -- what they said was the -- they  
25 want -- they are reconsidering the approach on how

1 they're implementing .africa.

2 Q. It says, No longer endorses individual  
3 initiatives --

4 A. Right.

5 Q. -- you were the only individual  
6 initiative, right?

7 A. No, actually, it wasn't. There was a  
8 lot of people. Those vested group I talked about,  
9 they used to go and request AUC, like the AfTLD.  
10 There were other groups that used to go and ask  
11 it -- to be endorsed.

12 So what their mandate is saying is  
13 they don't want individual initiatives.

14 Q. Right.

15 But who else was applying for .africa  
16 at that time other than you?

17 A. No. There's AfTLD.

18 Q. They were going to apply to .africa?

19 A. Right. We had --

20 Q. So the letter says they're not going  
21 to endorse any individual initiatives, and that  
22 included DCA -- you're saying it included DCA,  
23 among others?

24 A. Among others.

25 Q. Okay. So you had the letter that says

1 no endorsement of DCA, and you had this other  
2 letter where you asked for the reinstatement.

3 But the AUC didn't you give you a  
4 reinstatement, right?

5 A. No.

6 Q. No.

7 So when you applied to ICANN in March  
8 of 2012, why did you tell ICANN that you had the  
9 official endorsement of the AUC?

10 A. We submitted the 2009 letter, which is  
11 not withdrawn, and based on a conversation that I  
12 had with the Chairman at the time, who endorsed  
13 us, he did not withdraw our letter.

14 The letter that you are referring to  
15 seems extremely inconsistent. As you can see, it  
16 even says, Sophia Bekele, United States of  
17 America, While the endorsement was given to  
18 Sophia Bekele, DotConnectAfrica, in Africa.

19 We felt like this letter came out of  
20 the Deputy's office, while the other one came out  
21 of the Chairman's office, which could have easily  
22 been done by the Chairman.

23 So we thought there were a lot of  
24 irregularities with this letter that confirmed to  
25 us that it's not authentic. We --



1 Q. You asked the AUC to send you a second  
2 letter, right?

3 A. Right.

4 Q. Saying that the AUC endorses your  
5 application, correct?

6 A. Right.

7 Q. And you never got the letter?

8 A. No --

9 Q. Okay.

10 A. -- because they wanted it for  
11 themselves now --

12 Q. Okay.

13 A. -- so they consulted differently.

14 Q. You also said in response to one of  
15 the Panel's questions that you had, at the time  
16 that you submitted your application, the support  
17 of governments of Africa.

18 Which governments was that?

19 A. There was the Ethiopian Government and  
20 whichever one we filed with our application.

21 Q. Did you also file with your  
22 application that you had the support of the Kenyan  
23 Government?

24 A. Yeah, because we had the  
25 endorsement --

1 Q. Okay.

2 A. -- issued to us, right.

3 Q. And the Kenyan Government later issued  
4 an Early Warning advice against your application,  
5 correct?

6 A. I'm not familiar with that.

7 Q. You didn't see me use that today?

8 A. I think we discussed that Early  
9 Warning. The ccTLDs -- we believe it was the  
10 ccTLDs, not the actual governments, that issued  
11 the Early Warning. And we are aware of that  
12 because if you had gone back, we -- even in our  
13 Early Warning, we stated to ICANN that none of  
14 the -- these Early Warnings could be justified if  
15 it has to actually go back to the government, the  
16 Minister level, and -- to see if they were --  
17 would be authenticated.

18 So we still felt like the ccTLDs  
19 within the GAC structure originated the Early  
20 Warnings. It wasn't the actual governments.

21 Q. Well, you're saying what you think.  
22 You don't know that, right?

23 A. That's why we say -- that's why it  
24 should have been gone to be authenticated by the  
25 government.

1 Q. Okay. And GAC Early Warning notice  
2 doesn't actually have any legal significance,  
3 right? Correct?

4 A. I don't think so.

5 Q. And you responded to it with a lengthy  
6 response, correct?

7 A. Right.

8 Q. And did you -- did you say that the --  
9 that you had the support of the AUC?

10 A. Our -- our -- our endorsement was just  
11 submitted. Whatever we have of support, it was  
12 submitted during the application open.

13 And after that, we were waiting for  
14 the evaluation by ICANN of all our -- the  
15 technical and financial evaluation, which I think  
16 the other competition was 301, and ours was about  
17 1500. So we would assume -- we were hoping the  
18 results of the evaluation coming first and if  
19 they have a viable application or not.

20 And then ours were 1500, the number.  
21 This is a lottery system that you pick. So  
22 whichever viable application comes out of  
23 .africa, we expected then to work with AUC and  
24 the other governments to show if our application  
25 was viable, then we will ask support.

1 Q. Okay. But in the period between the  
2 time you submitted your application and the time  
3 that the GAC issued the consensus advice -- so  
4 that's about a 13-month period, right, March of  
5 2012 to April of 2013?

6 A. Right.

7 Q. -- in that period, you did not submit  
8 to ICANN any additional written support from any  
9 country in Africa, correct?

10 A. No.

11 Q. Okay. No, I'm not correct; or, yes,  
12 I'm correct?

13 A. No, no; you are correct.

14 Q. Okay.

15 Now, the Panel asked you a bunch of  
16 questions about the impetus of why the AUC  
17 changed its mind. So let me ask you few  
18 questions about that.

19 You said that -- first of all, you're  
20 clear, in your own mind, right, that the AUC was  
21 entitled to support an applicant other than  
22 DotConnectAfrica, correct?

23 A. That's okay.

24 Q. Okay. And the AUC was also entitled  
25 to change its mind -- it was entitled to have a --

1 support your application and then change its mind  
2 to support somebody else later, right?

3 A. Sure.

4 Q. Pardon?

5 A. Sure.

6 Q. Okay. So what I think I heard you say  
7 was -- is that ICANN told the AUC that it could  
8 "reserve" the name for itself.

9 Is that what you said?

10 A. What I said was the Chief of Staff  
11 said that the reason we wrote you that letter is  
12 because ICANN made a presentation in our offices,  
13 and we are now going to go through a regulatory  
14 framework.

15 Q. But the word you used -- I wrote it  
16 down because you said it at least three times --  
17 was that the AUC could "reserve" .africa for  
18 itself.

19 That's what you said earlier today,  
20 right?

21 A. Right.

22 Q. Okay. Here's what I'm struggling,  
23 because you heard my opening statement this  
24 morning, right?

25 A. Um-hum.

1 Q. And you saw that I put Dr. Crocker's  
2 letter up on the Board. It's Exhibit C-24. It's  
3 in your binder.

4 And Dr. Crocker made it very clear to  
5 the AUC that it could not reserve .africa, right?

6 So what you're saying is that someone  
7 told you in the fall of 2011 that the reason that  
8 the AUC changed its mind was because it thought  
9 it would get .africa as a reserve name.

10 A. But of course.

11 Q. Okay. But it turns out that whoever  
12 told the AUC that, if, in fact, it was told, they  
13 were wrong, right? Because ICANN did not permit  
14 the AUC to reserve .africa.

15 A. Yes.

16 Q. Okay. But irrespective of whether --  
17 whether the name is reserved or not -- we know now  
18 it was never reserved -- the AUC was entitled to  
19 endorse an applicant, right? Originally, they  
20 endorsed you.

21 What was wrong with the AUC deciding  
22 that they wanted to sponsor their own application  
23 through their own RFP process? Was there  
24 anything in the Guidebook that prevented that?

25 A. The Guidebook does not specifically

1 say to applicant -- to another regulatory  
2 authority to -- that they can develop their only  
3 policies and RFP and endorse an applicant. It's  
4 not specific.

5 Q. Just silent?

6 A. Right.

7 Q. Okay. So the -- the premise of your  
8 objection to the AUC's role was that the AUC was  
9 endorsing an application, but there's actually  
10 nothing in the Guidebook that says it can't do  
11 that?

12 A. No. They endorsed ours, so we don't  
13 have any premise of any --

14 Q. Let me rephrase it. Maybe I didn't  
15 say it the way I should have.

16 The AUC selected what became the ZACR  
17 to apply for .africa.

18 They submitted an actual application,  
19 right?

20 A. (No audible response.)

21 Q. Again, you're nodding your head, so --

22 A. Yes, yes, they did.

23 Q. And my point is, there's nothing in  
24 the Guidebook that says that the AUC could not do  
25 exactly what it did, correct?

1 A. No.

2 Q. Okay. And there's -- there's --

3 HONORABLE JUDGE CAHILL: Correct no?

4 That's a double negative.

5 Was that -- there was nothing in the

6 Guidebook that prevented them from doing

7 this.

8 That's correct, right?

9 THE WITNESS: Right.

10 HONORABLE JUDGE CAHILL: Okay.

11 BY MR. LEVEE:

12 Q. Okay. And so you then asked ICANN to

13 change the Guidebook, right? You said, Now that

14 the AUC's involved, we should -- ICANN should

15 change the Guidebook by eliminating the

16 requirement for the 60 percent support.

17 You saw the exhibits I put up this

18 morning?

19 A. I think we said a lot more detail than

20 that.

21 Q. But you did ask ICANN to do that,

22 right?

23 A. But we have a whole page or maybe many

24 written as to why we say that --

25 Q. I understand.



1 A. -- and I -- may -- may I continue?

2 Q. Of course.

3 A. Okay.

4 -- that is in response to the fact  
5 that AUC's support letter is as -- is for the  
6 reserve name, that same reserve name that you  
7 rejected, ICANN has rejected, and you have  
8 managed to accept it as part of the application  
9 process.

10 And so we say the other applicant,  
11 ZACR, does not also have support. Their support  
12 letter -- their purported support is not in  
13 compliance with the New gTLD Process.

14 So, therefore, we knew ICANN -- when  
15 the Early Warning was being issued to us, we knew  
16 ICANN did not know what to do, either ICANN will  
17 be exposed giving an application to, you know --  
18 because, again, we are not able to see the -- the  
19 endorsements publicly -- either ICANN will  
20 complicate the .africa process so Africa will not  
21 have the .africa gTLD, which actually resulted in  
22 that right now, as we speak, and -- or -- so we  
23 were trying to advise ICANN to do the right  
24 thing.

25 It wasn't trying to say give a

1 favorable position for DCA. It was trying to  
2 save the project, because we knew that the  
3 support provided by AUC/ZACR was not correct.

4 Q. I think what you're saying is you were  
5 trying to help both applications because neither  
6 one of them had support?

7 A. I think it's only fair to advise to  
8 say give it to the one that's viably -- that has a  
9 viable application based on financial, technical  
10 and other criteria that's evaluated by ICANN, and  
11 then, eventually, try to work with that particular  
12 applicant to get the right support.

13 And isn't that what you guys did,  
14 Mr. LeVee?

15 Q. Let's be clear, Ms. Bekele.  
16 That's not what you asked the Board to  
17 do, right?

18 A. Okay. Let's -- we can review it --

19 Q. Yeah, let's do that.  
20 You asked the Board to eliminate --

21 A. To waive. That's the word we used,  
22 "waive."

23 Q. Let's look first at Exhibit C-35,  
24 Page 5.

25 Now, this is your response to the

1 Early Warning notices that were submitted,  
2 correct? Yes?

3 A. Yes.

4 Q. Okay. And on Page 5, why don't you  
5 read the paragraph that I highlighted?

6 A. We believe that the endorsement issue  
7 should no longer being considered as relevant in  
8 the evaluation of the .africa gTLD as a geographic  
9 strength. We therefore urge the ICANN Board to  
10 waive this requirement because of the confusing  
11 role that -- that was played by the African Union.  
12 The organization has created huge problems of  
13 legitimacy regarding the endorsement issue by  
14 acting both as endorser and the coapplicant for  
15 .africa. It's also our view that the final  
16 decision by ICANN regarding the delegation of  
17 .africa string should now only be based on  
18 evaluated technical, operational and financial  
19 criteria, and not the issue of endorsement, which  
20 has been highly politicized.

21 Q. Okay. Let me ask you about  
22 Mr. Buruchara. I'm sure I'm not pronouncing his  
23 name correctly. I'm not sure anyone here has.

24 He was the chairman of your -- of the  
25 DCA Strategy Committee at one point in time,

1 correct?

2 A. Correct.

3 Q. Are you and he friends?

4 A. No.

5 Q. Have you worked together on any  
6 business matters before?

7 A. Before? No.

8 Q. Okay. Did you consider it a conflict  
9 of interest that he was the chairman of your  
10 Strategy Committee before being appointed as the  
11 GAC advisor to the Government of Kenya?

12 A. No.

13 Q. Okay. Did you ask him to object to  
14 the GAC advice?

15 A. I don't remember. But if I did, it's  
16 within the context of our application.

17 Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

1 Redacted - GAC Designated Confidential Information

1

2

Redacted - GAC Designated Confidential  
Information

23           Q.       Okay. The last question: You knew  
24   that Mr. Buruchara was the GAC advisor for Kenya,  
25   not the GAC representative, correct?

1           A.     To be honest with you, I wouldn't know  
2     the difference between the two. I was only aware  
3     of it after the fact --

4           Q.     Okay.

5           A.     -- I'm not a GAC person or --

6           Q.     Okay. I thought DCA had issued a  
7     press release announcing that he had been  
8     appointed as the GAC advisor.

9                     Do you remember that?

10          A.     Okay.

11          Q.     And it says that --

12          A.     Again, I would not know the difference  
13     between an advisor and a representative. I only  
14     came to learn the difference between the two after  
15     the issue became an issue.

16          Q.     Okay.

17                     MR. LEVEE: Well, in that case, I'll  
18     conclude.

19                     Thank you.

20                     PRESIDENT BARIN: Thank you,

21     Mr. LeVee.

22                     Mr. Ali.

23                     MR. ALI: I have nothing further.

24                     ARBITRATOR KESSEDJIAN: Nothing.

25                     HONORABLE JUDGE CAHILL: No.





## 1 CERTIFICATE OF

2 CERTIFIED REGISTERED MERIT REAL-TIME COURT REPORTER

3 I, CINDY L. SEBO, Registered Merit Reporter,

4 Certified Real-Time Reporter, Registered

5 Professional Reporter, Certified Shorthand Reporter,

6 Certified Court Reporter, Certified LiveNote

7 Reporter, Real-Time Systems Administrator and

8 LiveDeposition Authorized Reporter, do hereby

9 certify that the foregoing transcript is a true and

10 correct record of the Hearing on the Merits, that I

11 am neither counsel for, related to, nor am employed

12 by any of the parties to the action; and further,

13 that I am not a relative or employee of any attorney

14 or counsel employed by the parties thereto, nor

15 financially or otherwise interested in the outcome

16 of the action.

17 The witnesses being duly sworn by the

18 President of the proceedings, BABAK BARIN, to tell

19 the truth, the whole truth, and nothing but the

20 truth.

21 Signed this 1st day of June 2015.

22  
23 \_\_\_\_\_  
24 CINDY L. SEBO, RMR, CRR, RPR, CSR,  
25 CCR, CLR, RSA, LiveDeposition  
Authorized Reporter

THE MATTER OF AN INDEPENDENT REVIEW PROCESS  
BEFORE INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

_____ )	
DOTCONNECTAFRICA TRUST, )	
Claimant. )	
v. )	ICDR Case No.
INTERNET CORPORATION FOR )	50 2013 00 1083
ASSIGNED NAMES AND NUMBERS, )	
Respondent. )	Volume II
_____ )	

CONTINUED HEARING ON THE MERITS  
BEFORE THE PANEL: PRESIDENT BABAK BARIN,  
HONORABLE JUDGE WILLIAM CAHILL, AND  
PROFESSOR CATHERINE KESSEDJIAN  
Saturday 23, 2015; 9:13 a.m.

Reported by: Cindy L. Sebo, RMR, CRR, RPR, CSR,  
                    CCR, CLR, RSA, LiveDeposition Authorized Reporter  
Job No. 14040

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

Continued Hearing on the Merits in the  
above-styled manner, held at the offices of:

Jones Day  
51 Louisiana Avenue Northwest  
Washington, D.C. 20001  
202.879.3939

The continued proceedings having been  
reported by the Registered Merit Real-Time Court  
Reporter, CINDY L. SEBO, RMR, CRR, RPR, CSR, CLR,  
RSA, and LiveDeposition Authorized Reporter.

1    A P P E A R A N C E S :

2

3           Attorneys for Claimant:

4                   WEIL, GOTSHAL & MANGES LLP

5                   ARIF HYDER ALI, ESQUIRE

6                   RICARDO AMPUDIA, ESQUIRE

7                   ERIN K. YATES, ESQUIRE

8                   1300 Eye Street, Northwest

9                   Suite 900

10                  Washington, D.C. 20005

11                  202.682.7004

12                  arif.ali@weil.com

13                  ricarado.ampudia@weil.com

14                  erin.yates@weil.com

15                           -and-

16                  MEREDITH CRAVEN, ESQUIRE

17                  767 Fifth Avenue

18                  New York, New York 10153

19                  212.310.8067

20                  meredith.craven@weil.com

21

22

23

24

25

1 A P P E A R A N C E S (Continued):

2

3 Attorneys for Respondents:

4 JONES DAY

5 JEFFREY A. LEVEE, ESQUIRE

6 RACHEL H. ZERNIK, ESQUIRE

7 555 South Flower Street

8 Fiftieth Floor

9 Los Angeles, California 90071

10 213.243.2572

11 jlevee@jonesday.com

12 rzernik@jonesday.com

13

14 ALSO PRESENT:

15 SOPHIA BEKELE ESHETE, On behalf of the Claimant

16 AMY STATHOS, Deputy General Counsel at  
17 ICANN

18

19

20

21

22

23

24

25

CONTENTS :

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

CLOSING STATEMENTS :	PAGE :
BY CLAIMANT	485, 638
BY RESPONDENT	538
AFTERNOON SESSION	655

E X H I B I T S

(Exhibits Retained by Counsel.)

HEARING EXHIBITS :	MARKED	ADMITTED
Exhibit Number 4	655	---

## P R O C E E D I N G S

Washington, D.C.

Saturday, May 23, 2015; 9:13 a.m.

PRESIDENT BARIN: Good morning,  
everyone.

The second day of the Merits Hearing  
in the IRP under the American Arbitration  
Association Case Number 50 2013 00 1083.

We are going to have the closing  
arguments this morning, but a preliminary  
housekeeping matter.

After yesterday's hearing of the  
witnesses produced by both ICANN and  
DCA Trust, the Panel, having consulted one  
another, would like to get, Mr. LeVee, a  
copy of the reports of the Subcommittee on  
Ethics and Conflicts that's available in  
relation to the testimony that Mr. Chalaby  
gave yesterday.

So to the extent those are available  
and -- then the Panel would request that a  
copy be provided to it.

MR. LEVEE: Yes, I understand the



1 request. Because the documents are  
2 privileged, I will take the request back  
3 to ICANN and have an answer for you next  
4 week.

5 PRESIDENT BARIN: Okay. Thank you.

6 MR. LEVEE: Thank you.

7 PRESIDENT BARIN: Okay. Then that  
8 brings us to the closing argument.

9 Mr. Ali, good morning.

10 - - -

11 CLOSING STATEMENT ON BEHALF OF CLAIMANT

12 DOTCONNECTAFRICA TRUST

13 - - -

14 MR. ALI: Good morning.

15 And thank you, Members of the Panel.

16 Good morning colleagues from  
17 Jones Day.

18 One of the best things about a  
19 closing before such a hot Panel, and I  
20 mean that in the sense of a very active  
21 Panel, is that, in many respects, make  
22 our life --

23 HONORABLE JUDGE CAHILL: Thank you.

24 Thank you.

25 MR. ALI: -- easier.

1           But I should say that I'm sure I  
2           don't speak just for myself, but sort of  
3           the colleagues from ICANN. We very much  
4           appreciate the degree of preparedness of  
5           the questions that you put to us and to  
6           the witnesses.

7           And, of course, as one does a  
8           closing, one tries to divine what it is  
9           that's of the greatest interest to a  
10          panel. And with any sort of predictive  
11          process of that nature, what ends up  
12          happening is that rather than presenting  
13          a symphony, one presents something that's  
14          more like a Bohemian Rhapsody.

15          So I will -- with that caveat --

16          HONORABLE JUDGE CAHILL: "Bohemian  
17          Rhapsody For A Hot Panel," that's a great  
18          title.

19          MR. ALI: -- to try and present a  
20          coherent view of what it is that we  
21          believe has happened and why it is that  
22          ICANN has breached its Bylaws and  
23          Articles of Incorporation, as well as the  
24          Applicant Guidebook.

25          Let me start out with some quick

1 pointed remarks associated with the  
2 presentation of yesterday from my  
3 colleague and friend, Mr. LeVee.

4 Mr. LeVee took the position, which I  
5 must say I find quite remarkable, that  
6 ICANN is not a regulator, but ICANN is  
7 just an administrator; that the AGB, the  
8 Applicant Guidebook, is just a contract;  
9 and ICANN simply promises to evaluate the  
10 applications that are put forward in  
11 accordance with this contract.

12 Now, ultimately, there are some  
13 questions that are immediately raised by  
14 a contract that apparently has only  
15 limited enforceability in any fora and,  
16 apparently, even before you.

17 So that's Point Number 1.

18 In fact, it isn't just a contract;  
19 it is a set of rules that are reflective  
20 of ICANN's core principles and reflective  
21 of the fundamental underlying principle  
22 in ICANN's Articles -- written Articles  
23 of Incorporation that ICANN must conduct  
24 itself in accordance with local law and  
25 international law.

1           That constitutive document, which  
2           constitutes part of ICANN's raison d'être  
3           and ICANN's commitment that they're  
4           reflected in the Bylaws, and the Bylaws  
5           get reflected in the Applicant Guidebook.

6           So ICANN's promise is not just  
7           evaluate the application according to the  
8           Applicant Guidebook, but to evaluate the  
9           application according to the Guidebook,  
10          the Bylaws and the Articles of  
11          Incorporation, everything that they  
12          reflect and incorporate and the promise  
13          that is thereby made to parties that are  
14          seeking to participate in the domain name  
15          system which ICANN is responsible for.

16          And you need only look at Article IV  
17          of the Articles of Incorporation. The  
18          quote would state The corporation shall  
19          operate for the benefit of the Internet  
20          community as a whole, carrying out its  
21          activities in conformity with relevant  
22          principles of international law and  
23          applicable international conventions and  
24          local law and, to the extent appropriate  
25          and consistent with these Articles and

1           its Bylaws, through open and transparent  
2           processes that enable competition and  
3           open entry in Internet-related markets.

4           Then one need just simply go through  
5           various parts of ICANN's bylaws.

6           Article I, The mission of the Internet  
7           Corporation for Assigned Names and  
8           Numbers is to coordinate, at the overall  
9           level, the global Internet's systems of  
10          unique identifiers and, in particular, to  
11          ensure the stable and secure operation of  
12          the Internet's unique identifier systems.

13          In particular -- and there are a  
14          variety of obligations and functions of  
15          ICANN, including policy development.

16          Now, a coordinator of policy  
17          development also ensures that the  
18          policies are implemented. And ICANN does  
19          that through the various mechanisms that  
20          we have heard about.

21          So ICANN does have a regulatory  
22          function. ICANN is a body that is the  
23          curator of the Internet domain name  
24          system. It governs who it is that  
25          actually has the right to seek Internet

1 domain name, and it governs who it is  
2 that ultimately can go forward in terms  
3 of a domain name being put into the  
4 Internet server.

5 So ICANN will tell you, No, that's  
6 the U.S. Government, and there are others  
7 involved, but those are ultimately really  
8 rubber stamps that are applied once ICANN  
9 has done its job, which one hopes is done  
10 fairly, transparently and in a balanced  
11 way, and in accordance with the missions  
12 they're going to look at.

13 So the question was -- was put to  
14 Mr. LeVee by the President as to who is  
15 ICANN answerable if there is an issue.  
16 Who is ICANN answerable to if -- in light  
17 of this litigation waiver?

18 When an applicant has a problem --  
19 yes, ICANN is answerable to governments  
20 generally, although it pushes back and  
21 says, No, we do not, we're not guided by  
22 governments, but we have a bottom-up  
23 process.

24 But at the end of the day, the only  
25 people that ICANN is accountable to are

1 the three of you in the -- in this  
2 particular instance, the Independent  
3 Review Panels.

4 Within the system that they have  
5 created, one that constitutes a -- in  
6 this instance, the NGPC, which is part of  
7 the Board, a Board Governance Committee  
8 that reviews the NGPC's work, and the  
9 NGPC adopts the Board Governance  
10 Committee's recommendations.

11 Somewhat incestuous, particularly  
12 when one looks at the number of people  
13 who are on the Board -- the Board, the  
14 NGPC, the Board Governance Committee.  
15 It's all -- there's a fair amount of --  
16 of overlap.

17 And so where does the accountability  
18 come in? When we have no right to seek  
19 damages, according to ICANN, that is; we  
20 have no right to go to public forum; we  
21 have no right to apparently seek a  
22 binding decision, according to the rules  
23 that they have written and rules which  
24 they change as and when they wish.

25 Now, that's put down to

1 interpretation, but I would submit to you  
2 that it is arbitrary application of rules  
3 that are very clear as to what must  
4 happen.

5 But ICANN chooses how those rules  
6 will be applied. And when those rules  
7 are applied in a way that creates for an  
8 applicant, such as DCA Trust, a -- a -- a  
9 significant problem in that its vision,  
10 its goals, its objectives, its work is  
11 simply wiped away, but they can go  
12 nowhere but to an IRP Panel that could  
13 only issue a recommendation which the  
14 very Board whose conduct is being  
15 questioned can decide whether they're  
16 going to accept it or not.

17 Is that a real system of  
18 accountability?

19 I would submit to you, no. The  
20 accused cannot decide whether it will  
21 accept the verdict as correct or not.

22 At the end of the day, there is a  
23 decision that ICANN will tell you, Oh, of  
24 course, we will comply with it, but we're  
25 not bound by it.



1           So the curator of the Internet and  
2           fair play in the Internet governance  
3           system cannot decide what it will do when  
4           it wants to and decide whether or not it  
5           is going to be bound by the hard work  
6           that you are doing.

7           Now, we're also told that ICANN  
8           tries to be neutral but has no obligation  
9           to be neutral.

10          Let me table that for one side,  
11          because that's going to be a core part of  
12          my overall presentation.

13          And I'm quoting Mr. LeVee. ICANN  
14          tries to be neutral but has no obligation  
15          to be neutral.

16          Now, I know that Mr. LeVee knows the  
17          Bylaws inside and out. And the Bylaws  
18          are replete with references to  
19          neutrality, transparency, equity,  
20          nondiscrimination, and fairness and  
21          equitable treatment.

22          So let's -- let's just turn now, if  
23          we might, to some of the key facts that  
24          we have now become aware of and that we  
25          believe are undisputed, and those which

1 are disputed and which we would hopefully  
2 convince you that the evidence falls in  
3 our favor in terms of our view of what  
4 happened.

5 So there's no question that through  
6 2007 to 2010, DCA has gone about  
7 gathering support in support of its -- or  
8 endorsements in support of its idea, its  
9 initiative.

10 Maybe ICANN will say it's irrelevant  
11 that, ultimately, .africa was  
12 Ms. Bekele's idea and initiative and  
13 vision.

14 But what did DCA do? DCA went  
15 around the African continent and obtained  
16 support at the highest levels of the AUC,  
17 which, like most public bodies, is rife  
18 with politics. But she got the support  
19 of Chairman Ping; she got the support of  
20 UNECA, a UN body that -- that represents  
21 African interests; it got the support of  
22 the Ethiopian Government; got the support  
23 of the Kenyan Government.

24 And we've heard two things from  
25 ICANN, that at the time the application

1 was submitted, DCA Trust did not have the  
2 support that was required.

3 Well, that's incorrect. Perhaps  
4 there are questions that can be raised  
5 about the AUC's position, which certainly  
6 should be viewed under a cloud, in light  
7 of what the AUC is doing at the same  
8 time, which is acting as a competitor or  
9 was a competitor to DCA Trust.

10 But when the application was  
11 submitted, there was support. And as the  
12 rules state very clearly, that support  
13 can continue to be garnered throughout  
14 the process of evaluation of financial  
15 and technical and other infrastructure  
16 aspects -- do something that is very  
17 technical, operate a registry that will  
18 not, in any way, undermine the security  
19 and stability of the Internet.

20 And so support will come along  
21 during this process.

22 What we do know, though, is that  
23 ZACR, the AUC's applicant, actually  
24 didn't have, technically, the same kind  
25 of support that DCA did when the

1 application was submitted.

2 What ZACR was relying upon was the  
3 support that was given by the AUC -- AU  
4 Members for the Reserved Names Initiative  
5 that, ultimately, ICANN rejected.

6 Now, insofar as this issue of  
7 support is concerned, I would simply ask  
8 you to look at the correspondence between  
9 ICANN Staff and the independent  
10 Geographic Names Panel, because that  
11 documentation, which we will visit  
12 shortly, makes it very clear that the  
13 independent Geographic Names Panel  
14 certainly considered that DCA did have  
15 support.

16 And this discussion went on for over  
17 a year between ICANN Staff -- between  
18 ICANN -- really, one shouldn't make a  
19 distinction. ICANN Staff operates at the  
20 behest and direction of the Board.

21 ICANN -- I mean, for -- for -- for  
22 Mr. LeVee to say, Well, you can only look  
23 at Board action or inaction, independent  
24 of ICANN Staff, I find to be, with all  
25 respect, something of an absurd

1 proposition.

2 ICANN Staff only does what they are  
3 directed to do or what they believe they  
4 can do if they do not have specific  
5 direction and are, therefore, part of the  
6 overall accountability through the  
7 mechanism of the IRP examining the  
8 actions or inaction of the Board and,  
9 thereby, ICANN and its constituent  
10 organizations.

11 And I will point you shortly to  
12 where it says that ICANN is responsible  
13 or that your responsibility is to look at  
14 the overall application of the system --  
15 ICANN system that includes ICANN, the  
16 Secretariat and the constituent bodies.

17 So DCA's gathered support. ZACR  
18 doesn't have it -- doesn't have support  
19 when it files its application. At the end  
20 of the day, there's a big question mark of  
21 how they're going to deal with this  
22 question of support.

23 The application window opens in  
24 January 2012. Slightly before that, we  
25 have seen the request that was made by the

1           AUC. The AUC has written to ICANN  
2           October 2011.

3           And what the AUC wants -- and we heard  
4           some reference to this yesterday about  
5           country code top-level domains, such as  
6           .fr; or .us; or, in the special instance of  
7           the European Union, .eu.

8           Well, the African Union Commission --  
9           the Secretariat has made a request to ICANN  
10          saying, We want the same thing as the EU.  
11          Yes, we accept that we're not the EU --  
12          they know that -- but we want the same  
13          thing that the EU has. We want .africa  
14          reserved. Although it's well-recognized  
15          country code, it's not on the list of  
16          country codes, but we want .africa,  
17          .afrikia, you know, .afrique reserved for  
18          us.

19          And ICANN writes back telling the AUC,  
20          after some months of deliberation, which  
21          includes, as we have seen, consultation of  
22          some sort with the GAC -- and, clearly,  
23          Ms. Dryden couldn't remember how much  
24          consultation, or perhaps could have been  
25          reminded through documentation, which we

1 didn't have, of the degree of consultation  
2 that took place.

3 But we know that she was given the  
4 opportunity to review the final  
5 communication that went back to the AUC's  
6 request.

7 And what is it that the -- that ICANN  
8 tells the AUC?

9 Well, it says, Look, we can't do what  
10 you want because the Reserve Names List is  
11 closed. And you don't technically fall  
12 within this reserve names category, but we  
13 are going to tell you how you can achieve  
14 the same end through the processes that are  
15 in place.

16 And I would suggest to you that  
17 there's nothing necessarily sinister about  
18 that. But is the same direction, guidance,  
19 advice being given to .africa or other  
20 applicants where the applicant will be able  
21 to use the system to its own benefit when  
22 the other applicants aren't being told --  
23 the nongovernmental applicants aren't being  
24 told that governments can apply -- oh,  
25 well, it doesn't say that governments can't

1 apply, so, therefore, governments can  
2 apply -- and that governments can use the  
3 system in any way they so wish to benefit  
4 themselves?

5 That really isn't fairness. That's an  
6 imbalance of power within the context of  
7 what is supposed to be rules that apply  
8 with equal force and effect to all parties.

9 And to the -- and that is what ICANN,  
10 in some respects, is saying. Look, we  
11 cannot do for you what you want, but play  
12 in this system where these rules apply,  
13 but, by the way, you can game the system to  
14 your benefit to achieve the same ends.

15 And, of course, as we come to see, the  
16 AUC took that very much to heart.

17 Now, the AUC -- again, Ms. Dryden  
18 couldn't help us very much as to why the  
19 AUC was part -- made part of the GAC, how  
20 it moved from being a nonvoting member to a  
21 voting member.

22 And, apparently, nobody really quite  
23 knows, including the GAC Chair, as who it  
24 is to be a voting member, a nonvoting  
25 member, whether or not you can issue



1 Early Warnings or not, whether or not you  
2 can issue GAC advice or participate in the  
3 issuance of GAC advice or not.

4 If the GAC Chair isn't clear, how is  
5 it that DCA Trust is supposed to know what  
6 any of this means?

7 But I will put forward to you, as the  
8 Independent Review Panel, the following  
9 proposition: that when the system allows  
10 applicant to also participate in the  
11 overall judging, there is a higher degree  
12 of care that is required in the evaluation  
13 of that application.

14 And what is it that we know from the  
15 documents? There is a debate that starts  
16 as early as August 2012, soon after the  
17 application period is closed. There is a  
18 debate that's taking place about the highly  
19 politicized nature of these applicants, the  
20 controversy associated with these  
21 applications.

22 Everybody appreciates and understands  
23 that there are issues associated with these  
24 applications, issues associated with  
25 potential conflicts of interests vested

1 interests, that there are two applicants,  
2 there's the AUC, the AUC may not  
3 necessarily be entitled to be in the  
4 position that it is.

5 Well, all of this considered and  
6 evaluated by intelligent individuals and many  
7 individuals within the ICANN infrastructure  
8 should lead to the outcome that I'm suggesting,  
9 that we need to apply a heightened degree of  
10 diligence and care associated with these  
11 applications because of the imbalance of power.

12 Now, I wish I had the documentation  
13 that would allow me to prove the propositions  
14 that we fundamentally believe that ICANN and the  
15 GAC and the AUC were basically rigging the  
16 system. And I think that there's enough there  
17 for you to be able to make -- to arrive at the  
18 conclusion that what they were doing was perhaps  
19 not purposely, perhaps not in a sinister fashion,  
20 but ICANN, as a political organization, was  
21 tilting the balance in favor of one of the  
22 parties to achieve the ccTLD outcome through a  
23 process which is not the right process, because  
24 it couldn't use the right process to achieve the  
25 outcome that the AUC wanted.

1           All right. So we -- there are  
2 question marks now that are raised about the GAC  
3 advice that are, I believe, incredibly  
4 significant.

5           What's the image that was created in  
6 my mind as I heard Ms. Dryden speak? A large  
7 room filled with people milling in and out,  
8 having discussions, discuss- -- discussions in  
9 the corridor, discussions in the room. And  
10 there's Ms. Dryden, who puts forward a  
11 proposition that apparently appears on the agenda  
12 that we haven't seen, but what we're told is, All  
13 the agenda says is .africa and DCA's application.  
14 That's her testimony.

15                           Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

19                   As she tells you, Well, we had no  
20                   rationale. We're not required to give a  
21                   rationale. I didn't give a rationale. That's  
22                   not the GAC's job.

23                   What does she tell you? Whose job is  
24                   it? It is the Board's job. It is our job to  
25                   somehow reflect some type of consensus, consensus

1 of one government that raises its hand, consensus  
2 by acquiescence or silence, and the Board then  
3 simply accepts that.

4 What sort of system of fairness,  
5 transparency and integrity is that? Certainly  
6 not one that I believe is appropriate for the  
7 massive responsibility that ICANN has to the  
8 Internet domain name system and the applicants  
9 who spend their money and come before ICANN  
10 asking for a fair deal.

11 How is it fair that ICANN Staff are  
12 trying to strong-arm the independent Geographic  
13 Names Panel? Why?

14 Ask yourself the following questions,  
15 please: What role is it of ICANN Staff to say to  
16 the Geographic Names Panel whether or not the  
17 AUC's endorsement is valid or not and to say, no,  
18 it's not in August 2012; to question whether or  
19 not UNECA's support is sufficient; to delay the  
20 very questions, the clarifying questions that the  
21 GNP is insisting, per the Guidebook, per the  
22 rules, by the Bible, by the Koran, per the --  
23 whichever book you wish, the very, very rules say  
24 that these clarifying questions should be issued.

25 Why delay? Why delay? Why delay?

1 Delay for over a year?

2 No, you mustn't send those out, please  
3 confirm that you are not going to send those out.

4 You mustn't contact the AU. You  
5 mustn't contact the AU- -- well, actually, they  
6 don't say, Don't contact the AUC; they say, Don't  
7 contact the AU.

8 Send the clarifying questions to the  
9 individual applicants, is their final concession;  
10 but within days of that final consensus, they  
11 write back and say, Oh, don't send out the  
12 clarifying questions and, by the way, the AU  
13 support -- or the AUC support is sufficient; a  
14 complete about-face between May of 2012 and May  
15 of 2013.

16 Is that fair? Is that transparent?

17 I believe not.

18 So let's take a look very quickly at  
19 some of these -- some of the standards that we  
20 believe you should be applying.

21 I, yesterday, addressed the -- the  
22 question of the standard review, so I won't  
23 repeat myself. But, of course, I look forward to  
24 answer any questions that you have.

25 I'll simply emphasize that please

1 think of the standard review within the context  
2 of where you sit, the litigation waiver, the fact  
3 that there is this incestuous circular system of  
4 checks and balances or controls within ICANN.  
5 And at the end of the day, you are the only  
6 independent objective reviewers of what it is --

7 HONORABLE JUDGE CAHILL: What do you  
8 mean by "litigation"?

9 MR. ALI: The litigation waiver,  
10 sir?

11 HONORABLE JUDGE CAHILL: Yes.

12 MR. ALI: Yes. As you know, as --  
13 when an applicant files an application,  
14 they are required --

15 HONORABLE JUDGE CAHILL: The  
16 waiver -- the trial --

17 MR. ALI: -- to waive all of their  
18 rights with respect to taking ICANN to  
19 any forum other than the IRP --

20 HONORABLE JUDGE CAHILL: I  
21 understand what --

22 MR. ALI: -- so I think that that,  
23 to me, is dispositive.

24 HONORABLE JUDGE CAHILL: What you're  
25 talking about is when you say, I'm not

1 going to go to Court, right?

2 MR. ALI: Yes. We cannot take you  
3 to Court. We cannot take you to  
4 arbitration. We can't take you anywhere.  
5 We can't sue you for anything.

6 The only thing you, applicant, can  
7 do is come before this Panel, which, by  
8 the way, cannot issue anything that's  
9 binding against us, which, of course, we  
10 don't agree with, as -- as DCA, and the  
11 Panel, you know, must defer to -- to the  
12 omnipotence of ICANN.

13 So let's just go back, if we could.  
14 Let's run back to Slide 4.

15 I already told you about Slide -- on  
16 the third slide, you had the Articles of  
17 Incorporation.

18 I'd like you to take a look at  
19 Slide 4.

20 This is direct response to  
21 Mr. LeVee's submission yesterday on  
22 neutrality.

23 Let's take a look at what ICANN's  
24 core values provide.

25 In performing its mission, the



1 following core values should guide the  
2 decisions and actions of ICANN. And  
3 Number 8, Making decisions by applying  
4 documented policies neutrally and  
5 objectively, with integrity and fairness.

6 Those are words that are incredibly  
7 important, "integrity and fairness,"  
8 "neutrally and objectively."

9 Let's take a look at Section 3 of  
10 the Bylaws.

11 ICANN shall not apply its standards,  
12 policies, procedures or practices  
13 inequitably or single out any particular  
14 party for disparate treatment unless  
15 justified by substantial and reasonable  
16 cause, such as the promotion of effective  
17 competition.

18 Yes, there is a carve-out, the  
19 promotion of effective competition.

20 Well, the disparate treatment to  
21 which -- that was applied to -- to  
22 .africa -- to DCA Trust, was that to  
23 promote effective competition?

24 Not at all. It was completely the  
25 opposite. There was no reason to single

1 out or treat DCA Trust in the way that it  
2 was treated.

3 Article III, Transparency. ICANN  
4 and its constituent bodies shall operate,  
5 to the maximum extent feasible, in an  
6 open and transparent manner and  
7 consistent with procedures designed to  
8 ensure fairness.

9 I wish to speak. I say something  
10 that is incomprehensible. The GAC Chair  
11 reformulates what I say, tables a motion  
12 based on what she says. And that is  
13 supposed to be fairness?

14 The consequence that it has with --  
15 the GAC Chair knows what the consequence  
16 could be because the GAC Chair  
17 participates in the subsequent meetings.

18 And there are at least two meetings,  
19 May 8th and June 4th of 2013, when the  
20 GAC Chair is participating in the NGPC  
21 review, or the GAC advice.

22 And she cannot recall whether she  
23 said anything, and she cannot recall  
24 whether anything was raised.

25 I recall what I said about the

1           heightened standard that should be  
2           applied.

3           I'm not saying by evidentiary  
4           standard; I'm saying greater diligence  
5           when you know that there are  
6           sensitivities at play.

7           When it should be just so obvious,  
8           as it was to Mr. Chalaby when I put my  
9           last question to him about conflicts of  
10          interest. And Mr. Chalaby, who said that  
11          he applies the highest standards of  
12          conflict of interest, that you have  
13          applicant and judge within the system,  
14          well, greater care is required, greater  
15          diligence is required of the NGPC. Ask  
16          questions, investigate, do what you are  
17          required to do according to the very  
18          Bylaws that govern the way you are  
19          supposed to operate.

20          But they give it short shrift. It  
21          goes to the Board Governance Committee,  
22          which includes some people of the NGPC,  
23          and the Board is required to conduct  
24          investigations, or at least it should  
25          conduct greater investigation of the

1 matter. But it doesn't; it gives it  
2 short shrift.

3 Now, Mr. LeVee told us yesterday --  
4 we can go to Slide Number 8. My numbers  
5 are different. Go a slide back,  
6 please -- that I don't know that the core  
7 values refer to anticompetitive conduct  
8 within a particular gTLD string. The  
9 mission of ICANN was to increase  
10 competition in the registry space.

11 I mean, that's, to me, akin to  
12 saying that the United States economy is  
13 an open capitalist economy, and it  
14 doesn't matter if Microsoft acts  
15 anticompetitively.

16 No. Competition applies at every  
17 level. It applies a granular level,  
18 because without those grains, the system  
19 can't grow and remain anti- -- remain  
20 competitive.

21 So I think that is a statement which  
22 Mr. LeVee may want to retract.

23 So we'll move on.

24 I've talked a little bit about the  
25 GAC. So let's -- you know, we've -- no

1 distinct rules; there is the limited  
2 public records; fluid definitions of  
3 memberships and quorums; fluid  
4 definitions of what can happen within the  
5 context of the -- the GAC.

6 It's all politicized. We're not  
7 quite sure even what different GAC  
8 Members do within the GAC.

9 So, you know, again, I think that  
10 there is yet another violation of the --  
11 that -- there's another element of  
12 unfairness as a result of how the GAC  
13 operated.

14 But the GAC then transfers over  
15 responsibility to -- to the Board. And I  
16 must say, I -- I think, with respect to  
17 this interaction between the Board -- the  
18 GAC and the NGPC, the following  
19 statements should say it all:

20 "Question: So not all countries  
21 share the same view as to what entities,  
22 such as the AUC, should -- what they  
23 should be able to do. Is that what you  
24 said?

25 "Answer: Right, because that would

1           only get clarified if there is  
2           circumstances where you find the force --  
3           I'm sure that's meant to say  
4           something else -- meant to sent something  
5           else. But this is the interesting  
6           part -- in our business, we talk about  
7           creative ambiguity. We leave things --  
8           we leave things unclear so we don't have  
9           conflict."

10                   "Creative ambiguity," I don't find  
11           those words anywhere in the GAC  
12           principles. I don't find those words  
13           anywhere in the Bylaws. I don't find  
14           those words anywhere articulating any  
15           principle of California law or  
16           international law.

17                   But creative ambiguity is what was  
18           applied, and creative ambiguity is the  
19           responsibility that is then transferred  
20           over, according to Ms. Dryden, to the  
21           Board.

22                   What does she say with respect to  
23           the GAC consensus of advice that's a  
24           result of creative ambiguity?

25                   That isn't my concern as the Chair.

1           It's really for the Board to interpret --  
2           to interpret the creative ambiguity  
3           outputs coming from the GAC.

4           Okay. So does -- and then she goes  
5           on to tell you, I'm telling you the GAC  
6           did not provide a rationale. And that  
7           was not a requirement for issuing GAC  
8           advice.

9           So GAC issues this advice through  
10          facts that we now know that reflect a  
11          decision taken in moments, creative  
12          ambiguity as the overall atmosphere, and  
13          now it goes over to the Board.

14          And you can take a look at what it  
15          is that the Board is supposed to do.

16          Let's go to the slide that shows  
17          what the Board must do in exercising due  
18          diligence in care. And this is some  
19          element of the standard review.

20          So even if we look at the specific  
21          elements of what it is that -- that  
22          the -- that the Board is supposed to  
23          particularly do -- do. So did the Board  
24          act without conflict of interest in  
25          taking its decision?

1 Well, just very briefly on the  
2 conflict of interest -- and I had made an  
3 absolute commitment to Mr. LeVee that I  
4 would end on 45 minutes.

5 So five minutes left, if you're  
6 timing me.

7 MR. LEVEE: I'm not timing you.

8 MR. ALI: Okay.

9 The -- on the question of the  
10 conflict of interest, I mean, we know  
11 very little, other than the fact that  
12 Mr. Chalaby doesn't know and cannot  
13 recall whether or not he interviewed, in  
14 his digging and digging and digging and  
15 digging, Mr. Silber and Mr. Disspain.  
16 But they normally dig and dig and dig,  
17 but he can't remember whether that  
18 happened here or not.

19 He can't remember what materials  
20 were actually presented as part of this  
21 overall conflict of interest.

22 And, frankly, given the timing of  
23 this conflict-of-interest review, six to  
24 eight weeks after the actual vote was  
25 taken, what difference would it have



1           made?

2                   This review that they took -- that  
3           they apparently did, digging and digging  
4           and digging, wouldn't have changed the  
5           outcome if they had come to the  
6           conclusion that there was a conflict of  
7           interest.

8                   Why? Because, apparently, they had  
9           enough votes anyway.

10                   So there's a fundamental  
11           inconsistency here.

12                   How can you, on one hand, say the  
13           vote was fair, transparent, and that  
14           nothing untoward took place insofar as  
15           the potential conflicts were concerned,  
16           and, at the same time, say that we did a  
17           very thorough conflicts of interest  
18           review?

19                   The only reason we were given was  
20           that if conflicts of interest had been  
21           determined, those who were -- those who  
22           were the conflicted parties would have  
23           been removed from the Board for purposes  
24           of subsequent decisions.

25                   That doesn't help DCA Trust. And we

1 don't know, because we don't have  
2 details. They don't provide details. We  
3 don't have the details as to what  
4 Mr. Disspain's role or what Mr. Silber's  
5 role was in guiding the outcomes.

6 But we do know that Mr. Silber is on  
7 the -- is -- is a nonexecutive Board  
8 member of ZADNA, and ZADNA has endorsed  
9 the AUC application.

10 Actual, potential, or perceived  
11 conflict of interest? I think that all  
12 three standards are satisfied here.

13 Now, there's no obligation for the  
14 NGPC to follow the GAC advice. It  
15 doesn't say that. It doesn't say they  
16 must accept GAC advice. It simply says  
17 that it should be duly taken into  
18 account.

19 Well, I would say that that actually  
20 means something when you decide to adopt  
21 a GAC advice. There's no doubt that the  
22 Board members understand how the GAC  
23 operates. That requires the Board, as a  
24 control mechanism, to dig into and  
25 understand what it is that happened

1 within the GAC advice and how that GAC  
2 advice has come about.

3 Why else does Heather Dryden  
4 participate as a nonvoting liaison? A  
5 liaison liases. A liaison provides  
6 information. A liaison describes what  
7 happened. Ah, here were the  
8 communications that took place, this is  
9 what Kenya said, here is what was the  
10 final agreed text of the governments, and  
11 here's what happened at the meeting.

12 That's what she's supposed to  
13 present as a liaison; that's what's  
14 supposed to be the inquiry by the Board;  
15 and that is what Mr. Chalaby is supposed  
16 to be directing. But, apparently, none  
17 of that happened.

18 So once the NGPC unanimously accepts  
19 the GAC advice, DCA files a request for  
20 reconsideration, which now goes to the  
21 Board Governance Committee. And the  
22 Board Governance Committee also has  
23 certain obligations. It doesn't --  
24 again, there is what they call their  
25 "control mechanism." These are the

1 internal checks and balances.

2 The Board Governance Committee is --  
3 is supposed to conduct a meaningful  
4 review, according to the Bylaws,  
5 Section -- Article IV, Section 2, that  
6 lays out a number of things that the  
7 Board should do.

8 And here, in this instance where the  
9 Board Governance Committee and the NGPC  
10 know how complicated and politically  
11 sensitive this application is with two  
12 applicants competing and one applicant  
13 having certain superpowers or certain  
14 extraordinary influence on the outcomes,  
15 the control mechanisms don't work.

16 The NGPC -- well, the GAC basically  
17 lies down. The Board Governance  
18 Committee says, Well, we'll just casually  
19 accept, with wave of a hand, that we got  
20 from the GAC -- the NGPC, sorry, and then  
21 the Board Governance Committee says,  
22 Well, you know, we will sort of look at  
23 this application. We don't see anything  
24 that causes us any concern, so we're  
25 going to accept the NGPC's -- we're

1 not -- we're going to deny the request  
2 for reconsideration.

3 And then all the Board Governance  
4 Committee members walk next door to the  
5 room that says NGPC, and they say, Well,  
6 we adopt the Board Governance Committee's  
7 recommendation. And they then tell  
8 ICANN Staff, "ICANN Staff, please, go  
9 right ahead."

10 And ICANN Staff goes right ahead and  
11 does what it wanted to do, which is to  
12 draft the support letter from the AUC to  
13 the Geographic Names Panel.

14 Okay. Yes, it was a template, but  
15 this is just nothing more than reflective  
16 of how they were treating this applicant  
17 all along.

18 But even more telling is the fact  
19 that after months and months and months  
20 and months of delay, some of which may  
21 have been partly due to legitimate  
22 debate, and some of it, I'll even  
23 concede, may have been due to the fact  
24 that ICANN Staff is somewhat busy and  
25 overburdened, but 12 months of debate,

1 12 months of delay, 12 months of  
2 resisting what it is that the GNP is  
3 asking.

4 And then, as soon as the Board  
5 Governance -- as soon as the NGPC accepts  
6 the GAC advice, it's now rush, rush,  
7 rush, rush, rush. We need to get this  
8 application approved; and we need to get  
9 this application voted on; and we need to  
10 get this application pushed through.

11 Not fair, not in the least bit  
12 equitable, no transparency. And  
13 certainly, their internal systems that  
14 they're asking you to defer to didn't  
15 operate with the rigor or care that one  
16 would expect and DCA Trust expected when  
17 it put its application in and the rules  
18 and the Bylaws and the Articles of  
19 Incorporation demand.

20 So with that, I will stop exactly on  
21 48 minutes, and thank you very much for  
22 your attention.

23 HONORABLE JUDGE CAHILL: Thank you.

24  
25 MR. ALI: I should have said if you

1 had any questions, now, I'm happy to  
2 answer them or --

3 HONORABLE JUDGE CAHILL: Don't  
4 worry. We would have.

5 ARBITRATOR KESSEDJIAN: I just have  
6 a very short question. And it came up  
7 yesterday when Ms. Bekele was testifying.

8 Could you, at some stage before the  
9 end of the proceedings, point out to us  
10 the exact rule -- it's probably in the  
11 Guidebook -- which says that an applicant  
12 can have an extra time to garner support  
13 after the first application has been -- I  
14 was unable to find the exact rule.

15 But you can answer later if you  
16 want, but --

17 MR. ALI: It's right here. I may  
18 forget.

19 PRESIDENT BARIN: We do have some  
20 questions for Mr. Ali. I'm happy to ask  
21 them now or after Mr. LeVee is done.

22 MR. ALI: I will point to -- take a  
23 look in our opening slides at two  
24 particular slides, 31 and 32.

25 Thirty-one --

1 HONORABLE JUDGE CAHILL: What pages?

2 PRESIDENT BARIN: Just one minute.

3 HONORABLE JUDGE CAHILL: What page  
4 numbers?

5 MR. ALI: Thirty-one and 32 of our  
6 opening slides.

7 ARBITRATOR KESSEDJIAN: Okay. So  
8 that's in your --

9 MR. ALI: Yes, the evaluation --  
10 sorry -- well, 31 says -- addresses, I  
11 think, a fundamental point here that --  
12 which reflects the process, that really  
13 does reflect what can happen here and  
14 what the -- what the Bible says, which  
15 is, you know what, countries can accept  
16 the applications or support the  
17 applications of two applicants, fair  
18 game. Let them go into the ring and let  
19 them, you know, duke it out with each  
20 other.

21 So that's what 31 tells you.

22 And 32 says, on -- on Page 32, which  
23 is Claimant's Exhibit 11, Page 72, AGB  
24 Module 2.2.1.4.4, In cases where an  
25 applicant has not provided the required



1 documentation, the applicant will be  
2 contacted and notified of the requirement  
3 and given -- given a limited time frame  
4 to provide the documentation.

5 HONORABLE JUDGE CAHILL: Who makes  
6 the -- who contacts the -- the applicant?

7 MR. ALI: The GNP is supposed to.

8 HONORABLE JUDGE CAHILL: The GNP is  
9 supposed to contact the applicant --

10 MR. ALI: Yes.

11 HONORABLE JUDGE CAHILL: -- and say,  
12 You don't have enough support?

13 MR. ALI: Right, the GNP is supposed  
14 to have this opportunity to do that.

15 And then it says, The applicant will  
16 have additional time to obtain the  
17 required documentation; however, if the  
18 applicant has not produced the required  
19 documentation by the required date (at  
20 least 90 calendar days from the date of  
21 notice), the application will be  
22 considered incomplete.

23 So there are a number of  
24 opportunities for the applicant to garner  
25 the political -- the support, the

1           endorsements, along the way.

2                   At the end of the day, that  
3           support -- you know, that's a soft  
4           requirement. I mean, governments change,  
5           political whims change, as we've seen.

6                   At the end of the day, the technical  
7           and financial criteria cannot change  
8           because those two elements go to the core  
9           functioning of the Internet stability and  
10          integrity.

11                   PRESIDENT BARIN: Now, in Procedural  
12          Order Number 18 -- we don't have to stick  
13          to that -- we said we would ask you  
14          questions after Mr. LeVee is done with  
15          his presentation.

16                   I do have some questions for you.  
17          So I'm happy to ask them now or wait  
18          until Mr. LeVee --

19                   MR. LEVEE: That's your pleasure.

20                   PRESIDENT BARIN: Okay.

21                   While we have you, Mr. Ali, let's --

22                   MR. ALI: I'm not going anywhere.

23                   PRESIDENT BARIN: -- let's ask you,  
24          because then -- then, if my colleagues  
25          have any questions, then they can

1 follow-up.

2 I would like you to do -- well, I  
3 have a couple of questions. One of them  
4 is the following -- you can also take the  
5 time to amend if you wish.

6 If you look at Article IV, Section 3  
7 of the ICANN rules -- sorry -- Bylaws, I  
8 want to know how you would assist the  
9 Panel in reconciling what Section 3,  
10 Subparagraph 4 says with Section 11.

11 So -- and you -- put the screen up  
12 yourself, if you will.

13 MR. ALI: So Bylaws, Article IV?

14 PRESIDENT BARIN: Right.

15 MR. ALI: Article IV, Section 3?

16 PRESIDENT BARIN: Article IV,  
17 Section 3, that's Subparagraph 4, which  
18 says, Requests for independent review  
19 shall be referred to the IRP, which shall  
20 be charged with comparing contested  
21 actions of the Board through the Articles  
22 of Incorporation and Bylaws, and then  
23 declaring whether the Board has acted --  
24 and then the questions that it sets out.

25 Then, if you turn to Subsection 11,

1           it says, The IRP Panel shall have the  
2           authority to.

3           And you, yourself, put up, I guess,  
4           a number of these. And one of them in  
5           11.c. says, Declare whether an action or  
6           inaction of the Board was consistent with  
7           the Articles of Incorporation or Bylaws.

8           So is the IRP -- my question to you  
9           is, Is the IRP allowed to do all of that,  
10          do a combination of 4 and 11? And where  
11          do you draw in terms of any limits there  
12          are in terms of what the IRP can or  
13          cannot do?

14          Is my question clear?

15          MR. ALI: I think sufficiently for  
16          me to give you an answer now. And I will  
17          certainly reflect upon what you've asked.

18          And this was a question -- a very  
19          similar question that was put to us by  
20          the Schwebel Panel, and it's something  
21          that's very, I think, to a certain  
22          degree, controversial because of the way  
23          in which ICANN has designed its  
24          accountability mechanisms.

25          Given how much of a mess the

1           accountability system is at ICANN -- and  
2           ICANN is now undergoing a full review of  
3           its accountability mechanisms in light of  
4           the fact that it has been heavily  
5           criticized for what it has done -- I  
6           think that you are at a certain liberty  
7           to try and to put order within -- you  
8           know, that applies to the particular case  
9           that's before you. But to take the  
10          construct, the construct that is provided  
11          by the Bylaws, that's provided -- keeping  
12          in mind that the Bylaws are supposed to  
13          reflect the principles reflected in the  
14          Articles of Incorporation -- and apply  
15          those within the Board of construct or  
16          the dispute resolution framework, that  
17          you are free to and have so far  
18          constructed that is appropriate for the  
19          particular case at hand.

20                 Now, with respect to what you can  
21          do, you are testing Board action and  
22          inaction. To use the terminology that  
23          was provided by Mr. LeVee, what the Board  
24          knew and what the Board should have  
25          known, what the Board did and what the

1 Board should have done with reference to  
2 the principles that are set out in the  
3 Articles and the Bylaws and the Applicant  
4 Guidebook.

5 So, from our perspective,  
6 particularly when you -- you know, when  
7 you cradle all of this within the  
8 principles of international law that, to  
9 me, also include fundamental principles  
10 of -- of -- of procedure and due process,  
11 allows you to -- allows you considerable  
12 amplitude and latitude in terms of what  
13 it is that that you can do.

14 Now, at one level, you could be  
15 looking at the particular Bylaw and say,  
16 Well, technically, yes, this was  
17 breached, and that was not breached; or  
18 this was breached, and that was not  
19 breached. But I think that you have a  
20 more significant role, and that more  
21 significant role is -- is motivated,  
22 informed -- and informed by  
23 the -- the -- the Articles of  
24 Incorporation and the Bylaws, themselves.

25 PRESIDENT BARIN: Are you, in

1 essence, saying -- and I will obviously  
2 put the same question to you,  
3 Mr. LeVee -- are you, in essence, saying  
4 that, if you will, Subparagraph 4 gives  
5 us a framework, but that then Sub 11  
6 gives us the broad powers to decide what  
7 we need to -- perhaps in light of the  
8 facts and circumstances that you've given  
9 us?

10 Is that a fair characterization?

11 MR. ALI: That's a fair  
12 characterization --

13 PRESIDENT BARIN: Okay.

14 MR. ALI: -- but, ultimately, I  
15 believe that you have the latitude that  
16 you need to do what it is that's really,  
17 at its core, applying the standards and  
18 the Bylaws.

19 And every regulator will say, Let's  
20 take a look specifically at what my rules  
21 say, but, you know, at the end, they have  
22 to be applied in good faith in accordance  
23 with the core values.

24 And who is there to police the core  
25 values?

1           PRESIDENT BARIN: As a follow-up to  
2           that -- and I appreciate that I'm sort of  
3           throwing this at you now, but maybe when  
4           you sit down and reflect on it -- I would  
5           be interested in -- in seeing where you  
6           could find support -- maybe it goes  
7           without saying, but if, for example,  
8           staff or people involved in a -- in an  
9           organization do certain things or do not  
10          do certain things or whatever they are,  
11          that ultimately then sort of either goes  
12          up or down to -- to the Board -- the  
13          action or inaction.

14                 So to the extent that you can give  
15          the Panel some support for that, either  
16          Bylaws and Articles of Incorporation, I  
17          would be interested in that -- in seeing  
18          that.

19                 MR. ALI: Absolutely.

20                 I will respond, but I would like to  
21          think about that, because I think I have  
22          a -- a good response. But I want to  
23          articulate it since it is in a more  
24          coherent fashion than I have answered  
25          your last question.



1           PRESIDENT BARIN: In all fairness,  
2           that's why I asked it now as opposed to  
3           later.

4           I have one other question for you,  
5           and, again, you may reflect on this.

6           I want you to tell us, Mr. Ali, what  
7           it is exactly that -- and I want this  
8           articulated clearly -- what it is exactly  
9           the DCA Trust is asking this Panel to do.

10          I have put up on my own screen the  
11          relief requested in your Amended Notice  
12          of IRP, and I have also put up on my own  
13          screen the conclusion and the -- what I  
14          would say, the relief that you have  
15          requested in the DCA Memorial on the  
16          Merits.

17          And I think the Panel would be  
18          grateful if it has a very clear  
19          indication from you as to what it is that  
20          DCA Trust is seeking. Because,  
21          admittedly, I understand what the relief  
22          sought is in the Amended Notice of IRP;  
23          but when I read what is being sought in  
24          the Merits Memorial, it perhaps goes  
25          beyond what the initial request is.

1 MR. ALI: Sorry? Beyond?

2 PRESIDENT BARIN: It goes beyond the  
3 initial request, if you will.

4 And maybe that's my misunderstanding  
5 or maybe my characterization; but if I'm  
6 wrong, I would like to know that.

7 HONORABLE JUDGE CAHILL: Yes.

8 It's important we know what you're  
9 asking us to do.

10 MR. ALI: Yes. Let me review this  
11 specifically. Thinking of being more  
12 specific with respect to what we had put  
13 in the amended request, I will view the  
14 requests in light of the question you  
15 just put to me and, of course, also  
16 consult Ms. Bekele as to the precise  
17 relief we're requesting.

18 HONORABLE JUDGE CAHILL: On Page 56  
19 and 57 of your client's declaration, she  
20 also states what she's seeking. And I --  
21 not all -- we want it to be consistent,  
22 so we want to be very clear what you're  
23 seeking and she's seeking.

24 Okay?

25 MR. ALI: Okay.

1           ARBITRATOR KESSEDJIAN: May I add on  
2 this particular problem?

3           The way I read your submissions was  
4 that, basically, what is here in Page 30,  
5 3-0, of your Memorial of the Merits was  
6 superceding, in a way, or, kind of, you  
7 know, the -- the actual --

8           MR. ALI: It's an evolution, yes, of  
9 what was in the amended request. So it  
10 is more -- it is a -- it is a more  
11 precise articulation, at least that's how  
12 we'd intended it, of what it is that we  
13 wanted.

14           The way I would put it, both with  
15 respect to the amended request, as well  
16 as with respect to Ms. Bekele's  
17 statement, is that the amended request,  
18 the statement ultimately reflected an  
19 articulation of the requested relief at  
20 Paragraph 56.

21           But I will --

22           ARBITRATOR KESSEDJIAN: Fifty-six?  
23 I was reading that only.

24           So in your response later on, you  
25 must tell us whether I was correct or

1           whether we should do something else.

2           MR. ALI: Yes, absolutely.

3           PRESIDENT BARIN: And, again, I'm  
4 going to insist on that, because we have  
5 to walk away from this knowing exactly  
6 what it is that's being sought --

7           MR. ALI: Absolutely.

8           PRESIDENT BARIN: -- so depending on  
9 what your answer is and how you  
10 articulate it, then I will certainly have  
11 some questions for you --

12          MR. ALI: Okay.

13          PRESIDENT BARIN: -- but I'd rather  
14 give you the time to reflect on that, and  
15 then we can come back to it.

16          MR. ALI: I must consult with my  
17 client to make sure we've got it down  
18 with the requisite precision.

19          PRESIDENT BARIN: I understand.

20          HONORABLE JUDGE CAHILL: When I  
21 first read it, I was wondering whether we  
22 had the power to do some of the things  
23 you were asking for, even if we agree  
24 with you on the standard of care, the  
25 standard review and everything else.

1           It seemed like there was some --

2           MR. ALI: Fair question.

3           And that's, again, what we will be  
4 discussing with Ms. Bekele and relay that  
5 to the Panel. A very fair question.

6           HONORABLE JUDGE CAHILL: Okay.

7           PRESIDENT BARIN: Okay.

8           Thank you.

9           MR. ALI: Thank you.

10          PRESIDENT BARIN: Would you like a  
11 little break?

12          MR. LEVEE: I would like a very  
13 short break so I can deal with the  
14 computer issues and get everything  
15 switched around.

16          PRESIDENT BARIN: Okay.

17          Great. So maybe --

18          MR. LEVEE: Ten minutes is fine.

19          PRESIDENT BARIN: -- 10 minutes?

20          10:30?

21          MR. LEVEE: Thank you.

22                                 - - -

23                 (Whereupon, a brief recess was taken  
24                 from 10:23 a.m. to 10:35 a.m.)

25                                 - - -

1 PRESIDENT BARIN: Mr. LeVee.

2 - - -

3 CLOSING STATEMENT ON BEHALF OF RESPONDENT  
4 INTERNET CORPORATION FOR ASSIGNED NAMES AND NUMBERS

5 - - -

6 MR. LEVEE: Thank you,  
7 Mr. President.

8 Let me begin my closing by  
9 acknowledging that the Members of the  
10 Panel, opposing counsel, everyone has put  
11 in an enormous amount of effort into this  
12 matter.

13 On behalf of ICANN, we very much  
14 appreciate the effort and the attention  
15 you paid, and we -- we do appreciate that  
16 very much.

17 I know there's more to do, but this  
18 is the culmination of a -- particularly  
19 for the two of you, a very long period of  
20 time, much longer than ICANN hopes in  
21 these situations.

22 But we did have a death of a  
23 panelist and things happen, so we're very  
24 pleased to have reached this point.

25 I'm going to do three things in my

1 opening -- in my closing -- if I'm doing  
2 my opening, I'm a little late, I  
3 suppose -- first, I'm going to run  
4 through, pretty quickly, a couple of the  
5 Bylaws, provisions that you were looking  
6 with Mr. Ali.

7 Secondly, in the opening statement  
8 that DCA presented to you, they listed  
9 what they believe the various Bylaws and  
10 Guideline breaches were. I think there  
11 were seven of them. And I'm going to  
12 review them one by one with you.

13 And then, third, I'm going to  
14 return, again, briefly, to the  
15 assumptions that I laid out for you in my  
16 opening statement and demonstrate to you  
17 that after the testimony that we've had,  
18 that it is, in fact, the case that each  
19 of DCA's assumptions is false.

20 And so while DCA makes a number of  
21 arguments, each of those arguments is  
22 based on these assumptions. And if the  
23 Panel finds the assumptions false, then  
24 it should find in ICANN's favor.

25 First, you have already referred to

1 and quoted this provision of the Bylaws  
2 on multiple occasions, but Article IV,  
3 Section 3, Paragraph 2 does say that Any  
4 person materially affected by a decision  
5 or action by the Board that he or she  
6 asserts is inconsistent with the Articles  
7 or Bylaws may request an independent  
8 review.

9 The person must suffer injury or  
10 harm that is directly or causally  
11 connected to the Board's alleged  
12 violation of the Bylaws or the Articles  
13 of Incorporation, and not as a result of  
14 third parties acting in line with the  
15 Board's action.

16 So you asked a question yesterday,  
17 Well, what about the GAC?

18 And the answer is that an  
19 Independent Review Proceeding does not  
20 exist to test whether the GAC conformed  
21 to the ICANN Bylaws or the Articles, or,  
22 candidly, even to its own operating  
23 principles. So we're not here under the  
24 Bylaws to test whether the GAC got it  
25 right.



1           That's not to say that the GAC isn't  
2 relevant. Clearly, it is. Because the  
3 GAC issued consensus advice -- I'll call  
4 it "consensus advice," recognizing that  
5 there's a dispute -- and that advice went  
6 to the Board.

7           And then the question is, Did the  
8 Board deal with the advice consistent  
9 with the Guidebook, the Articles and the  
10 Bylaws?

11           But looking at whether the GAC does  
12 things really or whether the GAC has good  
13 operating principles or what -- what  
14 happened inside that room, it's not for  
15 this Panel to decide.

16           Next --

17           HONORABLE JUDGE CAHILL: Can I ask  
18 you a question about that?

19           MR. LEVEE: Of course.

20           HONORABLE JUDGE CAHILL: Is it your  
21 position that the Board has nothing --  
22 has no -- let me try this again.

23           The powers that the GAC have, where  
24 do they come from? The Board?

25           MR. LEVEE: The GAC. The GAC makes

1           its own rules.

2                   These are governments. The  
3 governments have no interest in having  
4 ICANN lay down rules or set rules.

5                   The GAC determines its rules.  
6 Ms. Dryden said that yesterday.

7                   HONORABLE JUDGE CAHILL: No. I  
8 remember that.

9                   PRESIDENT BARIN: Let me just follow  
10 up on that, then.

11                   Who is responsible for the GAC?

12                   MR. LEVEE: The GAC.

13                   PRESIDENT BARIN: And does the GAC  
14 report to anybody?

15                   MR. LEVEE: When you say "report,"  
16 the GAC issues communiqués to ICANN.  
17 You've seen one of them, but it does so  
18 in almost every meeting of the Board.

19                   It then has a nonvoting liaison, the  
20 Chair, who participates in ICANN  
21 meetings, but not as a voting member.

22                   But it doesn't really report to  
23 anyone. It -- it -- the GAC is -- is --  
24 it is its own body.

25                   PRESIDENT BARIN: Okay. But then --

1           then help me out in terms of trying to  
2           understand.

3                     If the GAC then issues the  
4           communiqué, is the communiqué of the GAC  
5           of any significance without the approval  
6           of the Board?

7                     MR. LEVEE: The communiqué has  
8           significance to the governments, and then  
9           the communiqué is transmitted to the  
10          Board.

11                    Now, it depends what the communiqué  
12          says. The communiqué can say to ICANN,  
13          We recommend that you look at something.  
14          The communiqué can say to ICANN, We wish  
15          that we be involved in policy relating to  
16          something.

17                    You have seen only GAC communiqué  
18          that relates to specific advice relating  
19          to the new gTLD program. That advice  
20          does get transmitted to the Board, and it  
21          creates what we've seen, the strong  
22          presumption if the advice should be  
23          accepted.

24                    But that's only one piece of what  
25          the GAC has done.

1           Historically, prior to the new gTLD  
2           program, the GAC issued communiqués on  
3           all sorts of subjects, and they were  
4           transmitted to ICANN. And, typically,  
5           they were in the form of requesting  
6           information, requesting that ICANN do  
7           something, requesting that ICANN take  
8           things into account. And ICANN would  
9           listen and ask.

10           PRESIDENT BARIN: But, you know,  
11           let's be very specific about this,  
12           because --

13           MR. LEVEE: Sure.

14           PRESIDENT BARIN: -- the communiqué  
15           that's issued by the GAC, if it's just a  
16           communiqué and it goes nowhere, then it's  
17           simply a reflection or, I guess, a -- a  
18           reprint of what transpired as -- you  
19           know, in a certain event, right?

20           I mean, does it have any more  
21           meaning than that? In other words --

22           MR. LEVEE: To be clear, all GAC  
23           communiqués are transmitted to the Board.

24           PRESIDENT BARIN: Right.

25           And if they're transmitted to the

1 Board, to the extent that the Board then  
2 acts on them, does it not create, I  
3 guess, the value that that GAC -- GAC  
4 communiqué then brings forward? In other  
5 words, without the approval of the Board,  
6 what is the value of the GAC communiqué?

7 MR. LEVEE: I get your point.

8 You're exactly right. The advice of  
9 the GAC can only be acted on by the  
10 Board, particularly in the sense of  
11 advice not -- that a particular  
12 application should not proceed.

13 But sometimes -- I'm just trying to  
14 be clear that sometimes the GAC is  
15 issuing communiqués that the GAC is  
16 saying, We wish to be involved. Even  
17 with the new gTLD program, the GAC  
18 periodically said, Hey, you guys are  
19 doing something. We, as governments,  
20 would like to be involved. And so we  
21 hereby notify ICANN to, you know, talk to  
22 us.

23 PRESIDENT BARIN: But in this  
24 case -- specifically in this case, when  
25 GAC says, for example, We are objecting

1 to it or there's an objection to an  
2 application --

3 MR. LEVEE: Yes.

4 PRESIDENT BARIN: -- if the Board  
5 does not approve that, then is the  
6 decision of the GAC of any value?

7 MR. LEVEE: No. With these two  
8 caveats: first, the Guidebook says that  
9 the -- the issuance of consensus advice  
10 by the GAC creates a strong presumption  
11 that the Board should follow.

12 Then the Bylaws -- separate and  
13 apart from the Guidebook, the Bylaws have  
14 a provision that says that if ICANN is  
15 not going to follow GAC advice, there's  
16 then a process that has to occur where  
17 the parties talk to one another -- and  
18 that's in my first -- in my opening  
19 statement, I had -- it was part of my  
20 opening statement yesterday -- so the  
21 parties would have to talk to each other.

22 ICANN cannot simply say, Thank you,  
23 GAC, for recommending something, nah, and  
24 we're done. There's a process --

25 PRESIDENT BARIN: Okay.

1           MR. LEVEE: -- but, otherwise, I'm  
2 not -- I think I'm answering your  
3 question. I'm just not sure.

4           PRESIDENT BARIN: No; you are. You  
5 are.

6           But I just want to follow up just on  
7 one more thing.

8           If -- if the Board gets a communiqué  
9 from the GAC and thinks that it should  
10 follow up, as you say, on the communiqué,  
11 or perhaps something was followed or not  
12 followed, or whatever, it can then go  
13 back and say, Why was this done this way  
14 or not done this way? Or is that  
15 possible?

16           MR. LEVEE: I do believe that the  
17 Board has the power to ask the GAC to  
18 clarify advice. I'll be candid. I've  
19 never seen it happen, but I do believe  
20 the Board has the power to ask the GAC,  
21 Why did you send me this advice or Could  
22 you amplify on it?

23           I certainly believe that that's one  
24 thing within the Board's --

25           HONORABLE JUDGE CAHILL: There's no

1 way to answer that question from the  
2 testimony we heard because she doesn't  
3 have an idea of what the reasons are.  
4 She just accepts the --

5 MR. LEVEE: I think Ms. Dryden was  
6 worried about dealing with it  
7 hypothetically, because there's so many  
8 different scenarios that come up.

9 From the GAC's perspective, when the  
10 GAC issues advice, they do so at a place  
11 and time, and it is their advice.

12 Governments change, policies change,  
13 advisors and representatives change. And  
14 so she can never be confident that  
15 something that the GAC says in March  
16 would be the same outcome of what the GAC  
17 might say in August, because the people  
18 in the room are different and the  
19 governments might have changed policy --

20 I'm sorry.

21 ARBITRATOR KESSEDJIAN: Sorry. I  
22 didn't want to interrupt.

23 MR. LEVEE: -- so her whole --  
24 Ms. Dryden's whole point was that she  
25 doesn't -- there can be communication --



1 HONORABLE JUDGE CAHILL: Right.

2 MR. LEVEE: -- but when the GAC  
3 issues something, they view it as final.

4 Now, if the Board comes back to the  
5 GAC and says, Well, we want to discuss  
6 something or We need your rationale, the  
7 GAC could then choose to provide it or  
8 not. The GAC would have -- would be  
9 under no obligation to -- to say, Well,  
10 the Board has asked me to clarify  
11 Section 2 that I issued on the communiqué  
12 in April, but we choose not to.

13 PRESIDENT BARIN: Sorry.

14 ARBITRATOR KESSEDJIAN: Go ahead.

15 PRESIDENT BARIN: Let me follow on  
16 this, because these are important  
17 questions.

18 MR. LEVEE: I'm with you.

19 PRESIDENT BARIN: To the extent  
20 that -- and I'm putting a hypothetical to  
21 you -- to the extent that the Board then  
22 adopts a view or a communiqué of GAC  
23 without taking the time to perhaps either  
24 look at it closely or analyze it or do  
25 further examination of it, and approves

1           it, then is it not then the Board's  
2           decision, and the consequences then  
3           follow from that? In other words, where  
4           else can the issue be put to if it's not  
5           to the Board?

6           MR. LEVEE: Yes. So applied here --  
7           and that's what I was trying to make  
8           clear -- applied here -- I'm not saying  
9           at all that the Board's decision  
10          vis-a-vis the GAC advice on DCA's  
11          application is not reviewable by this  
12          Panel; it is.

13          The Board did something. It acted.  
14          It approved the GAC advice. It had a  
15          Guidebook that said there was a strong  
16          presumption that it should. It reviewed  
17          various materials. It reached that  
18          conclusion. That conclusion is  
19          reviewable by this Panel, undoubtedly.

20          Have I clarified that?

21          PRESIDENT BARIN: You have. Thank  
22          you.

23          HONORABLE JUDGE CAHILL: But -- I'm  
24          sorry. Go ahead.

25          ARBITRATOR KESSEDJIAN: I'll be

1 patient.

2 No, no. You may ask the same  
3 question as I have in mind. And if so,  
4 then I will be quiet; but if not, I will  
5 go after you.

6 HONORABLE JUDGE CAHILL: I think I  
7 forgot my question now.

8 DCA is arguing that the GAC, when it  
9 made its decision to stop the  
10 application, basically killed the  
11 project -- killed DCA's project.

12 Does the Board have any  
13 responsibility? Because the Board is  
14 supposed to evaluate the applications  
15 based on financial, technical, all that,  
16 but that never happened because of what  
17 happened at the GAC. And --

18 MR. LEVEE: Well, there was some  
19 evaluation, but once the GAC ruled and  
20 then the Board adopted the GAC advice, it  
21 is correct that, at that point, the  
22 application evaluation terminated.

23 The -- but I'm not sure I'm  
24 answering your question.

25 If -- the killing that Mr. Ali was

1 referring to is the fact that because of  
2 the strong presumption, there has to be  
3 an awfully good reason for the Board not  
4 to accept the GAC advice.

5 DCA, under the Guidebook, was given  
6 an opportunity to respond to the GAC  
7 advice. It did with a 15-page response.  
8 It's in the exhibits that I gave to you  
9 yesterday.

10 The Board considered -- the NGPC  
11 considered that response along with the  
12 GAC advice, along with the Guidebook, and  
13 made a decision; it accepted the advice.

14 So the killing, I suppose -- I don't  
15 like using the word --

16 HONORABLE JUDGE CAHILL: I know.

17 MR. LEVEE: -- but the decision to  
18 suspend evaluation of that application  
19 was done by the Board, and that is  
20 certainly a decision that the Panel can  
21 review.

22 HONORABLE JUDGE CAHILL: And review  
23 in what way? That we can say -- we can  
24 go back and look at the GAC process and  
25 decide -- have an opinion as to whether

1 GAC did its job right?

2 MR. LEVEE: No. That's what --

3 HONORABLE JUDGE CAHILL: That's  
4 where we're stuck here.

5 MR. LEVEE: -- the -- and that's  
6 why -- let me lay out -- it's actually in  
7 the next slide, although I don't want to  
8 jump ahead.

9 ARBITRATOR KESSEDJIAN: I have a  
10 question.

11 HONORABLE JUDGE CAHILL: You have a  
12 different one?

13 MR. LEVEE: If you have a different  
14 one, let's go there. And the next slide  
15 answers the next question.

16 PRESIDENT BARIN: I assure you, you  
17 will have all the time you need.

18 MR. LEVEE: Turn off the watch.

19 HONORABLE JUDGE CAHILL: You have  
20 48 minutes.

21 PRESIDENT BARIN: We are asking you  
22 questions, but these are important  
23 questions, so . . .

24 MR. LEVEE: I've always encouraged  
25 you to interrupt.

1           ARBITRATOR KESSEDJIAN: Okay. So my  
2 question goes to your Slide Number 2 --  
3 if we could have it on the screen -- and  
4 your last -- actually, the slide on the  
5 screen is not the one we have in our --  
6 there's something missing --

7           HONORABLE JUDGE CAHILL: That's  
8 Number 2.

9           ARBITRATOR KESSEDJIAN: -- the last  
10 bullet.

11           That's it. That's it.

12           HONORABLE JUDGE CAHILL: I see. I  
13 see.

14           There I am.

15           ARBITRATOR KESSEDJIAN: So you are  
16 telling us that we do not have the  
17 mandate to review GAC's conduct?

18           MR. LEVEE: Correct.

19           ARBITRATOR KESSEDJIAN: Now, several  
20 questions: One, what is the legal  
21 basis -- where in the Bylaws, Articles of  
22 Incorporations or Guidebook do you see  
23 the basis for this assumption, for  
24 this --

25           MR. LEVEE: In the paragraph I quote

1 above and the paragraph on the next  
2 slide.

3 ARBITRATOR KESSEDJIAN: The  
4 paragraph above does not say what you  
5 say.

6 MR. LEVEE: Obviously, we're  
7 disagreeing.

8 ARBITRATOR KESSEDJIAN: What you're  
9 saying is that your interpretation of  
10 Article IV, 3, 2 --

11 MR. LEVEE: And -- and Article IV,  
12 3, 4, which is --

13 ARBITRATOR KESSEDJIAN: Where does  
14 it say?

15 MR. LEVEE: That's the next -- you  
16 can look. It's on the next page --

17 ARBITRATOR KESSEDJIAN: Okay --

18 MR. LEVEE: -- it says --

19 ARBITRATOR KESSEDJIAN: -- so your  
20 basis -- the legal basis for you is IV,  
21 3, 2 and IV, 3, 4?

22 MR. LEVEE: And, really, if you look  
23 in the entirety of Section IV -- so  
24 here -- why are we here today?

25 We're here because ICANN created

1           what we've -- you and I have had this  
2           discussion before -- ICANN created this  
3           very unusual process that says We're  
4           going to permit Independent Review Panels  
5           to evaluate things.

6                     ICANN's position is these are  
7           unique, we get to decide the rules.

8                     Now, to be clear, these rules were  
9           created with thousands of public  
10          comments, accountability panels, experts,  
11          all of that. It's not the Staff and I  
12          sitting in a room wishing for an outcome.

13                    But the decision was made to adopt  
14          this particular form of independent  
15          review.

16                    We could have adopted a form of  
17          independent review that specifically  
18          says, By the way, we're also going to  
19          review what the Staff does.

20                    That exact proposal is under  
21          consideration as we speak, but it's not  
22          what these Bylaws say.

23                    ARBITRATOR KESSEDJIAN: I have  
24          follow-up.

25                    Now I know what's your answer to my



1 first question.

2 My second question is, If it were  
3 true that the GAC's conduct cannot be  
4 reviewed by us, why in the world you ask  
5 Ms. Dryden to be a witness?

6 You were the ones who gave us the  
7 declaration, and it's because you did  
8 this that we went on and on and on  
9 discussing what the GAC was doing and  
10 what the processes in the GAC were --  
11 were done.

12 So I don't understand the rationale  
13 behind your procedure or strategy.

14 MR. LEVEE: I can tell you exactly.  
15 We had this exact discussion.

16 The application challenged the  
17 Board's decision to accept the GAC  
18 advice, and it said that the GAC advice  
19 was not consensus advice.

20 That was DCA's amended notice,  
21 which, by the way, was all I had at the  
22 time Ms. Dryden -- we had to make the  
23 decision.

24 I had a 25-page piece of paper that  
25 said, Here's what Mr. Buruchara had

1 written in an e-mail. He objected to GAC  
2 advice.

3 He wasn't at the meeting. He may or  
4 may not have been the GAC representative  
5 from Kenya. He may or may not have the  
6 authority to do what he was e-mailing  
7 about. But their notice said, Here's  
8 what we've got.

9 So I called Ms. Dryden. I said,  
10 This seems like an incomplete picture.  
11 Can you tell me what actually happened?  
12 And she did.

13 By submitting her declaration, I  
14 then explained to you that the Board  
15 should have had and did have confidence  
16 that what the GAC told the Board was  
17 accurate.

18 The GAC did issue consensus advice,  
19 according to Ms. Dryden.

20 We can debate -- I know the Panel  
21 will ultimately look at these issues  
22 fresh -- but Ms. Dryden's view is that  
23 it's not a close call.

24 She explained to you how you issue  
25 consensus advice and it was done.

1           That's why we gave you her  
2           declaration, to demonstrate that the  
3           Board's reliance on the GAC advice was --  
4           was a good thing, was accurate, was  
5           within its realm.

6           Because if I had given you no  
7           declaration and we had just this  
8           assertion that the GAC advice was not GAC  
9           advice, then I think it would be  
10          reasonable for somebody to say, Well, if  
11          the Board was on notice that the GAC  
12          advice was not, in fact, consensus  
13          advice, why didn't the Board do its own  
14          investigation?

15          ARBITRATOR KESSEDJIAN: Would you  
16          agree, nonetheless, that at least, as you  
17          say, as far as the Board's way of taking  
18          its decision, the GAC conduct is  
19          pertinent?

20          MR. LEEVEE: It is. I'm not  
21          suggesting that it's not.

22          ARBITRATOR KESSEDJIAN: Thank you.

23          HONORABLE JUDGE CAHILL: I think she  
24          did a better job than me.

25          Go ahead.

1           PRESIDENT BARIN: I just want to  
2 complete one circle coming back to  
3 Professor Kessedjian's question.

4           If you look at the last bullet  
5 point, where you say GAC conduct is not  
6 the proper subject of an IRP.

7           If I was to ask you to complete that  
8 sentence in saying GAC conduct is the  
9 proper subject of what review --

10          MR. LEVEE: In this instance,  
11 there's no specific accounting mechanism  
12 to challenge GAC advice that is  
13 separate -- in other words, the GAC  
14 issues advice, and no one does anything  
15 with it.

16          So take my previous example where  
17 the GAC says, I want to be involved in  
18 the creation of the New GTLD Program.  
19 Somebody might think that's a bad thing  
20 for governments to do. There would be no  
21 basis to challenge that.

22          The only basis would be when the  
23 Board adopts or does not adopt specific  
24 GAC advice, you are clearly free to look  
25 at the Board's decision. And in that

1           regard, if you were to find that the  
2           Board was on notice that the GAC just  
3           fell down, that there was no GAC needed,  
4           that the -- you know, that the  
5           representative of Kenya walked into the  
6           Board meeting and said, Wait a second, I  
7           was at the GAC meeting and I jumped up  
8           and down, and Ms. Dryden refused to  
9           recognize me when I tried to oppose the  
10          issuance of GAC advice, if those types of  
11          things had happened, then you would say  
12          maybe the Board didn't do due diligence  
13          because the applicant submits a response  
14          to the Board, and the Board reads it, and  
15          maybe the Board didn't do due diligence  
16          in evaluating it.

17                 Instead, what we know is what  
18          Ms. Dryden testified in her declaration  
19          and testified to the Panel, and she does  
20          attend the Board -- these meetings as a  
21          liaison. She's doesn't remember this  
22          particular meeting. I'm not surprised.  
23          She's attended literally hundreds of  
24          meetings during her tenure as the GAC  
25          Chair.

1           And while what brings us here today  
2           is important for all of us, what I heard  
3           her say yesterday was that there are a  
4           lot of other things that are also very  
5           important, much more complicated  
6           politically for her to deal with.

7           So I don't know that this was the  
8           most important thing that ever happened  
9           to her at the GAC.

10          PRESIDENT BARIN: So, in other  
11          words, if I was to say it in my way, the  
12          GAC decision and conduct is whatever it  
13          is, and it's not really reviewable or  
14          subject to any, if you will, analysis up  
15          until the time it's then put up to the  
16          Board?

17          And then the Board accepts it or  
18          approves it or acts on it --

19          MR. LEVEE: Yes.

20          PRESIDENT BARIN: -- at which point  
21          in time, it becomes something that has  
22          value, at which point in time, it becomes  
23          subject to the IRP?

24          MR. LEVEE: Yes.

25          HONORABLE JUDGE CAHILL: You require

1 actual notice to the Board if something  
2 is going wrong in the GAC, right?

3 MR. LEVEE: I didn't hear you.

4 HONORABLE JUDGE CAHILL: You would  
5 require -- for instance, Mr. Ali's  
6 arguing that the -- there was just this  
7 quiet, you know -- very quickly, it was  
8 approved -- the issue was tabled and  
9 there was consensus on it --

10 MR. LEVEE: Yes.

11 HONORABLE JUDGE CAHILL: -- and it  
12 basically sounds like it happened in a  
13 minute, but -- and that's one of the  
14 things he really has been hitting us on.

15 Does the Board -- you're saying that  
16 the Board doesn't know that or know that  
17 objection, then the Board is reasonable  
18 to accept the GAC's recommendation --

19 MR. LEVEE: What the Board in this  
20 instance had, it had a communiqué from  
21 the GAC saying we have issued consensus  
22 advice against the Application Number so  
23 forth. It then had Ms. Bekele's response  
24 to the GAC advice, 15 pages, in which she  
25 explains why she thinks the GAC advice

1           should not sway the Board and was  
2           improperly issued.

3           The Board then meets -- it has this  
4           information. It meets. It approved the  
5           GAC advice.

6           So the Board is not operating in a  
7           vacuum, say, taking the GAC advice and  
8           not listening to anybody else. It had a  
9           thorough response from the applicant that  
10          did not persuade the Board.

11          And Ms. Dryden -- one of the  
12          purposes of Ms. Dryden's declaration was  
13          to explain to you that the objection that  
14          DCA made was not, in fact, accurate.

15          ARBITRATOR KESSEDJIAN: Mr. LeVee,  
16          the Board has records and minutes?

17          MR. LEVEE: It does.

18          ARBITRATOR KESSEDJIAN: Do we have  
19          those in the binder?

20          MR. LEVEE: We do. They were in the  
21          binder I gave to you yesterday,  
22          the minutes of that particular meeting  
23          showing what the Board reviewed.

24          I'll get you the exhibit number.

25          But it's the minutes of the



1 meeting that show -- it's Exhibit R-1.  
2 It's the formal minutes of the ICANN NGPC  
3 meeting of June 2013, and it says what  
4 the Board looked at.

5 HONORABLE JUDGE CAHILL: So you  
6 would say, with all due respect to  
7 Mr. Ali, the fact that you think that the  
8 GAC operated unfairly is really  
9 irrelevant to what my job is to do here  
10 because you -- no matter what they did,  
11 they had the other side of the story?

12 MR. LEVEE: Okay. Let me come to it  
13 now. I was going to come to it later.

14 I have a completely different  
15 perspective of whether the GAC acted  
16 fairly or unfairly.

17 The GAC had an agenda that had been  
18 generated three weeks in advance of the  
19 meeting, according to Ms. Dryden's  
20 testimony yesterday. Three countries  
21 placed on the agenda their interest in  
22 having a consensus advice objection  
23 issued vis-a-vis DCA's application.

24 Ms. Dryden, her job is then to go  
25 through the agenda. She goes through the

1 agenda. Redacted - GAC Designated Confidential  
Information

13 We went from a few minutes to a  
14 nanosecond during Mr. Ali's closing --

15 HONORABLE JUDGE CAHILL: Fair  
16 enough.

17 MR. LEVEE: -- but whatever  
18 second -- however much time it takes, I  
19 don't think it takes a long time to  
20 register that no one opposes.

21 In fact, no one opposes. The  
22 request carries, at which time, there is  
23 applause in the room, according to  
24 Ms. Dryden. So people were paying  
25 attention.

1           So I think the GAC advice was issued  
2 exactly as it was supposed to be.

3           There isn't necessarily supposed to  
4 be tons of debate at the meeting. What  
5 Ms. Dryden said is we put these things on  
6 the agenda three weeks in advance so that  
7 the government officials can go back to  
8 their own countries and get instructions.  
9 And then they come to the meeting.

10           If there is consensus, it will be  
11 reflected at the meeting. There's  
12 nothing more to do. There's no debate to  
13 have.

14           Redacted - GAC Designated Confidential Information

19           We know Mr. Katundu, who is the  
20 representative from Kenya, he's  
21 physically in Beijing. He's physically  
22 attending GAC meetings. And all  
23 Ms. Dryden told you was, Look, I've got a  
24 lot of these meetings. There's 70 to 150  
25 people in the room. I can't tell you at

1 the moment whether he was there or not.

2 HONORABLE JUDGE CAHILL: So if the  
3 GAC -- Mr. Ali argues that the GAC  
4 procedures were flawed and the result was  
5 not fair, that's -- that, to you, no  
6 matter what the answer to that question  
7 is, we don't get to look at that?

8 MR. LEVEE: No, you don't --

9 HONORABLE JUDGE CAHILL: Okay.

10 MR. LEVEE: -- and there -- first of  
11 all, this is the first time I'm hearing  
12 that the notion of issuing consensus  
13 advice is unfair --

14 HONORABLE JUDGE CAHILL: He said the  
15 procedure -- the procedure is what he's  
16 talking about.

17 MR. ALI: -- but this is how the GAC  
18 has been operating since Ms. Dryden was  
19 involved in 2007. That's her testimony.

20 And there's no indication that the  
21 GAC has ever operated in any other  
22 fashion.

23 HONORABLE JUDGE CAHILL: Well, she  
24 said this is the first time that this was  
25 done this way.

1 MR. LEVEE: For gTLDs --

2 MR. ALI: Fair enough.

3 MR. LEVEE: -- the GAC has issued  
4 consensus advice many, many times.

5 It's the first time that a gTLD --  
6 and she also said there were several  
7 other gTLDs on the agenda, one of which  
8 got consensus advice, another of which  
9 did not.

10 ARBITRATOR KESSEDJIAN: Mr. LeVee,  
11 have you attended a GAC meeting ever?

12 MR. LEVEE: A long time ago, not  
13 recently.

14 ARBITRATOR KESSEDJIAN: Okay. So is  
15 my assumption correct that each  
16 government has a flag, has a --

17 MR. LEVEE: No. They actually made  
18 a decision some time ago not to have  
19 flags.

20 ARBITRATOR KESSEDJIAN: No, I mean  
21 flags -- something with their name or  
22 something with the name of the country.

23 MR. LEVEE: Like a name tag or a  
24 card?

25 ARBITRATOR KESSEDJIAN: Yeah.

1 MR. LEVEE: No, I don't think they  
2 even do that now. They didn't when I was  
3 there. I don't think they do that now.

4 Ms. Dryden knows everyone in the  
5 room.

6 ARBITRATOR KESSEDJIAN: So you  
7 answered the question that was coming.

8 MR. LEVEE: Yes.

9 ARBITRATOR KESSEDJIAN: So how do  
10 you reconcile that to the fact that she  
11 says that she didn't know whether Katundu  
12 was there or not? She knows everybody.  
13 She says it's the Chair's job to know  
14 everybody.

15 MR. LEVEE: She does know everyone.

16 I think Ms. Dryden was being  
17 incredibly honest. She was saying -- I  
18 wanted her to say, Wasn't he in the  
19 room --

20 ARBITRATOR KESSEDJIAN: I'm not  
21 asking you that. I'm not asking you to  
22 rehearse what she said.

23 MR. LEVEE: Why doesn't she  
24 remember? I think it's easy.

25 There are so many people in these

1 rooms -- she did not say one thing I wish  
2 she would have said, which is to explain  
3 that the GAC meeting sometimes go on for  
4 eight, 10, 12 hours. People are coming  
5 and going.

6 She did say that a lot of the real  
7 work of the GAC is done --

8 ARBITRATOR KESSEDJIAN: You should  
9 have been on the stand instead of her.

10 MR. LEVEE: She -- what she said was  
11 that people are coming and going, and a  
12 lot of the work is done outside.

13 When I asked her, when we were  
14 sitting together drafting her  
15 declaration, and I said, Can you place  
16 him in the room?

17 She said, Look, there are so many  
18 meetings that I cannot, at that meeting,  
19 say that he was there.

20 I know he didn't speak at the  
21 meeting because, if he did, I would  
22 remember that he was there.

23 But I have no fault for Ms. Dryden  
24 not remembering that a particular  
25 individual -- it turned out to be

1 important to us whether the  
2 representative from Kenya was in the room  
3 or not, but it was not something she  
4 would have known at the time to even look  
5 for.

6 HONORABLE JUDGE CAHILL: Okay. So  
7 the authority for us that we read, we  
8 have no power to evaluate what the GAC  
9 did is in what you have given us in  
10 Article IV, right?

11 PRESIDENT BARIN: Let me -- I just  
12 want to clarify one last question.

13 When the Board -- and the minutes  
14 are there. I've looked at them, but you  
15 can perhaps help -- when the Board looks  
16 at the consensus advice that's being put  
17 before it in this case for DCA Trust --  
18 and you earlier said, if I understood  
19 correctly, that there was, of course, the  
20 submission, if you will, of DCA Trust or  
21 its opposition --

22 MR. LEVEE: Yes.

23 PRESIDENT BARIN: -- that the Board  
24 was then able to compare, and then based  
25 on that, I believe your position was that



1           then the Board took its decision -- was  
2           the Board privy to also what happened in  
3           that meeting that Ms. Dryden was at and  
4           the particular facts or the explanations  
5           that she gave when that request was  
6           raised?

7           MR. LEVEE: The Board members would  
8           not ordinarily be attending the GAC  
9           meetings where those issues are  
10          addressed. They're actually excluded.

11          They attend other meetings.

12          So if you're asking whether Board  
13          members were in attendance, the answer  
14          would be no.

15          PRESIDENT BARIN: No.

16          Did the Board members ask questions  
17          from Ms. Dryden, who was there and who  
18          was the --

19          MR. LEVEE: They have the ability to  
20          do so.

21          Ms. Dryden's testimony was that she  
22          didn't remember that there was discussion  
23          or not. She just didn't remember.

24          PRESIDENT BARIN: And there's  
25          nothing reflected in the minutes?

1 MR. LEVEE: Correct.

2 ARBITRATOR KESSEDJIAN: Am I correct  
3 to think that the -- the NGPC had Ms.  
4 Bekele answer, so 15 pages?

5 MR. LEVEE: Yes.

6 ARBITRATOR KESSEDJIAN: And I see --  
7 I'm reading R-1.

8 MR. LEVEE: Yes. It's highlighted  
9 on Page 4 of 5 what the NGPC had before  
10 it.

11 Do you see that?

12 ARBITRATOR KESSEDJIAN: Okay.  
13 There's nothing highlighted in the copy I  
14 have, but it's okay. I will read it  
15 thoroughly.

16 MR. LEVEE: It is on Page 5. And  
17 I'm sorry that yours is not highlighted.

18 PRESIDENT BARIN: I can explain why.  
19 In your copy yesterday, I remember  
20 clearly it was highlighted. You were  
21 absolutely right, Mr. LeVee.

22 But then copies were made for us. I  
23 asked your colleague to make -- and these  
24 are probably the new copies that we got  
25 that don't have the highlighting, which

1 explains why.

2 MS. ZERNIK: That's a copy of all  
3 our exhibits.

4 ARBITRATOR KESSEDJIAN: So we should  
5 take the copy in the opening statement?

6 PRESIDENT BARIN: Right --

7 MR. LEVEE: That's the version  
8 that's highlighted.

9 PRESIDENT BARIN: -- and then you  
10 will have a highlighted version there.

11 MR. LEVEE: Okay.

12 ARBITRATOR KESSEDJIAN: Got it.

13 PRESIDENT BARIN: I just want to  
14 clarify this was the first -- the one and  
15 only time, in the case of a gTLD, that  
16 this issue of a consensus advice was  
17 being put up.

18 MR. LEVEE: It was the first and the  
19 second at the same meeting. In other  
20 words, there were two gTLDs that received  
21 consensus advice at that meeting.

22 It was the first time that the GAC  
23 had taken up any of the applications.

24 The -- the -- the applications were  
25 not published to the world until June of

1           2012.

2                   This was the GAC meeting in April of  
3           2013. It was the first time they had  
4           been, in essence, digesting and going  
5           through the applications.

6                   Subsequently, there had been more,  
7           but it was the first time that they had  
8           done this.

9                   PRESIDENT BARIN: Okay. So I'm  
10          going to put a very hard question to you.  
11          And I realize it's a hard question,  
12          Mr. LeVee, but I want to do it for the  
13          Panel and for what this Panel does.

14                   Do you think the Board did what it  
15          should have and it could in light of all  
16          the facts that it had when an application  
17          was put up for the first time for the  
18          gTLD with the actual, if you will, Chair  
19          of the gTLD being present at that -- at  
20          that Board meeting in arriving at the  
21          conclusion or the decision that it  
22          reached?

23                   MR. LEVEE: Absolutely.

24                   Now, you guys obviously have a very  
25          different perspective --

1           PRESIDENT BARIN: I don't want you  
2           to think we have any perspective, because  
3           at this point, we don't.

4           MR. LEVEE: I will be candid. You  
5           won't like my answer, but I don't view  
6           this as a close call. I know you do.

7           This is why I don't: The GAC has a  
8           process for issuing consensus advice. It  
9           does it all the time. Yes, this was the  
10          first time it issued consensus advice  
11          vis-a-vis a particular application, but  
12          it followed the policy that it always  
13          follows. Ms. Dryden laid that out for  
14          you.

15          You put an item on the agenda. It  
16          allows governments to deliberate. And  
17          then you do -- then you come at the  
18          meeting.

19          What happens at the meeting is what  
20          happens. And there are a lot of  
21          political reasons for that, because  
22          literally -- as she said, you're taking a  
23          decision at a place and time.

24          So I think what the GAC did was  
25          absolutely appropriate.

1           Did it have a consequence?  
2           Absolutely, it did. It was intended to.  
3           The Guidebook gave the GAC the ability  
4           that the GAC had not previously had,  
5           which was to give ICANN advice that ICANN  
6           was almost forced to take into account.

7           It created a -- a so-called "strong  
8           presumption." That language didn't exist  
9           previously with the GAC. The GAC had  
10          requested the ability to have that kind  
11          of influence over the course of  
12          several years of negotiating the  
13          Guidebook.

14          The GAC got that influence. It  
15          exercised that influence.

16          I -- the fact that it's the first  
17          time doesn't mean that -- that we ought  
18          to give it a bogey and say, Well, we  
19          really think you should do it again. I  
20          think they did it exactly how they were  
21          supposed to.

22          PRESIDENT BARIN: All right.  
23          Understood.

24          But how do you then reconcile, if  
25          you will, what we understood -- and,

1           again, subject to being corrected -- but  
2           the GAC end of it was perhaps, if you  
3           will, the consensus, the political, the  
4           endorsements, the views that were being  
5           expressed by Members that were there --

6           MR. LEVEE:   Yes.

7           PRESIDENT BARIN:  -- there is then  
8           what I call the sort of technical,  
9           financial, all of the ability and the  
10          time and know-how and the \$185,000 that  
11          goes into this application, all of that  
12          sort of gets by the wayside because you  
13          have a decision of the GAC that says --  
14          or a proposal by the GAC that says,  
15          Somebody raised their hand and said, This  
16          application should not go forward?

17          MR. LEVEE:  The answer to your  
18          question --

19          PRESIDENT BARIN:  I told you it was  
20          a tough question.

21          MR. LEVEE:  Again, I don't view it  
22          as a tough question.

23          -- the answer to your question is  
24          the Guidebook is very clear that any  
25          applicant that applies subject to GAC

1           advice -- any applicant could have put  
2           in years and years of time, passed all of  
3           the other evaluations, been the best TLD  
4           that anyone could have ever imagined for  
5           the entire world, and if the GAC issues  
6           advice that creates the strong  
7           presumption, the Board adopts it, that's  
8           how -- that's the rule.

9           You may say you don't like the rule.  
10          I get that.

11          But if ICANN is following the rule,  
12          what did it do wrong?

13          ARBITRATOR KESSEDJIAN: We don't  
14          contest that this is the rule. We  
15          contest the way -- I mean -- we contest.  
16          Sorry -- we -- we are puzzled at this --  
17          I am puzzled by the way it was done.

18          I see the rule. I'm totally with  
19          you with the rule. And it happens that I  
20          know, because I have studied the  
21          Guidebook for other cases, so I know what  
22          they are.

23          But what the perception is to this  
24          moment is that the accumulation of a  
25          number of hiccups in the process may end



1 up giving the conclusion that the -- the  
2 Bylaws -- the exact words in your  
3 Bylaws -- the ICANN Bylaws, that the  
4 process -- the processes must be fair,  
5 must be transparent, must be neutral.

6 I mean, you have set up -- the "you"  
7 being ICANN -- ICANN has set up for  
8 itself a very high standard --

9 MR. LEVEE: Yes, it has.

10 ARBITRATOR KESSEDJIAN: -- and what  
11 I am struggling with, because I don't  
12 want to speak for my colleagues, of  
13 course, on the Panel -- but what I'm  
14 struggling with is did -- in this  
15 particular case, did we respect those  
16 high standards?

17 And, you know, when you -- when you  
18 point out our attention to R-1 and you  
19 want us to be just satisfied by those  
20 three little paragraphs that say  
21 nothing -- I'm sorry, they say nothing  
22 that you have highlighted in the -- in  
23 the -- now I found the highlighted  
24 version -- how do you want us to -- to  
25 make a decision on this?

1           MR. LEVEE: But that's how ICANN  
2 does minutes. It does not do minutes by  
3 having a scribe write down what everybody  
4 says.

5           So there are so many meetings, so  
6 many decisions by the Board that ICANN  
7 literally -- and it's very public about  
8 what it does.

9           You would like for the minutes to  
10 say there was an objection, the Board  
11 talked about the consensus advice, the  
12 Board asked Ms. Dryden 50 questions, and  
13 there was an hour-long discussion.

14           I don't actually know whether any of  
15 that did or did not happen, but it gets  
16 encapsulated in the minutes. And that's  
17 what ICANN does.

18           ARBITRATOR KESSEDJIAN: I'm used to  
19 organizations who are more prolific in  
20 their --

21           MR. LEVEE: There are times where  
22 ICANN has transcripts, full Board  
23 meetings, various other meetings that do  
24 get posted. Not every meeting and not  
25 every NGPC meeting.

1           But let me posit one other scenario.  
2           I was going to save this for last, but --  
3           the fairness issue, I think, comes back  
4           to the question that you asked Ms. Bekele  
5           yesterday about the time and the effort  
6           and so forth that went into this.

7           I respect that. She did a lot of  
8           work. I get that.

9           And maybe the AUC took her idea and  
10          made it its own. And -- and that's too  
11          bad.

12          I don't see anything in the  
13          Guidebook that tells me they couldn't do  
14          that.

15          But there's one thing that we do  
16          know, which is that Ms. Bekele knew that  
17          she had lost the AUC support. She goes  
18          ahead and applies, and she submits with  
19          her application the 2009 letter from the  
20          AUC. But she knew in 2011 that the AUC  
21          had stopped supporting her -- actually,  
22          she knew in 2010. She asked for a  
23          reinstatement in 2011. She didn't get  
24          it.

25          One question you might ask is, Why

1 did she proceed?

2 Did she believe in good faith that  
3 she had the ability to get 60 percent of  
4 the countries of Africa to support her  
5 when the AUC, which was her main trump  
6 card at the beginning, had withdrawn the  
7 card to go elsewhere?

8 So fairness is in the eyes of the  
9 beholder. My only point is that ICANN --  
10 and it's in the rest of the slides. I'll  
11 try to get through them -- ICANN did  
12 treat the applicants equally pursuant to  
13 the terms of the Guidebook.

14 When -- it wasn't ICANN that said Go  
15 to the GAC. There's no evidence of that.  
16 It wasn't ICANN that put the AUC on the  
17 GAC. It wasn't -- and by the way, the  
18 AUC didn't even put the issue on the  
19 GAC's agenda.

20 Redacted - GAC Designated Confidential Information

24 MR. LEVEE: -- so the GAC then  
25 issues consensus advice. None of this

1 has happened as a result of a single  
2 thing that ICANN did.

3 The only piece of evidence that --  
4 that DCA has ever pointed to is  
5 Dr. Crocker's letter, which I am more  
6 than happy to rely on, because it  
7 factually says what the Guidebook says.

8 So ICANN did not maneuver this.  
9 What happened is that the AUC decided to  
10 support one particular proposal. It  
11 issued an RFP. DCA didn't respond -- she  
12 explained her view as to why she did  
13 that -- and then it submits an  
14 application.

15 And the countries of Africa then  
16 say, Well, we want to support the AUC.  
17 Sixteen of them issue Early Warning  
18 notices that say we want what the AUC is  
19 doing.

20 ARBITRATOR KESSEDJIAN: Mr. LeVee,  
21 there's something that I don't understand  
22 what you just said to us.

23 The AUC is not an applicant.

24 MR. LEVEE: They supported an  
25 applicant.

1           ARBITRATOR KESSEDJIAN: Well, they  
2 supported an applicant but they are not  
3 an applicant --

4           MR. LEVEE: Correct.

5           ARBITRATOR KESSEDJIAN: -- and that  
6 makes a fairly strong difference.

7           There's another thing that you are  
8 not saying here, as Ms. Bekele testified  
9 yesterday, that -- and it is in her  
10 written statement, so we didn't hear it  
11 yesterday, that ICANN went to Africa -- I  
12 don't remember the country, Dakar or  
13 whatever -- explained to a bunch of  
14 people in the room how to do it -- they  
15 didn't know how to do it, so how to do  
16 it -- bypassing DCA.

17           The person from ICANN, the employee  
18 from ICANN got a reprimand, got a  
19 novation -- I don't know how Ms. Bekele  
20 characterized the whole thing. I call it  
21 a reprimand.

22           So you are saying here ICANN didn't  
23 do anything, ICANN is a virgin. But I  
24 hear from the other side, that, in fact,  
25 ICANN did a number -- again, the

1 impression I get -- and I hope you  
2 understand my point. I'm trying the best  
3 I can to be fair myself.

4 And, therefore, what I'm hearing is  
5 every single step may not -- as of  
6 itself, if it were isolated, may not be  
7 of such a nature to actually trigger a  
8 problem for ICANN, but it's the  
9 accumulation of everything, the fact that  
10 DCA has not been called to certain  
11 meetings where they should have been  
12 called, the way they have been treated,  
13 the fact that -- I mean, I have not heard  
14 from you -- of course, we have asked you  
15 a lot of questions, so you were not  
16 able -- but that is the one question I  
17 would like you to address.

18 Madam Bekele said yesterday that  
19 even ZACR didn't have the proper support.

20 So why is ZACR treated one way and  
21 DCA is treated another way?

22 MR. LEVEE: It is in the slides, but  
23 let me -- let me respond to the one thing  
24 about ICANN going to Africa with a  
25 proposal.

1 I also heard the testimony  
2 yesterday. If we were in a court of law,  
3 as you know, none of that testimony gets  
4 admitted. It's entirely hearsay.

5 I have no way of challenging it.  
6 There's not a single piece of paper that  
7 anyone has produced -- not in our files,  
8 and DCA didn't produce it -- that says  
9 that ICANN, in the fall of 2011, went to  
10 Africa and said, Here's how you do it,  
11 you get a reserve name.

12 All I know is that when the AUC  
13 asked ICANN formally to reserve the name,  
14 ICANN said no.

15 So I'll be candid. That testimony  
16 is very puzzling to me. I, personally,  
17 have no basis to credit it because  
18 there's not any corroborating evidence --

19 PRESIDENT BARIN: But --

20 MR. LEVEE: -- and even if it  
21 occurred, what I don't know is did  
22 ICANN -- like, when Mr. -- when  
23 Dr. Crocker, Chairman of the Board of  
24 ICANN, writes a nine-page letter to the  
25 African Union answering all of their



1 requests, not giving them what they want,  
2 but telling them a bunch of other things,  
3 that letter is 100 percent accurate.

4 What I don't know is if there was a  
5 meeting of people who I never met -- so I  
6 don't know who they are, other than the  
7 possibility that someone from the AUC  
8 then reported it -- I don't know if that  
9 person from the AUC was at the meeting,  
10 but then they reported it, apparently, to  
11 Ms. Bekele -- I don't know if the same  
12 basic presentation wasn't given, which  
13 is, if Africa wants to have a name, there  
14 are ways of going about doing that, which  
15 would have been a completely factually  
16 based presentation.

17 I simply don't know.

18 What I do know is this: There's no  
19 reason that one particular applicant  
20 should be the only applicant. Ms. Bekele  
21 acknowledged that there was nothing  
22 improper for the AUC to sponsor ZACR for  
23 their application. And I don't know -- I  
24 just -- I don't understand why that  
25 alleged event causes anyone to feel that

1 something happened that was unfair.

2 If ICANN communicated factually, we  
3 have a New GTLD Program. It's about  
4 to -- our application window is about to  
5 open. If you are interested, we're happy  
6 to come talk to you.

7 What's wrong with that?

8 Nothing.

9 So I also hear --

10 ARBITRATOR KESSEDJIAN: Do you do  
11 that with all applicants?

12 MR. LEVEE: Any applicant that  
13 wanted information, absolutely. People  
14 ask questions of ICANN -- ICANN provided  
15 a ton of information in addition to the  
16 Guidebook.

17 ARBITRATOR KESSEDJIAN: Do you meet  
18 with potential applicants?

19 MR. LEVEE: ICANN would -- I don't  
20 remember meetings.

21 There were -- I don't attend. I  
22 know Amy is not -- my understanding is  
23 that anyone that had questions about the  
24 application process, a letter to apply,  
25 did, in fact, and was encouraged to, meet

1 with ICANN.

2 And, in fact, some of the senior  
3 officials of ICANN went all over the  
4 world explaining to people what this  
5 program was. There was a whole  
6 communications program that ICANN adopted  
7 to let people know about this program,  
8 because they wanted people to apply.

9 And ICANN has gotten some prominence  
10 now, but back in 2011, nobody knew  
11 anything about ICANN. So it was trying  
12 to get people aware of this opportunity.

13 And if ICANN went to Africa and said  
14 to people in those countries that they  
15 have the ability to apply for a domain  
16 name, including .africa, that would have  
17 been a good thing, not a bad thing.

18 PRESIDENT BARIN: I'm very mindful,  
19 Mr. LeVee, that you have to -- that  
20 you've got slides that you want to go  
21 through.

22 So, please, do you want to take a  
23 few minutes to gather your thoughts or  
24 just go?

25 MR. LEVEE: No; I'm fine.

1 I'm fine. Let's keep moving.

2 PRESIDENT BARIN: I do want you to  
3 get to the end of your --

4 MR. LEVEE: Yeah.

5 HONORABLE JUDGE CAHILL: Sorry. But  
6 we're clear that the authority that we  
7 have not the ability to review the GAC is  
8 in the slides you gave us, right?

9 MR. LEVEE: Yes.

10 So this provision and the previous  
11 slide, that's the authority that says you  
12 look at what the Board has done, and then  
13 it says here, The IRP Panel must apply a  
14 defined standard review to the IRP  
15 request focusing on -- and then those --  
16 the three things that I'm not going to  
17 read in full.

18 Then -- and, Professor Kessedjian,  
19 you asked, Well, what about Paragraph 11,  
20 a little bit farther down, which says,  
21 The IRP Panel shall have the authority  
22 to: c., declare whether an action or  
23 inaction of the Board was consistent  
24 [verbatim] with the Articles of  
25 Incorporation or Bylaws --

1                   ARBITRATOR KESSEDJIAN: That was the  
2 Chair.

3                   MR. LEVEE: Oh, it was the Chair.  
4 My apology.

5                   -- and the answer is absolutely,  
6 there's no inconsistency. You do have  
7 the ability to declare whether an action  
8 or inaction of the Board was inconsistent  
9 with the Bylaws.

10                  What Paragraph 4 is doing is -- we  
11 want you to focus on these three things,  
12 but you have every right -- if the Board  
13 makes a decision, you have every right to  
14 declare that decision, in your view,  
15 right or wrong, as in consistent or  
16 inconsistent with the Bylaws.

17                  I'll note that in Paragraph d -- I  
18 don't have a slide for this, I  
19 apologize -- the Panel -- and by the way,  
20 Paragraph 11 is the authority of the  
21 Panel, what you have the authority to  
22 do --

23                  ARBITRATOR KESSEDJIAN: It's  
24 Paragraph 11 of the Bylaws?

25                  MR. LEVEE: Correct, we're in the

1 Bylaws. It's Article IV, Section 3.

2 ARBITRATOR KESSEDJIAN: Yes.

3 MR. LEVEE: And this is what the  
4 Panel has the authority to do.

5 You asked Mr. Ali, to come back,  
6 Well, what do you want us to do? This  
7 paragraph tells you what you have the  
8 authority to do.

9 And in d., it says that you can  
10 recommend that the Board stay any action  
11 or decision or that the Board take any  
12 interim action until such time as the  
13 Board reviews and acts upon the opinion  
14 of the IRP.

15 I'm not going to get into, today,  
16 the question of whether it's binding --  
17 your Panel's declaration is binding or  
18 not. You've already made a preliminary  
19 ruling on that. We don't have to discuss  
20 it --

21 HONORABLE JUDGE CAHILL: Yeah,  
22 whatever.

23 MR. LEVEE: -- my point is that  
24 these are the specific things that the  
25 Panel is authorized to do. And I do urge

1           you to look at Paragraph 11 when you make  
2           the decision.

3           One other thing that we now have --

4           HONORABLE JUDGE CAHILL: Let me  
5           ask -- sorry -- Mr. Ali makes the  
6           argument that there's an obligation in  
7           the Bylaws of ICANN for transparency,  
8           accountability, fairness and equitable  
9           treatment.

10          Does that apply to the GAC?

11          MR. LEVEE: No.

12          I think the GAC tries to do all of  
13          those things, but I don't think it's  
14          bound to do any of those things.

15          HONORABLE JUDGE CAHILL: Okay.

16          MR. LEVEE: We have a declaration  
17          that another IRP Panel made in March.  
18          And I don't view any IRP decision as  
19          binding, but the Articles do say that  
20          they are -- that they do provide  
21          precedent and -- much like developing  
22          case law.

23          We have a decision in the  
24          Booking.com matter, and, basically, what  
25          it says that it's not for the Panel to

1           opine on whether the Board could have  
2           acted differently. The IRP Panel's role  
3           is to assess whether the actions of the  
4           Board were consistent with the applicable  
5           rules found in the Bylaws -- Articles,  
6           Bylaws and Guidebook. Nor, as stated, is  
7           it for us to purport to appraise the  
8           policies and procedures established by  
9           ICANN in the Guidebook.

10           And my point here is simply, it's  
11           easy to second-guess anything that's in  
12           the Guidebook and wish that something was  
13           done differently. Indeed, the  
14           Booking.com Panel raised questions for  
15           ICANN to look at for the next Guidebook.  
16           And there will be another one some -- a  
17           few years for the next round.

18           But the Panel made it clear, We're  
19           going to look at the current Guidebook;  
20           we're going to look at ICANN's conduct  
21           vis-a-vis the current Guidebook.

22           And all I would ask this Panel is to  
23           do the same.

24           PRESIDENT BARIN: Can I then maybe  
25           stop you for a second?



1           MR. LEVEE: You can stop me anytime.

2           PRESIDENT BARIN: I did take the  
3 time to read, at your suggestion,  
4 particularly when you introduced it at --  
5 as an exhibit, if you will, in this case,  
6 this very paragraph in the Booking.com  
7 case.

8           I would need your help, Mr. LeVee,  
9 to reconcile the bold sentence that you  
10 have put there that says, In other  
11 words -- well, I think you have to start  
12 from That -- that -- That being said, we  
13 also agree with ICANN to the extent that  
14 in determining the consistency of Board  
15 action with the Articles, Bylaws and  
16 Guidebook.

17           Now, an IRP Panel is neither asked  
18 to, nor allowed to. The "asked to," I  
19 understand.

20           The "nor allowed to substitute its  
21 judgment for that of the Board," in other  
22 words, it is not for the Panel to opine  
23 on whether the Board could have acted  
24 differently than it did, how would you  
25 then reconcile that with 11.c. of the

1 Bylaws, which says, to you, The IRP shall  
2 have the -- the authority to declare  
3 whether an action or inaction of the  
4 Board was consistent or inconsistent with  
5 the Articles of Incorporation or Bylaws?

6 MR. LEVEE: I think they say exactly  
7 the same thing.

8 PRESIDENT BARIN: So do you agree  
9 that the Panel can decide whether there  
10 was an action or inaction?

11 MR. LEVEE: Oh, absolutely.

12 PRESIDENT BARIN: Okay. I don't get  
13 quite the same thing, then, from what the  
14 Booking.com, the bolded sentence --

15 MR. LEVEE: What I think the Panel  
16 in Booking was saying is that the  
17 applicant in Booking said, We think  
18 that -- it was a string similarity case.  
19 ICANN had a vendor that determined that  
20 .hotels, H-O-T-E-L-S, and .hoteis,  
21 H-O-T-E-I-S, were so similar that they  
22 should not be both put into the Internet  
23 root.

24 Booking did not like the process  
25 that the Guidebook had established for

1 the string similarity test. And Booking  
2 said, You know, we have our own expert,  
3 and he comes to a different conclusion.

4 What the Panel said was, We're not  
5 going to opine as to whether the Board  
6 could have set up things differently or  
7 whether, in this instance, the Board  
8 could have done something differently.

9 In that case, the Board didn't even  
10 review the decision. String similarity  
11 Panel said, These two are two confusingly  
12 similar. And under the Guidebook, it's  
13 automatically disqualifying for both.  
14 One of them will get to proceed, but not  
15 both.

16 So there was, actually, not even  
17 Board action. But what Booking was  
18 arguing -- that's the reason for the  
19 language -- Booking was saying, You  
20 should find that the process that the  
21 Board established was inconsistent with  
22 the Bylaws.

23 And the Panel said, No, we're not  
24 going to second-guess what the Board did.  
25 You could -- you could have set it up

1           differently, but the way you set it up  
2           was consistent with the Guidebook and the  
3           Articles and the Bylaws.

4           PRESIDENT BARIN: Yeah. And I guess  
5           the point is that a Panel is entitled to  
6           do that. But when you look at a  
7           situation objectively, what I was trying  
8           to point out to you is that 11.c., for  
9           example, says that the Panel can decide  
10          whether there was an inaction on the  
11          Board -- on the part of the Board,  
12          "inaction" meaning it could have done  
13          things differently.

14          MR. LEVEE: I see what you're --  
15          you're focusing on the word "inaction"?

16          PRESIDENT BARIN: Right.

17          MR. LEVEE: I understand.

18          If -- if you think, in this  
19          instance, that the Board had a duty to do  
20          something and it didn't, then I think  
21          that is an inaction.

22          We've had difficulty with the word  
23          "inaction" over the years because there  
24          are frequently situations where people  
25          write letters to ICANN, I'm unhappy, my

1 domain doesn't work, and ICANN does  
2 nothing, because it's not something ICANN  
3 does. It doesn't deal with people whose  
4 computers don't work.

5 And people say, We're going to  
6 initiate an IRP, it's a Board inaction.  
7 We say No, No. It's not a Board  
8 inaction, because there's no duty to act.

9 Here, I agree, the word "inaction"  
10 is in the Bylaws, and if you find an  
11 inaction where you felt there was an duty  
12 to act, then I think you have  
13 the -- the -- the legal ability under the  
14 Bylaws to so say.

15 PRESIDENT BARIN: Thank you.

16 MR. LEVEE: Okay. So here's what  
17 I'm going to do: I'm going to cut this  
18 short by doing it this way:

19 I'm not going to discuss -- I will  
20 explain to you what I'm going to do. I  
21 had -- at the back of the opening -- of  
22 my closing exhibit slides, I repeated the  
23 five assumptions that I made, and then I  
24 consolidated my responses to them.

25 I'm not going to cover that. Some

1 of them I've already done.

2 I'm going to leave you -- you guys  
3 are reading everything --

4 ARBITRATOR KESSEDJIAN: We have --  
5 we have it.

6 MR. LEVEE: -- you have it. You can  
7 look at it.

8 PRESIDENT BARIN: That I can assure  
9 you, we do read and have read --

10 MR. LEVEE: It's clear --

11 PRESIDENT BARIN: -- everything that  
12 you've given us --

13 MR. LEVEE: -- it's clear.

14 HONORABLE JUDGE CAHILL: --  
15 especially here.

16 MR. LEVEE: -- what I do want to  
17 do is -- and I will do this briefly -- go  
18 to DCA's opening Slide 9.

19 So, again, just as a reminder, DCA's  
20 opening Slide Number 9 was the slide that  
21 is entitled Summary of ICANN's Actions in  
22 Breach of the Bylaws.

23 HONORABLE JUDGE CAHILL: That  
24 Number 5 -- oh, their 9.

25 MR. LEVEE: Their Number 9.

1           PRESIDENT BARIN: I'm not following  
2           you.

3           Hold on one second.

4           MR. LEVEE: It's from yesterday,  
5           their opening, their Slide Number 9.

6           You don't even have to go find it --  
7           it's Slide 9.

8           ARBITRATOR KESSEDJIAN: That's  
9           DCA's, not ICANN's? DCA's?

10          MR. LEVEE: Yeah, DCA's.

11          This is what Mr. Ali and his  
12          colleagues allege were the breaches --

13          PRESIDENT BARIN: Right.

14          MR. LEVEE: -- and I just want to go  
15          through those.

16          So if you turn to the next slide,  
17          Slide 6, right at the top, I'm repeating,  
18          at the top, so DCA, colon, this is what  
19          they say on Slide 9 --

20          ARBITRATOR KESSEDJIAN: It's each of  
21          the bullets --

22          MR. LEVEE: Correct, the --

23          ARBITRATOR KESSEDJIAN: -- of DCA's  
24          slides --

25          MR. LEVEE: Correct.

1 ARBITRATOR KESSEDJIAN: -- so this  
2 is Slide 9, first bullet?

3 MR. LEVEE: Correct.

4 PRESIDENT BARIN: Sorry. Just one  
5 minute.

6 Can you help me? I'm not following.

7 HONORABLE JUDGE CAHILL: Here.

8 ARBITRATOR KESSEDJIAN: You take  
9 Slide 9 of DCA of the -- of the opening?

10 HONORABLE JUDGE CAHILL: The  
11 opening?

12 ARBITRATOR KESSEDJIAN: Okay. Got  
13 it.

14 So each bullet is the title of --

15 PRESIDENT BARIN: Great. Thank you.

16 MR. LEVEE: Okay.

17 I'll run through these fairly  
18 quickly because, to some degree, I think  
19 I've already done it.

20 The first allegation of the Bylaws  
21 breach was that the Board directed the  
22 AUC on using the GAC to quash DCA's  
23 competing application.

24 I've already told you and Ms. Dryden  
25 told you that ICANN has no authority over



1 GAC membership.

2 By the way, we were requested to  
3 produce, and we did produce, every  
4 communication between the GAC relating in  
5 any way to the AUC, relating in any way  
6 to .africa. There is no evidence of some  
7 correspondence or conspiracy.

8 The only evidence was Dr. Crocker's  
9 letter, Exhibit C-24.

10 I'm not going to go through it.  
11 It's on the next slide.

12 The guts of the letter say, you want  
13 to reserve .africa. You can't. But the  
14 countries of Africa can have significant  
15 influence over the outcome. Of course,  
16 they could. Any string that was going to  
17 be named Africa had to have support of  
18 60 percent of the governments.

19 Now, Dr. Crocker did not say, Go  
20 join the GAC. He did not say, And when  
21 you do, you can issue -- get the GAC to  
22 issue consensus advice.

23 It's not in the letter, and there's  
24 no evidence of any other communication  
25 saying the same.

1           So I skipped the next slide because  
2           that was just discussing the letter.

3           Second, DCA alleges as a breach that  
4           the NGPC failed to investigate the many  
5           overt indications that the GAC advice was  
6           not consensus advice.

7           I think I covered this in some  
8           considerable amount in answers to earlier  
9           questions. But Ms. Dryden told you how  
10          consensus advice works.

11          You may not like that. You may wish  
12          that the -- that the people had to speak  
13          at length before consensus advice would  
14          be issued. But the GAC has a process,  
15          and the process worked.

16                   Redacted - GAC Designated Confidential Information

24           Now, if you turn to the next slide,  
25           Section 3.1 of the Guidebook provides

1           that the GAC advice is intended to  
2           address applications that are identified  
3           by governments to be problematic, e.g.,  
4           that potentially violate national law or  
5           raise sensitivities.

6           The Panel had questions yesterday as  
7           to what that means, problematic,  
8           violating national law, raising  
9           sensitivities.

10          Now, the GAC advice can be raised  
11          with respect to any application that a  
12          government, for whatever reason, deems  
13          problematic. We've heard that there are  
14          no restrictions for which GAC advice may  
15          be issued.

16          And the GAC is not required to  
17          provide a rationale.

18          But we know something else. We know  
19          that 16 individual African governments  
20          had issued Early Warning notices. And in  
21          those notices, they said they want  
22          .africa to be managed by the AUC for the  
23          benefit of the African region.

24          That was the reasons that they gave  
25          for issuing the Early Warning notices,

1 and that clearly falls within the  
2 sensitivities that would be perfectly  
3 appropriate for the GAC to issue  
4 consensus advice.

5 Now, as Ms. Dryden explained, the  
6 GAC doesn't give a rationale. There's no  
7 appendix. So it -- it doesn't feel that  
8 it has to do that.

9 But we know that the governments,  
10 themselves, that issued the  
11 Early Warnings, they very much had a  
12 rationale.

13 Finally -- you have to turn to the  
14 next slide -- DCA, in the opening  
15 statement, says that the NGPC failed to  
16 investigate these indications and that  
17 the Committee itself should have done  
18 more.

19 Let's be clear that when the -- when  
20 ICANN's Board received the consensus  
21 advice, it created a, quote/unquote,  
22 strong presumption that DCA's application  
23 should not proceed.

24 The New gTLD Committee acted in  
25 accordance with the Bylaws; it acted in

1           accordance with the Guidebook; it  
2           reviewed the materials that Ms. Bekele  
3           submitted; and it made a decision.

4           Now, the Guidebook also says that  
5           the Board may consult with an independent  
6           expert. And DCA has argued that we  
7           should have. I get that.

8           But nothing an independent expert  
9           would have done here would have addressed  
10          DCA's main concern, which was that they  
11          did not think the consensus advice, in  
12          fact, was consensus.

13          No independent expert, somebody who  
14          didn't even attend the meeting, could  
15          have shed light on that issue.

16          So where the Board has discretion  
17          whether to retain an expert, the failure  
18          to do so in an instance where the  
19          applicant can't even tell you what  
20          exactly the expert could have shed light  
21          on can't possibly be a violation of the  
22          Guidebook.

23          The next bullet in the opening was  
24          that ICANN Staff improperly coordinated  
25          with the Geo Names Panel.

1           First, we haven't heard any  
2           connection to the Board on this, only  
3           that the Staff interacted, but let's get  
4           past that.

5           The evidence presented by DCA  
6           actually disproves the notion that ICANN  
7           coordinated with the AUC with respect to  
8           .africa.

9           If there was coordination, surely,  
10          ICANN would have said right at the outset  
11          that the AUC's support was sufficient for  
12          60 percent name -- 60 percent support  
13          requirement. Instead, there was a lot of  
14          back-and-forth, by the way, applied to  
15          both applicants.

16          Why? Because DCA had submitted the  
17          2009 letter of support, even though that  
18          support had been withdrawn.

19          There was great confusion as to who  
20          AUC was supporting. So, yes, it did take  
21          a long time to sort out who we're going  
22          to talk to, what we're going to ask and  
23          what we're going to accept.

24          If the AUC's support had been  
25          counted right off the bat, the AUC's

1 endorsed candidate, ZACR, would have  
2 passed the Geo Names review almost  
3 immediately. And, by the way, DCA would  
4 have then failed at that same time.

5 Instead, the process was -- took a  
6 long time. By the way, ICANN received  
7 1930 applications. They weren't staffed  
8 to be prepared to process that many, and  
9 it did take a long time to evaluate.

10 DCA argued (but provided no actual  
11 evidence) that ICANN received the ICC's  
12 recommendation to count the AUC's  
13 endorsement only after the GAC advice was  
14 accepted by ICANN's Board.

15 We have already given to you in our  
16 briefs -- and this is part of the reason  
17 I -- I just didn't accept all of these  
18 arguments yesterday, because it's  
19 literally addressed in two pages of all  
20 of the briefing that DCA submitted.

21 We responded in our brief. It's on  
22 Page 23. We cite an exhibit, C-R-16, and  
23 others. We make it clear that ICANN  
24 accepted the ICC's recommendations  
25 sometime before April 26, 2013, while

1 DCA's application was still pending.

2 So the timing is not nefarious. The  
3 timing is not evidence that we're trying  
4 to support one or the other. The timing  
5 reflects that it takes time.

6 Moving along. The next bullet  
7 continues that ICANN Staff improperly  
8 coordinated with the Geo Names Panel.

9 The evidence that you have been  
10 provided makes it clear that the Staff  
11 expressed concern that both applicants for  
12 .africa be treated equally and be given the  
13 same opportunity to demonstrate the  
14 requisite support.

15 Now, ultimately, this issue then  
16 becomes irrelevant for DCA, because the  
17 DCA's application didn't proceed once the  
18 Board accepts the GAC advice.

19 Nothing that the Geo Names Panel could  
20 ever have done would have changed that.

21 Now, I do want to address -- you  
22 asked, this morning, the Panel -- there was  
23 a reference that you could submit stuff  
24 later.

25 And there's two slides in the -- in



1 the closing that Mr. Ali gave you, and I  
2 wanted to just note that it's not the case  
3 that you could submit your application and  
4 then have some unlimited amount of time to  
5 go get support of the governments.

6 What these slides were saying -- it  
7 says --

8 HONORABLE JUDGE CAHILL: Which ones  
9 are they?

10 MR. LEVEE: I'm on 31 and 32 --

11 HONORABLE JUDGE CAHILL: Thank you.

12 ARBITRATOR KESSEDJIAN: Of the  
13 closing?

14 MR. LEVEE: -- of Mr. Ali's closing.

15 PRESIDENT BARIN: Sorry.

16 When you say 31 and 32, I have only  
17 got Page 27.

18 HONORABLE JUDGE CAHILL: Well, I've  
19 got 27.

20 ARBITRATOR KESSEDJIAN: That must be  
21 the opening.

22 MR. LEVEE: And you have the  
23 opening?

24 PRESIDENT BARIN: No; I have the  
25 closing.

1 HONORABLE JUDGE CAHILL: No. The  
2 closing is Page 27.

3 MR. LEVEE: I have, at the bottom,  
4 Slide 31.

5 ARBITRATOR KESSEDJIAN: So that must  
6 be the opening.

7 MR. LEVEE: My apology. You are  
8 correct. This is the opening.

9 PRESIDENT BARIN: So it's the  
10 opening?

11 HONORABLE JUDGE CAHILL: You were  
12 just testing us.

13 MR. LEVEE: I'm testing myself, I  
14 think.

15 HONORABLE JUDGE CAHILL: This is  
16 what you're talking about (indicating)?

17 PRESIDENT BARIN: We're still alert.

18 MR. LEVEE: Now --

19 HONORABLE JUDGE CAHILL: This one  
20 (indicating) is what you're talking  
21 about?

22 MR. LEVEE: Correct.

23 HONORABLE JUDGE CAHILL: Okay.

24 MR. LEVEE: -- Slide 31 address a  
25 situation where an application for a

1 string representing a name -- if there's  
2 more than one application, and the  
3 applications have the requisite  
4 government approvals -- so you have a  
5 situation where two applicants each have  
6 the requisite Government approvals.  
7 That's not this case.

8 The AUC did -- was not endorsing  
9 DCA's application on the day Ms. Bekele  
10 submitted it. And although she submitted  
11 it, it -- this paragraph has nothing to  
12 do with these facts.

13 Only if the two applicants both had  
14 the requisite support would you then set  
15 it aside.

16 The next page, Slide 32 from the  
17 opening yesterday, is the other provision  
18 that Mr. Ali said gives me more time --  
19 gives DCA more time.

20 This is, again, only in a situation  
21 where the applicant has not provided the  
22 required documentation. The applicant  
23 will be contacted and given additional  
24 time.

25 So, as you know, the support letters

1 had to say certain things. The AUC's  
2 original support didn't, so, ultimately,  
3 it had to be corrected.

4 If an applicant submits  
5 documentation, but it's not the required  
6 documentation, ICANN said, Look, we're  
7 going to give you some more time. You  
8 can go have additional time and -- and  
9 get us the language that is correct.

10 Again, that's not the issue for DCA.  
11 It's not that she had or -- had all of  
12 the documentation submitted and the  
13 documents were wrong; it's that she did  
14 not actually have the support of the  
15 governments or the AUC that she said.

16 I'm almost done.

17 PRESIDENT BARIN: You can take your  
18 time, Mr. LeVee.

19 MR. LEVEE: The next bullet was  
20 the -- DCA argued that the Staff drafted  
21 a passing letter of endorsement for  
22 ZACR's application.

23 I want to be clear. This was  
24 entirely appropriate. There's absolutely  
25 nothing wrong with ICANN and an entity

1           that wants to support an application  
2           working together to write the correct  
3           words.

4           It sounds -- they make it sound  
5           nefarious, but it's also appropriate if  
6           the entity is struggling to figure out  
7           how to do it.

8           There's a sample attached to the  
9           Guidebook but nothing untoward.

10          But even more importantly, it just  
11          doesn't matter here, because DCA's  
12          application had already been stopped.  
13          And so it doesn't affect the evaluation  
14          of DCA's application.

15          Finally, there's a bullet that says  
16          that BGC failed to undertake an  
17          independent investigation.

18          I've quoted in this slide the  
19          provision of the Bylaws that says what  
20          the BGC is supposed to do. It then  
21          issued an 11-page recommendation saying  
22          that DCA had not met the standard.

23          I want to emphasize one thing.  
24          DCA's request for consideration focused  
25          on one topic, the Board's decision not to

1 get an expert.

2 DCA's reconsideration did not raise  
3 the GAC advice issue. It did not raise  
4 the conflict of interest issue. So there  
5 was nothing for the BGC to do.

6 DCA said, We want you to reconsider  
7 and, in doing so, we think you ought to  
8 get an expert.

9 BGC said, No. You haven't told us  
10 what an expert could say.

11 The very last bullet.

12 DCA argued yesterday that the New  
13 gTLD Program Committee reviewed and  
14 approved its own decision. And that's  
15 what happened, and I want to tell you  
16 why.

17 The Bylaws provide that the BGC is  
18 to review all reconsideration requests.

19 For reconsideration requests that  
20 involve Board action, as opposed to Staff  
21 action -- that's what happened here,  
22 Board action -- the BGC does not make the  
23 final determination; it makes a  
24 recommendation to the Board.

25 But something else had happened

1 here, which is that the Board had created  
2 the New gTLD Program Committee consisting  
3 of Members who did not have a conflict  
4 relative to the program.

5 ARBITRATOR KESSEDJIAN: There's so  
6 many acronyms.

7 MR. LEVEE: Way too many. I can't  
8 keep the acronyms straight.

9 Why, oh, why would you send the  
10 BGC's recommendation to a Board that  
11 consisted of people who had declared  
12 conflicts?

13 Instead, what -- as Mr. Chalaby  
14 testified, the New gTLD Program Committee  
15 was delegated all decision-making  
16 authority with respect to the program.  
17 So the Board resolved that in instances  
18 that relate to the New gTLD Program,  
19 including Board Governance request  
20 recommendations, we're going to send  
21 those to the NGPC, because that's the  
22 committee that is not conflicted.

23 That's what happened, and that's  
24 what should have happened.

25 Now, I'm going to skip to my

1 conclusion.

2 So all the other slides that I had  
3 addressing DCA's assumptions, you can  
4 read them separately. But it's a summary  
5 of what I said yesterday and the accuracy  
6 of those things.

7 So here's the conclusion slide.

8 You can look at it in your book.

9 ARBITRATOR KESSEDJIAN: That's okay.

10 MR. LEVEE: DCA had five assumptions

11 --

12 PRESIDENT BARIN: Are you on

13 Page 33?

14 MR. LEVEE: Pardon me?

15 PRESIDENT BARIN: Are you on

16 Page 33?

17 MR. LEVEE: I am on Page 33.

18 PRESIDENT BARIN: Okay.

19 MR. LEVEE: -- each of DCA's  
20 assumptions is false. The evidence  
21 yesterday confirmed that.

22 None of the purported breaches  
23 identified by DCA that I just went  
24 through represent Board action that  
25 violated the Articles, the Guidebook or



1 the Bylaws.

2 The AUC was entitled to sponsor an  
3 application for .africa. And that's  
4 where all of this goes sideways for  
5 Ms. Bekele, and I understand that.

6 And it can be argued whether that  
7 was fair to her or not, but it had  
8 nothing to do with ICANN.

9 ICANN didn't say, Oh, there's --  
10 Ms. Bekele is doing something here, and  
11 you should go trump her.

12 The AUC made an independent decision  
13 to sponsor an application for .africa.  
14 And they were entitled to do that, as  
15 Ms. Bekele confirmed when she testified.

16 Nothing in the Guidebook says that  
17 that sponsorship created a conflict of  
18 interest or, at that point, relieves any  
19 of the parties who are applying from the  
20 requirement that they get 60 percent of  
21 the support of the countries.

22 Whether the outcome is fair is truly  
23 not the issue. Many applicants have  
24 devoted years to this process but did not  
25 obtain a gTLD.

1           DCA knew the risks, knew in  
2           April 2010 that it had lost the AUC  
3           support and knew that it did not have  
4           support of 60 percent of the governments  
5           of Africa.

6           It also knew that its application  
7           could be the subject of GAC advice. It  
8           was right there in the Guidebook.

9           ICANN took no actions to tilt the  
10          "playing field" -- I put it in quotes  
11          because that's what Mr. Ali said in his  
12          opening -- in favor of AUC or ZACR.  
13          ICANN followed the rules.

14          The outcome may seem unfair to the  
15          applicant, but it does not create conduct  
16          inconsistent with the Bylaws.

17          I don't know if I've exhausted you.  
18          I have myself. But if you have other  
19          questions, I'd be more than prepared.

20          The only other thing I wanted to say  
21          is I know Mr. Ali is going to tell you  
22          now specifically what he seeks. And  
23          there were a couple of other questions.

24          I may wish to reserve three or four  
25          minutes to respond.

1           Other than that, I don't have  
2 anything else.

3           PRESIDENT BARIN: Absolutely,  
4 Mr. LeVee.

5           HONORABLE JUDGE CAHILL: I do have  
6 one question.

7           MR. LEVEE: Oh, okay.

8           HONORABLE JUDGE CAHILL: Yesterday,  
9 I asked you about constituent bodies,  
10 including the GAC --

11          MR. LEVEE: Yes.

12          HONORABLE JUDGE CAHILL: -- and in  
13 the closing argument I got from Mr. Ali,  
14 there's a Page 9 that quotes it, and they  
15 say this -- they argued your answer to be  
16 yes, the GAC is a constituent body.

17          Your first answer was, Yeah. Okay.

18          Then what you talked about -- what  
19 you then said was that Independent Review  
20 Proceedings don't apply to GAC --

21          MR. LEVEE: Yes.

22          HONORABLE JUDGE CAHILL: -- so is  
23 GAC a constituent body or --

24          MR. LEVEE: GAC is a constituent  
25 body.

1 HONORABLE JUDGE CAHILL: So why  
2 wouldn't it apply to the --

3 MR. LEVEE: The -- the GAC set up  
4 its own operating principles. And so  
5 it -- I'm not saying that the -- maybe I  
6 said it inartfully before. I'm not  
7 saying that -- where the Guidebook refers  
8 to the constituent bodies and their  
9 obligations, that those don't apply to  
10 the GAC; they do.

11 The -- what I'm saying is that the  
12 Board has no mechanism to determine,  
13 verify things that are happening in the  
14 GAC so that -- to know whether the GAC  
15 has done something right or wrong or  
16 otherwise.

17 So the GAC -- the GAC is supposed to  
18 have -- operate neutrally, operate  
19 fairly, all those things.

20 The GAC, because it's a political  
21 body, set up its own rules. And I think  
22 it does a -- an excellent job, but it  
23 is --

24 HONORABLE JUDGE CAHILL: So if that  
25 is part of the ICANN Bylaws, why wouldn't

1 the -- this Panel be able to look and see  
2 whether the GAC, as a constituent body,  
3 was feasible, open and transparent?

4 MR. LEVEE: Because the IRP process,  
5 which is defined in a different section,  
6 lays out what the purpose of the Panel  
7 is, which we went over.

8 HONORABLE JUDGE CAHILL: Okay.

9 MR. LEVEE: So, yeah, there are  
10 multiple constituent bodies within  
11 ICANN --

12 HONORABLE JUDGE CAHILL: Okay.

13 MR. LEVEE: -- none of the conduct  
14 of -- you know, I gave you one of them,  
15 which was the Generic Names Supporting  
16 Organization, which came up with the  
17 policy for this whole thing, the whole  
18 program.

19 We've never had an IRP challenging  
20 something that they do; it's only Board  
21 action.

22 HONORABLE JUDGE CAHILL: Okay.

23 PRESIDENT BARIN: Just before you  
24 go, Mr. LeVee -- but I think you also  
25 told us there is nothing there; in other

1 words, there's no process in place that  
2 can, in any way, examine or evaluate what  
3 the GAC does. In other words, the GAC  
4 can do whatever it wants to do and  
5 however it wants to do it.

6 MR. LEVEE: I think that's fair.

7 PRESIDENT BARIN: Is that a fair  
8 statement?

9 MR. LEVEE: Yes, yes. That's why I  
10 said -- I think that's right.

11 ARBITRATOR KESSEDJIAN: Then how do  
12 you explain that the Chair of the GAC is  
13 a liaison? If you -- if ICANN has felt  
14 important to have a liaison, to have  
15 somebody from the GAC who is not anybody  
16 from the GAC, it's the Chair, she is the  
17 one who organizes the meetings, who makes  
18 sure the agenda is what the agenda is.

19 So how -- are you saying -- why and  
20 how can you say that the Board doesn't  
21 have the means to review?

22 MR. LEVEE: What I'm saying is -- so  
23 there are five liaisons to the -- to the  
24 Board, not just the GAC Chair.

25 The GNSO has a liaison, all of the

1 supporting organizations have liaisons --

2 ARBITRATOR KESSEDJIAN: The  
3 committees.

4 MR. LEVEE: -- it's the means of  
5 liaisoning -- that's probably not a right  
6 word -- liaise? -- what I'm saying is  
7 that the Board does not have the -- the  
8 power to say to the GAC, You must do  
9 something --

10 ARBITRATOR KESSEDJIAN: No; but,  
11 remember, it is only a presumption the --  
12 the decision taken by the GAC is only a  
13 presumption. We are lawyers, so let's be  
14 clear on what it is.

15 Yes, it is a strong presumption, but  
16 it's still a presumption --

17 MR. LEVEE: Yes, I agree.

18 ARBITRATOR KESSEDJIAN: -- so the  
19 Board -- because the Board has the  
20 authority not to accept the GAC's advice,  
21 it seems, to me -- and because the Chair  
22 is here in the room, it seems, to me,  
23 that the Board has the possibility to  
24 review what the GAC has done.

25 MR. LEVEE: Oh, if I left a

1 different impression than that, I  
2 apologize.

3 ARBITRATOR KESSEDJIAN: You agree  
4 with me?

5 MR. LEVEE: I agree with you,  
6 absolutely. The Board can review what  
7 the GAC did; the Board can ask questions;  
8 the Board can say, GAC, we need more  
9 clarity --

10 ARBITRATOR KESSEDJIAN: Okay.

11 MR. LEVEE: -- the Board can do all  
12 of that.

13 And it can ask Ms. Dryden, We're a  
14 little confused. Can you tell us what  
15 happened at the meeting? The Board has  
16 the ability to do all of that.

17 ARBITRATOR KESSEDJIAN: And then  
18 refuse the advice?

19 MR. LEVEE: And in the past, the GAC  
20 has done certain things, and the Board  
21 said, You know what, we don't really like  
22 that; we're not going to do it.

23 Even when the Guidebook was being  
24 prepared, the GAC took multiple positions  
25 of things that it wanted, and ICANN said,



1 No, we're not going to give that to you.

2 So what happened was there were  
3 meetings -- Ms. Stathos was at a lot of  
4 them -- there were meetings where they  
5 tried to sort it out, but the GAC would  
6 say things, and the Board would say, I  
7 don't really like that.

8 PRESIDENT BARIN: Before you leave,  
9 there's just one last question.

10 Is it also possible for the Board to  
11 do that as part of the reconsideration  
12 process?

13 MR. LEVEE: To do?

14 PRESIDENT BARIN: To, in other  
15 words, look at an application or an issue  
16 that's come up through the GAC, for  
17 example?

18 MR. LEVEE: The reconsideration  
19 process is much narrower under the  
20 Bylaws. It is -- because they don't  
21 want -- every time someone has a decision  
22 made at the Board level, they don't want  
23 people basically appealing that decision.

24 So the reconsideration process was  
25 intentionally designed under the Bylaws.

1 We've put up the specific Bylaw. It was  
2 internally designed to be much narrower,  
3 where there are things you could have  
4 said, things that you could have done,  
5 things that you know the Board should  
6 have looked at but didn't.

7 So it's a much narrower nature of  
8 review.

9 PRESIDENT BARIN: Understood, in  
10 terms of explanation.

11 But in terms of the process, is it  
12 possible that -- is it possible for a  
13 reconsideration application to review  
14 what the GAC has done?

15 MR. LEVEE: I don't believe so --

16 PRESIDENT BARIN: Okay.

17 MR. LEVEE: -- it's very  
18 hypothetical, but it -- yeah.

19 PRESIDENT BARIN: Hypothetically, I  
20 ask, because if you look at the  
21 reconsideration provisions, which, again,  
22 I looked at carefully because it is part  
23 of the accounting and review process  
24 here, it says to you, The Board has  
25 designated the Board Governance Committee

1 to review and consider any such  
2 reconsideration requests. The Board  
3 Governance Committee shall have the  
4 authority to conduct whatever factual  
5 investigation is deemed appropriate.

6 MR. LEVEE: Yes.

7 PRESIDENT BARIN: So, to me, that  
8 seems that if the Board considers that  
9 perhaps something isn't done, should --  
10 should have been done or could have been  
11 done differently, or whatever else, it's  
12 part of that process.

13 MR. LEVEE: Within the defined  
14 standard of the mandate of the Board  
15 Governance Committee, absolutely, they  
16 have the right to go figure out what  
17 happened.

18 PRESIDENT BARIN: So in this case,  
19 could they have if they wanted to?

20 MR. LEVEE: They weren't asked to,  
21 and that was part of the -- the -- it was  
22 important. They weren't asked to find  
23 out anything about the GAC advice. They  
24 weren't asked to look into the conflict  
25 issue. They were asked why didn't the

1 Board hire an expert.

2 PRESIDENT BARIN: And who would have  
3 had to ask that?

4 MR. LEVEE: The applicant, DCA.

5 HONORABLE JUDGE CAHILL: Sorry.  
6 That raises one more.

7 You know, we have the issue about  
8 the conflict, and the -- and the  
9 ombudsman said at the time that there's  
10 been no discussion about .africa;  
11 therefore, at this time, there's no  
12 conflict.

13 And we had this discussion yesterday  
14 about the new fact, where the .africa  
15 comes in and it starts being discussed by  
16 the people who -- and objected to.

17 Whose responsibility would it be  
18 then to check to see at that time whether  
19 or not there was a conflict or not?

20 It could be you-all, because you  
21 have this higher standard, or it could be  
22 you don't respond unless the applicant  
23 asks you to.

24 But if it turns out that when they  
25 start talking about it, then it's got to

1 be reevaluated again, doesn't it?

2 MR. LEVEE: The -- the -- there are  
3 two things going on simultaneously: One  
4 is that each Board member is supposed to  
5 be updating his forms --

6 HONORABLE JUDGE CAHILL: Yes.

7 MR. LEVEE: -- and the second is  
8 that if an applicant is concerned, the  
9 applicant is supposed to be saying  
10 something.

11 HONORABLE JUDGE CAHILL: All right.  
12 And they -- okay.

13 So they say something, and it's  
14 clearly --

15 MR. LEVEE: They said something in  
16 2012.

17 HONORABLE JUDGE CAHILL: Yeah.  
18 But -- yeah, but -- you know, I'm not  
19 sure whether there's an actual conflict.  
20 Perceived conflict is a much more squishy  
21 concept, but it's kind of determined by  
22 outside people sometimes --

23 MR. LEVEE: Yeah.

24 HONORABLE JUDGE CAHILL: -- but when  
25 the time came to look at the perceived

1 conflict later, nobody asked you to do  
2 it, and you don't feel as though there  
3 was any obligation for the ombudsman or  
4 anyone else to look at that?

5 MR. LEVEE: The ombudsman usually  
6 only acts in response to a complaint. He  
7 doesn't initially investigate --

8 HONORABLE JUDGE CAHILL: So DCA  
9 should have made a new complaint?

10 MR. LEVEE: Yes.

11 Now, you know, we -- I skipped over  
12 this whole part because -- not in the  
13 slides, but the -- what we have in this  
14 situation is that because of the way it  
15 came up, where there was a speech,  
16 somebody thanked Mr. Disspain and  
17 Mr. Sadowsky, and another Board member  
18 said, Hey, shouldn't we just reconfirm  
19 this?

20 HONORABLE JUDGE CAHILL: Yeah.

21 MR. LEVEE: There was a very  
22 extensive process. We can debate the  
23 nature of the investigation and whether  
24 more or less should have been done --

25 HONORABLE JUDGE CAHILL: Yeah.

1 MR. LEVEE: -- but there was a very  
2 extensive process that was done at that  
3 time, all knowing that the Board's  
4 approval was unanimous.

5 But even so, they wanted to check,  
6 because if there were people conflicted,  
7 those people should not be voting.

8 HONORABLE JUDGE CAHILL: I  
9 understand that.

10 I'm not worried about the second  
11 one. That seems, to me, like it was  
12 handled properly.

13 MR. LEVEE: The conflicts policy  
14 does not really address your scenario of  
15 how this came up --

16 HONORABLE JUDGE CAHILL: Okay.  
17 Right.

18 MR. LEVEE: -- it did come up in  
19 some way as happenstance, but the Members  
20 were asked twice, once at the meeting and  
21 then once at the next meeting.

22 HONORABLE JUDGE CAHILL: It only  
23 came up once for Mr. Silber. That was  
24 the first time.

25 The second time, Mr. Silber was not

1           one of the two people in the statement  
2           that was made at the meeting, so  
3           Mr. Silber was not looked at a second  
4           time.

5                     But even though --

6                     MR. LEVEE:  Actually, Mr. Chalaby  
7           said that he was.

8                     HONORABLE JUDGE CAHILL:  That's  
9           right, he did say that.  Yep.

10                    MR. LEVEE:  Because he had been part  
11           of the first challenge.

12                    HONORABLE JUDGE CAHILL:  That was  
13           for an actual conflict, not a perceived  
14           conflict?

15                    MR. LEVEE:  Well, they knew there  
16           had been a challenge to Silber and  
17           Disspain.

18                    HONORABLE JUDGE CAHILL:  They knew  
19           that it was one day --

20                    MR. LEVEE:  Earlier.

21                    HONORABLE JUDGE CAHILL:  -- yeah,  
22           one day earlier.

23                    MR. LEVEE:  So they looked at Silber  
24           and Disspain again.  That's what Mr.  
25           Chalaby testified.



1 HONORABLE JUDGE CAHILL: I know. He  
2 looked at them for actual conflicts, it  
3 sounded to me, not for perceived  
4 conflicts.

5 MR. LEVEE: That's not how I heard  
6 it.

7 HONORABLE JUDGE CAHILL: Okay.  
8 Well, it's all there in pixel form.

9 By the way, I have no more  
10 questions.

11 MR. LEVEE: Thank you very much.

12 PRESIDENT BARIN: Thank you,  
13 Mr. LeVee.

14 How much --

15 MR. ALI: Five minutes.

16 PRESIDENT BARIN: Five minutes?

17 MR. ALI: Yes.

18 PRESIDENT BARIN: Do we need a  
19 break, perhaps?

20 ARBITRATOR KESSEDJIAN: If it is  
21 five minutes.

22 HONORABLE JUDGE CAHILL: It's not  
23 going to be five minutes when we ask  
24 questions.

25 MR. ALI: We can take a break

1 and . . .

2 PRESIDENT BARIN: Do you need a  
3 break?

4 HONORABLE JUDGE CAHILL: I'm fine.

5 PRESIDENT BARIN: So let's  
6 continue.

7 HONORABLE JUDGE CAHILL: The one  
8 thing I need to hear is what your  
9 response to we have no authority as this  
10 Panel to look at the -- the GAC conduct.

11 MR. ALI: That was going to be my  
12 second --

13 HONORABLE JUDGE CAHILL: Let me be  
14 quiet and let you do your job.

15 MR. ALI: Your wish is my command.

16 HONORABLE JUDGE CAHILL: No.

17 - - -

18 CLOSING STATEMENT (CONTINUED) ON BEHALF OF CLAIMANT

19 DOTCONNECTAFRICA TRUST

20 - - -

21 MR. ALI: So we had Mr. LeVee,  
22 yesterday and today, confirm that the GAC  
23 is a constituent body of ICANN. So that  
24 is now uncontroversial.

25 The -- the second thing that I -- as

1           you, Judge Cahill, pointed out, is  
2           Article III, Section 1 of the Bylaws. It  
3           says, ICANN and its constituent bodies  
4           shall operate, to the maximum extent  
5           feasible, in an open and transparent  
6           manner and consistent with the procedures  
7           designed to ensure fairness.

8                     And then Mr. LeVee pointed us to  
9           Article IV on Accountability and Purpose.  
10          And Article IV, Section 1 states, In  
11          carrying out -- previously, what I just  
12          read out was Article III, Section 1. So,  
13          here, I'm in Article IV, Section 1.

14                    And I quote, In carrying out its  
15          mission as set out in these Bylaws, ICANN  
16          should be accountable to the community  
17          for operating in a manner that is  
18          consistent with these Bylaws and with due  
19          regard for the core values set forth in  
20          Article I of these Bylaws.

21                    So that's, overall, the accounting  
22          framework.

23                    The provisions of this Article,  
24          creating processes for reconsideration  
25          and independent review of ICANN actions

1 and periodic review of ICANN's structures  
2 and procedures, are intended to reinforce  
3 the various accountability mechanisms  
4 otherwise set forth in these Bylaws,  
5 including the transparency provisions of  
6 Article III and the Board and other  
7 selection mechanisms set forth throughout  
8 these Bylaws.

9 Now, that is the only place where we  
10 can find a connection between the  
11 accountability mechanisms set forth in  
12 Article IV and the obligations of  
13 fairness and transparency that are also  
14 imposed on the -- on the constituent  
15 bodies.

16 I would submit to you that it was  
17 the intention of the drafters that the  
18 IRP be a mechanism through which the  
19 transparency and fairness, as set out in  
20 Article III, Section 1 of the Bylaws, be  
21 given effect and -- and enforced.

22 Otherwise, this is meaningless,  
23 simply because, as has been pointed out,  
24 there is no other mechanism foreseen,  
25 either in the GAC operating principles or

1 within the context of the Bylaws, whereby  
2 the GAC is held accountable.

3 So reading Article IV and  
4 Article III together, and based on the  
5 principle that rules or text or statutes  
6 must be read in a way that allows for  
7 them to be -- to be given effect in a  
8 F-A-O-T law, whatever the -- would be  
9 the -- the equivalent effective utility  
10 or to implement, I think that therein  
11 lies your avenue for reviewing the GAC  
12 processes.

13 We're not talking about, here,  
14 again, as was in Booking.com, whether or  
15 not somebody actually likes the Guidebook  
16 or not. We're talking about  
17 implementation --

18 HONORABLE JUDGE CAHILL: Right.

19 MR. ALI: -- and that implementation  
20 is tested at two levels: It is tested  
21 through Article IV and Article III, as  
22 I've just explained. And I think it's  
23 tested on the other side by virtue of the  
24 fact, as Ms. Dryden put it yesterday,  
25 that the Board interprets the outputs of

1 the -- of the GAC.

2 As you were pointing out, there's  
3 strong presumptions, but, ultimately, the  
4 NGPC has a duty. And as Mr. LeVee  
5 pointed out, if there is a duty, as you  
6 just indicated, then -- or he indicated  
7 in responding to your question,  
8 Mr. President, is that -- that the -- the  
9 discharge of that duty can be evaluated  
10 by you.

11 And in this particular instance,  
12 given the controversy, given the  
13 sensitivities, given the politics, given  
14 the fact that we had this imbalance in  
15 the application process, the Board had a  
16 duty, an absolute duty, to conduct  
17 additional diligence and to make  
18 inquiries as to what it is that had  
19 happened.

20 What -- they might have just asked  
21 one question of Ms. Dryden. We have an  
22 agenda, which we haven't seen, that was  
23 drafted three to four weeks before the  
24 GAC meeting.

25 Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential Information

1

Redacted - GAC Designated Confidential  
Information

10                   But the Board, what does the Board  
11 know -- why would the Board ask those  
12 questions?

13                   ARBITRATOR KESSEDJIAN: They have  
14 the 15-page of --

15                   MR. ALI: It has to be incumbent  
16 upon Ms. Dryden, as the liaison, to have  
17 provided them with the background  
18 briefing as to how the consensus advice  
19 emerged.

20                   I mean, it seems, to me, that as a  
21 decision is about to be taken of great  
22 consequence and import to an applicant,  
23 that Ms. Dryden, as the liaison for the  
24 GAC, might have provided even a brief  
25 summary of what had taken place in the



1 process.

2 Or Mr. Chalaby, given, again, the  
3 context of these applications, given the  
4 first time, this is new, we have a  
5 controversial set of circumstances  
6 surrounding these applications that  
7 everybody knows about, that it might --  
8 might've occurred to somebody, Heather,  
9 could you please provide us some  
10 background on what took place and how is  
11 it that we've come to this point?

12 Not very difficult. But we have  
13 absolutely no evidence to that effect.  
14 All we know is that a perfunctory line is  
15 included in a Board minute that says it  
16 was considered.

17 HONORABLE JUDGE CAHILL: If that had  
18 been done and the Board just said, Okay,  
19 I got it, and they list -- that -- that  
20 -- that -- we can't second-guess that  
21 decision had that been done, right?

22 MR. ALI: I can't tell you what it  
23 is that would have subsequently happened.  
24 What I can tell you is what you have just  
25 inquired about didn't happen. There was

1 no inquiry.

2 The Board had a duty. The Board has  
3 a duty. The Board is the curator of this  
4 system.

5 If the GAC is not subject to your  
6 review, then, somehow within this -- then  
7 the Board, as Ms. Dryden tells you, has  
8 the power to interpret and implement what  
9 the GAC is -- what the GAC's consensus  
10 advice is.

11 So thereby exists the control  
12 mechanism, which means a duty to  
13 investigate, a duty to make inquiries,  
14 even some inquiry. And that wasn't done.

15 So you can approach it from two  
16 different ways: either it's the GAC  
17 review, Article IV and Article III; or it  
18 is through the Board mechanism.

19 So just on this issue of -- of --  
20 very quickly on the Staff. I would just  
21 point you to the fact that the -- that  
22 this litigation waiver that is found in  
23 AGB Module 6.6 also covers the Staff; it  
24 covers consultants; it covers everybody.

25 So I think, for purposes of IRPs,

1           you have to look at the conduct as a  
2           whole, everybody that is part of this  
3           ICANN system that is administering, that  
4           is overseeing, that is implementing, that  
5           is caretaking the application of the  
6           Bylaws, the Articles and the Applicant  
7           Guidebook.

8                     If it is a rule book, somebody  
9           implements those rules. Those rules are  
10          being implemented by ICANN Staff on a  
11          day-to-day basis. Hence, the litigation  
12          waiver covers everybody, including ICANN  
13          affiliates.

14                    So I would -- it would suggest that  
15          Module 6.6, for purposes of the IRP, at  
16          least, would provide a basis for you to  
17          consider the action of Staff.

18                    It also says that DCA didn't know  
19          what was going on between the Geo Names  
20          Panel -- the Geographic Names Panel and  
21          ICANN Staff. DCA had no way of knowing  
22          what was going on in these internal  
23          e-mails.

24                    But DCA did raise on a number of  
25          occasions that their -- that ICANN Staff

1           was taking actions that were not fair to  
2           DCA, and they raised this with the NGPC.  
3           And we have Ms. Bekele's testimony to --  
4           to that effect.

5                     But the NGPC never made any  
6           inquiries as to what is going on with  
7           respect to Staff's Interactions With  
8           The -- With The -- With The Geo Names  
9           Panel.

10                    So I think that Staff has to be  
11           covered. They're the very important  
12           implementers of the direction of the  
13           Board.

14                    And if one were to simply say, Well,  
15           the Staff can do one thing, but the  
16           Board's actions are nonreviewable on the  
17           Board -- they're reviewable, but the  
18           Board is not responsible for Staff's  
19           actions, particularly when the CEO would  
20           be Staff and is on the Board, would be a  
21           really surprising outcome.

22                    Again, on the issue of support, I  
23           think the easiest path for you here, as  
24           opposed to the debate that we're having  
25           as to what was the right support from the

1 beginning, what was the right support at  
2 the end, is just to look at the  
3 correspondence that was taking place  
4 between the Geo Names Panel, a panel that  
5 was retained in order to conduct an  
6 independent evaluation. Its views, its  
7 recommendations and what it was saying  
8 was considered to be support.

9 The fact of the matter is that ZACR  
10 didn't have 60 percent support when it  
11 filed its applications from individual  
12 governments. And at the point in time  
13 when it entered into contract  
14 negotiations and the application was --  
15 was -- was approved, it still didn't have  
16 60 percent support from the individual  
17 governments.

18 What it did have was support from  
19 the AUC, which, again, you recall, was  
20 initially not considered to be support.

21 It subsequently becomes support.  
22 And if that support is applicable, then  
23 the support that .africa had -- or DCA  
24 has should also be subject to somebody's  
25 evaluation and interpretation.

1           Now, the answer that we're given by  
2           Mr. LeVee to the letter, I think, is  
3           something that perhaps applies as the  
4           capstone to this entire proceeding, at  
5           least from our perspective.

6           Mr. LeVee said, What's wrong with  
7           helping an entity that is struggling to  
8           figure it out?

9           I hope you recall him saying that.

10          HONORABLE JUDGE CAHILL: Um-hum.

11          MR. ALI: I just simply say, Let's  
12          substitute the word "entity" for what's  
13          wrong with helping applicant that is  
14          struggling to figure it out?

15          There's everything wrong, because  
16          you're helping out one applicant, opening  
17          every door all along the way for that  
18          applicant but closing the door for the  
19          other applicant.

20          So what's wrong with helping out one  
21          applicant that is struggling to figure it  
22          out?

23          Everything, because it's unfair,  
24          it's inequitable, it's discriminatory,  
25          and it's a violation of the Articles of

1 Incorporation, Bylaws, the Applicant  
2 Guidebook, international law and just --  
3 and general principles of good faith and  
4 fairness.

5 And so, with that, I have nothing  
6 more to add, except that I owe you the  
7 final relief requested, which is being  
8 specified with our client.

9 So this will be the document.

10 This may be an appropriate time to  
11 take a break. I'll finalize it, give to  
12 Mr. LeVee and then bring it back.

13 HONORABLE JUDGE CAHILL: Okay.

14 PRESIDENT BARIN: Mr. LeVee, do you  
15 want an opportunity to respond to what --

16 MR. LEVEE: Just very quickly on  
17 Staff -- the question of whether an IRP  
18 covers Staff --

19 PRESIDENT BARIN: I was going to ask  
20 you a question.

21 MR. LEVEE: -- I mean, it's a policy  
22 argument, right?

23 Mr. Ali's arguing he doesn't think  
24 it's right that the Staff should have a  
25 litigation waiver, but the language of

1 Article IV is very precise. It says, The  
2 Board --

3 PRESIDENT BARIN: But you don't  
4 disagree that the Board is ultimately  
5 responsible for the conduct of the Staff?

6 I mean, otherwise, who else is?

7 MR. LEVEE: No, no. In any  
8 corporate setting, the Board is  
9 ultimately responsible. But when a Staff  
10 member sends a letter or shows up in  
11 Africa to a meeting that may or may not  
12 have occurred, the Board may have some  
13 legal responsibility, but it's not for  
14 conduct --

15 PRESIDENT BARIN: I understand.

16 MR. LEVEE: -- that's the point I'm  
17 making. It's only Board conduct that's  
18 reviewable in an IRP. And ICANN did not  
19 want --

20 HONORABLE JUDGE CAHILL: But if the  
21 conduct is not supervising the personnel,  
22 isn't that --

23 MR. LEVEE: Well, you could argue  
24 that. You could also argue that it was  
25 the manager's responsibility.



1           No board that I'm aware of is  
2           responsible for each event that an  
3           employee does.

4           HONORABLE JUDGE CAHILL: That's  
5           probably right, but we'd have to have  
6           more facts. So . . .

7           MR. LEVEE: We would have to have  
8           more facts.

9           HONORABLE JUDGE CAHILL: Yeah,  
10          right.

11          PRESIDENT BARIN: Anything else?

12          MR. LEVEE: No.

13          PRESIDENT BARIN: Okay.

14          What I suggest, then, is while we  
15          wait for Mr. Ali and his team --

16          MR. ALI: It shouldn't take more  
17          than a few minutes.

18          PRESIDENT BARIN: That's fine. We  
19          can take a break.

20          We do have a few things.

21          HONORABLE JUDGE CAHILL: We have  
22          things to talk about.

23          PRESIDENT BARIN: It's 12:30.

24          If we were to resume -- I don't  
25          know --

1 MR. LEVEE: Ten minutes.

2 PRESIDENT BARIN: -- 10 minutes?

3 Fifteen minutes? Is that okay?

4 MR. LEVEE: Ten minutes would be

5 better.

6 PRESIDENT BARIN: In 15 minutes, it

7 will ten to 1:00.

8 In 15 minutes.

9 MR. LEVEE: Very good.

10 PRESIDENT BARIN: Thank you.

11 Mr. Ali and Mr. LeVee, I do want to

12 speak to the Panel Members first, but it

13 may be that I would ask you to come and

14 join us again for a few seconds.

15 MR. LEVEE: I'm not going anywhere.

16 (Whereupon, at 12:34 p.m., a

17 luncheon recess was taken.)

18

19

20

21

22

23

24

25



1           And I don't have any questions. It  
2           seems clear to me in terms of what you're  
3           asking.

4           MR. LEVEE: Since it has arrived as  
5           we were about to go on, in the event that  
6           ICANN has anything to say about it, may  
7           we send a very short letter to the Panel  
8           over the next several days?

9           PRESIDENT BARIN: Sure.

10          MR. LEVEE: I don't know that we  
11          will.

12          PRESIDENT BARIN: That's fine. I  
13          don't see a problem if you do have  
14          something that you want to say. You're  
15          just getting it at the hearing, so,  
16          that's fine, as long as it's to the point  
17          and brief.

18          HONORABLE JUDGE CAHILL: It will be  
19          brief.

20          MR. LEVEE: Understood.

21          MR. ALI: As you see, it's  
22          effectively the same as what we've  
23          previously provided.

24          PRESIDENT BARIN: That's fine.

25          But in all fairness, he's just

1 getting it now, so he can react to it.

2 MR. ALI: Yes.

3 PRESIDENT BARIN: Okay.

4 So are we done then, now, in terms  
5 of closing arguments?

6 MS. BEKELE: Mr. Chair, if I could  
7 just address the Panel one last time  
8 before we adjourn, I would appreciate  
9 that.

10 PRESIDENT BARIN: Do you have any  
11 objection?

12 MR. LEVEE: I would object.

13 PRESIDENT BARIN: What's the nature  
14 of the --

15 MS. BEKELE: I just wanted to thank  
16 the Panel for all the work they're doing.

17 MR. LEVEE: I have no objection to  
18 that.

19 HONORABLE JUDGE CAHILL: For your  
20 side --

21 PRESIDENT BARIN: I just wanted to  
22 make sure that I heard what she was going  
23 to say first before I --

24 ARBITRATOR KESSEDJIAN: You object  
25 before she said anything, just in case.

1           MR. LEVEE: I was envisioning  
2 something different.

3           HONORABLE JUDGE CAHILL: Yeah, me,  
4 too.

5           I do a lot of arbitrations, and  
6 these are as good a lawyers as they get.  
7 So whatever -- sorry. Don't tell them  
8 that I said that.

9           PRESIDENT BARIN: In terms of house  
10 cleaning -- and we'll get to that --  
11 we'll get to that, too --

12          HONORABLE JUDGE CAHILL: Housekeeping  
13 .

14          PRESIDENT BARIN: -- housekeeping --  
15 there's one other -- one last item  
16 that -- Mr. LeVee, the Panel would like  
17 to request from ICANN, and, that is, we  
18 understood yesterday that there are  
19 recordings of Board meetings of ICANN  
20 that are kept.

21          Now, whether they're available or  
22 not is a question that I put to you.

23          To the extent that the recordings  
24 are available, the Panel would appreciate  
25 getting the recording that relates to the

1 Board meeting of June 4, 2013, that's  
2 Exhibit R-1, and the main agenda for  
3 which was the Consideration of  
4 Nonsafeguard Advice in GAC's Beijing  
5 Communiqué and Rationale for Resolution  
6 of 2013/06/04. So if that's available.

7 MR. LEVEE: I will respond in the  
8 same time that I respond to the Panel's  
9 request for the other document relating  
10 to the Ethics Panel that we discussed  
11 yesterday.

12 PRESIDENT BARIN: Okay.

13 And, of course, you'll have a  
14 chance, Mr. Ali, to comment.

15 I note that there was a  
16 transcription of this proceeding. So  
17 what I suggest is that you will get a --  
18 a copy of that transcription, probably.  
19 And if counsel can sort of accord on the  
20 final text that gets to us.

21 Then you can have a look at it in  
22 the period that you do, but as long as we  
23 get a copy that we don't have to then be  
24 concerned as to whether there are any  
25 comments on it or not --

1 MR. ALI: Of course.

2 MR. LEVEE: That's fine.

3 PRESIDENT BARIN: -- in terms of the  
4 transcript.

5 MR. LEVEE: Yes.

6 And, yesterday, we discussed that we  
7 will not plan on closing briefs.

8 I just wanted to confirm that that  
9 remains the Panel's preference.

10 PRESIDENT BARIN: Well, to be  
11 perfectly candid, I don't think the Panel  
12 had any preference in particular, but --  
13 but I don't think one is necessary,  
14 unless -- if you want to put one in,  
15 we're not going to say no.

16 MR. LEVEE: The parties did not  
17 believe that additional briefing was  
18 necessary.

19 HONORABLE JUDGE CAHILL: Thank you.

20 PRESIDENT BARIN: But to follow  
21 that, what we will do, though, is --  
22 because we will have an important job now  
23 going forward deliberating on this -- and  
24 it will take us as long as it'll take  
25 us -- if we do need information,



1 documents or anything else, including  
2 submissions, then we will come back to  
3 you, perhaps, put it to you by written  
4 question. We'll evaluate it as we go  
5 forward.

6 MR. LEVEE: We have no objection to  
7 that at all.

8 PRESIDENT BARIN: Okay.

9 ARBITRATOR KESSEDJIAN: Could we  
10 have an idea of the calendar for  
11 the -- for the transcript? When are you  
12 going to send the drafts?

13 MR. LEVEE: We have a draft from  
14 last night already.

15 THE COURT REPORTER: It looks like  
16 June 8th and 9th.

17 ARBITRATOR KESSEDJIAN: Then you  
18 will have to work on it?

19 MR. ALI: Maybe a week or so or to  
20 confirm, maybe faster than that. But as  
21 soon as we get the clean from Ms. Sebo,  
22 we'll --

23 ARBITRATOR KESSEDJIAN: So around  
24 the 20th of June -- around the 20th of  
25 June, approximately, a clean transcript

1 for us?

2 MR. LEVEE: That's fine.

3 ARBITRATOR KESSEDJIAN: We will be  
4 able for us to plan our deliberations?

5 PRESIDENT BARIN: The 20th of June  
6 is a Saturday, so maybe the 19th, on or  
7 about.

8 How's that?

9 MR. ALI: We'll work it out. We  
10 understand why you need it, and we'll try  
11 and get it to you as quickly as we can.

12 PRESIDENT BARIN: So on or about  
13 June 19th, we'll get a final version of  
14 the -- of the transcript.

15 Okay. Any other issues? No?

16 Questions?

17 HONORABLE JUDGE CAHILL: Not me, no.  
18 I'm fine.

19 PRESIDENT BARIN: I do have a  
20 question for you.

21 And the question to both of you is  
22 that I trust you're happy with the way  
23 the Hearing went, that you're satisfied  
24 with the ability to make your  
25 presentations and an opportunity to make

1 your points known in as full of a manner  
2 as you could under the circumstances?

3 ARBITRATOR KESSEDJIAN: If you're  
4 not, it's too late.

5 MR. ALI: Thank you.

6 And from DCA Trust side, absolutely.  
7 Thank you.

8 HONORABLE JUDGE CAHILL: What are  
9 you going to say?

10 MR. LEVEE: Likewise.

11 PRESIDENT BARIN: The issue is if  
12 there's anything that you want to do that  
13 you haven't been able to do, this is the  
14 time to do it.

15 HONORABLE JUDGE CAHILL: The appeals  
16 say otherwise, that's fine, because --  
17 it's kind of a -- a loaded question.

18 PRESIDENT BARIN: Then that brings  
19 me to two last items, and that is I want  
20 to thank our stenographer, Cindy Sebo --  
21 I think I pronounced that perfectly  
22 well --

23 HONORABLE JUDGE CAHILL: Perfectly  
24 well.

25 PRESIDENT BARIN: -- from

1 TransPerfect, who has been sitting here  
2 the last one-and-a-half day, long days,  
3 for what she's done. So thank you.

4 And then I wanted to personally --  
5 and I'm sure my colleagues will  
6 definitely have their only words to  
7 say -- thank your -- the counsel, both  
8 Mr. LeVee and Mr. Ali, for -- and --  
9 pardon me -- and your team --

10 MR. ALI: Far more importantly.

11 PRESIDENT BARIN: -- some of whom,  
12 you said yesterday, were presenting for  
13 the first time. I think the Panel agrees  
14 that it was a very good job.

15 Well done.

16 HONORABLE JUDGE CAHILL: You'll  
17 probably always remember that, so good  
18 job.

19 PRESIDENT BARIN: I particularly  
20 want to commend you for -- for being  
21 extremely civil.

22 Sometimes these issues are not easy,  
23 but in the complete, thorough and, I  
24 think, excellent way -- and I say this in  
25 your front of your clients, both of your

1 clients -- the -- the Panel is very  
2 thankful and grateful.

3 We enjoyed being here, and we will  
4 go into the deliberations for the next  
5 however long it takes. So --

6 HONORABLE JUDGE CAHILL: Thanks for  
7 choosing the three of us. We get along  
8 very well.

9 ARBITRATOR KESSEDJIAN: We decided  
10 to propose at the end of this that we  
11 will form a permanent tribunal.

12 MR. LEVEE: ICANN has been looking  
13 for a permanent tribunal.

14 HONORABLE JUDGE CAHILL: Wait till  
15 you see what we do, because we don't know  
16 what we're going to do. Maybe you will  
17 want us back or maybe not.

18 PRESIDENT BARIN: With that, I wish  
19 you a good day, and have a great, long  
20 weekend.

21 MR. LEVEE: Thank you.

22

23

- - -

24 (Whereupon, the Hearing on the  
25 Merits concluded at 1:12 p.m.)

## 1 CERTIFICATE OF

2 CERTIFIED REGISTERED MERIT REAL-TIME COURT REPORTER

3 I, CINDY L. SEBO, Registered Merit Reporter,

4 Certified Real-Time Reporter, Registered

5 Professional Reporter, Certified Shorthand Reporter,

6 Certified Court Reporter, Certified LiveNote

7 Reporter, Real-Time Systems Administrator and

8 LiveDeposition Authorized Reporter, do hereby

9 certify that the foregoing transcript is a true and

10 correct record of the Hearing on the Merits, that I

11 am neither counsel for, related to, nor am employed

12 by any of the parties to the action; and further,

13 that I am not a relative or employee of any attorney

14 or counsel employed by the parties thereto, nor

15 financially or otherwise interested in the outcome

16 of the action.

17  
18  
19 Signed this 2nd day of June 2015.20  
21  
22 \_\_\_\_\_  
23 CINDY L. SEBO, RMR, CRR, RPR, CSR,  
24 CCR, CLR, RSA, LiveDeposition  
25 Authorized Reporter

**CLA-006**

INDEPENDENT REVIEW PROCESS

INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

VISTAPRINT LIMITED, ) ICDR CASE NO. 01-14-0000-6505  
 )  
Claimant, )  
 )  
and )  
 )  
INTERNET CORPORATION FOR ASSIGNED )  
NAMES AND NUMBERS, )  
 )  
Respondent. )  
\_\_\_\_\_ )

**ICANN'S RESPONSE TO CLAIMANT VISTAPRINT LIMITED'S  
REQUEST FOR INDEPENDENT REVIEW PROCESS**

Jeffrey A. LeVee  
Eric P. Enson  
Charlotte S. Wasserstein  
JONES DAY  
555 South Flower Street  
50<sup>th</sup> Floor  
Los Angeles, CA 90071  
Tel: +1 213-489-3939  
Fax: +1 213-243-2539

Counsel to Respondent  
The Internet Corporation  
For Assigned Names and Numbers



## TABLE OF CONTENTS

	<b>Page</b>
I. Vistaprint’s Claim That ICANN Breached Its Bylaws By “Blindly Accepting” The Expert Panel’s Determination Is Incorrect and Involves No Board “Decision or Action”.....	10
II. The BGC Did Not Violate Any Article Or Bylaws Provision In Denying Vistaprint’s Reconsideration Request.....	12
A. ICANN’s Bylaws Permit The BGC To Make Final Determinations Of Reconsideration Requests.....	13
B. Vistaprint’s Claim That The BGC “Got It Wrong” Has No Place In An IRP, And Is Without Merit In Any Event.....	13
1. ICDR’s Purported Failure To Appoint The First Expert In A Timely Manner Did Not Support Reconsideration.....	15
2. The First Expert’s Acceptance Of Additional Submissions Did Not Support Reconsideration.....	15
3. The ICDR’s Representation That An Expert Panel Determination Would Be Issued By 4 October 2013 Did Not Support Reconsideration.....	16
4. Removal Of The First Expert Did Not Support Reconsideration.....	17
5. The ICDR’s Acceptance Of The Objector’s Challenge To The Second Expert Did Not Support Reconsideration.....	18
6. Vistaprint’s Argument That The Expert Panel’s Determination Was Untimely Did Not Support Reconsideration.....	19
7. Vistaprint’s Argument That The Expert Panel Incorrectly Applied The Burden Of Proof Did Not Support Reconsideration.....	19
8. Vistaprint’s Argument That Expert Panel Incorrectly Applied The Standards Governing String Confusion Objections Did Not Support Reconsideration.....	20
III. Vistaprint Does Not Identify Any Instance Where The ICANN Board Violated Its Bylaws Or Articles Of Incorporation.....	22
IV. Response To Vistaprint’s Requested Relief.....	24

## INTRODUCTION

1. The Internet Corporation for Assigned Names and Numbers (“ICANN”) hereby submits its Response to the Request for Independent Review Process (“IRP Request”) submitted by claimant Vistaprint Limited (“Vistaprint”) on 11 June 2014.

2. This Independent Review Process (“IRP”) is conducted pursuant to Article IV, Section 3 of ICANN’s Bylaws, which creates a non-binding method of evaluating certain actions of ICANN’s Board of Directors.<sup>1</sup> This IRP Panel has one responsibility – to “declar[e] whether the Board has acted consistently with the provisions of [ICANN’s] Articles of Incorporation and Bylaws.”<sup>2</sup> An IRP is not an arbitration process, but rather a means by which entities that participate in ICANN’s processes can seek an independent review of decisions made by ICANN’s Board of Directors. Specifically, the IRP, when invoked, calls for the IRP Panel to consider and then declare whether the IRP Panel believes an action or decision of ICANN’s Board of Directors was consistent with ICANN’s Articles of Incorporation (“Articles”) or Bylaws.<sup>3</sup> The ICANN Board then considers that declaration. The declaration is not binding on the ICANN Board but, of course, ICANN takes the IRP seriously and the Board will consider the declaration at the first opportunity.

3. The IRP Panel is to “apply a defined standard of review to the IRP Request, focusing on”:

---

<sup>1</sup> ICANN’s Bylaws, *available at* <http://www.icann.org/en/about/governance/bylaws> and Cl. Ex. RM-2. Vistaprint submitted two sets of numbered exhibits: (1) an “Annex”; and (2) “Reference Materials”. Citations to “Cl. Ex. Annex- \_\_\_” refer to exhibits submitted in Claimant Vistaprint’s Annex, citations to “Cl. Ex. RM-\_\_\_” refer to exhibits submitted in Claimant Vistaprint’s Reference Materials, and citations to “Resp. Ex. \_\_\_” refer to exhibits submitted with Respondent ICANN’s Response.

<sup>2</sup> Bylaws, Cl. Ex. RM-3, at Art. IV, § 3.4. Vistaprint submitted as Cl. Ex. RM-2 ICANN’s Bylaws of 11 April 2013. ICANN’s Bylaws have been revised since that time, but the provisions relevant to Vistaprint’s IRP Request and ICANN’s response have not changed. For ease of reference, ICANN will refer to the Bylaws as submitted by Vistaprint in Cl. Ex. RM-2.

<sup>3</sup> Bylaws, Cl. Ex. RM-3, at Art. IV, § 3.4.

- a. did the Board act without conflict of interest in taking its decision?;
- b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?<sup>4</sup>

4. As the Bylaws make clear, the IRP addresses challenges to conduct undertaken by ICANN's Board of Directors; it is not available as a mechanism to challenge the actions or inactions of ICANN staff or third parties that may be involved with ICANN's activities.

5. Vistaprint's IRP Request relates to its two applications to operate a .WEBS generic Top Level Domain, or "gTLD." Vistaprint submitted its applications to ICANN in connection with ICANN's program to facilitate the creation of hundreds of new gTLDs to supplement those that have existed for many years, such as .COM, .NET, and .ORG. ICANN is administering this "New gTLD Program" pursuant to an Applicant Guidebook ("Guidebook") that ICANN adopted in June 2011 following years of consideration and public input.<sup>5</sup> The window for submitting new gTLD applications, which was open to all interested entities, commenced on 12 January 2012, and ICANN received 1,930 new gTLD applications.

6. In addition to VistaPrint's applications to operate a .WEBS gTLD, several entities applied to operate a .WEB gTLD. Pursuant to the Guidebook, Vistaprint's .WEBS applications were challenged by one of the applicants for .WEB in an independent dispute resolution process. In this dispute proceeding,<sup>6</sup> an expert panel ("Expert Panel") selected by the ICDR<sup>7</sup> was tasked with determining whether the relevant .WEBS and .WEB applications are so similar as to be

---

<sup>4</sup> *Id.*

<sup>5</sup> Vistaprint included the New gTLD Applicant Guidebook (version of 4 June 2012) as Cl. Ex. RM-5 ("Guidebook"). The Guidebook is also available at <http://newgtlds.icann.org/en/applicants/agb>.

<sup>6</sup> Guidebook, Cl. Ex. RM-5, at § 3.2.3.

<sup>7</sup> The International Center for Dispute Resolution ("ICDR").

confusing to Internet users. If the Expert Panel determined pursuant to the process set forth in the Guidebook that these applications were confusingly similar, only one of them could proceed.

7. In the dispute involving Vistaprint's applications for .WEBS and the Objector's application for .WEB, the Expert Panel determined they were confusingly similar.

8. Vistaprint sought to overturn the Expert Panel's decision by filing with ICANN a "Reconsideration Request," which is another ICANN accountability mechanism by which ICANN's Board Governance Committee ("BGC") evaluates whether ICANN properly followed its policies and procedures in taking the challenged action. The BGC found that neither the Expert Panel nor ICANN failed to follow policies and procedures, and therefore it denied Vistaprint's Reconsideration Request.

9. In this IRP, Vistaprint challenges the underlying Expert Panel Determination as well as the denial of Vistaprint's Reconsideration Request. Vistaprint first claims that ICANN's Board violated its Articles and Bylaws by "blindly accepting" the Expert Panel's Determination without reviewing its analysis or result. There is, however, no requirement that ICANN's Board conduct such an analysis. Indeed, "accepting" or "reviewing" the Expert Panel's Determination is not something ICANN's **Board** is tasked with doing or not doing. Per the Guidebook, the "findings of the panel will be considered an expert determination and advice that ICANN will accept within the dispute resolution process."<sup>8</sup> Following receipt of expert determinations, it is ICANN **staff** that is tasked with taking the next step, not ICANN's Board. As such there is no Board action in this regard for the IRP Panel to review.

10. Next, Vistaprint claims that ICANN breached its Articles and Bylaws when ICANN's BGC denied Vistaprint's Reconsideration Request without referring the matter to the

---

<sup>8</sup> Guidebook, Cl. Ex. RM-5, at § 3.4.6.

entire ICANN Board. But ICANN’s Bylaws specifically permit the BGC to reach its own conclusion when an ICANN staff action or inaction is at issue, as it was in Vistaprint’s case.

11. Finally, without identifying any particular Article or Bylaws provision violated, Vistaprint claims that the BGC just “got it wrong” when it denied Vistaprint’s Reconsideration Request. But the BGC did precisely what it was supposed to do in reviewing Vistaprint’s Reconsideration Request – it reviewed the Expert Panel’s and ICANN staff’s compliance with policies and procedures, rather than the substance of the Expert Panel’s determination, and found no policy or process violations.<sup>9</sup>

12. Ultimately, Vistaprint has initiated this IRP because Vistaprint disagrees with the Expert Panel’s Determination and the BGC’s finding on Vistaprint’s Reconsideration Request. ICANN understands Vistaprint’s disappointment, but IRPs are not a vehicle by which an Expert Panel’s determination may be challenged because neither the determination, nor ICANN accepting the determination, constitutes an ICANN Board action. Nor is an IRP the appropriate forum to challenge a BGC ruling on a Reconsideration Request in the absence of some violation by the BGC of ICANN’s Articles or Bylaws. Here, ICANN followed its policies and processes at every turn with respect to Vistaprint, which is all it is required to do.

## **BACKGROUND FACTS**

### **Background Information On ICANN**

13. ICANN was formed in 1998. It is a California not-for-profit public benefit corporation. As set forth in its Bylaws, ICANN’s mission “is to coordinate, at the overall level,

---

<sup>9</sup> The BGC’s determination is found at Cl. Ex. Annex-26.

the global Internet’s system of unique identifiers, and in particular to ensure the stable and secure option of the Internet’s unique identifier systems.”<sup>10</sup>

14. ICANN is a complex organization that facilitates input from stakeholders around the globe. ICANN has an international Board of Directors, nearly 300 staff members, and an Ombudsman. However, ICANN is much more than just the corporation—it is a community of participants. In addition to the Board, the staff, and the Ombudsman,<sup>11</sup> the ICANN community includes an independent Nominating Committee,<sup>12</sup> three Supporting Organizations (“SOs”),<sup>13</sup> four Advisory Committees (“ACs”),<sup>14</sup> a group of technical expert advisors,<sup>15</sup> and a large, globally distributed group of community members who participate in ICANN’s processes.

15. In its early years, and in accordance with its Core Values, ICANN focused on increasing the number of companies that could sell domain name registrations to consumers. ICANN also focused on expanding, although more slowly, the number of companies that operate gTLDs. In 2000, ICANN approved a few new gTLDs in a “proof of concept” phase that was designed to confirm that adding additional gTLDs would not adversely affect the stability and security of the Internet. In 2004 and 2005, ICANN approved a few more gTLDs.

### **Background Information On The New gTLD Program**

16. The New gTLD Program constitutes by far ICANN’s most ambitious expansion of the Internet’s naming system. The Program’s goals include enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of new gTLDs, including both new ASCII and non-ASCII internationalized domain name (IDN) gTLDs. In

---

<sup>10</sup> Bylaws, Cl. Ex. RM-2, at Art. I, § 1.

<sup>11</sup> *Id.* at Art. V.

<sup>12</sup> *Id.* at Art. VII.

<sup>13</sup> *Id.* at Arts. VIII-X.

<sup>14</sup> *Id.* at Art. XI.

<sup>15</sup> *Id.* at Art. XI-A, § 2.

developing the Program with the ICANN community, numerous versions of the Guidebook were drafted. The Guidebook provides instructions to gTLD applicants and forms the basis for ICANN's evaluation of new gTLD applications.<sup>16</sup>

17. Within the New gTLD Program, section 3.2.1 of the Guidebook enumerates grounds upon which objections to gTLD applications may be filed.<sup>17</sup> If an objection is filed on the grounds that an applied-for string is confusingly similar to another string (existing or applied-for), Section 3.2.3 provides that the ICDR will administer the dispute resolution process.<sup>18</sup>

18. Section 3.5.1 of the Guidebook provides that an objection will be upheld according to the following standard:

A DRSP panel hearing a string confusion objection will consider whether the applied-for gTLD string is likely to result in string confusion. String confusion exists where a string so nearly resembles another that it is likely to deceive or cause confusion. For a likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user. Mere association, in the sense that the string brings another string to mind, is insufficient to find a likelihood of confusion.<sup>19</sup>

19. If strings are determined to so nearly resemble each other that it is likely to deceive or cause confusion, the strings will be placed in a contention set, which is then resolved pursuant to the contention set resolution processes set out in the Guidebook.

20. Per the Guidebook, the dispute resolution provider selects the expert panel that renders a final determination on an objection.<sup>20</sup> Accordingly, ICANN's Board played no role in selecting the Expert Panel or issuing the Determination; Vistaprint does not claim otherwise.

---

<sup>16</sup> Vistaprint attached the 4 June 2012 version of the Guidebook to its IRP Request as Exhibit RM-5; the String Similarity Review provisions in this Guidebook version govern Vistaprint's application for .WEBS.

<sup>17</sup> Guidebook, Cl. Ex. RM-5, at § 3.2.1.

<sup>18</sup> Guidebook, Cl. Ex. RM-5, at § 3.2.3.

<sup>19</sup> Guidebook, Cl. Ex. RM-5, at § 3.5.1.

<sup>20</sup> Guidebook, Cl. Ex. RM-5, at § 3.4.4, 3.4.6.

21. The Guidebook does not provide for any procedure by which ICANN (or anyone else) is to conduct a substantive review of the Expert Panel’s results.<sup>21</sup>

**Relevant Facts Regarding Vistaprint’s Applications For .WEBS**

22. Vistaprint filed one community and one standard application for .WEBS.<sup>22</sup> Web.com Group, Inc. (“the Objector”), along with six other applicants, each applied for .WEB.

23. On 13 March 2013, the Objector objected (the “Objections”)<sup>23</sup> to each of Vistaprint’s applications,<sup>24</sup> claiming that “the applied-for gTLD string is confusingly similar to an existing TLD or to another applied-for gTLD string in the same round of applications.”<sup>25</sup>

24. On 23 May 2013, Vistaprint responded to the Objections.

25. On 28 June 2013, the ICC appointed Mr. Steve Y. Koh, Esq. as the expert to consider the Objections (the “First Expert”).

26. On 19 July 2013, the Objector submitted a supplemental written statement replying to Vistaprint’s response, to which Vistaprint objected; the First Expert accepted the submission and permitted Vistaprint to submit a sur-reply.

27. On 1 October 2013, the ICDR removed the First Expert due to a conflict that arose and on 14 October 2013, the ICDR appointed Bruce W. Belding, Esq. as the expert (the

---

<sup>21</sup> Guidebook, Cl. Ex. RM-5, at § 3.4.6.

<sup>22</sup> A community-based gTLD is a gTLD that is operated for the benefit of a clearly delineated community. An applicant designating its application as community-based must be prepared to substantiate its status as representative of the community it names in the application. A standard application is one that has not been designated as community-based. See <http://newgtlds.icann.org/en/applicants/glossary>.

<sup>23</sup> Because the Objections were consolidated and the Expert Panel issued just one Determination, this Recommendation may reference “Objection” and “Determination” in the singular or the plural; any singular references shall apply to both objections.

<sup>24</sup> On 6 May 2013, the ICDR consolidated the two objections, namely Case No. 50 504 T 00221 13 and Case No. 50 504 T 00246 13.

<sup>25</sup> Guidebook, Cl. Ex. RM-5, at § 3.2.1; *id.*, Cl. Ex. RM-5, Attachment to Module 3, New gTLD Dispute Resolution Procedure (“Procedure”), at Art. 2(e).



“Second Expert”). On 24 October 2013, the Objector challenged the appointment of the Second Expert, to which Vistaprint responded on 30 October 2013.

28. On 4 November 2013, the ICDR removed the Second Expert in response to the Objector’s challenge. On 20 November 2013, the ICDR appointed Professor Ilhyung Lee to serve as the expert to consider the Objector’s Objection (the “Expert Panel”). No party objected to the appointment of Professor Lee.

29. On 24 January 2014, the Expert Panel issued its Determination in favor of the Objector.<sup>26</sup> The ICDR then notified the parties of the Determination and ICANN staff posted the Determination on ICANN’s website. Thereafter, Vistaprint filed a Reconsideration Request.<sup>27</sup> Reconsideration, per ICANN’s Bylaws, involves a review conducted by the BGC.<sup>28</sup> Vistaprint’s Reconsideration Request asked ICANN to reject the Determination and instruct a new Expert Panel to issue a new Determination.<sup>29</sup>

30. The BGC denied Vistaprint’s Reconsideration Request, finding “no indication that the ICDR or the Expert violated any policy or process in reaching the Determination.”<sup>30</sup>

31. Dissatisfied with the denial of its Reconsideration Request, and following an informal attempt to resolve or narrow the issues,<sup>31</sup> Vistaprint filed this IRP.<sup>32</sup>

---

<sup>26</sup> Cl. Ex. Annex-24.

<sup>27</sup> See Vistaprint’s Reconsideration Request (Request 14-5), available at <https://www.icann.org/en/system/files/files/request-vistaprint-06feb14-en.pdf>, Cl. Ex. Annex-25.

<sup>28</sup> See Bylaws, Cl. Ex. RM-2, at Art. IV, § 2.

<sup>29</sup> See Vistaprint’s Reconsideration Request (13-5), Cl. Ex. Annex-25.

<sup>30</sup> See BGC Recommendation on Reconsideration Request 13-5, available at <https://www.icann.org/en/system/files/files/determination-vistaprint-27feb14-en.pdf>, and Cl. Ex. Annex-26.

<sup>31</sup> Request ¶ 53; Annex 28. Prior to initiating an independent review, parties are urged to enter into a period of cooperative engagement with ICANN for the purpose of resolving or narrowing the issues in dispute. Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.14. The parties engaged in the cooperative engagement process before commencing the independent review at issue here but were not able to resolve the dispute.

<sup>32</sup> See Vistaprint’s Notice of Independent Review.

## STANDARD OF REVIEW

32. The IRP is a unique mechanism available under ICANN's Bylaws. It is a non-binding process in which persons or entities that claim to have been materially and adversely affected by a decision or action of the ICANN Board that the person or entity asserts is inconsistent with ICANN's Articles or Bylaws may submit a request for independent third party review of that decision or action.<sup>33</sup>

33. The IRP Panel is tasked with determining whether the Board's actions are consistent with ICANN's Articles and Bylaws.<sup>34</sup> ICANN's Bylaws specifically identify the deferential standard of review that the IRP Panel must apply when evaluating the actions of the ICANN Board, and the rules are clear that the IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.<sup>35</sup>

34. ICANN has appointed the ICDR as ICANN's IRP Provider. ICANN's Bylaws and the Supplementary Procedures that the ICDR has adopted specially for ICANN IRP proceedings apply here.<sup>36</sup> Unlike arbitration or mediation, the Bylaws expressly provide that the IRP be conducted via "email and otherwise via the Internet to the maximum extent feasible."<sup>37</sup> The IRP Panel may also hold meetings via telephone where necessary, and "[i]n the unlikely

---

<sup>33</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, §§ 3.1, 3.2.

<sup>34</sup> See Bylaws, Cl. Ex. RM-2, at Art. IV, §§ 3.2, 3.4.

<sup>35</sup> See *id.*

<sup>36</sup> Absent a governing provision in ICANN's Bylaws or the ICDR's Supplemental Procedures, the ICDR Rules apply. But in the event of any inconsistency between the Supplementary Procedures and the ICDR's Rules, the Supplementary Procedures shall govern. Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.8; see also ICDR Supplementary Procedures for Internet Corporation for Assigned Names and Numbers, Independent Review Process, § 2, available at <https://www.adr.org/cs/groups/international/documents/document/z2uy/mde0/~edisp/adrstage2014403.pdf> ("Procedure").

<sup>37</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.12

event that a telephone or in-person hearing is convened, the hearing shall be limited to argument only; all evidence, including witness statements, must be submitted in writing in advance.”<sup>38</sup>

35. Consistent with ICANN’s Bylaws, the IRP Panel is to issue a written declaration designating, among other things, the prevailing party.<sup>39</sup> The IRP Panel’s declaration is not binding, however, because the Board is not permitted to outsource its decision-making authority. The Board will, of course, give serious consideration to the IRP Panel’s declaration and, “where feasible,” shall consider the IRP Panel’s declaration at the Board’s next meeting.<sup>40</sup>

## ARGUMENT

### I. VISTAPRINT’S CLAIM THAT ICANN BREACHED ITS BYLAWS BY “BLINDLY ACCEPTING” THE EXPERT PANEL’S DETERMINATION IS INCORRECT AND INVOLVES NO BOARD “DECISION OR ACTION.”

36. The IRP is only available to persons “materially affected by a decision or action of the [ICANN] Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws.”<sup>41</sup> The IRP is thus limited to challenging ICANN Board conduct, and is not available as a means to challenge the conduct of third parties or the conduct of ICANN staff. Vistaprint argues that ICANN breached its Bylaws by “accepting,” without any review or analysis, the Expert Panel’s Determination involving Vistaprint’s applications for .WEBS and the Objector’s application for .WEB.<sup>42</sup> But as set forth below, there is no Article or Bylaws provision that requires the ICANN Board to review or analyze expert panel determinations.

---

<sup>38</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.12; ICDR Supplementary Procedures, ¶ 10 (Resp. Ex. 2.) The Bylaws provide that IRP requests shall not exceed 25 pages (double-spaced, 12-point font) of argument (Vistaprint’s IRP Request was 25 pages), and that ICANN’s response shall not exceed that same length. Vistaprint states that it is “reserving all rights to rebut ICANN’s response in further briefs....” ICANN disagrees that Vistaprint has any “rights to rebut,” but will reserve discussion on that topic unless and until Vistaprint seeks leave to place additional information before the IRP Panel.

<sup>39</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.18.

<sup>40</sup> *Id.* at Art. IV, § 3.21.

<sup>41</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.2.

<sup>42</sup> IRP Request, ¶¶ 73, 6, 50.

37. The Guidebook states that the designated dispute resolution provider (here the ICDR), not ICANN, will appoint “one expert in proceedings involving a string confusion objection.”<sup>43</sup> The “findings of the [ICDR] panel will be considered an expert determination and advice that ICANN will accept within the dispute resolution process.”<sup>44</sup>

38. The Guidebook provides that “[i]n a case where a gTLD applicant successfully asserts string confusion with another applicant, the only possible outcome is for both applicants to be placed in a contention set and to be referred to a contention resolution procedure (refer to Module 4, String Contention Procedures).”<sup>45</sup>

39. The Guidebook could not be more explicit: Once the Expert Panel has sustained an objection involving two applied-for strings on string confusion grounds, “the only possible outcome” is for the two strings to be placed into a contention set.<sup>46</sup> This is a result not of any ICANN Board action, but a straightforward application of the Guidebook provisions to the *Expert Panel’s* Determination.

40. Vistaprint’s claim that the ICANN Board violated its Bylaws by “accepting” the Expert Panel’s Determination without a substantive review is not accurate. The ICANN Board took no action with respect to the Expert Panel’s Determination upon its issuance because the Guidebook does not call for the Board to take any such action and it is not required by any Article or Bylaw provision. Accordingly, it cannot be a violation of ICANN’s Articles or Bylaws for the Board to not conduct a “substantive review” of an Expert Determination. And because there is no Board action or decision associated with the Expert Panel’s Determination, there is nothing for the IRP Panel to review.

---

<sup>43</sup> Guidebook, Cl. Ex. RM-5, at § 3.4.4.

<sup>44</sup> Guidebook, Cl. Ex. RM-5, at § 3.4.6.

<sup>45</sup> Guidebook, Cl. Ex. RM-5, at § 3.2.2.1.

<sup>46</sup> Guidebook, Cl. Ex. RM-5, at § 3.2.2.1.

## II. THE BGC DID NOT VIOLATE ANY ARTICLE OR BYLAWS PROVISION IN DENYING VISTAPRINT’S RECONSIDERATION REQUEST.

41. Article IV, Section 2 of ICANN’s Bylaws permits an entity that has been adversely and materially affected by an ICANN staff or Board action or inaction to request that the Board reconsider that action or inaction.<sup>47</sup> In order to present a proper Reconsideration Request based on staff action or inaction, a requester must provide a detailed explanation of the facts as presented to the staff and the reasons why “one or more staff actions or inactions ... contradict established ICANN policy(ies).”<sup>48</sup> And, as the BGC has made clear on a number of occasions with respect to Expert Panel determinations like the one at issue in this matter, the reconsideration process does not allow for a full-scale, substantive review.<sup>49</sup> The BGC’s focus instead is whether the Expert Panel complied with its own and ICANN’s *policies and procedures* in reaching its determination.<sup>50</sup>

42. Vistaprint filed a Reconsideration Request seeking a review of the Expert Panel’s finding that .WEBS and .WEB are confusingly similar.<sup>51</sup> The BGC denied Vistaprint’s

---

<sup>47</sup> See Article IV, Section 2.2 of ICANN’s Bylaws states in relevant part that any entity may submit a request for reconsideration or review of an ICANN action or inaction to the extent that it has been adversely affected by:

- (a) one or more staff actions or inactions that contradict established ICANN policy(ies); or
- (b) one or more actions or inactions of the ICANN Board that have been taken or refused to be taken without consideration of material information, except where the party submitting the request could have submitted, but did not submit, the information for the Board’s consideration at the time of action or refusal to act; or
- (c) one or more actions or inactions of the ICANN Board that are taken as a result of the Board’s reliance on false or inaccurate material information.

<sup>48</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, §2.2.

<sup>49</sup> See BGC Determination on Reconsideration Request 14-9, p. 6, <https://www.icann.org/en/system/files/files/determination-merck-29apr14-en.pdf>; see also Bylaws, Art. IV, § 2.2(a).

<sup>50</sup> *Id.*

<sup>51</sup> See Vistaprint’s Reconsideration Request 14-5 at 18, Cl. Ex. Annex-25.

Reconsideration Request because it found “no indication that the ICDR or the Expert violated any policy or process in reaching the Determination.”<sup>52</sup>

43. Vistaprint takes issue with two aspects of the BGC’s decision. First, Vistaprint claims the BGC should have referred Vistaprint’s Reconsideration Request to the entire ICANN Board rather than decide the issue on its own.<sup>53</sup> Second, Vistaprint argues that the BGC got it wrong when it denied Vistaprint’s Reconsideration Request.<sup>54</sup> Neither of these claims supports Vistaprint’s IRP Request.

**A. ICANN’S BYLAWS PERMIT THE BGC TO MAKE FINAL DETERMINATIONS OF RECONSIDERATION REQUESTS.**

44. ICANN’s Bylaws specifically state that the BGC has the authority to “make a final determination of Reconsideration Requests regarding staff action or inaction, *without reference to the Board of Directors*.”<sup>55</sup> Because Vistaprint’s Reconsideration Request was a challenge to alleged staff action,<sup>56</sup> the BGC was well within its authority – and in compliance with the Bylaws – by denying Vistaprint’s Reconsideration Request.

**B. VISTAPRINT’S CLAIM THAT THE BGC “GOT IT WRONG” HAS NO PLACE IN AN IRP, AND IS WITHOUT MERIT IN ANY EVENT.**

45. Vistaprint dedicates most of its IRP Request to the notion that the BGC substantively erred in denying the Reconsideration Request. In its Reconsideration Request, Vistaprint argued that the Expert Panel did not comply with its own policies and processes in

---

<sup>52</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26.

<sup>53</sup> IRP Request, ¶ 52.

<sup>54</sup> IRP Request, ¶¶ 72-80.

<sup>55</sup> Bylaws, Art. IV, § 2.3(f), Cl. Ex. RM-2 (emphasis added).

<sup>56</sup> Vistaprint’s Reconsideration Request 14-5, Cl. Ex. Annex-25, at § 2 (seeking reconsideration of “Staff action/inaction.”); BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 19 (noting the BGC reviews expert panel determinations as staff action).

reaching its Determination.<sup>57</sup> Here, Vistaprint argues, exactly as it did in its Reconsideration Request, that the Expert Panel violated its processes or policies in the following fashions:

1. The ICDR's appointment of the First Expert was untimely;
2. The Expert Panel improperly accepted and considered unsolicited supplementary filings;
3. The ICDR violated established procedure when it informed the parties that an expert determination would be issued on 4 October 2013;
4. The First Expert failed to maintain his impartiality and independence;
5. The ICDR improperly accepted the Objector's challenge to the Second Expert; and
6. The Determination was untimely;
7. The Expert Panel improperly concluded that the Objector had met its burden of proof; and
8. The Expert Panel improperly applied the standards governing a string confusion objection.

46. But Vistaprint does not suggest that anything about the *BGC's* handling of Vistaprint's Reconsideration Request violated ICANN's Bylaws or Articles. In fact, Vistaprint fails to identify any ICANN Article or Bylaws provision that was allegedly violated by the BGC in reviewing Vistaprint's Reconsideration Request. Instead, just as it did in its Reconsideration Request, Vistaprint seeks to use the IRP to challenge the substantive decision of the IRP Panel. But again, the IRP may only be used to challenge ICANN Board actions, and may only challenge them on the grounds that they do not comply with ICANN's Articles or Bylaws, neither of which are present here.

47. Putting aside the fact that an IRP is not a forum for challenging substantive decisions of the BGC in connection with the reconsideration process, the BGC properly denied

---

<sup>57</sup> IRP Request, ¶¶ 52, 71, 75, 77.

Vistaprint's Reconsideration Request. The following briefly addresses why the BGC correctly determined that reconsideration was not warranted.

**1. ICDR's Purported Failure To Appoint The First Expert In A Timely Manner Did Not Support Reconsideration.**

48. Vistaprint claimed in its Reconsideration Request that the ICDR's appointment of the First Expert was untimely. Specifically, Vistaprint claimed that because its response to the Objection was submitted on May 23, 2013, the Expert Panel "had to be appointed by June 22, 2013."<sup>58</sup> Because it "took the ICDR until June 28, 2013 to appoint Steve Y. Koh, Esq.," Vistaprint contended that the First Expert's appointment was in violation of Article 13(a) of the Procedure, which provides: "The DRSP shall select and appoint the Panel of Expert(s) within thirty (30) days after receiving the Response."<sup>59</sup>

49. The BGC determined that Vistaprint failed to provide any evidence that it contemporaneously challenged the timeliness of the ICDR's appointment of the First Expert, and that a Reconsideration Request was not the appropriate mechanism to raise the issue for the first time.<sup>60</sup> More importantly, the BGC concluded that Vistaprint had failed to show that it was "materially" and "adversely" affected by the brief delay in appointing the First Expert, rendering reconsideration inappropriate.<sup>61</sup>

**2. The First Expert's Acceptance Of Additional Submissions Did Not Support Reconsideration.**

50. On 19 July 2013, the Objector submitted a supplementary filing to the First Expert. Vistaprint claimed that the First Expert's acceptance of this supplementary filing

---

<sup>58</sup> IRP Request, ¶ 33.

<sup>59</sup> Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 13(a).

<sup>60</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 8-9.

<sup>61</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26 at 9; Bylaws, Cl. Ex. RM-2, at Art. IV, §2.2.



violated Article 17 of the Procedure. But Article 17 of the Procedure clearly provides the Expert Panel with the discretion to accept such a filing:

**The Panel may decide** *whether the parties shall submit any written statements in addition to the Objection and the Response, and it shall fix time limits for such submissions.*<sup>62</sup>

As the BGC correctly found, it was not the BGC's place to second-guess the Expert's exercise of permitted discretion.<sup>63</sup>

**3. The ICDR's Representation That An Expert Panel Determination Would Be Issued By 4 October 2013 Did Not Support Reconsideration.**

51. In its Reconsideration Request, Vistaprint claimed that “[o]n September 18, 2013 (*i.e.* 82 days after the appointment of Mr. Koh as the Expert Panel) . . . the [ICDR] informed the parties that the expert determination was going to be issued on or about October 4, 2013 (*i.e.* 98 days after the appointment of Mr. Koh as the Expert Panel).”<sup>64</sup> Vistaprint contended, as it contends again here, that this would have resulted in the issuance of an untimely Determination because Article 21(a) of the Procedure provides that “[t]he DSRP and the Panel shall make reasonable efforts to ensure that the Expert Determination is rendered within forty-five (45) days of the constitution of the Panel.”

52. The BGC properly determined that Vistaprint's claims in this regard did not support reconsideration, for two reasons.<sup>65</sup> First, on 1 October 2013, *before* the Determination was purportedly to be issued, the ICDR removed the First Expert. The BGC therefore could not evaluate whether the First Expert rendered an untimely Determination in violation of the

---

<sup>62</sup> Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 17(a) (emphasis added).

<sup>63</sup> See BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26 at 9-10 (alterations in original).

<sup>64</sup> IRP Request, ¶ 34.

<sup>65</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 10-11.

Procedure, given that he was removed before a Determination could be issued. As such, the BGC concluded no established policy or procedure was violated.

53. Second, the 45-day timeline cited by Vistaprint applies to the Expert's submission of the Determination "in draft form to the DRSP's scrutiny as to form before it is signed."<sup>66</sup> The BGC correctly noted that the ICDR and the Expert are merely required to exercise "*reasonable efforts*" to issue a determination within forty-five days of the constitution of the Panel.<sup>67</sup>

#### **4. Removal Of The First Expert Did Not Support Reconsideration.**

54. On 1 October 2013, the ICDR informed the parties that "due to a new conflict, the Expert, Steve Koh ... will no longer be able to serve and has been removed."<sup>68</sup> Vistaprint argued in its Reconsideration Request that this "shows that Mr. Koh failed to maintain his impartiality and independence" in violation of the Procedure,<sup>69</sup> but this claim was (and is) unsupported, as the BGC properly found.

55. As the BGC noted when denying Vistaprint's Reconsideration Request, Article 13(c) of the Procedure states that "[a]ll Experts acting under this Procedure shall be impartial and independent of the parties."<sup>70</sup> Section 3.4.4 of the Guidebook provides that the ICDR will "follow its adopted procedures for requiring such independence, including procedures for challenging and replacing an expert for lack of independence."<sup>71</sup>

56. As the BGC noted, Vistaprint provided no evidence demonstrating that the First Expert failed to follow the applicable ICDR procedures for independence and impartiality.<sup>72</sup>

---

<sup>66</sup> Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 21(a)-(b).

<sup>67</sup> Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 21(a) (emphasis added).

<sup>68</sup> IRP Request, ¶ 43; Cl. Ex. Annex-15 at 11.

<sup>69</sup> IRP Request, ¶ 43.

<sup>70</sup> Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 13(c).

<sup>71</sup> Guidebook, Cl. Ex. RM-5, at § 3.4.4.

<sup>72</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 11-12.

Rather, all indications are that the First Expert and the ICDR complied with these rules as to this “new conflict,” which resulted in a removal of the First Expert. Further, Vistaprint presented no evidence of being materially and adversely affected by the First Expert’s removal, which is another justification for the BGC’s denial of the Reconsideration Request.<sup>73</sup>

**5. The ICDR’s Acceptance Of The Objector’s Challenge To The Second Expert Did Not Support Reconsideration.**

57. On 14 October 2013, the ICDR informed the parties that it had appointed Bruce W. Belding, Esq. as the Second Expert, the appointment of which the Objector timely challenged. On 4 November 2013, the ICDR accepted the Objector’s challenge and denied Vistaprint’s request to reconsider that challenge. Vistaprint claims that the ICDR’s acceptance of the Objector’s challenge to the Second Expert and denial of Vistaprint’s request to reconsider this decision constitute a violation of the Procedure.

58. As the BGC properly determined, this claim does not support reconsideration.<sup>74</sup>

59. Vistaprint has not stated which provision of the Procedure was purportedly violated, and the Procedure makes clear that the ICDR had the “sole discretion” to review and decide challenges to the appointment of expert panelists.<sup>75</sup>

60. While Vistaprint may disagree with the ICDR’s decision to accept the Objector’s challenge, it is not the BGC’s role to second guess the ICDR’s discretion, and it was not a violation of the ICANN Articles or Bylaws for the BGC to deny reconsideration on this ground, particularly given that Vistaprint provided no basis to believe that the ICDR’s decision was in violation of the ICDR’s policies.

---

<sup>73</sup> Indeed, had Vistaprint successfully challenged Mr. Koh for lack of independence at the time he was removed, the remedy under the applicable ICDR procedures would have been the removal of Mr. Koh, which was the result here.

<sup>74</sup> See BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 12-13.

<sup>75</sup> ICDR Supplemental Procedure, Cl. Ex. RM-17, at Art. 2, § 3.

**6. Vistaprint’s Argument That The Expert Panel’s Determination Was Untimely Did Not Support Reconsideration.**

61. On 20 November 2013, the ICDR appointed Professor Ilhyung Lee as the Expert Panel. Vistaprint claimed in its Reconsideration Request that, pursuant to Article 21 of the Procedure, the Determination therefore “should have been rendered by January 4, 2014,” which was forty-five (45) days after the Panel was constituted.<sup>76</sup> Because “it took this Panel until January 24, 2014 to render the Decision,” Vistaprint contended that the Determination was untimely because it was twenty days late.<sup>77</sup> The BGC properly held that this claim did not support reconsideration.<sup>78</sup>

62. According to the Procedure, the Expert must exercise “reasonable efforts” to ensure that it submits the Expert Determination “in draft form to the DRSP’s scrutiny as to form before it is signed” within forty-five (45) days of the Expert Panel being constituted.<sup>79</sup> As the BGC noted, there is no evidence that the Expert failed to comply with this Procedure, and reconsideration was therefore unwarranted on this ground.

**7. Vistaprint’s Argument That The Expert Panel Incorrectly Applied The Burden Of Proof Did Not Support Reconsideration.**

63. In its Reconsideration Request, Vistaprint claimed that the Expert Panel contravened ICANN process because “the Panel does not give an analysis showing that the Objector had met the burden of proof” and that “[i]t is unclear how the Panel came to [the] conclusion [that the .WEBS string would result in string confusion].”<sup>80</sup>

---

<sup>76</sup> IRP Request, ¶ 39; Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 21.

<sup>77</sup> IRP Request, ¶ 39.

<sup>78</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 13-14.

<sup>79</sup> Procedure, Cl. Ex. RM-5, attachment to Module 3, at Art. 21 (b).

<sup>80</sup> IRP Request, ¶ 46.

64. The BGC found that the Expert Panel extensively detailed the support for its conclusion that the .WEBS string so nearly resembles .WEB—visually, aurally and in meaning—that it is likely to cause confusion.<sup>81</sup> Indeed, the BGC noted that the Expert Panel adhered to the procedures and standards set forth in the Guidebook relevant to determining the existence of string confusion.<sup>82</sup> The BGC therefore properly found that reconsideration was not warranted on this basis.<sup>83</sup>

**8. Vistaprint’s Argument That Expert Panel Incorrectly Applied The Standards Governing String Confusion Objections Did Not Support Reconsideration.**

65. Finally, Vistaprint argued to the BGC that the Expert Panel violated ICANN processes by incorrectly applying the standards governing string confusion objections.<sup>84</sup> Specifically, Vistaprint contended that the Expert “failed to provide a description of the average, reasonable Internet user.”<sup>85</sup>

66. As the BGC set out in the reconsideration proceeding, Section 3.5.1 of the Guidebook states that, “For the likelihood of confusion to exist, it must be probable, not merely possible that confusion will arise in the mind of the average, reasonable Internet user.”<sup>86</sup> Vistaprint failed to cite any Guidebook provision or otherwise that requires the Expert to “provide a description of the average, reasonable Internet user” in the Determination. Absent an

---

<sup>81</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 15-16; Determination, Cl. Ex. Annex-24, at 10.

<sup>82</sup> BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26, at 15-16.

<sup>83</sup> Vistaprint also claims that “it is unclear whether [the Objector] could have met the burden of proof if its unauthorized additional submission had not been accepted.” IRP Request, ¶ 45. As set forth above, the acceptance of additional written submissions by both parties did not contravene ICANN process or policy. The acceptance of the supplementary filings therefore does not impact the BGC’s conclusion concerning the application of the burden of proof.

<sup>84</sup> IRP Request, ¶ 47.

<sup>85</sup> IRP Request, ¶ 47.

<sup>86</sup> Guidebook, Cl. Ex. RM-5, at § 3.5.1.

articulation of what policy or procedure Vistaprint claimed was violated in this regard, the BGC properly found that reconsideration was not appropriate.

67. Vistaprint also claims that the Expert Panel “failed to apply the burden of proof and the standards imposed by ICANN” because the Expert “questions whether the co-existence between Vistaprint’s <webs.com> and the Objector’s <web.com> for many years without (any evidence of) actual confusion is relevant to his determination.”<sup>87</sup>

68. As the BGC noted in the reconsideration process, the relevant consideration for the Expert is whether the applied-for gTLD string is likely to result in string confusion. Vistaprint does not cite any provision of the Guidebook, the Procedure, or the Rules that have been contravened in this regard, and accordingly, the BGC did not find a basis for reconsideration.

69. In sum, Vistaprint disagrees with the Expert Determination, but the BGC correctly stated that its job was not to evaluate the Expert Panel’s substantive Determination.<sup>88</sup> Likewise, an IRP is not intended to be an appeal mechanism to challenge the outcome of a request for reconsideration. The BGC followed the applicable policies and procedures in considering Vistaprint’s Request for Reconsideration, and Vistaprint does not argue those policies themselves violate any Article of Bylaw provision. Because Vistaprint presses the same arguments now that the BGC already rejected—and with good reason—the IRP Request should be denied.

---

<sup>87</sup> IRP Request, ¶ 48.

<sup>88</sup> See BGC Determination on Reconsideration Request 14-5, Cl. Ex. Annex-26 at 16-18.

**III. VISTAPRINT DOES NOT IDENTIFY ANY INSTANCE WHERE THE ICANN BOARD VIOLATED ITS BYLAWS OR ARTICLES OF INCORPORATION.**

70. In an attempt to frame its claims in a manner that suggests they are amenable to an IRP, Vistaprint argues that ICANN violated five principles enunciated in the Bylaws. However, each consists of a thinly veiled attack on the Expert Panel’s Determination, which neither forms a proper basis for an IRP nor (as set forth above) identifies any substantive or procedural deficiency in the Determination. Moreover, Vistaprint does not identify any ICANN *Board* action that supports its asserted Bylaws violation.

71. First, Vistaprint contends that ICANN failed to comply with the general principle of “good faith.” But the only reason Vistaprint asserts ICANN failed to act in good faith is in “refus[ing] to reconsider the substance” of the Determination or to “act with independent judgment[.]”<sup>89</sup> The absence of an appeal mechanism by which Vistaprint might challenge the Determination does not form the basis for an IRP because there is nothing in ICANN’s Bylaws or Articles of Incorporation requiring ICANN to provide one.

72. Second, Vistaprint contends that ICANN failed to apply its policies in a neutral manner. Here, Vistaprint complains that other panels let other applications proceed without being placed into a contention set, even though they, in Vistaprint’s opinion, presented “at least equally serious string similarity concerns” as .WEBS/.WEB.<sup>90</sup> Vistaprint’s claims about ICDR’s treatment of *other* string similarity disputes cannot be resolved by IRP, as they are even further removed from Board conduct. Different outcomes by different expert panels related to different gTLDs are to be expected. Claiming that other applicants have not suffered adverse

---

<sup>89</sup> IRP Request, ¶ 71.

<sup>90</sup> IRP Request, ¶ 74.

determinations does not convert the Expert Panel’s Determination into a “discriminatory ICANN Board act.”

73. Third, Vistaprint contends that the ICANN Board violated its obligation to act transparently for not investigating the “impartiality and independence” of the Expert Panel and thereby “did not seek to communicate with [ICDR] to optimize [its] service.”<sup>91</sup> Aside from the disconnect between the particular Bylaws provision invoked by Vistaprint requiring *ICANN’s* transparency, and the complaint that the *ICDR* did not act transparently, Vistaprint fails to identify any procedural deficiency in the ICDR’s actions regarding the removal of the First Expert, as set forth above. Moreover, Vistaprint cites no obligation in the Articles or Bylaws that the ICANN Board affirmatively investigate the impartiality of an Expert Panel, outside of the requirement that the ICDR follow its policies on conflicts, which the ICDR did.

74. Fourth, Vistaprint contends that ICANN “has not created any general process for challenging the substance of the so-called expert determination,” and thus has “brashly flouted” its obligation to remain accountable.<sup>92</sup> But again, Vistaprint does not identify any provision of the Articles or Bylaws that requires ICANN to provide such an appeals process.

75. Fifth, Vistaprint “concludes” that the ICANN Board neglected its duty to promote competition and innovation<sup>93</sup> when it failed to overturn the Expert Panel’s Determination. Vistaprint claims that the Objector’s “motive in filing the objection was to prevent a potential competitor from entering the gTLD market” and therefore ICANN’s “acceptance” of the objection purportedly contravenes ICANN’s core value of promoting competition. But every objection to a gTLD application by an applicant for the same string seeks to hinder a

---

<sup>91</sup> IRP Request ¶ 77.

<sup>92</sup> IRP Request, ¶ 79.

<sup>93</sup> Bylaws, Art. I, §2(10); Art. IV, § 1.



competitor's application. By Vistaprint's logic, ICANN's commitment to promoting competition requires that no objections ever be sustained and every applicant obtains the gTLD it requests. There is no provision in the Articles or Bylaws that require such an unworkable system.

76. All in all, Vistaprint's attempt to frame its disappointment with the Expert Panel's decision as the ICANN Board's dereliction of duties does not withstand scrutiny.

#### **IV. RESPONSE TO VISTAPRINT'S REQUESTED RELIEF.**

77. Vistaprint requests that, this IRP Panel issue a declaration "[r]equiring that ICANN reject the determination that .WEBS and .WEB are confusingly similar and disregard the resulting contention set" and "[r]equiring that ICANN organizes a new independent and impartial string confusion objection procedure between Vistaprint and [Objector] Web.com."<sup>94</sup>

78. Any request that the IRP Panel grant affirmative relief goes well beyond the IRP Panel's authority. An IRP Panel is limited to "declaring whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws" and *recommending* that the Board stay any action or decision or take any interim action until such time as the Board reviews and acts upon the opinion of the IRP Panel.<sup>95</sup> This IRP Panel simply does not have the authority to award affirmative relief or to require ICANN to undertake specific conduct.<sup>96</sup>

#### **CONCLUSION**

79. ICANN's conduct with respect to Vistaprint's application for .WEBS was fully consistent with ICANN's Articles and Bylaws. ICANN followed the procedures in the Guidebook and followed the procedures set forth in its Bylaws in evaluating Vistaprint's

---

<sup>94</sup> See IRP Request, ¶ 84.

<sup>95</sup> Bylaws, Cl. Ex. RM-2, at Art. IV, § 3.4 and § 3.11(c).


<sup>96</sup> Indeed, the IRP Panel in the first IRP ever constituted under ICANN's Bylaws found that "[t]he IRP cannot 'order' interim measures but do no more than 'recommend' them, and this until the Board 'reviews' and 'acts upon the opinion' of the IRP." See Advisory Declaration of IRP Panel, ICM Registry, LLC v. ICANN, ICDR Case No. 50 117 T 00224 08, at ¶ 133, Cl. Ex. RM-21.

Reconsideration Request. The fact that Vistaprint disagrees with the Expert Panel's Determination that put .WEBS and .WEB in a contention set does not give rise to an IRP. Vistaprint's IRP Request should be denied.

Respectfully submitted,

JONES DAY

Dated: July 21, 2014

By:   
Eric P. Enson

Counsel for Respondent ICANN

**CLA-007**

INDEPENDENT REVIEW PROCESS

INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

MERCK KGaA, ) ICDR CASE NO. 01-14-0000-9604  
 )  
Claimant, )  
 )  
and )  
 )  
INTERNET CORPORATION FOR ASSIGNED )  
NAMES AND NUMBERS, )  
 )  
Respondent. )  
\_\_\_\_\_ )

**ICANN'S RESPONSE TO CLAIMANT MERCK KGaA'S  
REQUEST FOR INDEPENDENT REVIEW PROCESS**

Jeffrey A. LeVee  
Rachel Zernik  
JONES DAY  
555 South Flower Street  
50<sup>th</sup> Floor  
Los Angeles, CA 90071  
Tel: +1 213-489-3939  
Fax: +1 213-243-2539

Counsel to Respondent  
The Internet Corporation  
For Assigned Names and Numbers

## TABLE OF CONTENTS

	Page
INTRODUCTION .....	1
BACKGROUND FACTS .....	6
STANDARD OF REVIEW .....	12
ARGUMENT .....	13
I.    ICANN’s Board Did Not “Accept” The Expert Determinations And Did Not Undertake Any Action That Is Reviewable In This Proceeding.....	14
II.   Likewise, The BGC Did Not Violate Any ICANN Article Or Bylaws Provision In Denying Merck’s Reconsideration Request.....	15
A.   The BGC Was The “Competent” Body To Review Merck’s Reconsideration Request, But It Is Not Authorized To, And Did Not, Engage In Any Substantive Analysis Of The Expert Determinations .....	17
B.   Merck Has No Basis To Argue That The BGC Was Biased Or Financially Motivated .....	19
C.   The BGC Did Not Violate The Bylaws By Declining To Recommend Further Action By The Board .....	19
D.   Merck’s Argument That The BGC Rendered An Incorrect Determination On Its Reconsideration Request Has No Place In An IRP, And Is In Any Event Without Merit .....	20
III.  ICANN’s Bylaws And Articles Of Incorporation Do Not Require That ICANN Provide For Appeal And Review Mechanisms Beyond Those Already Provided .....	23
IV.  Response To Merck’s Requested Relief .....	24
CONCLUSION.....	25

## INTRODUCTION

The Internet Corporation for Assigned Names and Numbers (“ICANN”) hereby submits its Response to the Request for Independent Review Process (“IRP Request”) submitted by claimant Merck KGaA (“Merck”) on 24 July 2014.

1. ICANN has been caught in the middle of a nearly century-old battle between two international pharmaceutical companies—Merck and its former affiliate, U.S.-based Merck Sharp & Dohme, Corporation (“MSD”)—that continue to litigate against one another in multiple fora. ICANN has not taken the side of either company. Both Merck and MSD have applied to ICANN for the opportunity to operate a “.MERCK” top-level domain (“TLD”) (like .COM or .ORG). Both Merck and MSD objected to the other’s applications, arguing that the proposed TLDs would infringe upon their respective legal rights. Consistent with ICANN’s procedures, which were accepted by Merck and by MSD, an independent expert was appointed by WIPO, an independent dispute resolution service provider, to decide the merits of the objections. Both Merck and MSD lost their objections. As a result (and as the parties were aware might happen when they chose to apply for the same gTLD), both parties’ applications for .MERCK are proceeding and have been placed in contention.

2. Only Merck has challenged the result of its objection to MSD’s applications. First, Merck asked the independent expert to reconsider his final determinations with respect to MSD’s applications. The independent expert did so, but still dismissed Merck’s objections. Merck then asked ICANN’s Board Governance Committee (“BGC”) to reconsider the expert determinations based on the same procedural and substantive arguments as the ones presented in Merck’s IRP Request. The BGC denied Merck’s request for reconsideration because it did not state a proper basis for reconsideration as defined in ICANN’s Bylaws. While conceding that it is not for ICANN to review the merits of the expert determination, Merck now argues that

ICANN has not acted consistently with the provisions of its Articles of Incorporation (“Articles”) and Bylaws when ICANN “accepted” the expert determination. However, as explained further herein, the ICANN Board has taken no action that violates either the ICANN Articles or Bylaws.

3. Merck continues to refuse to accept the final expert determination, claiming that MSD “plans to willfully violate” Merck’s legal rights.<sup>1</sup> Yet, Merck does not support this statement by any evidence other than its own interpretation of MSD’s intended use. The fact that Merck is dissatisfied because it is concerned that MSD might, in the future, violate Merck’s legal rights, is not a basis to claim that ICANN’s Board has violated its Articles or Bylaws by not taking action in Merck’s favor. Merck’s dissatisfaction with the decision of an independent expert is *not* a proper basis for an Independent Review Proceeding (“IRP”).

4. This IRP is to be conducted pursuant to Article IV, Section 3 of ICANN’s Bylaws, which creates a non-binding method of evaluating certain actions of ICANN’s Board of Directors.<sup>2</sup> The IRP Panel has one responsibility: to provide its opinion as to “whether the Board has acted consistently with the provisions of [ICANN’s] Articles of Incorporation and Bylaws.”<sup>3</sup> Absent Board action, there is nothing for the IRP Panel to evaluate. Here, however, Merck’s IRP Request does not challenge Board action, but rather improperly challenges the determination of an independent expert, designated by an independent third party dispute resolution provider. Merck argues that the Board violated its Bylaws or Articles by not reviewing the provider’s decision on the merits, but ICANN’s Bylaws and Articles do not contain any such requirement. To the contrary, the rules and procedures that govern the ICANN program in which Merck voluntarily participated do not even address the possibility that the Board would engage in

---

<sup>1</sup> IRP Request ¶ 27.

<sup>2</sup> ICANN’s Bylaws are available online at <http://www.icann.org/en/about/governance/bylaws> and are attached as Annex 16 to Claimaint’s IRP Request (“Bylaws”).

<sup>3</sup> Bylaws, Art. IV, § 3.4.

substantive reviews of independent expert decisions.

5. Merck’s IRP Request relates to competing New gTLD applications for strings incorporating the word “Merck,” including Merck’s application for .MERCK and MSD’s applications for MERCK and .MERCKMSD.<sup>4</sup> Merck and MSD submitted their applications to ICANN in connection with ICANN’s program to facilitate the creation of hundreds of new generic TLDs (“gTLDs”) to supplement those that have existed for many years, such as .COM, .NET, and .ORG. ICANN is administering this New gTLD Program pursuant to an Applicant Guidebook (“Guidebook”) that ICANN adopted in June 2011 following years of consideration and public input.<sup>5</sup>

6. As is explained in detail in Merck’s IRP Request, MSD was founded as a subsidiary of Merck, but subsequently became an independent American company. Merck and MSD currently exercise their rights in the “Merck” trademark under a reciprocal use agreement, which has been in force (through various versions and revisions) since the 1930s. MSD’s rights are territorially limited to certain countries within North America, whereas Merck retains those rights throughout the rest of the world. The two companies have a long and well-known history of litigating their rights to the “Merck” mark; Merck currently has cases pending against MSD in at least Germany, the United Kingdom, and France, and Merck claims that if MSD obtains the rights to operate the new gTLD of .MERCK, MSD will further infringe on Merck’s rights.

7. After Merck and MSD filed their respective applications for the .MERCK TLD, each used an objection process made available under the Guidebook—the legal rights

---

<sup>4</sup> Merck Registry Holdings, Inc. (“MRH”) applied for .MERCK and MSD Registry Holdings, Inc. (“MSDRH”) applied for .MERCKMSD. Both MRH and MSDRH are owned by MSD. *See* IRP Request, Annex 12, § 18(a); *id.*, Annex 14, § 18(a).

<sup>5</sup> The Guidebook is available online at <http://newgtlds.icann.org/en/applicants/agb> and attached as Annex 21 to Claimant’s IRP Request (“Guidebook”).



objection—to challenge the other’s gTLD applications as infringing on their existing legal rights to the “Merck” mark. Those challenges were heard by an independent expert panel (“Expert Panel”) selected by the World Intellectual Property Organization (“WIPO”). Pursuant to the Guidebook, if the Expert Panel had determined that an application did in fact infringe on the existing legal rights of the objector, that application would not have proceeded. However, in each of the legal rights objections involving Merck’s and MSD’s applications, the Expert Panel determined that the applications did not infringe on the existing legal rights of the objector. As a result, all of the relevant applications, including Merck’s for .MERCK, are still in the running, and the parties’ respective applications for .MERCK are in contention with each other.

8. Merck sought to overturn the Expert Panel’s determinations ruling in favor of MSD on Merck’s legal rights objections (“Expert Determinations”) by filing a “Reconsideration Request” with ICANN. The Reconsideration Request is an ICANN accountability mechanism by which ICANN’s Board Governance Committee (“BGC”) evaluates whether ICANN properly followed its policies and procedures in taking a challenged action. The BGC found that neither the Expert Panel nor ICANN failed to follow the required policies and procedures in finding against Merck, and therefore properly denied Merck’s Reconsideration Request.

9. Merck devotes the vast majority of its IRP Request to its contention that the Expert Panel was wrong. Merck claims that ICANN’s Board violated its Articles and Bylaws by “accepting” the “erroneous” Expert Determinations. However, neither the Bylaws, nor the Articles, nor the Guidebook require the ICANN Board to conduct any analysis of the decisions of expert panels that were retained for the purpose of having third party experts evaluate the legal challenges submitted against gTLD applications—they do not even suggest the Board would do so. To the contrary, ICANN’s Board is not intended to “accept” or “review” each expert

determination (and doing so would insert the Board into every dispute resolution process provided for in the Guidebook). Instead, the Guidebook provides that the “findings of the panel will be considered an expert determination and advice that ICANN *will accept* within the dispute resolution process.”<sup>6</sup> As such, there simply is no Board action for the IRP Panel to review.

10. Merck also argues that independent review is warranted because of the Board’s decision that there would not be any substantive appeals of expert determinations. But Merck does not demonstrate that the Board violated any Articles or Bylaws provision by adopting the Guidebook developed by the ICANN community, which did not include an “appellate process” for reviewing expert determinations. Merck’s argument also ignores the fact that nothing deprives Merck of the option of pursuing legal remedies against MSD if MSD is given the opportunity to operate. MERCK and Merck believes that MSD is infringing on Merck’s rights.

11. Merck also claims that ICANN breached its Articles and Bylaws when ICANN’s BGC denied Merck’s Reconsideration Request. Merck makes various arguments in this regard, including that the BGC was “incompetent” to review its Reconsideration Request, despite the fact that the Bylaws specifically designate the BGC to review Reconsideration Requests. In the end, Merck’s real argument is that the BGC did not rule in Merck’s favor and find that the Expert Panel made the wrong decision. However, the BGC did precisely what it was supposed to do—review the Expert Panel’s and ICANN staff’s compliance with policies and procedures.

12. In sum, IRPs are not a vehicle by which an expert panel’s determination may be challenged because neither the determination, nor ICANN’s acceptance of the determination, constitutes an ICANN Board action. Nor is an IRP the appropriate forum to challenge a BGC ruling on a Reconsideration Request absent some violation by the BGC of ICANN’s Articles or

---

<sup>6</sup> Guidebook, § 3.4.6 (emphasis added).

Bylaws in its conduct in reviewing that request. Here, ICANN followed its policies and processes at every turn with respect to Merck.

## **BACKGROUND FACTS**

### **Background Information On ICANN**

13. ICANN was formed in 1998. It is a California not-for-profit public benefit corporation. As set forth in its Bylaws, ICANN’s mission “is to coordinate, at the overall level, the global Internet’s system of unique identifiers, and in particular to ensure the stable and secure operation of the Internet’s unique identifier systems.”<sup>7</sup>

14. ICANN is a complex organization that facilitates input from stakeholders around the globe. ICANN has an international Board of Directors, approximately 300 staff members, and an Ombudsman. However, ICANN is much more than just the corporation—it is a community of participants. In addition to the Board, the staff, and the Ombudsman,<sup>8</sup> the ICANN community includes an independent Nominating Committee,<sup>9</sup> three Supporting Organizations (“SOs”),<sup>10</sup> four Advisory Committees (“ACs”),<sup>11</sup> a group of technical expert advisors,<sup>12</sup> and a large, globally distributed group of community members who participate in ICANN’s processes.

15. In its early years, and in accordance with its Core Values, ICANN focused on increasing the number of companies that could sell domain name registrations to consumers. ICANN also focused on expanding, although more slowly, the number of companies that operate gTLDs. In 2000, ICANN approved a few new gTLDs in a “proof of concept” phase that was designed to confirm that adding additional gTLDs would not adversely affect the stability and

---

<sup>7</sup> Bylaws, Art. I, § 1.

<sup>8</sup> *Id.*, Art. V.

<sup>9</sup> *Id.*, Art. VII.

<sup>10</sup> *Id.*, Arts. VIII-X.

<sup>11</sup> *Id.*, Art. XI.

<sup>12</sup> *Id.*, Art. XI-A, § 2.

security of the Internet. In 2004 and 2005, ICANN approved a few more TLDs.

### **Background Information On The New gTLD Program**

16. The New gTLD Program constitutes by far ICANN's most ambitious expansion of the Internet's naming system. The Program's goals include enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of new gTLDs, including both new ASCII and non-ASCII internationalized domain name (IDN) gTLDs.<sup>13</sup> In developing the Program with the ICANN community, numerous versions of the Guidebook were drafted. The version of the Guidebook published on 4 June 2012 provides instructions to gTLD applicants and forms the basis for ICANN's evaluation of new gTLD applications.

17. Within the New gTLD Program, section 3.2.1 of the Guidebook enumerates grounds upon which objections to gTLD applications may be filed.<sup>14</sup> If an objection is filed on the grounds that an applied-for string infringes the existing legal rights of the objector, Section 3.2.3 provides that WIPO will administer the dispute resolution process.<sup>15</sup> Section 3.5.2 of the Guidebook provides that an objection will be upheld according to the following standard:

[A] DRSP panel of experts presiding over a legal rights objection will determine whether the potential use of the applied-for gTLD by the applicant takes unfair advantage of the distinctive character or the reputation of the objector's registered or unregistered trademark or service mark ("mark") or IGO name or acronym (as identified in the treaty establishing the organization), or unjustifiably impairs the distinctive character or the reputation of the objector's mark or IGO name or acronym, or otherwise creates an impermissible likelihood of confusion between the applied-for gTLD and the objector's mark or IGO name or acronym.<sup>16</sup>

18. Where a legal rights objection is based on trademark rights, Section 3.5.2 the Guidebook specifies that in applying that standard, the panel will consider the following eight

---

<sup>13</sup> IDN gTLDs are gTLDs that include characters not within the US-ASCII (American Standard Code for Information Exchange) or Latin alphabets.

<sup>14</sup> Guidebook, § 3.2.1.

<sup>15</sup> *Id.*, § 3.2.3.

<sup>16</sup> *Id.*, § 3.5.2.

“non-exclusive” factors:

1. Whether the applied-for gTLD is identical or similar, including in appearance, phonetic sound, or meaning, to the objector’s existing mark.
2. Whether the objector’s acquisition and use of rights in the mark has been bona fide.
3. Whether and to what extent there is recognition in the relevant sector of the public of the sign corresponding to the gTLD, as the mark of the objector, of the applicant or of a third party.
4. Applicant’s intent in applying for the gTLD, including whether the applicant, at the time of application for the gTLD, had knowledge of the objector’s mark, or could not have reasonably been unaware of that mark, and including whether the applicant has engaged in a pattern of conduct whereby it applied for or operates TLDs or registrations in TLDs which are identical or confusingly similar to the marks of others.
5. Whether and to what extent the applicant has used, or has made demonstrable preparations to use, the sign corresponding to the gTLD in connection with a bona fide offering of goods or services or a bona fide provision of information in a way that does not interfere with the legitimate exercise by the objector of its mark rights.
6. Whether the applicant has marks or other intellectual property rights in the sign corresponding to the gTLD, and, if so, whether any acquisition of such a right in the sign, and use of the sign, has been bona fide, and whether the purported or likely use of the gTLD by the applicant is consistent with such acquisition or use.
7. Whether and to what extent the applicant has been commonly known by the sign corresponding to the gTLD, and if so, whether any purported or likely use of the gTLD by the applicant is consistent therewith and bona fide.
8. Whether the applicant’s intended use of the gTLD would create a likelihood of confusion with the objector’s mark as to the source, sponsorship, affiliation, or endorsement of the gTLD.<sup>17</sup>

19. Per the Guidebook, the dispute resolution provider selects the expert panel that renders a final determination on an objection.<sup>18</sup> ICANN’s Board played no role in selecting the Expert Panel or issuing the Determination; Merck does not claim otherwise. And, as noted

---

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* §§ 3.4.4, 3.4.6.

above, the Guidebook does not provide for any procedure by which ICANN (or anyone else) is to conduct a substantive review of the expert panel determinations.<sup>19</sup>

### **Relevant Facts Regarding Merck's and MSD's New gTLD Applications**

20. MSD filed one community and one standard application for .MERCCK, one standard application for .MERCCKMSD, and one standard application for .MSD.<sup>20</sup> Merck filed a community application for .MERCCK and a standard application for .EMERCK.

21. On 12 March 2013, Merck filed legal rights objections to MSD's applications for .MERCCK and .MERCCKMSD, arguing that "the string[s] comprising the potential new gTLD[s] infringe[] the existing legal rights of others that are recognized or enforceable under generally accepted and internationally recognized principles of law."<sup>21</sup> On 13 March 2013, MSD filed legal rights objections to Merck's applications, making the same argument.<sup>22</sup>

22. On 14 June 2013, WIPO appointed Willem J.H. Leppink as the Expert Panel to consider both Merck's objections and MSD's objections. On 30 July 2013 and 31 July 2013, the Expert Panel rendered its determinations on MSD's objections, finding Merck the prevailing party and dismissing the objections.<sup>23</sup> The Expert Panel determined that MSD had failed to demonstrate that Merck's applied-for gTLDs would infringe on MSD's existing legal rights.

---

<sup>19</sup> *Id.* § 3.4.6.

<sup>20</sup> A community-based gTLD is a gTLD that is operated for the benefit of a clearly delineated community. An applicant designating its application as community-based must be prepared to substantiate its status as representative of the community it names in the application. A standard application is one that has not been designated as community-based. See <http://newgtlds.icann.org/en/applicants/glossary>.

<sup>21</sup> See Determinations on WIPO Case Nos. LRO2013-2009, LRO2013-2010, LRO2013-2011, available online at <http://newgtlds.icann.org/sites/default/files/drsp/25sep13/determination-2-1-1702-28003-en.pdf>, <http://newgtlds.icann.org/sites/default/files/drsp/25sep13/determination-2-1-1702-73085-en.pdf>, <http://newgtlds.icann.org/sites/default/files/drsp/25sep13/determination-2-1-1704-28482-en.pdf>, and attached to Claimant's IRP Request as Annex. 33 (collectively, "Expert Determinations").

<sup>22</sup> See Determinations on WIPO Case Nos. LRO2013-0068 and LRO2013-0069, available online at <http://newgtlds.icann.org/sites/default/files/drsp/25sep13/determination-1-1-980-60636-en.pdf>, <http://newgtlds.icann.org/sites/default/files/drsp/25sep13/determination-1-1-980-7217-en.pdf>, and attached to Claimant's IRP Request as Annex 32.

<sup>23</sup> See Determinations on WIPO Case Nos. LRO2013-0068 and LRO2013-0069.

MSD did not submit a Request for Reconsideration with respect to this ruling and has not submitted a Request for Independent Review.

23. On 6 September 2013, the Expert Panel rendered its determinations on Merck's objections, finding MSD the prevailing party and dismissing the objections.<sup>24</sup> The Expert Panel determined that the Merck had failed to demonstrate that MSD's applied-for gTLDs would infringe on Merck's existing legal rights.

24. In its IRP Request, Merck repeatedly references an alleged factual error made by the Expert Panel in rendering the Expert Determinations. Merck previously raised that issue with the Expert Panel. Specifically, on 23 September 2013, Merck sent a letter to WIPO, challenging, among other things, the following statement in the Determinations:

*Applicant* has made it clear that it will take all necessary measures, including geo-targeting, to avoid that Internet users in the territories in which Objector has trademark rights[] will be able to visit websites that use the Disputed gTLD String.<sup>25</sup>

Merck's letter noted that while Merck's "commitment to using geo-targeting was made clear from the exhibits in the case . . . . [a]t no time has [MSD] indicated that it would consider using geo-targeting, or taking any other affirmative measures to prevent infringement or confusion."<sup>26</sup> Merck claimed that this misstatement was material to the Expert Panel's denial of the Objections.

25. On 24 September 2013, in response to Merck's correspondence, the Expert Panel issued an addendum to its determinations ("Addendum").<sup>27</sup> In the Addendum, the Expert Panel clarified that the inclusion in the determinations of the statement regarding MSD's commitment to geo-targeting was "inadvertent," but that the Expert Panel "was in fact aware of the

---

<sup>24</sup> *See id.*

<sup>25</sup> Geo-targeting is a method of determining the location of a website visitor and, based on that location, targeting unique content to that visitor.

<sup>26</sup> IRP Request, Annex 34, p. 2.

<sup>27</sup> *Id.*, Annex 33.

distinction in this regard, as is reflected in the pleadings as cited and summarized in the Expert Determinations.”<sup>28</sup> The Addendum also stated that the misstatement was not material to the Expert Determinations and explained the basis for the Expert Determinations.

26. On 27 February 2014, ICANN published the Addendum on its New gTLD microsite. On 13 March 2014, Merck filed a Reconsideration Request. Merck’s Reconsideration Request asked ICANN to reject the Expert Determinations and instruct a new Expert to issue new determinations.<sup>29</sup> On 29 April 2014, the BGC denied Merck’s Reconsideration Request, finding “no indication that the Panel violated any policy or process in reaching . . . the [Expert] Determinations.”<sup>30</sup> In response, Merck filed this IRP.<sup>31</sup>

27. MSD’s applications for .MERCK and .MERCKMSD, as well as Merck’s application for .MERCK, are currently on hold due to this IRP.<sup>32</sup> Absent this IRP, because both Merck’s and MSD’s objections were overruled, both parties’ applications for .MERCK would proceed. Because both Merck and MSD each filed a community application for .MERCK, their applications would be invited to Community Priority Evaluation (“CEP”). If only one party’s application prevails in CEP, that application will be the one that moves forward while the others will not. If neither application prevails in CEP, or if both applications do, both applications will proceed and their contention will have to be resolved. That contention can be resolved by

---

<sup>28</sup> *Id.*, p. 1. In a section summarizing the Requester’s arguments in support of its legal rights objection, the Determinations note that Requester argued that “[c]ontrary to [MSD], [Merck] uses geo-targeting tools to ensure that visitors from North America cannot access website content in which [Merck] is identified as ‘Merck.’ Internet users in North America that enter ‘www.merck.de’ into a browser will be redirected to ‘www.emdgroup.com.’” *See* Determination on WIPO Case Nos. LRO2013-2009, p. 4.

<sup>29</sup> *See* IRP Request, Annex 39 (“Request 14-9”).

<sup>30</sup> *See id.*, Annex 45.

<sup>31</sup> *See id.* Prior to initiating an independent review, parties are urged to enter into a period of cooperative engagement with ICANN for the purpose of resolving or narrowing the issues in dispute. Bylaws, Art. IV, § 3.14. The parties engaged in the cooperative engagement process before commencing the independent review at issue here but were not able to resolve the dispute.

<sup>32</sup> Merck is the sole applicant for .EMERCK and MSD is the sole applicant for .MSD. Those applications are not implicated by this IRP.



“voluntary agreement” between Merck and MSD.<sup>33</sup> If such voluntary agreement does not occur, the Guidebook provides that .MERCCK will proceed to auction, the last resort “tie-breaker method for resolving string contention among the applications within a contention set.”<sup>34</sup>

### STANDARD OF REVIEW

28. The IRP is a unique, non-binding process available under ICANN’s Bylaws for persons or entities that claim to have been materially and adversely affected by a decision or action of the ICANN Board. Those persons or entities may submit a request for independent third party review of that Board decision or action, explaining why they believe it was inconsistent with ICANN’s Article or Bylaws.<sup>35</sup> The IRP Panel is tasked with providing its opinion as to whether the Board’s actions violated ICANN’s Articles and Bylaws.<sup>36</sup> ICANN’s Bylaws specifically identify the deferential standard of review that the IRP Panel must apply when evaluating the actions of the ICANN Board, focusing on:

- a. did the Board act without conflict of interest in taking its decision?;
- b. did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?<sup>37</sup>

The IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.<sup>38</sup>

29. ICANN has appointed the ICDR as ICANN’s IRP Provider. ICANN’s Bylaws and the Supplementary Procedures that the ICDR has adopted specially for ICANN IRP

---

<sup>33</sup> Guidebook, § 4.3.

<sup>34</sup> *Id.*

<sup>35</sup> Bylaws, Art. IV, §§ 3.1, 3.2.

<sup>36</sup> *See id.* Art. IV, §§ 3.2, 3.4.

<sup>37</sup> *Id.*, Art. IV, § 3.4.

<sup>38</sup> *See id.*

proceedings apply here.<sup>39</sup> The Bylaws provide that the IRP be conducted via “email and otherwise via the Internet to the maximum extent feasible.”<sup>40</sup> The IRP Panel may also hold meetings via telephone where necessary, and “[i]n the unlikely event that a telephone or in-person hearing is convened, the hearing shall be limited to argument only; all evidence, including witness statements, must be submitted in writing in advance.”<sup>41</sup>

30. Consistent with ICANN’s Bylaws, the IRP Panel is to issue a written declaration designating, among other things, the prevailing party.<sup>42</sup> The Board will, of course, give serious consideration to the IRP Panel’s opinion and, “where feasible,” shall consider the IRP Panel’s declaration at the Board’s next meeting.<sup>43</sup>

### **ARGUMENT**

31. Merck and MSD have a long history and a complicated relationship. ICANN is not unsympathetic to the possibility that either Merck or MSD might violate the other’s rights in the event either becomes the registry operator for .MERCCK. But if such alleged violations occur after the delegation of .MERCCK, both Merck and MSD are fully capable of attempting to protect their rights, as they have done and continue to do in jurisdictions around the world.

32. Following years of discussion, policy development, and policy implementation, the ICANN community established a process for independent experts to review claims that a party’s rights might be impaired by another party’s operation of a particular gTLD. In this

---

<sup>39</sup> Absent a governing provision in ICANN’s Bylaws or the ICDR’s Supplemental Procedures, the ICDR Rules apply. But in the event of any inconsistency between the Supplementary Procedures and the ICDR’s Rules, the Supplementary Procedures shall govern. *Id.*, Art. IV, § 3.8; *see also* Ex. C-R-1, ICDR Supplementary Procedures for Internet Corporation for Assigned Names and Numbers, Independent Review Process (“Supplementary Procedures”), § 2, also available online at <https://www.adr.org/cs/groups/international/documents/document/z2uy/mde0/~edisp/adrstage2014403.pdf>.

<sup>40</sup> Bylaws, Art. IV, § 3.12

<sup>41</sup> *Id.*, Art. IV, § 3.12; Supplementary Procedures, ¶ 10..

<sup>42</sup> *Id.*, Art. IV, § 3.18.

<sup>43</sup> *Id.*, Art. IV, § 3.21.

instance, that Expert determined – after a careful review of the parties’ respective claims – that he would not sustain the objection of Merck to MSD’s applications based on the possibility that MSD might, if it becomes the registry operator, violate Merck’s rights by not using “geo-targeting.”<sup>44</sup> ICANN appreciates that Merck disagrees with the Expert’s determination, but for the reasons set forth herein, that disagreement does not constitute a basis for an IRP under ICANN’s Bylaws.

**I. ICANN’S BOARD DID NOT “ACCEPT” THE EXPERT DETERMINATIONS AND DID NOT UNDERTAKE ANY ACTION THAT IS REVIEWABLE IN THIS PROCEEDING.**

33. An IRP is available only to persons “materially affected by a decision or action of the [ICANN] *Board* that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws.”<sup>45</sup> An IRP is thus limited to challenging ICANN Board conduct and cannot be used as a means to challenge the conduct of third parties or even the conduct of ICANN staff.

34. Merck argues that ICANN breached its Bylaws by “accepting” the Expert Determinations without “exercis[ing] due diligence and care.”<sup>46</sup> However, the Board did not in fact “accept” the relevant Expert Determinations or take any other actions with respect to those determinations, and there is no Article or Bylaws provision that requires the Board to do so.

35. The Guidebook states that the designated dispute resolution provider (here, WIPO), not ICANN, will appoint “one expert, or, if all parties agree, three experts with relevant experience in intellectual property rights disputes in proceedings involving an existing legal rights objection.”<sup>47</sup> The “findings of the [ICDR] panel will be considered an expert

---

<sup>44</sup> The Expert similarly determined that he could not sustain the objection of MSD to Merck’s application.

<sup>45</sup> *Id.*, Art. IV, § 3.2 (emphasis added).

<sup>46</sup> IRP Request ¶ 48.

<sup>47</sup> Guidebook, § 3.4.4.

determination and advice that ICANN will accept within the dispute resolution process.”<sup>48</sup>

36. Accordingly, Merck’s claim that the ICANN Board “accepted” the Expert Determinations is wrong. The ICANN Board took *no action* with respect to evaluating or accepting the Expert Determinations and Merck has not shown otherwise. Nor is any such action required by any Articles or Bylaws provision. Because there is no Board action or decision associated with the Expert Determinations, there is nothing for this IRP Panel to review.

**II. LIKEWISE, THE BGC DID NOT VIOLATE ANY ICANN ARTICLE OR BYLAWS PROVISION IN DENYING MERCK’S RECONSIDERATION REQUEST.**

37. Merck is also incorrect in arguing that the BGC violated ICANN’s Articles and Bylaws in denying Merck’s Reconsideration Request. Article IV, Section 2 of ICANN’s Bylaws permits an entity that has been adversely and materially affected by an ICANN staff or Board action or inaction to request that the Board reconsider that action or inaction.<sup>49</sup> In order to present a proper Reconsideration Request based on staff action or inaction, a requester must provide a detailed explanation of the facts as presented to the staff and the reasons why “one or more staff actions or inactions . . . contradict established ICANN policy(ies).”<sup>50</sup> As the BGC made clear in its Determination—as well as on a number of occasions with respect to

---

<sup>48</sup> *Id.* § 3.4.6. As is discussed below, the decision not to provide for substantive appeals of expert determinations on objections reflects a considered decision of ICANN’s Board, made after significant public input and comment, that the experts (and not ICANN) should be resolving these types of objections.

<sup>49</sup> Article IV, Section 2.2 of ICANN’s Bylaws states in relevant part that any entity may submit a request for reconsideration or review of an ICANN action or inaction to the extent that it has been adversely affected by:

- (a) one or more staff actions or inactions that contradict established ICANN policy(ies); or
- (b) one or more actions or inactions of the ICANN Board that have been taken or refused to be taken without consideration of material information, except where the party submitting the request could have submitted, but did not submit, the information for the Board’s consideration at the time of action or refusal to act; or
- (c) one or more actions or inactions of the ICANN Board that are taken as a result of the Board’s reliance on false or inaccurate material information.

<sup>50</sup> Bylaws, Art. IV, §2.2.

Reconsideration Requests involving expert determinations like the one at issue in this matter<sup>51</sup>—the reconsideration process does not allow for a full-scale, substantive review of expert determinations. The BGC is not tasked with second-guessing expert determinations of ICANN’s dispute resolution providers. Its focus instead is whether the expert complied with the dispute resolution providers’ own and ICANN’s *policies and procedures*.<sup>52</sup>

38. Merck filed a Reconsideration Request seeking a review of the Expert Determinations that MSD’s applications did not infringe Merck’s legal rights.<sup>53</sup> In that Request, Merck argued that the Expert violated established policies and procedures by: (i) failing to apply the proper standard and instead “rel[ying] on the wholly inapplicable reasoning” of the UDRP standards, and (ii) failing to “take reasonable care in evaluating the parties’ respective evidence.”<sup>54</sup> The BGC denied the Reconsideration Request because it found “no indication that the ICDR or the Expert violated any policy or process in reaching the Determination.”<sup>55</sup>

39. Merck argues that, despite the fact that the Bylaws expressly authorize the BGC to issue determinations on Reconsideration Requests, the BGC was not a “competent” body to issue a determination on its Reconsideration Request. Merck then speculates, without proffering any evidence to support its claims, that the BGC has a financial interest in denying its Reconsideration Request. Next, Merck argues that the BGC improperly failed to recommend that the Board take further action on its Reconsideration Request. Finally, Merck claims that the BGC’s determination was substantively flawed. Each of these claims fails to support an IRP.

---

<sup>51</sup> See IRP Request, Annex 45 (“14-9 Determination”), p. 6; Ex. C-R-2, BGC Determination on Reconsideration Request 14-5, p. 7, also available online at <https://www.icann.org/en/system/files/files/determination-vistaprint-27feb14-en.pdf>; see also Bylaws, Art. IV, § 2.2(a).

<sup>52</sup> See 14-9 Determination, p. 6.

<sup>53</sup> See Request 14-9, p. 18.

<sup>54</sup> See *id.*, p. 10, 13-14.

<sup>55</sup> See 14-9 Determination, p. 14.

**A. THE BGC WAS THE “COMPETENT” BODY TO REVIEW MERCK’S RECONSIDERATION REQUEST, BUT IT IS NOT AUTHORIZED TO, AND DID NOT, ENGAGE IN ANY SUBSTANTIVE ANALYSIS OF THE EXPERT DETERMINATIONS.**

40. Pursuant to ICANN’s Bylaws, the BGC is designated with the authority to “review and consider” reconsideration requests.<sup>56</sup> For reconsideration requests regarding staff action, such as Merck’s Request, the BGC has the authority to “make a final determination . . . without reference to the Board of Directors.”<sup>57</sup> Merck argues that the BGC was “not competent” to review its Reconsideration Request because determining whether the Expert Panel correctly applied the standard for legal rights objections “necessarily also involve[d] a legal, substantive analysis of the Panel’s argument.”<sup>58</sup> Insofar as Merck is arguing that the BGC was required to conduct a substantive review of the Expert Determinations, that argument is wrong. As Merck itself acknowledges, the Bylaws provide that reconsideration of staff (or DRSP) action is appropriate only where that action “contradict[ed] established ICANN policy(ies),” and do not provide for a substantive review of expert determinations.<sup>59</sup> The fact that Merck views the expert as having made the wrong decision does not somehow vest the BGC with authority that it otherwise does not have to engage in a substantive legal analysis.<sup>60</sup>

41. Insofar as Merck is making the opposite argument—that the BGC “embarked on

---

<sup>56</sup> Bylaws, Art. IV, § 2.3.

<sup>57</sup> *Id.*, Art. IV, § 2.3(f).

<sup>58</sup> *Id.* ¶ 80.

<sup>59</sup> *Id.*; Bylaws, Art. IV, § 2.2.

<sup>60</sup> Merck also argues that the BGC should have “[s]ought the advice of an independent legal advisor” to help it address the issues raised by Merck’s Reconsideration Request. (IRP Request ¶ 82.) But the BGC is not tasked with performing substantive reviews of expert determinations. The one instance Merck cites in which a Board committee sought independent legal advice was when the New gTLD Program Committee (“NGPC”) – not the BGC – sought legal advice regarding specific advice that the NGPC had received from ICANN’s Governmental Advisory Committee. (*Id.*) The NGPC did so pursuant to Module 3.1 of the Guidebook, which provides that “the Board may consult with independent experts . . . in cases where the issues raised in the GAC advice are pertinent to one of the subject matter areas of the objection procedures.” (Guidebook, § 3.1.) This provision has no application with respect to Merck’s Reconsideration Request.

an *impermissible* substantive review of the [Expert Determinations] decision and analysis under the LRO Standards and non-exclusive factors”—that argument too is without merit.<sup>61</sup> The BGC engaged in no substantive legal analysis in rendering its determination on Merck’s Reconsideration Request. Instead, the BGC determined whether, as Merck had argued, the Expert Panel had failed to apply the proper standard in rendering its determinations. The BGC determined that the Expert Panel had applied the proper standard, noting that the Expert Panel had “correctly referenced and considered the eight non-exhaustive factors listed in the Guidebook and explained how those factors supported the Expert Panel’s Determinations.”<sup>62</sup> The fact that Merck did not like the Expert Panel’s conclusions is not a basis for reconsideration and, in conformance with the Bylaws, the BGC made no determination regarding the Expert’s substantive application of those factors.

42. In its Reconsideration Request, Merck also argued that the Expert Panel failed to apply the proper standard because it “relied on the wholly inapplicable reasoning” of the UDRP standards.<sup>63</sup> The BGC determined that no policy or procedure prevented the Expert Panel from “consider[ing] the UDRP as a means to provide further context” in assessing the Guidebook factors, and that the New gTLD Dispute Resolution Procedure makes clear that “in addition to apply the standards that have been identified by ICANN, the Expert Panel may ‘refer to and base its findings upon . . . any rules or principles that it determines to be applicable.’”<sup>64</sup> Again, in conformance with the Bylaws, the BGC made no legal or substantive conclusions regarding the UDRP standards, or regarding the Expert Panel’s consideration of those standards.

---

<sup>61</sup> IRP Request ¶ 44.

<sup>62</sup> 14-9 Determination, p. 8.

<sup>63</sup> Request 14-9, p. 14.

<sup>64</sup> 14-9 Determination, p. 9 (quoting New gTLD Dispute Resolution Procedure, Art. 20(b)).

**B. MERCK HAS NO BASIS TO ARGUE THAT THE BGC WAS BIASED OR FINANCIALLY MOTIVATED.**

43. Because both Merck's and MSD's objections to the other's applications for .MERCK were denied, both of those applications are still in contention. As noted above, because Merck and MSD each filed a community application for .MERCK, those applications will be invited to CPE. Therefore, assuming each will participate in CPE, .MERCK will proceed to auction only in the event that: (i) both community applications prevail in CPE or neither prevails in CPE, *and* (ii) Merck and MSD cannot reach a resolution among themselves. As the Guidebook makes clear, auction is a "last resort" means of contention resolution; and ICANN expects most parties to settle contention by mutual agreement.<sup>65</sup> While Merck speculates that ICANN is trying to encourage auctions so that it can collect funds for its own benefit, giving the BGC a financial incentive to deny Merck's Reconsideration Request (and, presumably, all other requests that might result in auctions), Merck does not offer *any* evidence to support its unfounded speculation.<sup>66</sup>

44. In any event, the proceeds of such an auction would not, as Merck claims, proceed "directly" to ICANN. Rather, as the Guidebook states, those proceeds "will be reserved and earmarked until the uses of [the] funds are determined," and must be used in a way that "allows ICANN to maintain its not for profit status."<sup>67</sup> As such, Merck's claim does not support independent review.

**C. THE BGC DID NOT VIOLATE THE BYLAWS BY DECLINING TO RECOMMEND FURTHER ACTION BY THE BOARD.**

---

<sup>65</sup> Guidebook, § 4.3.

<sup>66</sup> IRP Request ¶ 88.

<sup>67</sup> Guidebook, § 4.3. Possible uses contemplated by the Guidebook include the "formation of a foundation with a clear mission and a transparent way to allocate funds to projects that are of interest to the greater internet community" or the "establishment of a security fund to expand [the] use of secure [internet] protocols, conduct research, and support standards development organizations." *Id.*



45. Merck argues that the BGC improperly failed to “recommend[] that the ICANN Board take appropriate measures that the BGC is incompetent to make.”<sup>68</sup> Merck does not cite to any Article or Bylaws provision that would require the BGC to recommend further action on Merck’s Reconsideration Request. To the contrary, as noted above, the Bylaws provide that the BGC may “make a final determination on Reconsideration Requests regarding staff action or inaction, [including DSRPs and related expert panels,] without reference to the [Board].”<sup>69</sup>

**D. MERCK’S ARGUMENT THAT THE BGC RENDERED AN INCORRECT DETERMINATION ON ITS RECONSIDERATION REQUEST HAS NO PLACE IN AN IRP, AND IS IN ANY EVENT WITHOUT MERIT.**

46. The crux of Merck’s argument is that the BGC substantively erred in denying Merck’s Reconsideration Request. However, Merck fails to identify any Article or Bylaws provision that the BGC allegedly violated in taking action on Merck’s Reconsideration Request. Instead, just as it did in its Request, Merck seeks to use the IRP to challenge the substantive decision of the Expert Panel, which is not appropriate for an IRP for several reasons, not the least of which is that this is not an ICANN *Board* action. Even so, ICANN briefly responds below.

47. In its Reconsideration Request, Merck argued that the Expert violated established policies and procedures by: (i) failing to apply the legal rights objection standard and instead “rel[ying] on the wholly inapplicable reasoning” of the UDRP standards, and (ii) failing to “take reasonable care in evaluating the parties’ respective evidence.”<sup>70</sup> The BGC denied the request,

---

<sup>68</sup> IRP Request ¶ 82.

<sup>69</sup> Bylaws, Art. IV, § 2.3(f). Merck argues that the BGC recommended further action in its determinations on Reconsideration Requests 13-9 and 13-10, presumably suggesting that if the BGC has recommended further action in other cases, it must do so here. This argument is without merit. As set out in the Bylaws, it is wholly within the BGC’s discretion to determine if a recommendation for further Board action is warranted..

<sup>70</sup> Request 14-9, p. 10, 13-14. Merck does not appear to dispute the BGC’s finding that the Panel did not base its determinations on an incorrect finding of fact. And as discussed above, the Panel itself addressed that argument, noting that its error was inadvertent, did not represent a misunderstanding of the evidentiary record, and in any event involved a fact immaterial to the Panel’s determinations.

finding that the Expert Panel: (i) correctly referenced and considered the factors required by the Guidebook, and (ii) did not base its determinations on an incorrect finding of fact.<sup>71</sup>

48. Merck argues that the BGC failed to address the Expert Panel’s alleged failure to apply the correct standard in evaluating Merck’s Objections.<sup>72</sup> But the BGC’s determination explicitly addresses Merck’s claim, noting that the Expert Panel “correctly referenced and considered the eight non-exhaustive factors listed in the Guidebook and explained how those factors supported [its] Determinations.”<sup>73</sup> Disagreeing with the BGC’s determination in this regard is not a proper basis for independent review.<sup>74</sup>

49. Merck also argues that the Expert Panel failed to apply the correct legal rights objection standard by failing to determine “whether the potential use of the applied-for gTLD by the applicant takes unfair advantage of . . . or unjustifiably impairs the distinctive character or the reputation of [Merck]’s mark . . . or otherwise creates a likelihood of confusion between the applied-for gTLD and [Merck’s mark].”<sup>75</sup> Merck is wrong: the Expert Panel found that “the potential use of [.MERCK and .MERCKMSD] by [MSD] [did] not” take unfair advantage of, unjustifiably impair, or otherwise create a likelihood of confusion with Merck’s mark. In making that determination, the Expert Panel, as it was required to do, considered and applied the eight required Guidebook factors (and, again, this is not a matter for independent review).<sup>76</sup>

50. Merck’s real complaint is with the Expert Panel’s substantive (and logical)

---

<sup>71</sup> 14-9 Determination, p. 8-12.

<sup>72</sup> IRP Request ¶ 92.

<sup>73</sup> 14-9 Determination, p. 8. In considering and applying those eight factors, the Expert Panel was applying the correct legal rights objection standard—the Guidebook provides that those are the factors experts are to consider in determining whether the “potential use of the applied for gTLD by the applicant” infringes on the existing legal rights of the objector. Guidebook, § 3.5.2.

<sup>74</sup> Merck also argues that the Expert Panel did not give enough weight to the “potential use of the applied-for gTLD” (as set forth in Section 3.5.2 of the Guidebook) in making its decision, but again, this is a challenge to the Expert Panel’s findings, not a question of whether the Expert Panel applied the correct criteria.

<sup>75</sup> IRP Request ¶ 52, *Id.*, § 3.5.2.

<sup>76</sup> Expert Determinations, p. 6-8.

conclusion that:

The question [raised by Merck’s Objections] is whether a *bona fide* trademark owner that owns trademark rights in certain countries but does not have rights to a certain trademark in all countries of the world, should for that reason be prevented from obtaining a gTLD. In the view of the Panel, such a proposition does not make sense. . . .

. . . .

Of course a rejection of the Objection[s] does not preclude the Objector from taking regular legal action should the use of the Disputed gTLD String[s] by Applicant be infringing. It is not, however, for this Panel to anticipate all the possible types of use [MSD] could make of the Disputed gTLD String.<sup>77</sup>

Merck disagrees because it believes that MSD’s Applications reflect that MSD has the intent to, sometime in the future, violate Merck’s intellectual property rights in countries located outside of North America.<sup>78</sup> But Merck’s substantive disagreement with the Expert Panel’s determination does not relate to any ICANN Board action and thus cannot be a basis for independent review.

51. Merck apparently wanted the Expert Panel to assume, based on a lack of affirmative assurances in MSD’s Applications, that MSD was going to infringe on Merck’s marks.<sup>79</sup> The Expert Panel declined to do so, finding that it was not the Expert Panel’s place to “anticipate all the possible types of use [MSD] could make” of its applied-for gTLDs” and noting that, if MSD did in fact infringe on Merck’s marks, Merck was not precluded from enforcing its rights by taking legal action.<sup>80</sup> Merck’s disagreement with that conclusion does not indicate that the Expert Panel failed to assess the “potential use of the applied-for gTLDs.” More importantly, none of this suggests that the BGC erred in denying Merck’s Request or should

---

<sup>77</sup> *Id.*, p. 6.

<sup>78</sup> IRP Request ¶ 22.

<sup>79</sup> For example, it is unclear how MSD’s statement that it intends to use “geographical indicators as second-level domain names” constitutes MSD “admit[ting] its intention to use the gTLDs in an unrestricted and impermissible manner.” *Id.* (quoting MSD’s Applications, § 22).

<sup>80</sup> The IRP Request reflects that Merck has been doing just that, bringing suit against MSD in courts in Germany, the United Kingdom, and France. *Id.* ¶ 11.

prevail in this IRP.

**III. ICANN’S BYLAWS AND ARTICLES OF INCORPORATION DO NOT REQUIRE THAT ICANN PROVIDE FOR APPEAL AND REVIEW MECHANISMS BEYOND THOSE ALREADY PROVIDED.**

52. Merck argues that the fact that the Guidebook provides no mechanism for the substantive review of expert determinations itself violates ICANN’s Bylaws and Articles of Incorporation.<sup>81</sup> Merck apparently is challenging the outcome of the Guidebook development process, a process that was started many years ago and completed over two years ago, and one for which the time for challenge has long since past. As noted above, ICANN adopted the Guidebook following years of consideration and community involvement.<sup>82</sup> Merck argues that the Board’s failure to provide for a substantive appeals mechanism violates Article I, Section 2.8 of the Bylaws, which requires ICANN to “mak[e] decisions by applying documented policies neutrally and objectively, with integrity and fairness.”<sup>83</sup> But the decision to have no appeals mechanism is applied neutrally, as there is no substantive appeals mechanism for *any* expert determinations.<sup>84</sup>

53. Further, as Merck acknowledges, “[t]he availability of the Legal Rights Objection as an administrative dispute resolution option does not preclude court options which either party may have to submit the dispute to court.”<sup>85</sup> This is especially important here because Merck’s main concern is that its rights might, one day, be impaired if MSD becomes the registry operator for .MERCK and then operates the registry in a manner that affects Merck’s rights. The ICANN

---

<sup>81</sup> See *id.* ¶¶ 99-111.

<sup>82</sup> Merck points to several public comments suggesting that the Guidebook include a substantive review mechanism. (IRP Request, Annex 56.) However, none of the ten versions of the Guidebook, each of which was discussed and debated by the community, has contained such a mechanism, revealing that the overall community was not in favor of including a substantive review mechanism.

<sup>83</sup> Bylaws, Art. I, § 2.8.

<sup>84</sup> Contrary to what Merck argues, ICANN’s Board has not adopted the “Proposed Review Mechanism to Address Perceived Inconsistent Expert Determinations on String Confusion Objections.” IRP Request ¶ 83; *Id.* Annex 55

<sup>85</sup> Ex. C-R-3, Legal Rights Objections FAQs, also available online at <http://www.wipo.int/amc/en/domains/lro/faq/#19a>; IRP Request ¶ 103.

Board cannot possibly violate its Bylaws or Articles by “declining to address” a theoretical concern about what might happen in the future between two entities that have been dealing with such trademark-related issues for decades.

54. Merck cites to a United States District Court order dismissing a case arising out a legal rights objection to argue that courts “deny jurisdiction” over cases involving legal rights objections and “show prejudice to [] parties who have not exhausted ICANN accountability mechanisms.”<sup>86</sup> But Merck’s characterization of the Court’s order in *Del Monte Int. v. Del Monte Corp.* is not accurate: the Court decided to exercise jurisdiction over the case even though it had the discretion to decline jurisdiction under the Declaratory Judgment Act.<sup>87</sup> The Court then dismissed the case not for any failure to exhaust ICANN’s accountability mechanisms, but because the new gTLD at issue *had not been delegated*.<sup>88</sup> The Court specifically noted that its ruling did not “foreclose application of the [Anti-Cybersquatting Consumer Protection Act] in the context of *successful* gTLD registrations” that infringe on existing legal rights.<sup>89</sup>

#### **IV. RESPONSE TO MERCK’S REQUESTED RELIEF.**

55. Merck’s request should be denied in its entirety, including its request for relief. Merck requests that this IRP Panel issue a declaration “[r]equiring that ICANN instruct a DSRP to appoint a new LRO Panel or Panels to decide upon [Merck’s] Legal Rights objections with regard to [MSH’s Applications] . . . and/or provide any such relief as the Panel may find appropriate.”<sup>90</sup> An IRP Panel is limited to stating its opinion by “declaring whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws” and *recommending* that the Board stay any action or decision or take any interim action until such

---

<sup>86</sup> IRP Request ¶¶ 72, 105.

<sup>87</sup> *Id.*, Annex 58, p. 17-19.

<sup>88</sup> *Id.*, Annex 58, p. 36.

<sup>89</sup> *Id.* Annex 58, p. 34-35.

<sup>90</sup> *See* IRP Request ¶ 112.

time as the Board reviews and acts upon the opinion of the IRP Panel.<sup>91</sup> Even if there were a basis for some kind of relief here (which there is not), neither this nor any IRP Panel has the authority to award affirmative relief.<sup>92</sup>

### CONCLUSION

56. ICANN's conduct with respect to its evaluation of Merck's Reconsideration Request was fully consistent with ICANN's Articles and Bylaws. ICANN followed the procedures set forth in its Bylaws in evaluating Merck's Reconsideration Request. The fact that Merck disagrees with the Expert Determinations does not properly give rise to an IRP. Merck and MSD may well continue to litigate against one another for years to come, but ICANN's Board did not violate its Articles or Bylaws by declining to inject itself into that dispute. Merck's IRP Request should be denied.

Respectfully submitted,

JONES DAY

Dated: August 29, 2014

By: Jeffrey A. LeVee / JAL  
Jeffrey A. LeVee

Counsel for Respondent ICANN

---

<sup>91</sup> Bylaws, Art. IV, §§ 3.4, 3.11(c-d).

<sup>92</sup> Indeed, the IRP Panel in the first ever IRP found that "[t]he IRP cannot 'order' interim measures but do no more than 'recommend' them, and this until the Board 'reviews' and 'acts upon the opinion' of the IRP." See Ex. C-R-4, Advisory Declaration of IRP Panel, ICM Registry, LLC v. ICANN, ICDR Case No. 50 117 T 00224 08, ¶ 133, also available online at <https://www.icann.org/en/system/files/files/-panel-declaration-19feb10-en.pdf>.

**CLA-008**

**INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION**

**INDEPENDENT REVIEW PROCESS**

**Case No. 01-14-0000-9604**

***MERCK KGaA***  
**(Claimant)**

**-v-**

***Internet Corporation for Assigned Names and Numbers***  
**(Respondent)**

**FINAL DECLARATION OF THE INDEPENDENT REVIEW PROCESS  
PANEL**



## Section I – Procedural History

1. The Claimant, Merck KGaA (“Merck”), of Frankfurter Straße 250 64293 Darmstadt, Germany, is represented in this matter by Bettinger Schneider Schramm, Cuvilliesstraße 14, 81679 Munich, Germany.
2. The Respondent, Internet Corporation for Assigned Names and Numbers (“ICANN”), of Suite 300 12025 E. Waterfront Dr., Los Angeles, CA 90094, USA, is represented in this matter by Jones Day, 555 South Flower Street Fiftieth Floor Los Angeles, CA 90071, USA.
3. A Notice of Independent Review dated July 17, 2014 was filed by Merck with the International Centre for Dispute Resolution, together with its Request.
4. ICANN filed its Response on August 29, 2014.
5. The Panel held a preliminary hearing call on April 1, 2015 and issued the following direction by email thereafter:

### ***Merck KGaA V. ICANN - Case 01-14-0000-9604***

*The Preliminary Hearing Call in this matter took place at 9am, Pacific Time, on April 1, 2015, and was duly notified and convened. Counsel (Bettinger, with Gray, for Merck KGaA; LeVee for ICANN) for both parties made observations on the procedure to be adopted in this Independent Review Process. At the conclusion of the Preliminary Hearing Call the parties were asked whether there was anything further they wished to raise, and the answer from each side was no.*

*The Panel (Dinwoodie, Matz, and Reichert) now, bearing these observations in mind together with the materials already filed by the parties to date, issues the following directions:*

- 1. Merck KGaA shall file its Reply Submission on May 20, 2015.*
- 2. ICANN shall file its Rejoinder Submission on July 8, 2015.*
- 3. A page limit of 20 pages applies to both Submissions (the page limit does not apply to matters such as tables of contents).*

4. *The Submissions should only attach any additional evidentiary exhibit which is strictly necessary for the purpose of reply/rejoinder. Also, the parties must focus their Submissions on matters which are strictly for the purposes of reply/rejoinder, and not seek to reformulate the case as already presented.*

5. *If there is any dispute as to acronyms or other defined terms, the Submissions should clearly flag these in order that there is no misunderstanding.*

6. *As soon as possible after July 8, 2015, the Panel will communicate with the parties as to the next stages of this Independent Review Process.*

*As noted on the Preliminary Hearing Call by the ICDR representative, communications will now take place directly between the Panel and the parties, with a copy at all times to the ICDR.*

*For and on behalf of the Panel.*

*Klaus Reichert SC*

6. On May 20, 2015, Merck filed its Reply.
7. On July 9, 2015, ICANN filed its Rejoinder.
8. On July 12, 2015, the Panel issued the following direction by email:

*Dear Counsel,*

*The Panel has considered the submissions received.*

*Having considered the submissions made to date, do the parties wish to have an oral hearing? If the answer from a party is yes, we would like to know the likely duration of such a hearing, and whether there is a preference for it to be conducted in person, or by telephone.*

*Once we have received your responses to the foregoing we will consider the future conduct of this matter and revert to the parties.*

*We do not set a particular deadline for your responses, rather we ask that you reply as soon as possible.*

*Klaus Reichert*

9. On July 14, 2015, ICANN indicated that it believed that a hearing by telephone would be useful.
10. On July 21, 2015, Merck indicated that a hearing would be unnecessary.
11. On July 21, 2015, the Panel issued the following direction by email:

*Dear Counsel,*

*Noting Article 4 of the Supplementary Procedures for Internet Corporation for Assigned Names and Numbers (ICANN) Independent Review Process ("the Procedures"), the Panel has determined that a telephone hearing will not be necessary.*

*Noting Article 11 of the Procedures, we invite each side to submit their respective claims for costs by July 29, 2015. Thereafter an opportunity will be afforded to each side to comment on the claim for costs of the other.*

*Klaus Reichert*

12. On July 28, 2015, Merck stated that ICANN should be held responsible for (a) the fees and expenses of the panelists, and, (b) the fees and expenses of the administrator, the ICDR.
13. On July 28, 2015, ICANN stated that Merck should be held responsible for costs (identifying the same headings as those identified by Merck).
14. On July 28, 2015, the Panel issued the following direction by email:

*Dear Parties,*

*Thank you both for your letters on costs.*

*We now ask each side for any final observations they might wish to make on costs in light of the letters received today. The deadline is 4 August 2015.*

*Klaus Reichert*

15. On July 31, 2015, Merck stated that it had no comment on ICANN's letter regarding costs. ICANN did not make any final observations on costs.

### **Section II – The Panel's Authority**

16. The Panel's authority and mandate is as follows (from Article IV, Section 3.4 of ICANN's Articles of Incorporation and Bylaws):

*Requests for such independent review shall be referred to an Independent Review Process Panel ("IRP Panel"), which shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws. The IRP Panel must apply a defined standard of review to the IRP request, focusing on:*

- a did the Board act without conflict of interest in taking its decision?;*
  - b did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and*
  - c did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?*
17. The analysis which the Panel is mandated to undertake is one of comparison. More particularly, a contested action<sup>1</sup> of the Board is compared to the Articles of Incorporation and Bylaws in order to ascertain whether there is consistency. The analysis required for a comparison exercise requires careful assessment of the action itself, rather than its characterization by either the complainant or ICANN. The Panel, of course, does take careful note of the characterizations that are advanced by the Claimant and ICANN.
18. As regards the substantive object of the comparison exercise, namely, whether there was consistency as between the action and the Articles of Incorporation and Bylaws, the parameters of the evaluation for consistency are informed by the final part of Article IV, Section 3.4, which is explicit

---

<sup>1</sup> The Panel is of the view that inaction, depending upon the circumstances, may constitute an action within the meaning of Article IV, Section 3.4.

in focusing on three specific elements. The phrase “defined standard of review” undoubtedly relates to the exercise of comparison for consistency, and informs the meaning of the word “consistent” as used in Article IV, Section 3.4. The mandatory focus on the three elements (a-c) further informs the exercise of comparison.

19. The parties dwell in various ways on whether the Panel’s approach is deferential or *de novo*. The Panel does not find this debate to be of assistance as it diverts attention from the precise parameters of its authority, namely, to do exactly what it is mandated to do by Article IV, Section 3.4.
20. Nothing in the language of Article IV, Section 3.4, suggests that there be any deference afforded to the contested action. Either the action was consistent with the Articles of Incorporation and Bylaws, or it was not.
21. Discussion as regards whether the Panel should engage in a *de novo* standard of review is also apt to mislead. However, it is clear that the Panel may not substitute its own view of the merits of the underlying dispute.
22. In summary, the Independent Review Process is a bespoke process, precisely circumscribed. The precise language used in Article IV, Section 3.4 requires the party seeking to contest an action of the Board to identify exactly such action, and also identify exactly how such action is not consistent with the Articles of Incorporation and Bylaws. Thus, a panel is required to consider only the precise actions contested. Such a contesting party also bears the burden of persuasion.

### Section III – Analysis

23. The **first contested action**, as characterized and raised by Merck in paragraph 46 of the Request is:

*The ICANN Board has accepted three expert determinations which suffer from palpable mistakes and manifest disregard of its own LRO standards, without due diligence and care to prevent the acceptance of such determinations, resulting in fundamental unfairness and a failure of due process for the Claimant.*

24. Merck says that this is a violation of ICANN’s Articles of Incorporation and Bylaws, Article I, Section 2.8, which provide as follows:

*In performing its mission, the following core values should guide the decisions and actions of ICANN..... 8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.*

25. The Panel will first describe, based on its appreciation of the materials put before it, the background leading up to the initiation of this Independent Review Process.

26. Merck is a long-established pharmaceutical and chemical business in Germany. In 1917 its then American business (now Merck & Co., Inc. (“MSD”)) was separated from it by the Trading with the Enemy Act arising from the entry of the United States as a belligerent into World War I. The co-existence of Merck and MSD has been the subject of a number of formal agreements over the years, and also a number of disputes.

27. Merck and MSD each filed applications with ICANN for new gTLDs incorporating the word “Merck”. As a result, Merck and MSD then filed a number of Legal Rights Objections (“LROs”) against each other with the WIPO Arbitration and Mediation Centre in accordance with the New gTLD Dispute Resolution Procedure. At the heart of Merck’s complaint was the point that MSD apparently was not intending to limit, through

geo-targeting, the potential global reach of its applied-for domains. In contrast, Merck made explicit its intention to use geo-targeting.

28. By Determinations issued in July and September 2013, the Sole Panel Expert rejected the LROs. The following extract from LRO2013-0068 is reflective of the reasoning common to all:

*The starting point of this case is that Objector and Applicant are both bona fide users of the MERCK trademark, albeit for different territories.*

*The question is whether a bona fide trademark owner that owns trademark rights in certain countries but does not have rights to a certain trademark in all countries of the world, should for that reason be prevented from obtaining a gTLD. In the view of the Panel, such a proposition does not make sense. If the opposite view would be accepted, it would be expected from any trademark owner interested in a gTLD to have trademark registrations in all countries of the world as otherwise another party could register one trademark in an “uncovered” country and thus prevent the first trademark owner from applying for and using its own gTLD.*

*In essence there should not be a significant difference between the criteria for the legal rights objection as included in the Guidebook on the one hand and the provisions included in the Uniform Domain Name Dispute Resolution Policy (“UDRP”). If the applicant for a new gTLD is bona fide, it will not be likely that one of the three criteria will be met. It might be that advantage of the distinctive character or the reputation of the objector’s registered trademark is taken, but it is then likely not unfair. It might be that the distinctive character or reputation of the objector’s registered trademark is being impaired, but it is likely justified. It might be that a likelihood of confusion between the Disputed gTLD String and the objector’s mark is created, but it is not necessarily impermissible.*

*Of course a rejection of the Objection does not preclude Objector from taking regular legal action should the use of the Disputed gTLD String by Applicant be infringing. It is, however, not for this Panel to anticipate on all the possible types of use Applicant could make of the Disputed gTLD.*

*It is also not for this Panel to interpret the existing coexistence agreements and arrangements between the Parties. Should the application of a new gTLD allegedly violate any such agreement or arrangement, it will be for the Parties to settle their dispute by means of the dispute resolution provisions of the contracts governing their relationship or as provided under applicable law.*

*For the aforementioned reasons the Panel rejects the Objection.*

*In reaching the above conclusion, the Panel has considered the following non-exclusive list of eight factors.*

*The Panel addresses each of them in turn:*

*i. Whether the applied-for gTLD is identical or similar, including in appearance, phonetic sound, or meaning, to Objector's existing mark.*

*[Sole Panel Expert analysis follows]*

*ii. Whether Objector's acquisition and use of rights in the mark has been bona fide.*

*[Sole Panel Expert analysis follows]*

*iii. Whether and to what extent there is recognition in the relevant sector of the public of the sign corresponding to the gTLD, as the mark of Objector, of Applicant or of a third party.*

*[Sole Panel Expert analysis follows]*

*iv. Applicant's intent in applying for the gTLD, including whether Applicant, at the time of application for the gTLD, had knowledge of Objector's mark, or could not have reasonably been unaware of that mark, and including whether Applicant has engaged in a pattern of conduct whereby it applied for or operates TLDs or registrations in TLDs which are identical or confusingly similar to the marks of others.*

*[Sole Panel Expert analysis follows]*

*v. Whether and to what extent Applicant has used, or has made demonstrable preparations to use, the sign corresponding to the gTLD in connection with a bona fide offering of goods or services or a bona fide provision of information in a way that does not interfere with the legitimate exercise by Objector of its mark rights.*

*[Sole Panel Expert stated that this factor would be discussed together with the factor mentioned under vi.]*

*vi. Whether Applicant has marks or other intellectual property rights in the sign corresponding to the gTLD, and, if so, whether any acquisition of such a right in the sign, and use of the sign, has been bona fide, and whether the purported or likely use of the gTLD by Applicant is consistent with such acquisition or use.*

*[Sole Panel Expert analysis follows]*



vii. *Whether and to what extent Applicant has been commonly known by the sign corresponding to the gTLD, and if so, whether any purported or likely use of the gTLD by Applicant is consistent therewith and bona fide.*

*[Sole Panel Expert analysis follows]*

viii. *Whether Applicant's intended use of the gTLD would create a likelihood of confusion with Objector's mark as to the source, sponsorship, affiliation, or endorsement of the gTLD.*

*[Sole Panel Expert analysis follows]*

29. On September 23, 2013, Merck raised with WIPO a number of points of its concern with the contents of three of the Determinations. First, Merck noted that the Sole Panel Expert referenced intended geo-targeting by MSD, when in fact it was Merck which was intending to do so. Secondly, Merck stated that the Sole Panel Expert did not consider the three elements of the LRO Policy but rather those contained in the UDRP. In addition, Merck stated the following:

*There is no appeals process for incorrect decisions under the LRO procedure, and accordingly there is no clear way in which my client (Merck KgaA) can rectify the damage done by an inattentive Panel. No court can review these decisions, and indeed even ICANN likely has limited powers to overturn a decision, even where it has been entered based on a wholly erroneous review of the submitted facts and evidence.*

30. The Sole Panel Expert issued an Addendum dated September 24, 2013. As regards geo-targeting, he stated:

*It is correct that the Expert Determinations under 6. (Discussion and Findings) under the heading Trademark Infringement, under non-exclusive factor viii, should not have included the following sentence:*

*"Applicant has made it clear that it will take all necessary measures, including geo-targeting, to avoid that Internet users in the territories in which Objector has trademark rights, will be able to visit websites that use the Disputed gTLD String."*

.....

*Having noted this, the Panelist should make clear that, in reviewing LRO2013-0009, LRO2013-0010 and LRO2013-0011, he was in fact aware of the distinction in this regard, as reflected in the pleadings as cited and summarized in the Expert Determinations, between the latter three cases and cases LRO2013-0068 and LRO2013-0069 in relation to the competing applications at stake.*

*In any event, the Panelist considers it important to confirm that the above-mentioned sentence as such is immaterial to the conclusion which the Panelist reached in rejecting the Objections.*

31. As regards his application of UDRP or LRO Policy, the Sole Panel Expert was of the view that, UDRP comparisons notwithstanding, he had applied the specific LRO criteria.
32. On February 27, 2014, ICANN informed Merck that it had updated the LRO Determinations together with the Sole Panel Expert's Addenda.
33. On March 13, 2014, Merck filed a Request for Reconsideration. It requested ICANN to reject the advice recorded in the Sole Panel Expert's Determinations, and "instruct a panel to make an expert determination that applies the standards defined by ICANN".
34. Merck's grounds for its Request for Reconsideration were summarized as follows:

*In this case, the Expert Panel failed to take reasonable care in evaluating the parties' respective evidence and to make a correct application of the LRO standard developed by ICANN in the Applicant Guidebook, resulting in a denial of due process to the Requester in the context of its three LRO disputes.*

35. On April 29, 2014, the Board Governance Committee of ICANN ("BGC") made its Determination dismissing the Request for Reconsideration. The initial part of that Determination summarized the reasons:

*Merck Registry Holdings, Inc. applied for .MERCK and MSD Registry Holdings, Inc. applied for .MERCKMSD. The Requester, who also applied for .MERCK, objected to these applications and lost. The Requester claims that the Panel failed to comply with ICANN policies*

and processes in reaching its determinations. Specifically, the Requester contends that the Panel:

(i) improperly interpreted the factors governing legal rights objections in light of “wholly inapplicable” Uniform Domain Name Dispute Resolution Policy (“UDRP”) standards; and

(ii) failed to “accurately assess critical facts concerning the Parties’ pleadings, leading to mis-attribution of party intent [concerning geo-targeting commitments] and a material misrepresentation of the parties’ respective positions.” (Request, §§ 6, 8, Pgs. 6, 18.)

With respect to the claims submitted by the Requester, there is no evidence that the Panel either applied the improper standard or failed to properly evaluate the parties’ evidence. First, the Panel correctly referenced and analyzed the eight factors set out in the Applicant Guidebook relevant to legal rights objections and considered the UDRP only as a means to further provide context to one of the eight factors. The Requester does not identify any policy or process that was violated in this regard. Second, after the Requester brought the Panel’s mis-attribution of geo-targeting commitments to the attention of WIPO, the Panel issued an Addendum to the Determinations, confirming that the misstatement was “inadvertent,” that the Panel “was in fact aware of the distinction,” and that the misstatement was not material to the Determinations in all events. Because the Requester has failed to demonstrate that the Panel acted in contravention of established policy or procedure, the BGC concludes that Request 14-9 be denied.

36. On April 29, 2014, the BGC held a meeting and the minutes note the following:

*Reconsideration Request 14-9– Ram Mohan abstained from participation of this matter noting conflicts. Staff briefed the BGC regarding Merck KGaA's Request seeking reconsideration of the Expert Determinations, and ICANN's acceptance of those Determinations, dismissing Merck KGaA's legal rights objections to Merck Registry Holdings, Inc.'s application for .MERCK and MSD Registry Holdings, Inc.'s application for .MERCKMSD. After discussion and consideration of the Request, the BGC concluded that the Requester has not stated proper grounds for reconsideration because the Request failed to demonstrate that the expert panel acted in contravention of established policy or procedure. The Bylaws authorize the BGC to make a final determination on Reconsideration Requests brought regarding staff action or inaction; the BGC still has the discretion, but is not required, to recommend the matter to the Board for consideration. Accordingly, the BGC concluded that its determination on Request 14-9 is final; no consideration by the NGPC is warranted. □*

37. In light of the foregoing, this Panel now analyses the first contested action for the purposes of the comparison exercise. Although in paragraph 48 of its Request Merck characterizes the challenged action as the “acceptance” of by the Board of the BGC determination, it is clear from the Request as a whole that the focus of the complaint is the decision of the BGC. While this Panel’s focus is on the first contested action precisely as advanced by Merck (namely, “acceptance”), concomitant with that exercise will be an analysis (within the confines of this Panel’s jurisdiction) of the BGC’s Determination (noting ICANN’s Articles of Incorporation and Bylaws, Article I, Section 2.3(f)).
38. The question now arises as to whether the first contested action was consistent with Article I, Section 2.8, namely, was there a neutral and objective application, with integrity and fairness, by the Board of documented policies.
39. Assistance for this Panel is derived from the three elements defining the focus of the review in Article IV, Section 3.4, namely:
- a did the Board act without conflict of interest in taking its decision?;*
  - b did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and*
  - c did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?*
40. The Panel takes each of the three factors, a-c, in turn.
41. Factor (a): Did the Board act without conflict of interest in taking its decision? The Panel finds that there is no evidence whatsoever to suggest that there was any conflict of interest. Merck suggests that ICANN had a conflict of interest due to the potential for a financial windfall in the event of there being an Auction of Last Resort. This is a submission made without evidence, is speculative, and is unfounded. Moreover, this Panel

does not consider that this Independent Review was initiated (or capable of being initiated) to challenge, in substance, the policy decision of ICANN in 2012 to include the Auction of Last Resort.

42. The Panel finds that the answer to question “a” is yes.
43. Factor (b): Did the Board exercise due diligence and care in having a reasonable amount of facts in front of them? In the Panel’s assessment of the materials and arguments put before it, this appears to be at the heart of Merck’s complaints.
44. Merck criticizes severely the manner by which the Sole Panel Expert dealt with the issue of geo-targeting. Merck also takes particular issue with the application (or otherwise, as it suggests) by the Sole Panel Expert of LRO standards. It claims that these failings caused a denial of due process. Put another way, Merck is contending that the Sole Panel Expert got it so badly wrong, the process should be run again.
45. Merck’s criticisms of the Sole Panel Expert flow through into its complaints directed at the BGC.
46. Merck wanted the BGC to “reject the advice set forth in the Decisions, and instruct a panel to make an expert determination that applies the standards defined by ICANN”. Merck effectively wanted the BGC to overturn the Sole Panel Expert’s decisions and have the process re-run (which is what it, in substance, wants from this Panel). Its reasons for making that request of the BGC were that the Sole Panel Expert failed to decide the case on the basis of the correct and applicable LRO Standard, and moreover failed to decide the case on the basis of the true and accurate factual record which was presented to him in the course of the dispute. Merck then concludes from those points that it had “been denied fundamental due process, as its pleadings were not meaningfully taken into account in the course of the panel’s deliberations, and the panel elected to decide the case on inapplicable grounds”.

47. However, this basis for requesting relief does not sit easily with Merck's own stated position on September 23, 2013, noted above, and repeated here for emphasis:

*There is no appeals process for incorrect decisions under the LRO procedure, and accordingly there is no clear way in which my client (Merck KgaA) can rectify the damage done by an inattentive Panel....*

Merck plainly recognized that the sole recourse was by means of the Request for Reconsideration process (which Merck itself invoked). That process is of limited scope, with Article IV, Section 2.2, delineating that jurisdiction:

*Any person or entity may submit a request for reconsideration or review of an ICANN action or inaction ("Reconsideration Request") to the extent that he, she, or it have been adversely affected by:*

- a. one or more staff actions or inactions that contradict established ICANN policy(ies); or*
- b. one or more actions or inactions of the ICANN Board that have been taken or refused to be taken without consideration of material information, except where the party submitting the request could have submitted, but did not submit, the information for the Board's consideration at the time of action or refusal to act; or*
- c. one or more actions or inactions of the ICANN Board that are taken as a result of the Board's reliance on false or inaccurate material information.*

None of these three bases for the Request for Reconsideration process requires or even permits this Panel to provide for a substitute process for exploring a different conclusion on the merits.

48. The BGC recognized in its Determination that the Sole Panel Expert, in his Addenda, specifically noted the correct position as regards geo-targeting, and also that he further considered that his conclusions remained the same. In light of the Addenda, there is nothing to suggest that the Sole Panel Expert made his decision on the basis of incorrect facts. More importantly

for the purposes of this Review, the BGC analyzed whether he had done so.

49. Moreover, Merck's complaints about the Sole Panel Expert's application, or in its view, non-application of the LRO Standards lack merit. The BGC determined that the Sole Panel Expert did not apply the wrong standards. That is a determination which this Panel does not, because of the precise and limited jurisdiction we have, have the power to second guess. Rather, the critical question for this Panel is whether the BGC exercised due diligence and care in having a reasonable amount of facts in front of them. Merck complains that the BGC did not have "sufficient and accurate facts", and that Merck was thus deprived of an "accurate review of its complaints". These formulations miss the point, and indeed misstate the applicable test in proceedings such as these. The BGC had to have a reasonable amount of facts in front of it, and to exercise due diligence and care in ensuring that it did so. There is no evidence that the BGC did not have a reasonable amount of facts in front of it or consider them fully. It plainly had everything which was before the Sole Panel Expert. Nothing seems to have been withheld from the BGC.
50. Merck's complaints are, in short, not focused upon the applicable test by which this Panel is to review Board action, but rather are focused on the correctness of the conclusion of the Sole Panel Expert. Because this is not a basis for action by this Panel, the Panel answers question "b" with "yes".
51. Factor (c): Did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?  
The Panel does not see that Merck has mounted any attack through this route other than inferentially by vague references to the auction process. As regards that particular decision, there is no evidence (or indeed any concrete allegation) that the BGC or Board members did not exercise independent judgment.

52. In summary, therefore, the Claimant's first contested action complaint is dismissed.

53. The **second contested action** as characterized and raised by the Claimant in paragraph 46 of the Request is:

*The ICANN Board improperly disposed of the Claimant's RFR as the BGC violated its competency and independence in its evaluation of the application of the LRO standard. Further, its assessment was incorrect and failed to take into account the global use of the gTLD by Merck & Co. Additionally, the ICANN Board has provided the possibility for third-party review of some prima facie erroneous expert determinations while denying the same to other, similarly situated parties, including the Claimant. This results in discrimination and unfairness to, and failure of due process for, the Claimant.*

54. The Claimant says that this is a violation of ICANN's Articles of Incorporation and Bylaws, Article I, Section 2.8, which provide as follows:

*In performing its mission, the following core values should guide the decisions and actions of ICANN..... 8. Making decisions by applying documented policies neutrally and objectively, with integrity and fairness.*

55. The action of the Board, as precisely contested by Merck, is set out in paragraph 53 above. This particular action of the Board is developed by Merck as follows at paragraph 79 of the Request:

*The BGC did not address the Claimant's concerns (i) competently, (ii) independently, and (iii) substantively on the basis of the Claimant's legal argument.*

56. **Incompetence**: Merck asserts, at paragraph 82 of the Request that the BGC was incompetent because it had no alternative but to engage "in impermissible substantive analysis and interpretation". Merck then states that the BGC should have taken steps to address its concerns by, citing prior ICANN examples, appointing an independent legal advisor, or "recommending that the ICANN Board take appropriate measures that the



BGC is incompetent to make”. Drawing on these, Merck criticizes the fact that in some instances where there has been a prima facie erroneous determination ICANN provides for a review, whereas in others it does not. It says that this is a violation of the requirements of neutrality and fairness.

57. The Panel’s attention is drawn by Merck to a document recording the Resolutions of the Meeting of the New gTLD Program Committee (“NGPC”) on March 22, 2014, which notes that:

*...the Board may wish to seek a clear understanding of the legally complex and politically sensitive background on its advice regarding .WINE and .VIN in order to consider the appropriate next steps of delegating the two strings.*

58. A professor of law in Paris was commissioned to provide advice, and this was incorporated into the decision of the NGPC.

59. The Panel’s attention is also drawn to the Recommendation in relation to the Reconsideration Request 13-9 of October 10, 2013, made by the BGC. At the end of the Recommendation, the following is stated:

*Though there are no grounds for reconsideration presented in this matter, following additional discussion of the matter the BGC recommended that staff provide a report to the NGPC, for delivery in 30 days, setting out options for dealing with the situation raised within this Request, namely the differing outcomes of the String Confusion Objection Dispute Resolution process in similar disputes involving Amazon’s Applied-for String and TLDH’s Applied-for String. In addition, the BGC suggested that the strings not proceed to contracting prior to staff’s report being produced and considered by the NGPC.*

A proposed review mechanism is outlined thereafter.

60. Merck’s arguments are unavailing. If this Panel were to find that the BGC and Board are incompetent to assess the propriety of a Panel determination under the LRO this would effectively require a referral or appeal process for LRO decisions. Such a mechanism was not included in the delegation,

challenge and dispute resolution process adopted by ICANN and it is not open to this Panel to create it.

61. As to the claim of discrimination, this Panel finds that it was within the discretion of the BGC and Board, once the Sole Expert had revised his original determination to reflect his complete basis for the decision, to conclude that the Sole Expert had applied the correct legal standard to the correctly found set of facts. Of course, in different cases, the BGC and Board are entitled to pursue different options depending upon the nature of the cases at issue. It is insufficient to ground an argument of discrimination simply to note that on different occasions the Board has pursued different options among those available to it.
62. In conclusion, Merck was not discriminated against. These two examples, properly and fairly assessed, do not provide it with support for an allegation of discrimination.
63. Independence: Merck's complaint as to the lack of independence relies on the "Auction of Last Resort" argument which imputes to ICANN a financial interest, insinuating something improper. This is the same point, in substance, which was rejected by this Panel in paragraph 42 above. It is an argument which is speculative, and made without evidence to support it. In light of its dismissal above, it is also dismissed at this point.
64. Mischaracterization: Merck complains that the BGC mischaracterized its arguments. Merck describes its core concern as presented to the BGC as follows (paragraph 89 of the Request):

*...did the LRO Panel fail to decide the case on the basis of the correct and applicable LRO Standard, which requires it to consider the potential use of the applied-for gTLD ....*

65. This complaint is identical in substance to the matters already addressed by the Panel in paragraphs 43-50 above. In effect, Merck is running the same argument here as before, and it is therefore dismissed.

66. In summary, therefore, the Claimant's challenge to the second contested action complaint is dismissed.

67. The **third contested action** raised by Merck in paragraph 46 of the Request:

*As the result of the prior two violations, the ICANN Board has accepted without due diligence and care, a dysfunctional expert determination procedure within the New gTLD Program which has not provided for the possibility to review or overturn determinations on the basis of substantial errors or manifest disregard of the LRO Standards, despite the foreseeable and forewarned possibility of such, resulting in fundamental unfairness and a failure of due process for the Claimant.*

68. In light of the resolution of the first two contested actions against Merck, the Panel finds that this third contested action must also be dismissed. It is predicated for success upon the first two by use of the language “[A]s the result of the prior two violations”.

#### **Section IV – Costs**

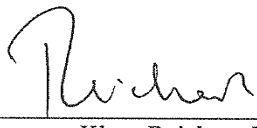
69. As ICANN is the prevailing party, Merck is held responsible for costs. Therefore the administrative fees and expenses of the International Centre for Dispute Resolution (ICDR) totaling US\$3,350.00 shall be borne by entirely by Merck KGaA, and the compensation and expenses of the Panelists totaling US\$97,177.08 shall be borne by entirely by Merck KGaA. Therefore, Merck KGaA shall reimburse ICANN the sum of US\$48,588.54, representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by ICANN.

**Section V – Declaration**

1. Merck has not succeeded in this Independent Review Process. ICANN is the prevailing party. As per paragraph 69, Merck must pay ICANN costs in the amount of USD \$48,588.54.

This Final Declaration of the Independent Review Process Panel may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

December 10, 2015  
Date

  
\_\_\_\_\_  
Klaus Reichert, Panelist/ Chair

\_\_\_\_\_  
Date

\_\_\_\_\_  
A. Howard Matz, Panelist

\_\_\_\_\_  
Date

\_\_\_\_\_  
Graeme Dinwoodie, Panelist

Section V – Declaration

1. Merck has not succeeded in this Independent Review Process. ICANN is the prevailing party. As per paragraph 69, Merck must pay ICANN costs in the amount of USD \$48,588.54.

This Final Declaration of the Independent Review Process Panel may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

Date	Klaus Reichert, Panelist/ Chair
------	---------------------------------

<i>December 10, 2015</i>	
Date	A. Howard Matz, Panelist

Date	Graeme Dinwoodie, Panelist
------	----------------------------

Section V – Declaration

1. Merck has not succeeded in this Independent Review Process. ICANN is the prevailing party. As per paragraph 69, Merck must pay ICANN costs in the amount of USD \$48,588.54.

This Final Declaration of the Independent Review Process Panel may be executed in any number of counterparts, each of which shall be deemed an original, and all of which shall constitute together one and the same instrument.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Klaus Reichert, Panelist/ Chair

\_\_\_\_\_  
Date

\_\_\_\_\_  
A. Howard Matz, Panelist

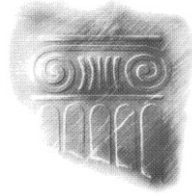
December 10, 2015

\_\_\_\_\_  
Date

Graeme B. Dinwoodie  
\_\_\_\_\_  
Graeme Dinwoodie, Panelist

**CLA-009**





**Arbitration CAS 2002/O/410 The Gibraltar Football Association (GFA)/Union des Associations Européennes de Football (UEFA), award of 7 October 2003**

Panel : Mr. Bruno Simma (Germany), President; Professor Pierre Lalive (Switzerland); Mr. Dirk-Reiner Martens (Germany)

*Football*

*Application for UEFA membership*

*Rules on membership applicable at the time when the application was made*

*Legality of a change of rule with a retrospective effect*

*Principles of fairness and good faith*

*Freedom of association*

- 1. According to the new version of Article 5 of the UEFA Statutes, UEFA membership is restricted to associations in countries which are recognised as independent States by the United Nations. This new rule should not be regarded as a rule dealing only with procedural aspects justifying immediate application regardless of when the facts at issue occurred. The immediate application in this matter would entail a violation of general principles of law which are widely recognised, particularly the principles of fairness and of good faith.**
- 2. According to the old version of Article 5 of the UEFA Statutes “Membership of UEFA is open to national football associations situated in the continent of Europe which are responsible for the organisation and implementation of football-related matters in their particular territory”. GFA indisputably exercises sole responsibility for the organisation and structure of football in its territory. The concept of “nation” or “country” in the sports environment must not necessarily be “understood within its common political meaning. More importantly, UEFA already has – and had at the time when the application was made – a number of member associations from countries which do not enjoy independent statehood, such as Scotland, Wales or the Faroe Islands.**
- 3. Generally, freedom of association includes the freedom of an association to accept or to refuse any applicant for membership, even if the applicant fulfils all statutory conditions. However, the exclusion of athletes, or of a sports association to which athletes are affiliated, from an international sports organisation which occupies a dominant or monopolistic position in the organisation of sports competitions may have the effect of a boycott. Such an exclusion should therefore be held invalid, at least to the extent that it is not grounded on objective and justified reasons.**

The Claimant, the Gibraltar Football Association (“GFA”), is an unincorporated body that is responsible for the organisation of all football in the territory of Gibraltar. The GFA was established in 1895, and today it has between 2000 and 2500 members.

The GFA has a Men’s senior league composed of three divisions, a Junior league, and Ladies and “Futsal” competitions. All football currently organised by the GFA is non-professional.

Despite proposals made in the past that the Claimant may become affiliated to the Spanish Football Association, the GFA has always been independent from any other football association, whether within Gibraltar or elsewhere.

The territory of Gibraltar is a dependent territory of the United Kingdom. It forms part of Her Majesty the Queen’s Dominions, but it is not part of the United Kingdom, and it is not an independent State either although it enjoys a certain level of autonomy.

The Respondent, the Union des Associations Européennes De Football (“UEFA”), is an association incorporated under the laws of Switzerland with its headquarters in Nyon, Switzerland. UEFA is the governing body of European football, dealing with all questions relating to European football and exercising regulatory, supervisory and disciplinary functions over national associations, clubs, officials and players of the European continent.

The Respondent is one of the continental football confederations. All national associations located in Europe and which wish to be affiliated to the Fédération Internationale de Football Association (“FIFA”) must previously become a member of UEFA.

In January 1997, the GFA applied to FIFA for membership.

On 27 November 1997, the English Football Association (“FA”) confirmed to FIFA its thorough support of the GFA's application for membership.

On 3 March 1999, FIFA wrote to the GFA confirming that the “*preliminary procedure*” was completed, and that “consequently, FIFA may submit the file to the confederation concerned for the second phase of the procedure (evaluation of the organisation for a period of at least two years)”.

In that same letter, FIFA further stated that “according to article 4.7 of the FIFA Statutes the confederation concerned shall decide whether to grant provisional membership or associate membership to the applicant association”.

In parallel to this letter, FIFA forwarded to UEFA the GFA's file for membership, as confirmed by UEFA to the Claimant on 23 March 1999. The GFA was consequently invited to make an oral presentation of its application to UEFA representatives in April 1999 in Nyon, Switzerland.

On 20 April 1999, following the presentation made by the GFA's representatives in Nyon, UEFA informed the Claimant that they would examine the file with FIFA, possibly proceed with a visit on site in Gibraltar, and then make a recommendation to the UEFA Executive Committee, outlining that “no final decision will be taken until the year 2000”.

On 7 January 2000, UEFA informed the GFA that FIFA was in the process of reviewing its affiliation procedure rules, that a meeting was scheduled to take place within FIFA's organisation in March 2000 and, therefore, that UEFA would not be able to give the GFA more information on the process of its own affiliation request until that time.

By letter dated 19 January 2000, the GFA responded to UEFA that it failed to understand why a “present ongoing review of affiliation procedure rules” within FIFA should affect the application by the GFA which had been made before such review was commenced. The Claimant further expressed its concern because the UEFA inspection of the GFA's facilities should have occurred already by the end of the year 1999, and it insisted that it be given “the necessary assurances that our application is being processed as per the present applicable procedures”.

By e-mail dated 25 March 2000, UEFA informed the GFA that “FIFA and UEFA administrations have discussed the application procedure for your association. After having received also the green light by the FIFA Committee for national associations we inform you that a joint FIFA/UEFA delegation will visit your association”.

On 25 April 2000, UEFA provided the GFA with details of the visit to the GFA's facilities and infrastructures by representatives of FIFA and of UEFA. Such visit was scheduled to take place between 8 and 10 May 2000.

A joint delegation from the FIFA and UEFA administrations eventually conducted the inspection visit in Gibraltar between 8 and 10 May 2000.

On 11 July 2000, the UEFA delegation issued a report of the visit conducted in Gibraltar two months earlier. In this report, the UEFA delegation proposed *inter alia* that “the FA of Gibraltar be admitted to UEFA on a provisional basis” under three cumulative conditions, namely that (i) Gibraltar teams could not enter club competitions or senior and Under-21 national-team competitions immediately, but only UEFA's youth, women's and amateur competitions; (ii) the football infrastructure in Gibraltar must correspond to the UEFA requirements at the time of entering the relevant competitions; and (iii) the GFA's statutes had to be adapted to UEFA's requirements.

The UEFA administration justified this position, which in principle favoured the affiliation of the GFA, by stating that “the FA of Gibraltar fulfils all requisite statutory conditions for admission to UEFA (Article 2 of the Regulations governing the implementation of the UEFA Statutes)”.

The report on the FIFA/UEFA joint visit to Gibraltar and the proposals contained therein were supposed to be submitted to the UEFA Executive Committee at its next meeting which was scheduled to be held on 25-26 August 2000.

On 3 August 2000, the FIFA Executive Committee apparently decided to freeze all applications from associations to FIFA, pending the approval of new FIFA Statutes in the year 2004. FIFA informed UEFA of this decision in September 2001.

On 26 August 2000, the UEFA Executive Committee decided to postpone its decision concerning the GFA's provisional membership until its next meeting which was scheduled to take place in October 2000, and to call a meeting between UEFA, the English FA and the Spanish FA on 22 September 2000 in order to discuss this matter.

The meeting between UEFA, the English FA and the Spanish FA did not take place until 30 November 2000. During its meeting on 4-5 October 2000, the UEFA Executive Committee had decided to postpone its decision on the matter again as it was waiting for the results of the aforementioned meeting with the English FA and the Spanish FA.

On 14-15 December 2000, the UEFA Executive Committee met again. In respect of the GFA's application for membership, it considered that independent legal advice was necessary for it to be able to evaluate the application. Therefore, the UEFA Executive Committee decided to set up a legal panel with three members from UEFA's External Legal Experts Panel which was entrusted with the preparation of a substantiated report to the UEFA Executive Committee based on the FIFA and UEFA Statutes (the "Expert Panel").

The Claimant was informed of these decisions by UEFA on 15 December 2000. At that time, UEFA also provided the GFA with a copy of a written report that had been filed by the Spanish FA (in which the latter opposed the GFA's application), asking the GFA to comment thereon in writing by the end of January 2001. The same request was made by UEFA to the English FA.

By the end of the year 2000, the Expert Panel set up by UEFA had received all of the written submissions by the Spanish FA, the English FA and the GFA. The Claimant also filed a supplementary report in March 2001.

The aforementioned three parties made oral submissions before the Expert Panel on 19 April 2001. According to the order of procedure decided by its members, the Expert Panel was then to submit a written legal report to the UEFA Executive Committee, for it to take a final decision on the GFA's application.

As from June 2001, the Claimant repeatedly asked the UEFA what the conclusions of the Expert Panel were. The UEFA Executive Committee was to meet in July 2001 and the GFA assumed that the report of the Expert Panel would be available before such meeting, where the GFA's application for membership would be on the agenda.

The UEFA Executive Committee met on 11-12 July 2001. It did not take any decision on the GFA's application. However, what the UEFA Executive Committee did decide was to put an amendment of the UEFA Statutes before the UEFA Congress to be held in October 2001.

According to this proposed amendment, UEFA membership would be restricted to associations in countries which are recognised as independent States by the United Nations.

On 30 July 2001 and 20 August 2001, the GFA again asked the UEFA what the conclusions of the Expert Panel were.

On 27 August 2001, the Expert Panel appointed by the UEFA rendered its written legal opinion to the UEFA Executive Committee.

The members of the Expert Panel unanimously considered that according to Art. 5 paragraph 1 of the UEFA Statutes (NB: the version that came into force on 24 December 1997 and was amended on 30 June and 1 July 2000) and to Art. 1 and 2, sentence 1 of the Regulations governing the implementation of the UEFA Statutes, "the GFA was entitled to provisional admission as a member of UEFA".

In the same Expert Report of 27 August 2001, the members of the Expert Panel suggested to the UEFA Executive Committee "to amend the UEFA Statutes (...) to avoid similar problems in the future". The Expert Panel thus proposed "an amendment to the effect that only UN-recognised States may apply for admission to and membership of UEFA".

On 30 August 2001, the UEFA confirmed to the GFA that the Expert Panel had rendered its decision. However, as per the order of procedure decided from the outset, the UEFA refused to communicate a copy of the Expert Report to the GFA. The UEFA indicated to the Claimant that the report would be discussed by the members of the UEFA Executive Committee on 6-8 September 2001 and that a decision on the GFA's application would then be taken.

In addition, the UEFA also communicated to the GFA on 30 August 2001 that "as regards the extraordinary Congress in October in Prague, we confirm that there is a request for a change of the UEFA Statutes, and especially the provision of UEFA membership. However we cannot provide you with a copy of these amendments until you are part of the UEFA family".

On 5 September 2001, FIFA's Secretary General wrote to UEFA stating that in FIFA's view it would be premature to proceed with the affiliation of the GFA in the forthcoming months, and that FIFA was planning to change its rules on membership.

On 7 September 2001, UEFA wrote to the GFA and informed it that, at its most recent meeting on the same day, "the Executive Committee did not enter into the request of the Football Association of Gibraltar to be provisionally affiliated to UEFA. The UEFA Executive Committee has already discussed and decided at its July 2001 meeting to change the membership conditions in the UEFA Statutes. These proposals will be dealt with by the UEFA member associations at the next extraordinary Congress in Prague in October 2001. (...) The decision concerning the affiliation request of the Football Association of Gibraltar is therefore postponed until further notice."

During the same meeting of the UEFA Executive Committee, a request for admission to UEFA filed by the Football Association of Kazakhstan was considered, and the Executive Committee agreed that such request should proceed.

The Football Association of Kazakhstan, which requested admission to UEFA after leaving the Asian confederation in 2001, was eventually admitted as a UEFA member by the UEFA Congress upon the recommendation of the UEFA Executive Committee in April 2002. Kazakhstan is an independent State and accepted as a member by the United Nations.

As from September 2001, the GFA repeatedly requested UEFA to render a decision on its request for provisional membership without delay, and to do so on the basis of the UEFA rules that existed at the time when the application was made.

On 5 October 2001, a meeting took place between senior officers of UEFA and of the GFA during which no solution could be found.

On 11 October 2001, the UEFA Congress approved the change of the UEFA Statutes, whereby UEFA membership would from then on be open only to associations in a country “recognised by the United Nations as an independent State”.

On 13 November 2001, UEFA wrote to the Claimant rejecting the latter’s repeated demands for immediate consideration of its affiliation request and stating that “the Executive Committee has so far not taken a *negative* decision on your application request but has only postponed its decision upon FIFA's request”.

The GFA replied to UEFA on 20 November 2001 that it considered that UEFA had acted illegally in this matter.

It must be noted that in November 2001, a number of national Football bodies of UK Dependencies which are not independent States and not members of the United Nations were already FIFA members, such as the FA of Anguilla or the FA of the Turks and Caicos Islands. Similarly, the FA of the Faroe Islands, which is not an independent State but a dependency of Denmark, is a FIFA member since 1988 and was admitted as a UEFA member in the mid-nineties.

On 26 April 2002, the GFA, acting through one of its counsel, wrote to UEFA stating that “the GFA (...) understands UEFA’s position to be that the GFA is not eligible for membership of UEFA under (new) Article 5.1 and that therefore the GFA's application cannot succeed”. The GFA further stated that “(a) UEFA’s failure to assess the GFA's application to become a member of UEFA by reference to the rules applicable when the application was made in 1999, under which the application would have been successful, and (b) UEFA’s decision instead to change the rules with purportedly retrospective effect in such a way as to make the GFA's application incapable of success, are illegal.”

In that same letter, the GFA requested UEFA to accept CAS arbitration in this matter. The same request was submitted again by the Claimant to UEFA on 6 June 2002.

On 12 July 2002, UEFA confirmed to the GFA that its Executive Committee had accepted CAS jurisdiction in respect of the GFA's claims against UEFA in this matter.

On 16 August 2002, the GFA filed a Request for Arbitration accompanied by 38 Exhibits with the CAS, asking principally (i) that the UEFA Executive Committee be ordered to consider the GFA's application for membership by reference to the rules applicable when the application was made in 1999, (ii) to declare that under those rules the GFA is entitled to provisional membership of UEFA with immediate effect, and (iii) to order payment by the Respondent UEFA of all costs of the arbitration as well as legal costs suffered by the Claimant.

The Respondent filed its Answer, accompanied by 8 Exhibits, on 27 September 2002, requesting the CAS to “dismiss all Principal Orders of the Request for Arbitration”, with all costs and compensations to be charged to the Claimant.

The hearing was held on 27 May 2003 in Lausanne.

The Claimant presented in its Request for Arbitration and specified in its Statement of Claim the following principal requests for relief:

- That UEFA be ordered to decide the GFA's application for membership by reference to the rules applicable when the application was made or was or ought to have been considered prior to 11 October 2001.
- That it be declared that under those rules the GFA is entitled to provisional membership of UEFA with immediate effect;
- That the Respondent UEFA be ordered to pay of all the costs of the arbitration as well as the legal costs incurred by the Claimant.

The Claimant principally submits that:

- a) Under the rules on membership contained in the UEFA Statutes before the modification approved by the UEFA Congress on 11 October 2001, the GFA's application for provisional membership fulfilled all requisite conditions.
- b) Under those rules, the GFA was therefore entitled to membership, as evidenced by the behaviour of the UEFA competent bodies in their processing of the Claimant's application.
- c) The change of the UEFA rules on membership was inspired by the simple wish to prevent the GFA's application from succeeding, and the reason for that wish was to be seen in the political pressure exercised by the powerful Spanish FA.
- d) In July 2001, when the UEFA Executive Committee proposed that the UEFA Statutes be amended to the effect that only associations in countries which are recognised by the United Nations as independent States are eligible for membership, the UEFA Executive Committee must have been aware of the Expert Panel's conclusions.
- e) It would be unfair under the circumstances to permit the dismissal of the GFA's application for affiliation by reference to the amended version of the UEFA rules on membership.

The Respondent submitted in both its Answer and its Response the following principal requests for relief:

- That all of the principal orders requested in the Request for arbitration be dismissed.
- That the Claimant be ordered to pay all of the costs of the arbitration as well as the legal costs incurred by UEFA.

The Respondent is principally of the opinion that:

- a) Under Swiss law, any association, such as UEFA, has a discretionary right to refuse a person or entity as a member, even if such person or entity fulfils all of the conditions stipulated in the association's statutes.
- b) While there are limits to this discretionary right of the association under Swiss law, namely the protection of the personality (art. 28 Swiss Civil Code) and the rules of Swiss Cartel law, those limits were not violated in the present case since UEFA's attitude was neither arbitrary nor based on unjustified reasons.
- c) UEFA's attitude in this matter was not dictated by political pressure exercised by the Spanish FA, which however openly opposed the application made by the GFA.

## LAW

1. The CAS has jurisdiction over this dispute on the basis of the correspondence exchanged by the parties on 6 June and 12 July 2002.  
Furthermore, during the hearing in Lausanne on 27 May 2003, it was explicitly acknowledged between the parties that the competence of the CAS is not in dispute.
2. Pursuant to Article R45 of the Code, the dispute must be decided "according to the rules of law chosen by the parties or, in the absence of such a choice, according to Swiss law".
3. The issue of the Claimant's right to membership of UEFA is to be examined in the light of the applicable UEFA Statutes. The Panel considers that Swiss civil law is applicable to all aspects of the dispute relating to the construction of the FIFA and UEFA Statutes and Regulations, in accordance with Article R45 of the Code, Article 4, par. 3 a) of the FIFA Statutes and Article 59, par. 1 of the UEFA Statutes.
4. In addition, to the extent that it deems it appropriate, the Panel may apply general principles of law, which are applicable as a type of *lex mercatoria* for sports regardless of their explicit presence in the applicable UEFA or FIFA Statutes. Such general principles of law include for example the principle of fairness, which implies *inter alia* the obligation to respect fair procedures (see, in particular, AEK Athens and SK Slavia Prague vs. UEFA, CAS 98/200,



sections 60/61 and 155 and seq., in Digest of CAS Awards II, 1998-2000, edited by Matthieu Reeb, pp. 65-66 and 102-103).

5. At the time when the GFA applied for membership to FIFA, and when FIFA subsequently forwarded the GFA's application file to UEFA, the criteria for eligibility as a member of UEFA provided for under Article 5 paragraph 1 of the UEFA Statutes were set out as follows:

“Membership of UEFA is open to national football associations situated in the continent of Europe which are responsible for the organisation and implementation of football-related matters in their particular territory” (the prevailing German text read “Mitglieder der UEFA können europäische Verbände werden, die in ihrem Gebiet für die Organisation und Durchführung des Fussballsports verantwortlich sind”; hereinafter the “Old Rule”).

6. Article 5 paragraph 1 of the UEFA Statutes was amended by the UEFA Congress on 11 October 2001. According to the new version of this provision, UEFA membership is restricted to associations in countries which are recognised as independent States by the United Nations (hereinafter the “New Rule”). The Panel interprets this text to mean that the respective country must have been admitted as a member of the United Nations. The United Nations do not “*recognise*” countries in the strict sense of the word. However, what is clear is that under the New Rule, the GFA would not be eligible as a member of UEFA, since Gibraltar is not an independent State admitted to membership in the United Nations.

7. The first question which the Panel must address is therefore to establish whether today, taking into account the circumstances of this particular case, UEFA may validly rely on the New Rule to appraise (and hypothetically dismiss) the GFA's application, although such application was filed and dealt with for a period of several years on the basis of the Old Rule.

8. The CAS has already considered in the past that in the absence of an express provision to the contrary, laws and rules relating to procedural matters apply immediately upon entering into force and regardless of when the facts occurred. On the other hand, it is a general principle that laws, regulations and rules of a substantive nature that were in force at the time when the facts occurred must be applied. Such principles were set out in particular in the CAS award S. vs. FINA, CAS 2000/A/274, sections 72-73 (see, in Digest of CAS Awards II, op. cit., p. 405):

“Under Swiss law, the prohibition against the retroactive application of law is well-established. In general, it is necessary to apply those laws, regulations or rules that were in force at the time that the facts at issue occurred (...).

This general principle is, however, subject to several exceptions, including an exception for laws or rules that are procedural in nature. In the absence of an express provision to the contrary, laws and rules relating to procedural matters apply immediately upon entering into force and regardless of when the facts at issue occurred (...).”

9. In the present instance, while the third sentence of Article 2 of the Regulations governing the implementation of the UEFA Statutes sets out the formal conditions which an application for

UEFA membership has to meet, it is quite another question whether Article 5 paragraph 1 of the UEFA Statutes is to be seen as merely procedural.

10. This provision sets out the substantive conditions that any applicant will need to fulfil in order to become a member. For this first reason, in accordance with the general principle of non-retroactivity of laws and rules, the Panel may have to consider that the New Rule may not apply to the GFA's application.
11. Even if the New Rule was to be regarded as a rule dealing only with procedural aspects, the Panel is of the opinion that its application in this matter would entail a violation of general principles of law which are widely recognised, particularly the principles of fairness and of good faith. In particular, the Panel refers to the principle of *venire contra factum proprium*. This principle provides that when the conduct of one party has led to raise legitimate expectations on the part of the second party, the first party is barred from changing its course of action to the detriment of the second party (see, AEK Athens and SK Slavia Prague vs. UEFA, CAS 98/200, in Digest of CAS Awards II, op. cit., pp. 38 and seq.; S. vs. FINA, CAS 2000/A/274, section 37, in Digest of CAS Awards II, op. cit., p. 400; Art. 2 of the Swiss Civil Code).
12. *In casu*, upon receipt of the GFA's application in 1997, the UEFA administration processed it at first without any reservations. The visit on site in Gibraltar by a delegation of UEFA and FIFA representatives in May 2000 was carried out in knowledge of the fact that FIFA was already considering changing its rules on membership in the future (see above).
13. In July 2000, a favourable report was rendered by the UEFA representatives who had inspected Gibraltar's facilities, outlining that all requisite conditions set out in the applicable UEFA Statutes and Regulations were fulfilled (see above). Subsequently, the UEFA Executive Committee decided to ask for advice of an Expert Panel before rendering a decision on the GFA's application. It was therefore legitimate for the GFA to understand that UEFA would decide on its application on the basis of the conclusions of the Expert Panel, bearing in mind that the GFA, the English FA and the Spanish FA had all been requested to make written and oral submissions in this context.
14. The Expert Panel came to the main conclusion that the GFA was entitled to UEFA provisional membership. In the Expert Report which was submitted in writing to the UEFA Executive Committee on 27 August 2001, the members of the Expert Panel suggested to the UEFA Executive Committee "to amend the UEFA Statutes (...) to avoid similar problems *in the future*" (emphasized added). The Expert Panel thus proposed "an amendment to the effect that only UN-recognised States may apply for admission to and membership of UEFA".
15. However, before any decision on the merits was taken by UEFA on the GFA's application on the basis of the Expert Panel's main conclusion, as one would have reasonably expected, the relevant Old Rule on membership was changed in October 2001 upon a recommendation made in July of that same year by the UEFA Executive Committee. The New Rule actually implemented the recommendation that the Expert Panel had made, but only for *future* cases.

16. The present Panel is of the opinion that such a recommendation to replace the Old Rule by the New Rule was made in the light of the conclusions of the Expert Panel. The fact that the UEFA Executive Committee had already made such an amendment proposal at its meeting of 11-12 July 2001 (i.e. prior to receiving the Expert Panel's written report in August) tends to suggest that the UEFA Executive Committee was aware of the Expert Panel's conclusions at that time. The panel is thus satisfied that one of the main purposes for the amendment proposal made by the UEFA Executive Committee was to prevent the GFA's application from succeeding.
17. To apply the New Rule to the Claimant's case under these circumstances would be unfair and contrary to the above mentioned general principles of law. It were the actions of UEFA itself which created legitimate expectations that the GFA's application would be processed under the Old Rule, with adequate speed or at least upon receipt of and in compliance with the advice of the Expert Panel that UEFA had appointed specifically for that purpose.
18. The GFA's application to be admitted as a provisional UEFA member shall therefore be examined on the basis of the Old Rule, namely the rule applicable when the application was made and on the basis of which the Expert Panel appointed by the UEFA rendered its opinion.
19. As mentioned above, according to the Old Rule "Membership of UEFA is open to national football associations situated in the continent of Europe which are responsible for the organisation and implementation of football-related matters in their particular territory".
20. When reviewing whether the GFA's application fulfilled the conditions set out in this provision, the Expert Panel considered that "given that Gibraltar is a European association which is no longer dependent on the [British] FA and which has become autonomous in a sporting respect, and given that the GFA indisputably exercises sole responsibility for the organisation and structure of football in its territory, Article 5 paragraph 1 can only be interpreted as to mean that the GFA from a legal perspective fulfils the criteria of the UEFA statutes for becoming a UEFA member".
21. The same opinion was given by the UEFA administration itself in its inspection report and recommendations issued on 11 July 2000 (see, sections 18 and 19 above).
22. The Panel considers that these opinions are accurate and that there is no reason for considering, as submitted by the Respondent on the basis of the words used in Article 5 paragraph 2 of the UEFA Statutes, that the Old Rule on UEFA membership should in fact – as the New Rule eventually expressed in an explicit way - be construed as restricting eligibility to associations of countries which are recognized politically as independent States.
23. Such a point of view is in fact not supported by the letter of the Old Rule. Neither is it consistent with the opinion of CAS, as expressed in previous cases, that the concept of "nation" or "country" in the sports environment must not necessarily be "understood within its common political meaning" (see, Celtic Plc vs. UEFA, CAS 98/2001, paragraphs 25 seq.,

in Digest of CAS Awards II, op. cit., pp. 118-120). More importantly, the Respondent's argument is contradicted by the fact that UEFA already has – and had at the time when the application was made – a number of member associations from countries which do not enjoy independent statehood, such as Scotland, Wales or the Faroe Islands.

24. As a consequence of the above considerations the Panel is of the opinion that the GFA's application for UEFA membership meets the requirements set out in Article 5 paragraph 1 of the Old Rule.
25. Upon receipt of an application file from FIFA, as in the present case, UEFA must "decide whether to grant provisional membership or associate membership to the applicant association" (Article 4 paragraph 7 of the FIFA Statutes).
26. Article 6 paragraph 3 of the UEFA Statutes provides that the UEFA Executive Committee is competent to admit an applicant association as a provisional UEFA member, while the decision on full admission must be taken by the UEFA Congress.
27. The Respondent submits that even though the GFA's application might meet all requisite conditions for UEFA membership, an association like UEFA remains free to admit or to refuse the applicant as a new member by virtue of the principle of autonomy of the association under Swiss law.
28. The Panel must therefore examine whether the fact that the GFA's application meets the requirements of Article 5 paragraph 1 of the Old Rule entitles the GFA to provisional membership or whether UEFA has discretion to invoke the principle of freedom of association and has the right to deny membership on that basis.
29. Generally, freedom of association includes the freedom of an association to accept or to refuse any applicant for membership, even if the applicant fulfils all statutory conditions (see, *inter alia* HEINI A., *Das Schweizerische Vereinsrecht*, Bâle 1988, p. 48).
30. However, this principle is now generally considered to be limited, such limits being derived in particular from:
  - (i) the contractual nature of the membership to an association and the related obligation to act in good faith in the context of contractual or pre-contractual discussions (Article 2 Swiss Civil Code; see, *inter alia* ZEN-RUFFINEN P., *Droit du sport*, Zurich 2002, n° 279 and references; BADDELEY M., *L'association sportive face au droit*, Genève 1994, p. 75; HEINI A., op.cit., p.48);
  - (ii) the general prohibition of arbitrary decisions and the need of a control of the association's decision to refuse a new member (Article 2 paragraph 2 Swiss Civil Code);
  - (iii) in professional matters, the provisions of competition law and the related need to protect personality rights (see, JdT 1957 I 202-212; Article 7 of the Swiss Federal Law on Cartels).

31. Furthermore, in the context of sports associations, it is now often considered that associations in a monopolistic position – which is undoubtedly the case for the Respondent in Europe – have in fact a duty to accept new members if they fulfil all statutory conditions to that effect. This opinion is derived both from the legislation on cartels and from the provisions on the protection of the personality (see, HEINI A., *op.cit.*, p. 49; BADDELEY M., *op. cit.*, p. 82).
32. The Panel holds, in that respect, that the exclusion of athletes, or of a sports association to which athletes are affiliated, from an international sports organisation which occupies a dominant or monopolistic position in the organisation of the sports competitions at issue may have the effect of a boycott. It is the Panel's opinion that such an exclusion should therefore be held invalid, at least to the extent that it is not grounded on objective and justified reasons.
33. The Respondent itself admitted that a refusal by UEFA to grant the GFA provisional membership could be considered as illegal if it were arbitrary or based on "unjustified reasons".
34. The above legal considerations lead to the general conclusion that, under Swiss law, an association does not remain entitled, under any circumstances, to accept or refuse a new member at its sole discretion. However, in order to rule on the present case, there is no need for the Panel to develop a position of principle on this question. The Panel thus leaves open the question of the right of UEFA to accept or refuse new members at its sole discretion. The Panel is of the opinion that it may rely on the particular circumstances surrounding the GFA's application and the way it was processed by UEFA to decide upon the present case.
35. As pointed out above, UEFA acted from the outset as if the applicant would be granted provisional membership if all applicable conditions were met. The GFA invested a considerable amount of time and resources in obtaining its admission as a UEFA member, relying on the legitimate expectation that UEFA would not refuse its application without any justified reason.
36. The Panel holds that it is therefore the behaviour of the UEFA itself which created such legitimate expectations on the part of the Claimant (visits on site, favourable visit report and recommendation, appointment of an Expert Panel to assist the Executive Committee to decide on the case, favourable conclusions of the Expert Panel following a comprehensive and adversary procedure, etc.).
37. UEFA chose to process thoroughly the GFA's application and by doing so, it led the Claimant to believe that it would be admitted as a provisional member if the Statutes' conditions were met. By doing so, UEFA waived the right that it may have had under Swiss law to reject the Claimant's request for membership without justified reasons.
38. In that respect, it is the Panel's opinion that neither the change of membership rules by UEFA, the purpose of which may have been to enable UEFA to dismiss the GFA's application, nor the clearly negative position allegedly taken by the Spanish FA, which may

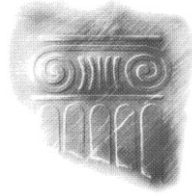
have influenced the UEFA's change of attitude and progressive reluctance to decide in a timely manner upon the GFA's application, constitute any such justified reasons.

39. The 11 July 2000 report by the UEFA delegation (see, section 18 above) lists certain conditions which have to be met in order for the GFA application for UEFA membership to succeed. It is for UEFA to decide whether these conditions are in fact met. Given the length of time which has elapsed since the application was first made, such a decision will have to be taken forthwith and will have to conform with the views expressed in this award.
40. The Panel further stresses that the possible change of FIFA rules on membership, which has been put forward by the Respondent as a reason for postponing any decision on the GFA's application, should not be an impediment to the UEFA granting provisional UEFA membership to the GFA.
41. Under Art. 4 paragraph 7 of the FIFA Statutes, the confederation "shall notify FIFA as soon as it considers a provisional member national association to be qualified to become a member of FIFA". This wording suggests that in two years' time, the UEFA shall remain entitled to assess whether the GFA fulfils the criteria for FIFA membership on the basis of the FIFA Statutes then in force.

**The Court of Arbitration for Sport rules that:**

1. UEFA is ordered to decide on the GFA's application for membership on the basis of the UEFA rules applicable at the time when the application was made. The decision has to be made by the UEFA no later than 31 March 2004.
2. GFA's other motions are rejected.
3. (...)

**CLA-010**



**Arbitration CAS 98/200 AEK Athens and SK Slavia Prague / Union of European Football Associations (UEFA), award of 20 August 1999**

Panel: Mr. Massimo Coccia (Italy), President; Dr. Christoph Vedder (Germany); Dr. Dirk-Reiner Martens (Germany)

*Football*

*Conflicts of interest related to multi-club ownership within the same competition*

*Application of EC law to sport*

*Status of UEFA according to EC law*

*Right to be heard*

*Principle of procedural fairness*

1. If clubs with the same owner can take part in the same competitions, whether national or international, doubts may arise as to whether the outcome is really undecided in advance. The challenged UEFA Rule is therefore an essential feature for the organization of a professional football competition and is not more extensive than necessary to serve the fundamental goal of preventing conflicts of interest which would be publicly perceived as affecting the authenticity, and then the uncertainty, of results in UEFA competitions.
2. Membership of UEFA is open only to national football associations situated on the continent of Europe who are responsible for the organization and implementation of football-related matters in their particular territory. The UEFA Statutes attribute voting rights only to national federations, and article 75 of the Swiss Civil Code (CC) refers to members which have voting rights within the association whose resolution is challenged. Clubs do not meet these requirements.
3. Under Article 75 CC, members of an association have the right to be heard when resolutions are passed which affect them to a significant extent. However, requiring an international sports federation to provide for hearing to any party potentially affected by its rule-making authority could quite conceivably subject the international federation to a quagmire of administrative red tape which would effectively preclude it from acting at all to promote the game.
4. The doctrine of *venire contra factum proprium* provides that where the conduct of one party has led to the legitimate expectations on the part of a second party, the first party is estopped from changing its course of action to the detriment of the second party. *In casu*, UEFA may not change its Cup Regulations without allowing the clubs sufficient time to adapt their operations to the new rules accordingly. However, such procedural defect by itself does not warrant the permanent annulment of the contested UEFA Rule.



- 5. Sport is subject to Community law only insofar as it constitutes an economic activity within the meaning of Article 2 of the EC Treaty. EC law does not prevent the adoption of rules or of a practice excluding foreign players from participation in certain matches for reasons which are not of an economic nature, which relate to the particular nature and context of such matches and are thus of sporting interest only.**

The Claimant AEK PAE (hereinafter «AEK») is a Greek football club incorporated under the laws of the Hellenic Republic and having its seat in Athens. AEK currently plays in the Greek first division championship and over the years has often qualified for the European competitions organized by UEFA. At the end of the 1997/98 football season AEK ranked third in the Greek championship, thus becoming eligible to participate in the 1998/99 UEFA club competition called «UEFA Cup». AEK is owned as to 78.4% by ENIC Hellas S.A., a company wholly controlled, through subsidiaries, by the English company ENIC plc.

The Claimant SK Slavia Praha (hereinafter «Slavia») is a Czech football club incorporated under the laws of the Czech Republic and having its seat in Prague. Slavia currently plays in the Czech-Moravian first division championship and along the years has often qualified for the UEFA competitions. At the end of the 1997/98 football season, Slavia ranked second in the Czech-Moravian championship, thus becoming eligible to participate in the 1998/99 UEFA Cup. Slavia is owned as to 53.7% by ENIC Football Management Sarl, a company wholly controlled, through subsidiaries, by ENIC plc.

Both AEK and Slavia are under the control of ENIC plc (hereinafter «ENIC»), a company incorporated under the laws of England and listed on the London Stock Exchange. In the last couple of years ENIC, through subsidiaries, has invested in several European football clubs, acquiring controlling interests in AEK, Slavia, the Italian club Vicenza Calcio SpA, the Swiss club FC Basel, and a minority interest in the Scottish club Glasgow Rangers FC.

The Respondent Union of European Football Associations (hereinafter «UEFA»), association which has its seat in Nyon, Switzerland, is a sports federation which has as its members all the fifty-one national football associations (*i.e.* federations) of Europe. UEFA is the governing body for European football, dealing with all questions relating to European football and exercising regulatory, supervisory and disciplinary functions over national associations, clubs, officials and players. Pursuant to the UEFA Statutes, member associations must comply with such Statutes and with other regulations and decisions, and must apply them to their own member clubs. Until the 1998/99 European football season UEFA has organized three main club competitions: the Champions' League, the Cup Winners' Cup and the UEFA Cup. UEFA has recently resolved to cancel the Cup Winners' Cup and, as of the 1999/2000 season, has reduced the main club competitions to the Champions' League and the UEFA Cup.

During 1997 ENIC acquired the above-mentioned controlling interests in AEK, Slavia and Vicenza. In the 1997/98 European football season, these three clubs took part in the UEFA Cup Winners'

Cup and all qualified for the quarter final. At this stage, the three ENIC-owned clubs were not drawn to play against each other and only one of them reached the semi-finals (AEK lost to the Russian club Lokomotiv Moscow, Slavia lost to the German club VfB Stuttgart, whereas Vicenza defeated the Dutch club Roda JC). Being confronted with a situation where three out of eight clubs left in the same competition belonged to a single owner, UEFA started to consider the problems at stake.

On 24 February 1998, at ENIC's request, representatives of UEFA and ENIC met in order to discuss the issue of «multi-club ownership», that is the ethical and non-ethical questions raised by the circumstance that two or more clubs controlled by the same owner take part in the same competition. In that meeting ENIC proposed to UEFA a «code of ethics» to be adopted by football clubs, with a view to convincing UEFA not to adopt a rule banning teams with common ownership from participating in the same UEFA competition.

After the meeting, ENIC exchanged correspondence with UEFA and submitted a draft code of ethics for consideration. Thereafter, UEFA referred the issue of multiple ownership to some of its internal bodies, namely the Committee for Non-Amateur Football, the Juridical Committee and the Committee for Club Competitions. These came to the conclusion that there was no guarantee that a code of ethics would be effectively implemented and that a code of ethics was not a viable solution. They therefore recommended to the Executive Committee of UEFA that the rule at issue in this arbitration be adopted.

On 7 May 1998, UEFA sent to its member associations several documents to be communicated to the clubs entitled to compete in the 1998/99 UEFA Cup. In particular, UEFA sent the regulations and the entry forms for the 1998/99 UEFA Cup and the booklet entitled «Safety and security in the stadium – For all matches in the UEFA competitions». The UEFA Cup regulations set forth the conditions of participation without any mention of a limitation related to multi-club ownership. Moreover, the regulations did not make reservation for future amendments, except in the event of «force majeure». At that time, pursuant to the regulations, both AEK and Slavia were entitled to compete in the 1998/99 UEFA Cup because of their results in the 1997/98 national championships.

On 19 May 1998, the UEFA Executive Committee finally addressed the issue of multi-club ownership and adopted the rule at issue in these proceedings (hereinafter the «Contested Rule»). The Contested Rule is entitled «*Integrity of the UEFA Club Competitions: Independence of the Clubs*» and reads as follows:

*«A. General Principle*

*It is of fundamental importance that the sporting integrity of the UEFA club competitions be protected. To achieve this aim, UEFA reserves the right to intervene and to take appropriate action in any situation in which it transpires that the same individual or legal entity is in a position to influence the management, administration and/or sporting performance of more than one team participating in the same UEFA club competition.*

### *B. Criteria*

*With regard to admission to the UEFA club competitions, the following criteria are applicable in addition to the respective competition regulations:*

1. *No club participating in a UEFA club competition may, either directly or indirectly:*
  - (a) *hold or deal in the securities or shares of any other club, or*
  - (b) *be a member of any other club, or*
  - (c) *be involved in any capacity whatsoever in the management, administration and/or sporting performance of any other club, or*
  - (d) *have any power whatsoever in the management, administration and/or sporting performance of any other club participating in the same UEFA club competition.*
2. *No person may at the same time, either directly or indirectly, be involved in any capacity whatsoever in the management, administration and/or sporting performance of more than one club participating in the same UEFA club competition.*
3. *In the case of two or more clubs which are under common control, only one may participate in the same UEFA club competition. In this connection, an individual or legal entity has control of a club where he/she/it:*
  - (a) *holds a majority of the shareholders' voting rights, or*
  - (b) *has the right to appoint or remove a majority of the members of the administrative, management or supervisory body, or*
  - (c) *is a shareholder and alone controls a majority of the shareholders' voting rights pursuant to an agreement entered into with other shareholders of the club in question.*
4. *The Committee for the UEFA Club Competitions will take a final decision with regard to the admission of clubs to these competitions. It furthermore reserves the right to act vis-à-vis clubs which cease to meet the above criteria in the course of an ongoing competition».*

On 20 May 1998, UEFA released a press statement announcing the adoption of the Contested Rule. On 26 May 1998, UEFA communicated the Contested Rule to all its member associations through Circular Letter no. 37, a copy of which was sent to ENIC, informing that the new provision would be effective as of the start of the new season.

Subsequently, pursuant to Paragraph B.4 of the Contested Rule, the UEFA Committee for Club Competitions decided that the following criteria would determine which of two or more commonly owned clubs should be admitted to a UEFA club competition: first, the club with the highest «club coefficient» (based on the club's results of the previous five years) would be admitted; then, if the club coefficients were the same, the club with the highest «national association coefficient» (based on the previous results of all the teams of a national association) would be admitted; lastly, in case of equal national association coefficients, lots would be drawn.

On 25 June 1998, UEFA informed AEK of the criteria adopted by the UEFA Committee for Club Competitions and of the resulting non-admission of AEK to the UEFA Cup, while Slavia was authorized to compete. The Hellenic Football Association was called upon to enter a substitute for AEK, by designating the club which finished the domestic championship immediately below AEK. In the same letter, UEFA granted AEK a last opportunity to take part in the competition, if it were

to submit a statement confirming a change of control in compliance with the Contested Rule by 1 July 1998 (this was later extended to 20 July 1998).

On 12 June 1998, the parties executed an arbitration agreement, by which they agreed to submit the present dispute to the Court of Arbitration for Sport («CAS») in accordance with the Code of Sports-related Arbitration (the «Code»).

On 15 June 1998, AEK and Slavia filed with the CAS a request for arbitration together with several exhibits, primarily petitioning that the Contested Rule be declared void or annulled (*see infra*, para. 32). On the same day, AEK and Slavia also filed a request for interim relief, petitioning that during the proceedings UEFA be restrained from giving effect to the Contested Rule and, in particular, from excluding either Claimant from the 1998/99 UEFA Cup competition.

UEFA filed its reply to the Claimants' request for interim relief on 26 June 1998 and filed its answer to the request for arbitration, with some exhibits, on 22 July 1998.

On 15 July 1998, the President of the Ordinary Division of CAS held a hearing at the CAS offices in Lausanne, where the parties and their counsel answered questions of fact and law raised by the President and counsel presented oral arguments.

On 16 July 1998, the CAS issued a «Procedural Order on Application for Preliminary Relief», granting the following interim relief:

- «1. For the duration of this arbitration or for the duration of the 1998/99 season of the UEFA Cup, whichever is shorter, the Respondent shall not give effect to the decision taken by its Executive Committee on May 19, 1998 regarding the "Integrity of the UEFA Club Competitions: Independence of the Clubs";
2. As a result, the Respondent shall admit AEK Athens to the 1998/99 UEFA Cup Competition, in addition to Slavia Prague;
3. The costs of the present stage of the proceedings shall be settled in the final award or in any other final disposition of this arbitration».

As a result, AEK and Slavia were allowed to participate in the 1998/99 UEFA Cup (where they were eliminated after winning a few rounds of the competition and did not end up playing each other).

According to the grounds of the interim order, released the following day, the CAS based its decision primarily on the circumstance that UEFA violated its duties of good faith and procedural fairness insofar as it enacted the Contested Rule too late, when the Cup Regulations for the 1998/99 season – containing no restriction for multiple ownership – had already been adopted, and shortly before the start of the 1998/99 season, at a time when ENIC and its clubs could legitimately expect that no restriction was going to be adopted for the said season.

In the interim order the CAS left open for the final award the question whether the Contested Rule could be deemed lawful under competition law and civil law, stating that all findings of fact and legal

assessments were made on a *prima facie* basis, without prejudice to the CAS final award to be rendered after additional factual and legal investigation.

On 23 July 1998, the CAS issued a notice that the CAS Arbitration Panel for the present dispute (hereinafter the «Panel») was constituted in the following composition: Mr. Massimo Coccia as President, Dr. Christoph Vedder as arbitrator appointed by the Claimants and Mr. George Abela as arbitrator appointed by the Respondent.

On 4 September 1998, upon request of the Claimants, pursuant to Article R44.3 of the Code the Panel ordered the Respondent to produce the reports and minutes of the meetings of the UEFA Juridical Committee and of the UEFA Committee for Club Competitions related to the present case. UEFA produced such documents, later providing a few more internal documents upon request of the Claimants.

On 14 September 1998, the CAS issued an order of procedure, detailing the procedural guidelines for the conduct of the arbitration. The order of procedure was accepted and countersigned by both sides. Subsequently, in the course of the proceedings, the Panel supplemented the initial order of procedure with several other orders concerning procedural and evidentiary questions.

On 15 October 1998, the Claimants filed their statement of claim, together with eleven bundles of exhibits. UEFA's response, together with forty exhibits, was submitted to the CAS on 27 November 1998.

On 18 November 1998, the Claimants filed with the CAS a petition pursuant to Article R34 of the Code, challenging the appointment of Mr. George Abela as arbitrator, on the grounds that some circumstances gave rise to legitimate doubts over his independence *vis-à-vis* UEFA, and requesting his removal. On 25 November 1998, Mr. Abela communicated to the CAS that he deemed the Claimants' allegations to be totally unfounded and unjustified; however, because of the very fact that doubts had been expressed regarding his independence and impartiality, for the sake of the CAS he felt that he had to resign from his function as arbitrator in the present case.

On 3 December 1998, the Respondent communicated to the CAS that, in substitution of Mr. Abela, it appointed as arbitrator Dr. Dirk-Reiner Martens. Therefore, the Panel was reconstituted in the new formation comprising Mr. Coccia as President and Messrs. Vedder and Martens as arbitrators. No objection has been raised by either party with respect to the new formation of the Panel.

On 24 December 1998, the Claimants filed with the CAS their reply to UEFA's response. On 1 February 1999, the Respondent filed its rejoinder. Subsequently, on 26 and 28 February 1999, both sides submitted their lists of witnesses and expert witnesses to be summoned to the hearing.

On 12 March 1999, the Panel issued a procedural order detailing directions with respect to the hearing and to the witnesses and experts to be heard.

The hearing was held on 25 and 26 March 1999 at the World Trade Center in Lausanne. The Panel was present, assisted by the *ad hoc* clerk Mr. Stefano Bastianon, attorney-at-law in Busto Arsizio/IT,

and by Mr. Matthieu Reeb, attorney-at-law and counsel to the CAS. The Claimants were represented by Mr. Petros Stathis, General Manager of AEK, and Mr. Vladimir Leska, General Manager of Slavia Prague, assisted by his personal interpreter, and represented and assisted by the following attorneys: Mr. Michael Beloff QC and Mr. Tim Kerr, attorneys-at-law in London/UK (Gray's Inn), Mr. Stephen Kon, Ms. Lesley Farrel and Mr. Tom Usher, attorneys-at-law in London/UK (SJ Berwin), Mr. Jean-Louis Dupont, attorney-at-law in Brussels/BEL, Mr. Marco Niedermann and Mr. Roberto Dallafior, attorneys-at-law in Zurich/CH. The Respondent was represented by Mr. Marcus Studer, Deputy Secretary General of UEFA, and represented and assisted by Mr. Ivan Cherpillod, attorney-at-law in Lausanne/CH, and by Mr. Alasdair Bell, attorney-at-law in Brussels/BEL. With the agreement of all parties two directors of ENIC, Mr. Rasesh Thakkar and (after his testimony had been given) Mr. Daniel Levy, also attended the hearing.

During the two days of hearing the following witnesses and expert witnesses were heard: Mr. Gerald Boon (economist of Deloitte & Touche), Mr. Ivo Trijbits (legal counsel to the Dutch club AFC Ajax NV), Mr. Daniel Levy (managing director of ENIC), Sir John Smith (advisor on security issues to the English Football Association), Lord Kingsland QC (former Member of the European Parliament) and Prof. Paul Weiler (professor of law at Harvard Law School), all called by the Claimants; Mr. Gordon Taylor (chief executive of the Professional Footballers Association) and Prof. Gary Roberts (professor of law at Tulane Law School), called by the Respondent. Each witness and expert witness was invited by the Panel to introduce himself and to tell the truth subject, as to statements related to facts, to the sanctions of perjury in accordance with Article R44.2 of the Code and Articles 307 and 309 of the Swiss Penal Code; each witness and expert witness rendered his testimony and was then examined and cross-examined by the parties and questioned by the Panel.

The parties presented their opening and intermediate statements on 25 March 1999 and their final arguments on 26 March 1999, the Respondent having the floor last in accordance with Article R44.2 of the Code. At the end of the final arguments both sides confirmed their written legal petitions (*infra*, paras. 1 and 4), with counsel for the Claimants also petitioning that the interim stay of the Contested Rule be extended indefinitely and that the award be communicated to the parties on a Friday after the closing of the London stock exchange and rendered public on the following Monday. The parties did not raise with the Panel any objection in respect of their right to be heard and to be treated equally in the present arbitration proceedings.

On 26 March 1999, after the parties' final arguments, the Panel closed the hearing and reserved its final award.

## LAW

### Parties' legal petitions and basic positions

1. The Claimants presented in their request for arbitration of 15 June 1998 and confirmed in their statement of claim of 15 October 1998 the following legal petitions:

*«That it be declared that the resolution of the Executive Committee of the UEFA of 19 May 1998, as notified to the UEFA member associations on 26 May 1998, regarding the Integrity of the UEFA Club Competitions: Independence of the Clubs is void;*

***eventualiter:***

*that the resolution of the Executive Committee of the UEFA of 19 May 1998, as notified to the UEFA member associations on 26 May 1998, regarding the Integrity of the UEFA Club Competitions: Independence of the Clubs be annulled;*

***subeventualiter:***

*that the Defendant be ordered not to deny now and in the future the admission of the Clubs to the UEFA Club Competitions on the ground that they are under common control; with all costs and compensations to be charged to the Defendant».*

At the hearing the Claimants also petitioned that the stay of the Contested Rule ordered by the CAS on 16 July 1998 be extended indefinitely and that the award be notified to the parties on a Friday afternoon and rendered public on the following Monday. The latter petition was subsequently reiterated in writing, with no objection raised by the Respondent.

2. The Claimants argue that the Contested Rule is unlawful because it violates Swiss civil law, European Community (hereinafter «EC») competition law and Swiss competition law, general principles of law, and EC provisions on freedom of establishment and free movement of capital. The Claimants focus their grievances particularly on Paragraph B.3 of the Contested Rule, providing that «in the case of two or more clubs which are under common control, only one may participate in the same UEFA club competition». In summary, they assert the unlawfulness of the Contested Rule on the following ten grounds:
  - (a) *infringement of Swiss civil law* (grounds 1, 2, 3 and 4 of the statement of claim): violation of the UEFA Statutes because of the argued creation of different categories of members; breach of the principle of equal treatment because of discrimination between clubs which are under common control and clubs which are not; disregard of the Claimants' right to be heard; unjustified violation of the Claimants' personality;
  - (b) *infringement of EC competition law* (grounds 5 and 7 of the statement of claim): contravention of Article 85 (now 81) of the EC Treaty, because of an agreement between undertakings which has the object and effect of restricting, distorting and preventing competition and limiting investment within the common market; contravention of Article 86 (now 82) of the EC Treaty, because of an abuse by

- UEFA of its dominant position within the market for the provision of European football and related markets;
- (c) *infringement of Swiss competition law* (grounds 6 and 8 of the statement of claim): contravention of Article 5 of the Swiss Federal Act on cartels, because of an agreement between undertakings significantly affecting competition; contravention of Article 7 of the Swiss Federal Act on cartels, because of an abuse of UEFA's dominant position;
  - (d) *infringement of EC law on freedom of movement* (ground 10 of the statement of claim): contravention of Articles 52 (now 43) and 73 B (now 56) of the EC Treaty, because of restrictions on freedom of establishment and on free movement of capitals;
  - (e) *infringement of general principles of law* (ground 9 of the statement of claim): abuse by UEFA of its regulatory power with the purpose of preserving its position as the dominant organizer of European football competitions.
3. Underlying all such grounds are the Claimants' basic allegations that UEFA's predominant purpose in adopting the Contested Rule has been to preserve its monopolistic control over European football competitions and that a code of ethics would be adequate enough to address the issue of conflict of interests in the event that two commonly owned clubs are to participate in the same UEFA competition.
4. The Respondent submitted both in its answer of 22 July 1998 and in its response of 27 November 1998 the following legal petition:
- «UEFA respectfully requests the Court of Arbitration for Sport to dismiss all the legal petitions submitted by the Claimants, with all costs and compensations to be charged to the Claimants».*
5. The Respondent asserts that each and every legal ground put forward by the Claimants is entirely without merit. In particular, the Respondent asserts that it enacted the Contested Rule with the sole purpose of protecting the integrity of European football competitions and avoiding conflicts of interests. The Respondent argues that a code of ethics would be inadequate to that purpose, whereas the Contested Rule is a balanced and proportionate way of addressing the question, as it deals only with the issue of common control – basing the definition of «control» on EC Directive no. 88/627 (the so-called «Transparency Directive») – rather than with investment in football clubs.

## **Procedural issues**

### *Jurisdiction of the CAS*

6. The CAS has jurisdiction over this dispute on the basis of the arbitration agreement executed by and between the parties on 12 June 1998. Neither side has contested the validity of such arbitration agreement nor raised any objection to the jurisdiction of the CAS over the present dispute.



7. In addition, the Panel notes that the CAS could also be deemed to have jurisdiction under Article 56 of the UEFA Statutes, according to which «CAS shall have exclusive jurisdiction to deal with all civil law disputes (of a pecuniary nature) relating to UEFA matters which arise *between UEFA and Member Associations, clubs, players or officials, and between themselves*» (emphasis added).

#### *Applicable law*

8. Pursuant to Article R45 of the Code, the dispute must be decided «*according to the rules of law chosen by the parties or, in the absence of such a choice, according to Swiss law*». The parties agreed at the hearing of 15 July 1998 and confirmed in their briefs that Swiss law governs all issues of association law arising in this arbitration, and that the Panel should apply EC competition law and Swiss competition law if the dispute falls within the scope of these laws.
9. The choice of Swiss law does not raise any questions. Even if the parties had not validly agreed on its application, Swiss civil law would be applicable anyway pursuant to Article R45 of the Code and to Article 59 of the UEFA Statutes, according to which UEFA Statutes are governed in all respects by Swiss law. As to Swiss competition law, an arbitration panel sitting in Switzerland is certainly bound to take into account any relevant Swiss mandatory rules in accordance with Article 18 of the Swiss private international law statute (*Loi fédérale sur le droit international privé* of 18 December 1987, or «LDIP»).
10. With regard to EC competition law, the Panel holds that, even if the parties had not validly agreed on its applicability to this case, it should be taken into account anyway. Indeed, in accordance with Article 19 of the LDIP, an arbitration tribunal sitting in Switzerland must take into consideration also foreign mandatory rules, even of a law different from the one determined through the choice-of-law process, provided that three conditions are met:
  - (a) such rules must belong to that special category of norms which need to be applied irrespective of the law applicable to the merits of the case (so-called *lois d'application immédiate*);
  - (b) there must be a close connection between the subject matter of the dispute and the territory where the mandatory rules are in force;
  - (c) from the point of view of Swiss legal theory and practice, the mandatory rules must aim to protect legitimate interests and crucial values and their application must allow an appropriate decision.
11. The Panel is of the opinion that all such conditions are met and that, pursuant to Article 19 of LDIP, EC competition law has to be taken into account. Firstly, antitrust provisions are often quoted by scholars and judges as fundamental rules typically pertaining to the said category of mandatory rules. Then, the close connection with the case derives from the fact that EC competition law has direct effect in eighteen European countries – fifteen from the European Union and three from the European Economic Area – in whose jurisdiction one can find most of the strongest football clubs taking part in UEFA competitions and, in

particular, one of the Claimants (AEK). Lastly, the Swiss Cartel Law, as is the case with various national competition laws around Europe (well beyond the borders of the said eighteen countries), has been inspired by and modelled on EC competition law; accordingly, the interests and values protected by such EC provisions are shared and supported by the Swiss legal system (as well as by most European legal systems).

12. The Panel notes that the Claimants have argued *inter alia* that UEFA violated the provisions of the EC Treaty on the right of establishment and on free movement of capital, but the parties have not explicitly agreed on the applicability of such provisions to this case. However, for the same reasons outlined with respect to EC competition law (*supra*, paras. 10-11), the Panel holds that it must also take into account EC provisions on freedom of establishment and of movement of capital.

## Merits

### *Relevant circumstances concerning European football*

13. Prior to discussing the specific legal issues raised by the parties, the Panel wishes to describe and discuss certain circumstances and situations concerning European football which have to be taken into account with reference to all such legal issues. In particular, the Panel considers it useful to briefly describe the current structure and regulation of football in Europe and to address the issue of the so-called «integrity of the game».
  - a) Regulation and organization of football in Europe
14. In European football there are several private bodies performing regulatory and administrative functions, each of which has different institutional roles, constituencies and goals. Leaving aside the international football federation («FIFA»), which is certainly the body exercising the highest regulatory and supervisory authority worldwide, UEFA is the only regulator of football throughout Europe. UEFA performs its regulatory function with respect to both professional and amateur football, including youth football. For the time being, UEFA is also the only entity organizing pan-European competitions both for club teams and national representative teams. With particular regard to UEFA club competitions, each season the participating clubs are the few top-ranked clubs of each national league, which at the end of a season earn the right to play in the UEFA competitions of the subsequent season. As already mentioned, UEFA organizes the Champions' League, the Cup Winners' Cup (cancelled as of the 1999/2000 season) and the UEFA Cup, with the minor competition Intertoto Cup used also as a qualifier for the UEFA Cup. The competition format has traditionally been the knock-out system based on the aggregate result of one home-match and one away-match (played two weeks later), with away goals and penalty kicks as tie-breakers. Clubs (particularly those investing more) tend to dislike this system because a single unlucky match can be enough to terminate the whole international season, and because there are fewer high-level matches to play. Mainly for this

reason, UEFA has in recent years organized rounds of competition (particularly in the Champions' League) based on small groups of teams playing each other home and away in round-robin fashion, with the top clubs of each group qualifying for the next round. The trend seems to be towards increasing this competition format, reserving the knock-out system only for a few rounds of the competition.

15. Since UEFA is a confederation of fifty-one national football federations, it has below it many football associations and organizations which set rules for their constituent members, in particular clubs and individuals associated with them, and organize and/or oversee all national, regional and local competitions. The structure of European football is often described as a hierarchical pyramid (*see* the EC Commission's «consultation document» drafted by the Directorate General X and entitled *The European model of sport*, Brussels 1999, chapter one).
16. At national level, the primary regulators are the national federations. Each national federation has a wide constituency of regional and local federations, associations, clubs, leagues, and individuals such as players, coaches and referees. National federations are private bodies which pursue the mission – which in some countries is entrusted upon them by national legislation as a form of delegation of governmental powers (as is the case, *e.g.*, in France with Law no. 84-610 of 16 July 1984) – to promote and organize football at all levels and to care for the interests of the whole of the sport and all its members, whether they are involved in the amateur or in the professional game. National federations also organize and manage the national representative teams, selections of the best national players which compete against the other national representative teams in competitions such as the World Cup, the Olympic Games and the European Championship.
17. In the European countries where football is most developed, a very important role is also performed by professional «leagues» (*e.g.*, the «Premier League» in England, the «Liga Nacional de Fútbol Profesional» in Spain or the «Lega Nazionale Professionisti» in Italy). National professional leagues are bodies concerned only with professional football, as their members are only the clubs which participate in the most important national professional championships. They organize and manage yearly, under the jurisdiction of the respective national federation, the highest national professional championship. Such annual championship is traditionally organized in round-robin format, with each club playing against all the other clubs twice, once at home and once away; clubs are awarded points depending upon whether they win (three points), draw (one point) or lose matches (no points), and the club with the highest number of points each season is the champion (usually with no final playoff, differently from other sports). National professional leagues are indeed similar in many respects to trade associations. They exist primarily to protect the interests of their member clubs and to provide them with some services, for instance settling disputes between them and trying to maximize their commercial benefits (*e.g.*, selling collectively some of the television rights) and to minimize their costs (*e.g.*, negotiating with players' associations).

18. Throughout Europe a general trend can be detected towards an increasing independence and autonomy of leagues *vis-à-vis* the national federations; accordingly, tense confrontation between leagues and federations is nowadays not rare. However, thus far leagues are still associated within, and supervised by, the respective national federations – in several countries, this is even mandated by the law – with degrees of autonomy varying from country to country. Due to this system, national football leagues around Europe do not enjoy the absolute independence and autonomy which United States sports leagues enjoy. In addition to other major differences, European professional leagues are not «closed» leagues, and their membership varies slightly each season because at the end of the season some of the bottom-ranked clubs are relegated to the inferior national division and the highest ranked clubs from such division are promoted to the higher national division. This system of relegation and promotion applies more or less in the same way to all the other national and regional divisions and championships below the high-level ones. Consequently, it can happen in European football – as indeed it has done more than just a few times – that amateur or semi-amateur clubs, even from small towns, over the years earn their way up to professional championships and eventually transform into successful professional clubs. This system of promotion and relegation is generally regarded as «one of the key features of the European model of sport» (EC Commission, DG X, *The European model of sport*, Brussels 1999, para. 1.1.2).
  
19. At pan-European level, no transnational football leagues exist yet. Currently, there is only an association of the main national leagues in Europe, which does not organize any competitions and is basically only a forum for discussion and an instrument of coordination. Recently, a private commercial group («Media Partners») has attempted to create *ex novo* a European football league outside of the UEFA realm and has even notified the EC Commission of a number of draft agreements between Media Partners and eighteen founder clubs – comprising some of the most famous European clubs – concerning the establishment and the administration of two main pan-European football competitions, the «Super League» and the «Pro Cup», involving a total of 132 clubs from all territories covered by UEFA-affiliated national associations (*see Official Journal EC*, 13 March 1999, C 70/5). For the time being this attempt seems to have been aborted, *inter alia* probably because UEFA has modified the organization of its competitions in a way which is certainly pleasing to most important European clubs.
  
20. As to European football clubs, they are not all shaped in the same legal manner around Europe. Most professional clubs are incorporated as stock companies – and sometimes their shares are even listed on some stock exchanges (*e.g.* Manchester United and several other clubs in England, S.S. Lazio in Italy) –, but there are countries where some or all the clubs are still unincorporated associations with sometimes thousands of members who elect the association’s board (*e.g.* F.C. Barcelona and Real Madrid C.F. in Spain or the German clubs).
  
21. The above outlined traditional structure of European football might change in the future. In particular, especially after the cited attempt of Media Partners, it might be envisaged that sooner or later there will be in some countries or at a pan-European level some closed (or semi-closed) leagues independent from national federations and from UEFA and modelled

on United States professional leagues. However, for the time being, the above outlined structure still prevails and it is very difficult to compare it to the sports structure in the United States. Not only are there in Europe no closed professional leagues such as the NBA or the NFL, but there are no collegiate competitions such as the NCAA either. As a result, the Panel maintains that although any analysis of United States sports law is very instructive – in this respect the Panel appreciates the parties’ efforts in presenting the views and testimony of renowned experts on this subject – it has limited precedential value for the present dispute and its significance must be weighed very carefully. For example, the Panel considers that to characterize UEFA as a «league» comparable to United States professional leagues, as has been done in some testimony, is factually and legally misplaced and, therefore, potentially misleading for an examination of the present dispute.

b) The «integrity of the game» question

22. Much of the written and oral debate in this case has centred around the question of the «integrity of the game». Both Claimants and Respondent have shown that they are seriously concerned with this question. On the one hand, the Respondent has repeated over and over that it has a specific duty to protect the integrity of the game and that this has been the only motive behind the Contested Rule. On the other hand, the Claimants have expressly stated that they and ENIC accept and espouse the need to preserve sporting integrity, and that they also accept that UEFA has a current responsibility to safeguard the integrity of football in its role as organizer and regulator of European football competition.
23. Several witnesses have stated that the highest standards are needed for the integrity of the game (Mr. Taylor), that the integrity of sports is crucial to the sports consumer (Professor Weiler), and that *«football can only continue to be successful if it is run according to the highest standards of conduct and integrity, both on and off the field»* (Sir John Smith).
24. As concern for the integrity of the game is indeed common ground between the parties, the question is then how «integrity» needs to be defined and characterized in the context of sports in general and football in particular. Part of the debate between the parties has focused on integrity in its typical meaning of honesty and uprightness, and the Claimants have argued, supported by some witnesses (in particular Sir John Smith) for the necessity of a «fit and proper» test in order to vet owners, directors and executives of football clubs before allowing them to hold such positions. The debate has also evidenced the connection between the notion of integrity in football and the need for authenticity and uncertainty of results from both a sporting and an economic angle. Some witnesses have stated that uncertainty of results is the most important objective of football regulators (Mr. Taylor) and the critical element for the business value of football (Mr. Boon).
25. The Panel notes, quite obviously, that honesty and uprightness are fundamental moral qualities that are required in every field of life and of business, and football is no exception. More specifically, however, the Panel is of the opinion that the notion of integrity as applied to football requires something more than mere honesty and uprightness, both from a

sporting and from a business point of view. The Panel considers that integrity, in football, is crucially related to the *authenticity of results*, and has a critical core which is that, in *the public's perception*, both single matches and entire championships must be a true test of the best possible athletic, technical, coaching and management skills of the opposing sides. Due to the high social significance of football in Europe, it is not enough that competing athletes, coaches or managers are in fact honest; the public must perceive that they try their best to win and, in particular, that clubs make management or coaching decisions based on the single objective of their club winning against any other club. This particular requirement is inherent in the nature of sports and, with specific regard to football, is enhanced by the notorious circumstance that European football clubs represent considerably more in emotional terms to fans – the ultimate consumers – than any other form of leisure or of business.

26. The Panel finds *inter alia* confirmation and support for the view that the crucial element of integrity in football is the *public's perception of the authenticity of results* in two documents exhibited by the Claimants, *viz.* the well researched and very insightful reports presented by Sir John Smith to the English Football Association on «Betting on professional football within the professional game» (1997) and on «Football, its values, finances and reputation» (1998). The Smith reports are particularly valuable evidence because they were not prepared specifically for this case. Both reports make quite clear that the most important requirement for football is not honesty in itself or authenticity of results in itself, but rather the public's perception of such honesty and such authenticity.

27. Here are a few excerpts from the Smith reports (with emphasis added):

*«public perception* dictates that players and others involved in the game should not benefit from their “insider” position»;

*«the public has a right to expect* that a participant in football will play for his team to win, or make management decisions based on the team winning, as their sole objective. Anything whatsoever that detracts from that prime purpose has to be positively discouraged»;

*«even if a result of such a bet is not that a player or official actually intends not to try to win the game, the public's perception* of the integrity of the game would be prejudiced in such a situation»;

*«the interest of fans in the game would quite rightly not continue at present levels if they had reason to believe* that the outcome of any matches was or may be controlled by factors other than personal efforts of those participating in the game, aimed at their team winning»;

*«football must preserve its great strength in business terms: the enormous hold which individual clubs have over the loyalty of their supporters. This makes the game attractive to advertisers, sponsors, television and so on. Maintaining that loyalty is not being sentimental; being responsive to spectator concerns is simply good business. That means, amongst other things, being able to reassure supporters* that the game is straight».

28. Having clarified what is meant by integrity of the game, the question is then whether multiple ownership of clubs in the context of the same competition has anything to do with

such integrity and, therefore, represents a legitimate concern for a sports regulator and organizer. In other words, can multiple ownership within the same football competition be publicly perceived as affecting the authenticity of sporting results? Can the public perceive a conflict of interest which might contaminate the competitive process when two commonly owned clubs play in the same sporting event?

29. The Claimants have addressed this question mostly from the angle of match-fixing, arguing that it is highly unlikely that a match could be fixed without being detected sooner or later and that, insofar as match-fixing is possible at all, it is also feasible – as has happened on some occasions in the past – with respect to matches between unrelated clubs. In particular, the Claimants have argued that match-fixing necessarily involves complicity by a significant number of people whom, if the truth were discovered, would be ruined and each of whom would, after the event, have a hold over the accomplices. The Claimants have also argued that it is in the interest of a common owner, especially if the common owner is a corporation listed on the stock exchange, that each club does as well as possible on both the economic and sporting level, and that the existing criminal and sporting penalties are sufficient to deal with the risk of match-fixing as well as the perceived risk thereof. The Claimants have supported such arguments with several written statements by players, referees and managers, all essentially asserting in a similar vein that it is almost impossible to fix a football match, that multi-club ownership does not entail any greater threat to sporting integrity than single ownership and that a pledge to respect a «code of ethics» would suffice. Mr. Boon has also testified that multi-club owners would place their entire business at risk if they sought to fix matches and, therefore, this cannot be part of their financial strategy or activity. The Respondent has, in turn, presented some written statements supporting its argument that common ownership is a threat to the integrity of competition and that self-control by multi-club owners through a code of ethics would not be an adequate response to such threat.
30. The Panel is not persuaded that the main problem lies in direct match-fixing (meaning by this the instructions and bribes given to some players so that they lose a match). Indeed, the Panel finds some merit in the Claimants' arguments that direct match-fixing in football is quite difficult (albeit far from impossible, as notorious past cases in France, Italy or other countries demonstrate), that an attempt at direct match-fixing has a fair chance of being detected sooner or later, that any such discovery would eventually harm the multi-club controlling company and that in principle the honesty rate of multi-club owners, directors and executives cannot be any worse than that of single club owners, directors and executives.
31. However, even assuming that no multi-club owner, director or executive will ever try to directly fix the result of a match between their clubs or will ever break the law, the Panel is of the opinion that the question of integrity, as defined, must still be examined, also in the broader context of a whole football season and of a whole football competition. In short, the Panel finds that the main problem lies in the aggregate of three issues that need further analysis: the allocation of resources by the common owner among its clubs, the

administration of the commonly owned clubs in view of a match between them, and the interest of third clubs.

32. The analysis of such issues relies on two assumptions. The first assumption, as already mentioned, is that multi-club owners, directors or executives do not try to directly fix a match and always act in compliance with any laws and with sporting regulations. The second underlying assumption is that the multi-club controlling company's executives are in constant contact with the controlled clubs' own executives and structures, as is normal within a group of companies; in fact, according to EC case law and practice all the companies within a group – parent companies, holding companies, subsidiaries, *etc.* – are considered as a single economic entity (*see e.g.* the EC Commission Notice «on the concept of undertakings concerned», in *Official Journal EC*, 2 March 1998, C 66/14, para. 19). The Panel has indeed been impressed by ENIC's description of its *bona fide* efforts at isolating the management of each of its controlled clubs from the controlling company's and from other clubs' structures. However, the analysis is not to be made with reference to ENIC but with reference to a hypothetical individual, company or group owning two or more football clubs and whose organization might be less careful than ENIC about isolating each controlled club's structure. After all, even ENIC's isolation policy does not seem so strict, as Mr. Boon reports that:

*«during the time for completion of this report, I have also noted that employees from ENIC's head office in London have travelled to Greece, Italy, the Czech Republic and Switzerland to impart their industry and cross-club experience to individual clubs controlled by ENIC».*

This has been confirmed by Mr. Patrick Comminos, General Manager of AEK, who has stated in his written testimony:

*«As general Manager, my contact with the owners of the club is on a daily basis, especially with whichever member of ENIC is in Athens at the time».*

Accordingly, the Panel is of the opinion that also the second underlying assumption is appropriate.

33. The first issue is the *allocation of resources by the common owner among its clubs*. Given that in UEFA competitions there is only one sporting winner and there are only a few business winners (the clubs which advance to the last rounds of the competition), and given that a huge amount of money is required in order to keep a football club at the top European level, it would appear to be a waste of resources for a common owner to invest in exactly the same way in two or more clubs participating in the same competition. This is particularly true if the commonly owned clubs are located in different countries (as is generally the case, since at national level there are often rules hindering multiple ownership). After the *Bosman* ruling (EC Court of Justice, Judgement of 15 December 1995, case C-415/93, in *E.C.R.* 1995, I-4921), competition for hiring the top European players is wholly transnational, whereas most of a club's revenues – television rights, game and season tickets, merchandising, advertising and sponsorship – still depend on the national and local markets because of consumer preferences and natural barriers. Therefore, although the costs of creating a team which will potentially be successful in a UEFA competition tend nowadays



to be comparable all over Europe – players’ remuneration being by far the single most important cost for professional clubs – a club’s revenues and rates of return on investments are quite different even with comparable successful sporting results. Revenues and rates of return for football clubs are much higher in a few countries, such as England, France, Germany, Italy and Spain. This explains why the best, and most costly, players always end up in those few countries and why clubs from those countries currently dominate UEFA competitions.

34. The data contained in the economic report presented by Mr. Boon provide ample support for such propositions. As to transnational competition for players and as to their remuneration, Mr. Boon’s research shows that: *«internationally renowned clubs in Europe are willing to compete for the services of leading football players to maintain their successful international position. They are also typically the clubs with the financial resources to do so. ... it costs a significant amount to buy a leading player out of his existing club contract and, typically, to offer the player a premium on his remuneration to entice him to move elsewhere. ... the rate of increase in players’ wages has been nothing short of spectacular in the last five years. In Italy, from 1995/96 to 1996/97 the increase was 24.1% and 35% in the English Premier League».*

Mr. Boon’s report shows also that *«there is an active cross-border European transfer market in which clubs compete for the top players. ... 31% of transfers between major European associations in 1996/97 were cross border».*

With regard to the enormous disparity of revenues between different countries, Mr. Boon reports that *«in 1996/97 the second largest English club (Newcastle) had a turnover of ... \$69.9 million and Juventus’ turnover in Serie A was \$74.1 million; whereas SK Slavia Prague (the number 2 Czech club) had an income of ... \$2.2 million and AEK (one of the top 3 Greek clubs) an income of ... \$4.9 million»* (figures in national currencies have been omitted).

With regard to sporting results deriving from this situation, Mr. Boon confirms the well-known fact that *«there is some polarisation of market power developing within the European market. That polarisation is manifest in that clubs from the larger (and relatively more prosperous) countries with bigger “budgets” for transfers and players’ wages have increasingly come to dominate European competition».*

35. Given the above situation, assuming the viewpoint of the shareholders of a corporation controlling two clubs of different nationality participating in the same UEFA competition, it would certainly be a more efficient and more productive allocation of the available resources (and thus an economically sounder conduct by directors and executives) to allocate them, and thus to allocate the best players, in such a way as to have a «first team», capable of competing at top European level and situated in the richer market, and a «second team» located in the less developed market and which would be useful for, *inter alia*, allowing younger players to gain experience and to be tested with a view to a possible transfer to the first team. The testimony of Mr. Trijbits has given some empirical evidence of this kind of attitude by top rated clubs which acquire interests in clubs of lower rank.

36. The Panel is of the opinion that such differentiated allocation of resources among the commonly owned clubs is in itself perfectly legitimate from an economic point of view, and given its economic soundness it might even be regarded as a duty of the directors *vis-à-vis* the shareholders of the controlling corporation. However, the fans/consumers of the «second club» – which, in order to be eligible for UEFA competitions, is necessarily one of the top clubs of its country, supported in its international matches by most of the football fans of that country – would inevitably perceive that management decisions are not based on the only objective of their club winning against anybody else.
37. Furthermore, even if the different clubs are located in equally profitable (or unprofitable) markets and there is no diverse treatment as a first team and a second team, the common parent company might nevertheless decide, as is usual in a group of companies, to divert resources from one controlled club to another in order to follow wholly legitimate business strategies, for example if the sale of one of the clubs is contemplated. Some examples of such diversion of resources have been provided by Mr. Taylor, who stated in his written testimony:

*«When we had common ownership in this country of Oxford United and Derby County by Robert Maxwell there was a transfer of Oxford United's leading players to Derby County at a sum that was less the normal market value and this was very much against the wishes of the then manager of Oxford, Mark Lawrenson. We also had problems regarding Peter Johnson, owner of Tranmere Rovers, moving to Everton and consequent problems with the transfer of monies and questions about the transfer of the goalkeeper from Tranmere to Everton. Similar problems occurred with common ownership by Anton Johnson of Rotherham United and Southern United and there were allegations of asset stripping».*

In any event, the Panel is of the opinion that in situations of common ownership, even if a diversion of resources does not really happen, the fans of either club would always be inclined to doubt whether any transfer of players or other management move is decided only in the interest of the club they support rather than in the interest of the other club controlled by the same owner.

38. The second issue is the *administration of commonly owned clubs before a match between them*. It has already been described how shareholders, and thus executives, of the common parent company might have a legitimate economic interest in seeing a given controlled club prevail over another because of the better financial rewards which can be reaped from the success of the first one. In line with the initial assumption, the Panel considers that multi-club owners or executives might favour one club over another without any need to violate the law or to resort to risky attempts of direct match-fixing. In this respect, if a coach (or maybe a club physician) is encouraged or forced to ensure that the best team available is not fielded, it is unclear whether this could meet the definition of match-fixing. However, since there are sporting rules prescribing that clubs always field the best team available – albeit such rules are usually deemed impossible to apply and enforce – and risks (due to the involvement of coaches or physicians) perhaps close to those of direct match-fixing, the Panel does not wish to take into account this hypothetical circumstance in the present analysis.

39. Executives might have various ways of affecting or conditioning the performance of their teams in a given match, or set of matches, without even getting close to violating laws or sporting regulations and without even speaking to players or coaches. A first way might be connected with performance-related bonuses, which are wholly legitimate under any law. As has been evidenced at the hearing, bonuses linked to results in single matches or in entire championships are always a fair portion of players' (and coaches') remuneration, and ENIC clubs are no exception to this practice (Mr. Levy's testimony). In Mr. Boon's written report it is stated that one of the relevant costs associated with a club playing in Europe is «player bonuses for playing and winning UEFA matches». Mr. Boon also testified that all club owners and executives would, understandably, like a larger percentage of the total player remuneration to relate to performance than the percentage which usually applies (10% to 20%). The Panel observes that the widespread practice of bonuses demonstrates that professional players – no differently from other professionals (one can think of contingent fees) – are quite sensitive to incentives. Accordingly, it would be easily possible and perfectly legal for multi-club executives, by adjusting bonuses, to highly motivate the players of one team with suitable incentives and not at all (or much less) the players of the other team.
40. A second way might be connected with players' transfers. Up to a certain point in the football season (nowadays, very late in the season) it is always possible to obtain new players or to let players leave. It is quite easy to induce players to move from a club to another through a wage hike or the opportunity to play in a winning team. Therefore, at any moment before a match between the commonly owned clubs, team rosters could easily change because of management and business needs rather than coaching decisions. One can find in the sporting press plenty of examples of players given away or hired by club owners and executives without the prior consent, and sometimes even without the prior knowledge, of the coaching staff.
41. A third relevant way of influencing the outcome of a match between commonly owned clubs might be connected with «insider information». One team could have, through common executives, access to special knowledge or information about the other team which could give the first team an unfair advantage. There is a relevant difference between widely available information (such as tapes of the other team's official matches or any news which has appeared in the press) and confidential information obtained from a person within the opponent club's structure (*e.g.* with regard to unpublicized injuries, training sessions, planned line-up, match tactics and any other peculiar situation concerning the other team).
42. Another, more trivial, way of conditioning team performances could even be connected with the day-to-day administration of a team in view of a match, particularly of an away match. There are plenty of choices usually made by club executives – *e.g.* with regard to travel, lodging, training, medical care and the like – which may condition either positively or negatively the attitude and performance of professional football players.
43. The third issue concerns *the interest of third clubs*. Whenever competitions have qualification rounds based on groups of teams playing each other home and away in round-robin format, the interest of unrelated third clubs ending up in a qualification group together with two

commonly owned clubs is quite evident. Football history provides unfortunately various instances of matches – even in the World Cup under the eyes of hundreds of millions of television viewers – where both teams needed a draw to the detriment of a third team and in fact obtained such a draw without much effort and without anybody explicitly admitting any agreement afterwards (in fact, probably true agreements were never made, common interest being enough for an unspoken understanding, an «*entente cordiale*»). It is true, this can happen with single owned clubs as well as with commonly owned clubs, but the multi-club owner or executive has additional ways of facilitating an (already easy) unspoken understanding between the teams, for example setting bonuses for drawing higher than, or even equal to, bonuses for winning the match. A third club's interest might also be affected when, before playing the last match or matches of a round-robin group, one of the two commonly owned clubs has already virtually qualified or been eliminated and the other is still struggling; in this case the multi-club owner or executive might be tempted to induce (by the described lawful means) the first club to favour the other club in the last match or matches.

44. As mentioned (*supra*, para. 14), due also to the preferences of the most influential clubs, the current trend in the organization of UEFA competitions (particularly the Champions' League) is more and more towards qualification rounds in round-robin format and, conversely, away from competition rounds played in knock-out format. Such an organizational trend renders this issue particularly delicate, because it increases the need to protect third competitors. Needless to say, even if in fact the outcome of a game between two commonly owned clubs is absolutely genuine, a disadvantaged third club and its fans will inevitably tend to perceive the outcome as unfair.
45. The analysis of the three above issues shows that, even assuming that multi-club owners, directors or executives always act in compliance with the law and do not try to directly fix any match, there are situations when the economic interests of the multi-club owner or parent company are at odds with sporting needs in terms of public perception of the authenticity of results. It may be desirable that multi-club directors and executives safeguard sporting values and act counter to the parent company's wishes and economic interests. However, what about the legitimate economic interests of the shareholders? What about the investors in the stock exchange? Would the shareholders and investors be prepared to accept from a director or an executive the «sporting uncertainty» justification for not having done his/her best, without violating any laws, to promote their economic interests? The Panel is of the opinion that in such a situation there is an inescapable pressure for legitimate (or sometimes «grey-area») behaviour which is in the interest of the controlling company and in the interest of some of the controlled clubs, but not in the interest of *all* the controlled clubs and their fans, or not in the interest of third clubs or football fans in general. As a result, the Panel holds that a problem of *conflict of interest* does exist in multi-club ownership situations.
46. Several sporting bodies and some State legislators have indeed issued rules in order to deal with this question. For example, among European sports bodies there are rules dealing with multi-club ownership in the English Premier League, the English Football League, the Scottish Football Association, and the Spanish football and basketball professional leagues.

In Spain a limit to multi-club ownership in the same competition is prescribed by law: Article 23 of the 1990 Sports Act (*«Ley 10/1990, de 15 de octubre, del Deporte»* as subsequently amended) currently forbids any kind of cross-ownership between Spanish professional clubs and limits the possible direct or indirect shareholding or voting rights in more than one club participating in the same competition to 5%. In Spain, the issue appears to be of particular public awareness because of the case of a well-known entrepreneur who has been suspected and found to hold indirectly, through various companies or figure-heads, shares in various professional football clubs, some of them participating in the same league division. In particular, the Spanish press raised some serious suspicions with regard to the outcome of certain matches between clubs allegedly under common control. Rules prohibiting investment in more than one professional club can also be found in renowned United States sports leagues, such as the National Basketball Association («NBA»), the National Football League («NFL»), the National Hockey League («NHL»), and in baseball the American League and the National League (forming together the Major League Baseball or «MLB») and the minor leagues associated with the National Association of Professional Baseball Leagues («NAPBL»). This attitude by the most important American sports leagues seems to be shared by the United States Court of Appeals for the Second Circuit, which has stated that *«no single owner could engage in professional football for profit without at least one other competing team. **Separate owners for each team are desirable in order to convince the public of the honesty of the competition**»* (Judgement of 27 January 1982, *NASL v. NFL*, 670 F.2d 1249, at 1251, emphasis added).

47. The Panel notes that there is evidence enough showing that a certain number of sports regulators, and some national legislators or judges, perceive that multi-club ownership within the same sporting competition implies a conflict of interest. Even Mr. Karel Van Miert, EC Commissioner for competition policy, has stated before the European Parliament, in reply to written and oral questions posed by some Parliament Members, that *«clearly, if clubs with the same owner can take part in the same competitions, whether national or international, **doubts may arise as to whether the outcome is really undecided in advance**»* (answers given by Mr. Van Miert on behalf of the Commission to parliamentary questions nos. E-3980/97, 0538/98, P-2361/98, emphasis added).

In his testimony, Professor Weiler characterized this conflict of interest issue as an «illusion» and counsel for the Claimants picked up and utilized such locution in the course of the final oral argument. The Panel is of the opinion that, even assuming (but not conceding) that there is no true conflict of interest, it must be acknowledged that «clearly ... doubts may arise» (as put by Mr. Van Miert). The mere fact that some knowledgeable authorities like sports regulators, national legislators or judges, and European commissioners are under such «illusion» proves that the general public – the consumers – might also easily fall under an analogous «illusion». After all, even Professor Weiler himself, a couple of years before studying in depth the issue of multi-club ownership in order to be an expert witness before this Panel, wrote that *«from the point of view of the League as a whole, there are also significant potential advantages from assigning control and responsibility for individual teams to an identifiable owner. On the playing field or court, **this reinforces the impression among fans that their favored team is fully committed to winning all its games.** ... With respect to business decisions made off the field, separate*

*ownership and control of individual teams may be more likely to enhance the team's appeal and extract the revenues available in its local market»* (WEILER, *Establishment of a European League*, in *FIBA International Legal Symposium (June 1997)*, Bilbao 1999, 77, at 87-88).

Therefore, the perception of an inherent conflict of interest in multi-club ownership within the same championship or competition seems wholly reasonable.

48. As a result, the Panel finds that, when commonly controlled clubs participate in the same competition, the *«public's perception will be that there is a conflict of interest potentially affecting the authenticity of results»*. This reasonable public perception, in the light of the above characterization of the integrity question within football (*see supra*, paras. 25-27), is enough to justify some concern, also in view of the fact that many football results are subject to betting and are inserted into football pools all over Europe. This finding in itself, obviously, does not render the Contested Rule admissible under the different principles and rules of law which still have to be analyzed. At this stage of its findings, the Panel merely concludes that ownership of multiple clubs competing in the same competition represents a justified concern for a sports regulator and organizer.

#### *Swiss civil law*

49. The Claimants argue that the Contested Rule is unlawful under Swiss civil law because of the procedure by which it was adopted and for reasons of substance. With respect to procedural grounds, the Claimants assert that in adopting and enforcing the Contested Rule the Respondent (1) violated the UEFA Statutes by creating different categories of members, and (2) failed to observe fair procedures, disregarding in particular the clubs' right to a legal hearing. As to substantive grounds, the Claimants assert that the Respondent (3) infringed the principle of equal treatment by discriminating between clubs which are under common control and clubs which are not, and (4) violated without justification the personality of the clubs. The Respondent rejects all such claims.
- a) Compliance with UEFA Statutes
50. Article 75 CC provides that a resolution taken by an organ of an association which contravenes the law or the association statutes can be judicially challenged by any member of the association who has not approved it.
51. The Claimants argue that they should be considered as «indirect members» of UEFA because they are members of the respective national associations (*i.e.* federations) which, in turn, are members of UEFA. Therefore, they claim that UEFA violated its own Statutes insofar as the Executive Committee created different categories of clubs – clubs under common control *vis-à-vis* clubs which are not – and thus different categories of indirect members, without the power to do so (as the creation of different categories of members would require an amendment to the Statutes, which can be done only by the UEFA

Congress). In response, UEFA points out that the national federations rather than the clubs are its members and that, in any event, it did not create different membership categories but it merely amended the conditions of admission to UEFA club competitions in order to eliminate conflict of interest situations.

52. The Panel is not persuaded that clubs could be considered «indirect members» of UEFA. Art. 65.1 CC provides that the general assembly of a Swiss association is competent to decide on the admission of its members. If clubs had a right to be considered (indirect) members of UEFA because they are affiliated to their national federation, they evidently would acquire such status through a decision of such national federation, that is a body which surely is not the competent general assembly – the UEFA Congress – and this would be hardly compatible with Article 65.1 CC. Moreover, Article 5.1 of the UEFA Statutes, entitled «Membership», establishes that «membership of UEFA is open only to national football associations situated in the continent of Europe who are responsible for the organization and implementation of football-related matters in their particular territory»; clearly clubs do not meet these requirements. Clubs are not ignored by the Statutes, as they are mentioned in several provisions (Articles 1, 7, 23, 45, 46, 49, 54, 55 and 56) but without any hint of them being considered indirect members. The UEFA Statutes attribute voting rights only to national federations, and Article 75 CC refers to members which have voting rights within the association whose resolution is challenged. Clubs are affiliated to and may have membership and voting rights within their national federations, where they can elect the federation’s board and president, who represents the national federation and thus all the national clubs within UEFA. Within the national federations there are indeed different categories of clubs – *e.g.* female and male clubs, amateur and professional clubs – but this depends only on provisions included in the statutes of the national federations.
53. In any event, even assuming that the clubs could be regarded as indirect members of UEFA, the Panel does not see in the Contested Rule any creation of different categories of member clubs but rather the establishment of conditions of participation in UEFA competitions. Among such conditions are also, for example, stadium safety requirements (Articles 3 and 8 of the 1998/99 Regulation of the UEFA Cup and the related booklet; *see supra*, para. 8). Applying the Claimants’ rationale, this would imply the creation of different categories of clubs, those with an adequate stadium and those without. In other words, any condition of admission to a competition could be interpreted as a creation of categories of clubs. The Panel considers that there is a substantial difference between «club categories» and «conditions of participation». On the one hand, the notion of category implies a club’s formal and steady status, which is prerequisite for any kind of competition (national or international) in which that club takes part, and which is modifiable only through given formal procedures (*e.g.*, the transformation of an amateur club into a professional one, or *vice versa*). On the other hand, the notion of «conditions of participation» implies more volatile requirements which are checked when, and only when, a club enters a given competition, and which are often specific to that competition (*e.g.*, in order to compete in some national championships, clubs must provide financial guarantees which are different in type and amount from country to country; at the same time, in order to compete in, say, the Greek

championship it is absolutely irrelevant that the owner of a participating club controls other clubs abroad).

54. Article 46.1 of the UEFA Statutes provides that the «*Executive Committee shall draw up regulations governing the conditions of participation in and the staging of UEFA competitions*». As the UEFA Statutes confer to the Executive Committee the power to enact rules concerning conditions of participation in a UEFA competition, the Panel holds that in adopting the Contested Rule the UEFA Executive Committee did not act *ultra vires*, and thus UEFA did not violate its own Statutes.
- b) Right to a legal hearing and to fair procedures
55. The Claimants argue that, under Article 75 CC, members of an association have the right to be heard when resolutions are passed which affect them to a significant extent. Therefore, the Claimants assert that, being indirect members of UEFA, they were entitled to a legal hearing before the adoption of the Contested Rule, and that UEFA therefore infringed the principle *audiatur et altera pars*. More generally, the Claimants assert that association members have a right to fair procedures, and that *inter alia* the Respondent adopted the Contested Rule too shortly before the start of the new season. The Respondent replies by insisting that the clubs are not indirect members of UEFA and by asserting that it acted strictly in accordance with its statutory regulations and that AEK had enough time to adjust to the Contested Rule.
56. The Panel notes that the Claimants base this ground, like the previous one, on the assumption that clubs are «indirect» members of UEFA, because they are affiliated to their respective national federations which in turn are members of UEFA. For the reasons already stated, the Panel is not persuaded by this construction. The Panel finds the argument even less persuasive if such characterization of the clubs as indirect members implies, as the Claimants argue, the necessary consequence that *every indirect member* should be heard by UEFA before passing a resolution which could affect such indirect member. This would mean that, if a resolution affects amateur clubs, UEFA should consult with tens (perhaps even hundreds) of thousands of clubs. As all players, coaches and referees are also affiliated to their national federations – millions of individuals throughout Europe –, they could also claim to be indirect members and every one of them could request that he/she be heard by UEFA. Even if one was to limit the right to be heard only to clubs potentially interested in UEFA competitions – *i.e.* all clubs competing in the highest championship of every UEFA member federation – there would still be hundreds of clubs to be consulted. For an international federation, this would amount to a procedural nightmare and would paralyze any possibility of enacting regulations. The Panel maintains that the consequence is so absurd that the reasoning is fallacious.
57. In any event, even assuming that for some purposes clubs could be considered as indirect members of UEFA, the Panel is of the opinion that «indirect» members could not be wholly equated with «direct» members. Therefore, clubs could not claim anyway the right to be



heard when general resolutions are adopted by UEFA. It is certainly opportune that UEFA consults with at least some of the clubs, or possibly with some of the national leagues, before adopting rules concerning conditions of admission to its competitions, but in the Panel's view this cannot be construed as a legal obligation under Swiss association law.

58. With regard to the right to be heard, the Panel wishes to stress that the CAS has always protected the principle *audiatur et altera pars* in connection with any proceedings, measures or disciplinary actions taken by an international federation *vis-à-vis* a national federation, a club or an athlete (*see* CAS 91/53 *G. v. FEI*, award of 15 January 1992, in M. REEB [ed.], *Digest of CAS Awards 1986-1998*, Berne 1998, 87, paras. 11-12; CAS 94/129 *USA Shooting & Q. v. UIT*, award of 23 May 1995, *ibidem*, 203, paras. 58-59; CAS OG 96/005, award of 1 August 1996, *ibidem*, 400, paras. 7-9). However, there is a very important difference between the adoption by a federation of an *ad hoc* administrative or disciplinary decision directly and individually addressed to designated associations, teams or athletes and the adoption of a general regulation directed at laying down rules of conduct generally applicable to all current or future situations of the kind described in the regulation. It is the same difference that one can find in every legal system between an administrative measure or a penalty decided by an executive or judicial body concerned with a limited and identified number of designees and a general act of a normative character adopted by the parliament or the government for general application to categories of persons envisaged both in the abstract and as a whole. The Panel remarks that there is an evident analogy between sports-governing bodies and governmental bodies with respect to their role and functions as regulatory, administrative and sanctioning entities, and that similar principles should govern their actions. Therefore, the Panel finds that, unless there are specific rules to the contrary, only in the event of administrative measures or penalties adopted by a sports-governing body with regard to a limited and identified number of designees could there be a right to a legal hearing. For a regulator or legislator, it appears to be advisable and good practice to acquire as much information as possible and to hear the views of potentially affected people before issuing general regulations – one can think of, *e.g.*, parliamentary hearings with experts or interest groups – but it is not a legal requirement. As a United States court has stated, requiring an international sports federation «*to provide for hearings to any party potentially affected adversely by its rule-making authority could quite conceivably subject the [international federation] to a quagmire of administrative red tape which would effectively preclude it from acting at all to promote the game*» (*Gunter Harz Sports v. USTA*, 1981, 511 F. Supp. 1103, at 1122).
59. Furthermore, in any event, the Panel observes that ENIC – clearly being the most interested party and evidently representing also the Claimants – was in fact heard by UEFA at a meeting held on 24 February 1998 (*supra*, para 6). In a letter from Mr. Hersov of ENIC (enclosing the proposed *Code of Ethics*) sent on the following day to Mr. Studer of UEFA, it is possible to read *inter alia*:

«*We appreciated your and Marcel's open and frank discussion with us, and the mutual recognition of UEFA and ENIC's interests, objectives and concerns. From UEFA's perspective, the sanctity of the game and the various European competitions are paramount. You are also under some pressure to be seen to be responding responsibly to members concerns, and we appreciate and recognize this pressure. ... We feel that the proposed rule change banning teams with common ownership from competing*

*in the same competition would be extremely damaging to ENIC. Its implementation would be very harmful to ENIC and it would materially impact the clubs which we currently own ...»* (emphasis added).

Hence, at the meeting of 24 February 1998 UEFA did raise the issue of a rule such as the Contested Rule being contemplated and the Claimants in fact had a possibility, through their common parent company ENIC, of expressing their opinion to UEFA and of making very clear their dissatisfaction with the envisaged new rule on multi-club ownership and the potential damage deriving therefrom. For all the above reasons, the Panel holds that the Respondent did not infringe the principle *audiatur et altera pars* and did not violate any right to be heard in adopting the Contested Rule.

60. With regard to the more general requirement of respecting fair procedures, however, the Panel considers that this is a principle which must always be followed by a Swiss association even *vis-à-vis* non-members of the association if such non-members may be affected by the decision adopted. In this respect, the Panel notes that the President of the Ordinary Division of the CAS based its interim order of 16-17 July 1998 on the circumstance that UEFA violated the principle of procedural fairness. The Panel agrees with the President's view that UEFA adopted the Contested Rule too late, when the Cup Regulations for the 1998/99 season, containing no restriction for multiple ownership, had already been issued. In the CAS interim order it was observed *inter alia*:

*«By adopting the Regulation to be effective at the start of the new season, UEFA added an extra requirement for admission to the UEFA Cup after the conditions for participation had been finally settled and communicated to all members. It did so at a time when AEK already knew that it had met the requirements for selection of its national association. Furthermore, it chose a timing that made it materially impossible for the clubs and their owner to adjust to the new admission requirement. ...*

*The doctrine of venire contra factum proprium ... provides that, where the conduct of one party has led to the legitimate expectations on the part of a second party, the first party is estopped from changing its course of action to the detriment of the second party ...*

*By referring to this doctrine, CAS is not implying that UEFA is barred from changing its Cup Regulations for the future (provided, of course, the change is lawful on its merits). However, it may not do so without allowing the clubs sufficient time to adapt their operations to the new rules, here specifically to change their control structure accordingly».*

61. The Panel essentially agrees with the foregoing remarks by the President of the Ordinary Division of the CAS and with the ensuing conclusion that UEFA violated its duties of procedural fairness with respect to the 1998/99 season. Indeed, a sports-governing organization such as an international federation must comply with certain basic principles of procedural fairness *vis-à-vis* the clubs or the athletes, even if clubs and athletes are not members of the international federation (*see* the Swiss Supreme Court decision in the *Grossen* case, in ATF 121 III 350; *see also infra*). The Panel does not find a hurried change in participation requirements shortly before the beginning of the new season, after such requirements have been publicly announced and the clubs entitled to compete have already been designated, admissible. Therefore, the Panel approves and ratifies the CAS Procedural

Order of 16 July 1998, which has granted interim relief consisting in the suspension of the application of the Contested Rule «for the duration of this arbitration or for the duration of the 1998/99 season of the UEFA Cup, whichever is shorter».

62. The Panel observes that the above conclusion does not require that the Contested Rule be annulled on procedural grounds, given that the lawfulness of the Contested Rule must be evaluated on its merits with respect to all future football seasons. In the Panel's view, if the Contested Rule would be found to violate any of the substantive rules and principles of Swiss and/or EC law invoked by the Claimants, no amount of procedural fairness could save it; conversely, if the Contested Rule would not be found to infringe such rules and principles, a minor lack of procedural protection could not render it unlawful *per se*. Therefore, while approving the interim stay of the Contested Rule, the Panel holds that UEFA's procedural unfairness concerning the timing of the new rule's entry into force is of a transitory nature and, as a result, it is not such as to render the Contested Rule unlawful on its merits with respect to all future football seasons. The Claimants' request to annul the Contested Rule on this procedural ground is thus rejected. However, as will be seen *infra*, the said procedural defect will have some consequences with respect to the temporal effects of this award.
- c) Principle of equal treatment
63. The Claimants remind that Article 75 CC also protects members of a Swiss association against resolutions which infringe the principle of equal treatment of the association's members and, therefore, argue that the Contested Rule violates the corresponding rights of the Claimants. In particular, the Claimants assert that UEFA formed different categories of members and violated the principle of relative equality because it established membership distinctions – clubs commonly controlled *vis-à-vis* the other clubs – in an arbitrary manner. The Claimants argue that there are no substantial objective grounds which UEFA could invoke to justify the unequal treatment provided by the Contested Rule because the Contested Rule is neither necessary, nor appropriate and, in addition, fails the test of proportionality insofar as it is a disproportionate means of achieving the objective of protecting the integrity of UEFA competitions. In reply, the Respondent argues that the principle of equal treatment does not prevent differentiation between objectively different situations, that the common control of clubs is an objectively relevant factor, and that in any event the Contested Rule is a proportionate response to the need to protect the integrity of the game.
64. The Panel notes that this argument is also based on the assumption that clubs are indirect members of UEFA, as under Article 75 CC only association members can judicially challenge a resolution infringing their right to equal treatment. The Panel has already disavowed such construction of the clubs' status within UEFA and here refers to the views previously stated in this respect (*see supra*, paras. 52 and 56).

65. The Panel has also already expressed the opinion that, even assuming that the clubs could be regarded as indirect members of UEFA, the Contested Rule did not create different categories of clubs but rather established an additional condition of participation in UEFA competitions (*see supra*, para. 53). The Panel does not find any discrimination or unequal treatment in establishing conditions of participation which are applicable to all clubs. It seems to the Panel that there is no discrimination in denying admission to a club whose owner is objectively in a conflict of interest situation; likewise, *e.g.*, there is no discrimination in denying admission to a club whose stadium is objectively below the required safety standards. In both cases, if the shareholding structure or the safety conditions are modified, the club is admitted to the UEFA competition. Therefore, the Contested Rule does not target or single out specific clubs as such but simply sets forth objective requirements for all clubs willing to participate in UEFA competitions.

66. As a result, the Panel holds that the Contested Rule does not violate the principle of equal treatment. Since the proportionality test is supposed to be applied only in order to verify whether an unequal treatment is justified, it is not necessary to rule on the proportionality issue in connection with this ground. In any event, the Panel observes that the discussion on proportionality developed under Article 81 (*ex* 85) of the EC Treaty (*infra*, paras. 131-136) could be applied in its entirety to this ground as well.

d) Personality of the clubs

67. The Claimants argue that the Contested Rule is not compatible with Article 28 CC, which reads as follows:

*«1. Celui qui subit une atteinte illicite à sa personnalité peut agir en justice pour sa protection contre toute personne qui y participe. 2. Une atteinte est illicite, à moins qu'elle ne soit justifiée par le consentement de la victime, par un intérêt prépondérant privé ou public, ou par la loi»* («1. A person who is unlawfully injured in his personality may bring proceedings for protection against any party to such injury. 2. Such injury is unlawful unless it is justified by consent of the injured person, by an overriding private or public interest, or by the law»).

The Claimants assert that Article 28 CC applies both to individuals and to corporate legal entities, and that the development of both the sporting and economic personality of commonly owned clubs would be impaired as a consequence of the non-admission to a UEFA competition. The Respondent argues that Article 28 CC has no relevance at all because it is applicable to different types of situations, and that in any event UEFA pursued overriding interests in enacting the Contested Rule.

68. The Panel is not persuaded that Article 28 CC could be applied to the case at stake. The notion of «personality» (or of «personhood») is to be characterized by reference to the fundamental attributes which every person, and in some measure every legal entity such as an association or a corporation, has a right to see protected against external intrusion and interference. It is difficult to find definitions in the abstract as there is an indefinite number of liberties, varying from time to time and from country to country, which can be

encompassed within the concept of personality rights. Examples are core rights related to privacy, name and personal identity, physical integrity, image, reputation, marriage, family life, sexual life and the like.

69. Swiss case law has sometimes stretched the notion of personality rights in order to protect a wider number of rights, such as the right to be economically active and even the freedom of performing sporting activities. The Claimants argue that the present dispute can be compared to the *Gasser* case, concerning the two-year exclusion of an athlete from any kind of competition due to a doping offence. In the *Gasser* case, the judge considered as a personality right the athlete's freedom of action and freedom of physical movement and, therefore, «*the freedom of performing sporting activities and of participating in a competition between athletes of the same level*» (Office of Judge III, Berne, Decision of 22 December 1987, in *SJZ*, 1988, 84 at 87). However, the Panel finds the *Gasser* case quite different from, and thus of no precedential value for, the present dispute. Indeed, the Contested Rule is a general regulation establishing a condition of participation applicable to all clubs (*see supra*, paras. 53 and 58) and not, as in the *Gasser* case, a disciplinary measure individually addressed to a designated athlete. Accordingly, the Contested Rule as such cannot be considered an exclusionary sanction within the meaning of the *Gasser* ruling. Moreover, the Contested Rule sets forth a condition for access to a single competition rather than an absolute exclusion from all sporting activities. The Panel considers that, while an unfairly adopted long doping ban might harm the whole sporting career of an athlete, and thus his/her personality, a club's non-participation in a UEFA competition would involve some loss of income but, since the club would still take part in other important football competitions such as the national championship and the national cup (which are competitions appreciated by fans and economically rewarding, as will be seen *infra* at para. 131), its «personality» would not be affected. In any event, even a restriction of a personality right could be justified by an «overriding private or public interest» (Article 28.2 CC), and the Panel is of the opinion that the public's perception of a conflict of interest potentially affecting the authenticity of results (*see supra*, para. 48) would constitute such an «overriding interest».
70. The Claimants have also made reference to Swiss judgements limiting an association's right to exclude a member, pursuant to Article 72.2 CC, in situations where the exclusion would injure the personality of the member concerned. Swiss courts have applied this doctrine to associations which hold monopolistic positions, such as professional associations or sports federations. However, apart from the illustrated difficulty of considering the Claimants as (indirect) members of UEFA (*see supra*, paras. 52 and 56), the Panel observes that non-admission to a competition cannot be equated to the loss of membership due to expulsion from an association and, therefore, cannot be considered as an injury to personality. In any event, even if one were to admit that the effects of the Contested Rule could be compared to an actual exclusion from membership, according to Swiss case law this could always be justified if there is «good cause» (Swiss Federal Court, Decision of 14 March 1997, in *SCP* 123 III, 193). The Panel is of the opinion that the public's perception of a conflict of interest potentially affecting the authenticity of results (*see supra*, para. 48) would constitute «good cause». In conclusion, the Panel holds that the Contested Rule does not violate Article 28 CC.

*European Community competition law*

a) Introductory remarks

71. Article 81.1 (*ex* 85.1) of the EC Treaty prohibits *«as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market»*.

Under Article 81.2 (*ex* 85.2) *«any agreements or decisions prohibited pursuant to this Article shall be automatically void»*.

Under Article 82 (*ex* 86) of the EC Treaty *«any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States»*.

72. According to the EC Commission's «Notice on cooperation between national courts and the Commission in applying Articles 85 and 86 of the EC Treaty» (in *Official Journal EC*, 13 February 1993, C 39/6), before ascertaining whether there is an infringement of the prohibitions laid down in Article 85.1 (now 81.1) or 86 (now 82), national courts (and thus arbitrators) *«should ascertain whether the agreement, decision or concerted practice has already been the subject of a decision, opinion or other official statement issued by an administrative authority and in particular by the Commission. Such statements provide national courts with significant information for reaching a judgement, even if they are not formally bound by them»* (*ibidem*, para. 20).

73. The Panel is not aware of any decision, opinion or other official statement issued by the Commission or other administrative authority with regard to the Contested Rule. However, as already mentioned (*supra*, para. 47), there have been a few replies by the Commission under Article 197 (*ex* 140) of the EC Treaty to questions specifically devoted to the Contested Rule put to it by some Members of the European Parliament (questions nos. E-3980/97, 0538/98, P-2361/98). The wording of all such replies is similar or identical. In the answer given on 3 September 1998 (*Official Journal EC*, 1999, C 50/143), the EC Commissioner responsible for competition policy Mr. Van Miert, answering on behalf of the Commission, has stated as follows:

*«The Commission is aware that the Union of European football associations (UEFA) has recently adopted rules that regulate the participation in European competitions of clubs belonging to the same owner. It seems at first sight that these rules have a sporting nature and that they aim to preserve uncertainty of results, an objective which the Court of Justice has recognised as legitimate in its judgement of 15 December 1995 in the Bosman case. Clearly, if clubs with the same owner can take part in the same competitions, whether national or international, doubts may arise as to whether the outcome is really undecided in advance. Nevertheless, it is necessary to determine whether these UEFA rules are limited to what is strictly necessary to attain the objective of ensuring the uncertainty as to results or whether there exist less restrictive means to achieve it. Provided that such rules remain in proportion to the sporting objective pursued, they would not be covered by the competition rules laid down in the EC Treaty. At this stage, the Commission does not possess all the*

*necessary information to assess the compatibility of the rules with Articles 85 and 86 of the EC Treaty. Whether UEFA has or not consulted other bodies is not relevant for this assessment».*

74. The Respondent has attributed great weight to this statement, while the Claimants have underlined that it has no legal force whatsoever and that anyway it provides no answer to the question of whether the Contested Rule is compatible with the EC Treaty. The Panel is not sure whether an answer given by the Commission in the European Parliament can be regarded as a «decision, opinion or other official statement» within the meaning of the above-mentioned Commission Notice. Probably, the Commission did not have in mind answers to parliamentary questions when it drafted the Notice, and its reference to *official* statements would imply a less informal statement than a parliamentary one. In any event, since Mr. Van Miert's answer is quite concise and given without the Commission *«possess[ing] all the necessary information to assess the compatibility of the rules with Articles 85 and 86 of the EC Treaty»*, and since any statement issued in the Parliament inevitably has a political rather than a legal nuance, the Panel is of the opinion that it should not base this award on Mr. Van Miert's answer.
75. The Panel also notes that the EC Commission has recently issued a more general statement with regard to the application of competition rules to sport. The Commission has publicly noted as follows: *«Sport comprises two levels of activity: on the one hand the sporting activity strictly speaking, which fulfils a social, integrating and cultural role that must be preserved and to which in theory the competition rules of the EC Treaty do not apply. On the other hand a series of economic activities generated by the sporting activity, to which the competition rules of the EC Treaty apply, albeit taking into account the specific requirements of this sector. The interdependence and indeed the overlap between these two levels render the application of competition rules more complex. Sport also has features, in particular the interdependence of competitors and the need to guarantee the uncertainty of results of competitions, which could justify that sporting organizations implement a specific framework, in particular on the markets for the production and the sale of sports events. However, these specific features do not warrant an automatic exemption from the EU competition rules of any economic activities generated by sport, due in particular to the increasing economic weight of such activities»* (EC Commission, Press Release no. IP/99/133, 24 February 1999).
76. The Panel shares the EC Commission's position that the application of competition rules to sports regulations is a particularly complex task because of the peculiarities of sport and because of the inescapable link between sporting and economic aspects. Therefore, all the relevant elements of competition law have to be carefully weighed in this award together with the peculiar sporting elements, in order to ascertain whether the Contested Rule violates Articles 81 (*ex* 85) and 82 (*ex* 86) of the EC Treaty or not.
- b) Position of the parties
77. With respect to Article 81 (*ex* 85) of the EC Treaty, the Claimants assert, firstly, that the Contested Rule is a decision by an association of undertakings, and/or an agreement between undertakings, falling within the scope of such provision. Then, they argue that the

Contested Rule has the effect of both actually and potentially affecting competition to an appreciable extent in the football market, and in various ancillary football services markets, by preventing or restricting investments by multi-club owners in European clubs, by changing the nature, intensity and patterns of competition between commonly controlled clubs and the others, and by enhancing the economic imbalance between football clubs. They also assert that the Contested Rule affects the pattern of trade between Member States. They also argue that no «sporting exception» could be applied to this issue, that the Contested Rule is unnecessary and disproportionate to the professed objective, and that less restrictive alternatives exist. For these reasons, the Claimants contend that the Contested Rule is incompatible with Article 81.1 and, as no exemption has been given by the EC Commission under Article 81.3, it is automatically void pursuant to Article 81.2. The Respondent counter-argues that the Contested Rule is not caught by Article 81, or by any other provision of the EC Treaty, because it is a rule of sporting interest only, which is proportionate to the legitimate objective of preventing situations of conflict of interest and, thus, of promoting and ensuring genuine competition between the clubs playing in pan-European competitions.

78. With respect to Article 82 (*ex 86*), the Claimants argue that UEFA is the only body empowered to organize European competitions and, consequently, holds a dominant position in the European professional football market and the ancillary football services markets. Then, they assert that the Contested Rule constitutes an abuse by UEFA of its dominant position contrary to Article 82 because, without any objective justification, it restricts competition, it is unnecessary and disproportionate, and it unfairly discriminates between clubs with different ownership structures. The Respondent replies by denying that it is in a dominant position, and by asserting that the adoption of a rule in order to preserve the integrity of club competitions could not amount to an abuse.

c) The «sporting exception»

79. The Respondent argues that the Contested Rule is not caught at all by EC law, because it is a rule of a merely sporting character purporting to protect the integrity of the game by preventing any conflict of interest within UEFA club competitions. The Respondent refers to what has come to be termed as the «sporting exception», after the EC Court of Justice stated in the *Walrave* and *Donà* cases that «*the practice of sport is subject to Community law only in so far as it constitutes an economic activity within the meaning of Article 2 of the Treaty*» (Judgements of 12 December 1974, case 36/74, *Walrave*, in *E.C.R.* 1974, 1405, para. 4; 14 July 1976, case 13/76, *Donà*, in *E.C.R.* 1976, 1333, para. 12), that EC law «*does not affect the composition of sport teams, in particular national teams, the formation of which is a question of purely sporting interest and as such has nothing to do with economic activity*» (*Walrave*, para. 8), and that EC law does not «*prevent the adoption of rules or of a practice excluding foreign players from participation in certain matches for reasons which are not of an economic nature, which relate to the particular nature and context of such matches and are thus of sporting interest only, such as, for example, matches between national teams from different countries*» (*Donà*, para. 14).



In both cases, the Court also added that the «restriction on the scope of the provisions in question must however remain limited to its proper objective» (*Walrave*, para. 9; *Donà*, para. 15).

80. In the more recent *Bosman* case, the Court of Justice referred to the *Walrave* and *Donà* precedents in order to reiterate that «sport is subject to Community law only in so far as it constitutes an economic activity within the meaning of Article 2 of the Treaty» (Judgement of 15 December 1995, case C-415/93, *Bosman*, in E.C.R. 1995, I-4921, para. 73), and that «the provisions of Community law concerning freedom of movement of persons and of provision of services do not preclude rules or practices justified on non-economic grounds which relate to the particular nature and context of certain matches. It stressed, however, that such a restriction on the scope of the provisions in question must remain limited to its proper objective. It cannot, therefore, be relied upon to exclude the whole of the sporting activity from the scope of the Treaty» (*ibidem*, para. 76).
81. The Claimants acknowledge that some matters concerned with the rules of the game would fall within the so-called sporting exception, mentioning as examples «a ban on drugs, the size of the pitch or the ball, or the methods of selection of national teams». However, the Claimants deny that the Contested Rule might fall within such an exception because it is economic in its language, its subject matter and its effects. In the final oral argument, counsel for the Claimants vividly described the Contested Rule as «impregnated» with economic elements.
82. The Panel observes that it is quite difficult to deduce the extent of the «sporting exception» from the mentioned case law of the Court of Justice. It is clear that a sporting exception of some kind does exist, in the sense that some sporting rules or practices are somewhat capable of, as the Court puts it, «restricting the scope» of EC provisions. In the light of the Court's jurisprudence, it seems that a sporting rule should pass the following tests in order not to be caught by EC law: (a) it must concern a question of sporting interest having nothing to do with economic activity, (b) it must be justified on non-economic grounds, (c) it must be related to the particular nature or context of certain competitions, and (d) it must remain limited to its proper objective.
83. With regard to test (a), the Contested Rule certainly concerns a question of great sporting interest, such as the integrity of the game within the already illustrated meaning of the public perception of the authenticity of sporting results (*see supra*, para. 24 *et seq.*). However, the Contested Rule also has a lot to do with economic activity. Indeed, the Contested Rule addresses the question of ownership of clubs taking part in UEFA competitions, that is the economic status of clubs which certainly perform economic activities (*see infra*, para. 88). Therefore, the requirement of test (a) is not met, and the Panel holds that the Contested Rule is not covered by the «sporting exception». As a consequence, tests (b), (c) and (d) are not relevant in this context, and the Panel need not discuss them.
84. In the light also of the recent opinions of Advocate General Cosmas in the pending *Delière* case (opinion delivered on 18 May 1999, joint cases C-51/96 and C-191/97) and of Advocate General Alber in the pending *Lehtonen* case (opinion delivered on 22 June 1999, case C-176/96), the Panel wonders whether, applying the Court of Justice tests, it is really

possible to distinguish between sporting questions and economic ones and to find sporting rules clearly falling within the «sporting exception» (besides those expressly indicated by the Court, concerning national teams). For instance, among the examples indicated by the Claimants, the reference to anti-doping rules might be misplaced, because to prevent a professional athlete – *i.e.* an individual who is a worker or a provider of services – from performing his/her professional activity undoubtedly has a lot to do with the economic aspects of sports. The same applies to the size of sporting balls, which is certainly of great concern to the various firms producing them. In conclusion, the Panel is not convinced that existing EC case law provides a workable «sporting exception» and it must, therefore, proceed with a full analysis of the present dispute under Articles 81 (*ex* 85) and 82 (*ex* 86) of the EC Treaty.

d) Undertakings and association of undertakings

85. Article 81.1 (*ex* 85.1) of the EC Treaty prohibits any cooperation or coordination between independent undertakings which may affect trade between Member States and which has the object or the effect of preventing, restricting or distorting competition. Such forbidden cooperation or coordination between undertakings may be accomplished through agreements, decisions by associations of undertakings or concerted practices. Article 82 (*ex* 86) of the EC Treaty prohibits any abuse of a dominant position by one or more undertakings which may affect trade between Member States. Both provisions, in order to be applied, require that the Panel ascertain whether the Respondent can be regarded as an undertaking and/or an association of undertakings.
86. The notion of undertaking is not defined in the EC Treaty. The EC Court of Justice has stated that such notion includes «*every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed*» (Judgement of 23 April 1991, case C-41/90, *Höfnér*, in *E.C.R.* 1991, I-1979, para. 21). The fact that a given entity is a «non-profit» entity is irrelevant, provided that it does perform some economic activity.
87. As illustrated above, UEFA is a private association exerting regulatory authority in European football and organizing pan-European competitions. A good part of UEFA's activities is of a purely sporting nature, particularly when it adopts measures as a mere regulator of sporting matters. However, UEFA also carries out activities of an economic nature, *e.g.* with regard to advertising contracts and to contracts relating to television broadcasting rights (*see* EC Commission decision of 27 October 1992, *1990 World Cup*, in *Official Journal EC*, 12 November 1992, L 326/31, para. 47). Therefore, with respect to the economic activities in which it is involved, UEFA can be characterized as an undertaking within the meaning of EC competition law, as construed by the Court of Justice. The fifty-one national federations affiliated to UEFA also carry out economic activities at national level, notably by exploiting their logos, managing their national teams and selling television rights; with respect to those activities, they are also undertakings within the meaning of EC competition law. Therefore, the Panel holds that UEFA, with respect to the economic

activities in which it is engaged and in which national federations are engaged, is at the same time an undertaking and an association of undertakings.

88. The Panel wonders whether UEFA should also be regarded, as argued by the Claimants, as an «association of associations of undertakings» – within the meaning of the EC Commission decisions of 15 December 1982, *BNIC*, and of 7 December 1984, *Milchförderungsfonds*, in which Article 81.1 (*ex* 85.1) was applied to resolutions issued by trade associations having as their members other trade associations –, that is whether UEFA should be regarded not only as an association of (so to say) «federation undertakings» but also, through the federations, as an association of «club undertakings». In fact, if UEFA was found not to be an association of «club undertakings», its resolutions concerning the way club competitions are organized could not be considered as instruments of horizontal coordination of the clubs' competitive behaviour and would not be caught by Article 81.1 (*ex* 85.1) of the EC Treaty. In other words, with respect to UEFA rules which govern club competitions – *e.g.* establishing conditions of participation, disqualifying clubs or players from the competition, setting forth players' transfer rules, designating referees, fixing schedules, and the like – UEFA could be considered merely as a regulator above the clubs rather than a sort of clubs' trade association; accordingly, the Contested Rule would not be considered as the product of a horizontal collusion between the clubs and would not be caught by Article 81.1 (*ex* 85.1).
89. In order to ascertain whether UEFA should be regarded as an association of associations of undertakings or not, it is necessary to assess whether national football federations affiliated to UEFA are to be considered as associations of undertakings or not. There is no doubt that professional football clubs engage in economic activities and, consequently, are undertakings. In particular, they engage in economic activities such as the sale of entrance tickets for home matches, the sale of broadcasting rights, the exploitation of logos and the conclusion of sponsorship and advertising contracts. Numerous minor clubs, which are formally non-profit making, also engage in some of those economic activities – although on a much lower scale – and are also to be regarded as undertakings (for example, clubs taking part in championships pertaining to the third or fourth national divisions). In all national federations, there is also a very large number of truly amateur clubs (including youth clubs), which are run by unpaid volunteers, perform purely sporting activities and do not engage in any economic activity (the EC Commission has recently defined such clubs as «grassroots clubs» in the already quoted document *The European model of sport*, Brussels, 1999). Accordingly, these grassroots clubs should not be regarded as undertakings (*see* Judgement of 17 December 1993, joined cases C-159/91 and C-160/91, para. 18, where the Court of Justice held that an entity fulfilling a social function and entirely non-profit making does not perform an economic activity and thus is not an undertaking within the meaning of *ex* Article 85). The line between non-amateur clubs (which are undertakings) and amateur or grassroots clubs (which are not) should obviously be drawn at different levels from country to country, depending on the national economic development of football. What is common within all fifty-one European federations is the circumstance that the number of amateur or grassroots clubs is largely preponderant over that of non-amateur clubs.

90. Advocate General Lenz stated in his *Bosman* opinion that national football federations «are to be regarded as associations of undertakings within the meaning of Article 85. The fact that in addition to the professional clubs, a large number of amateur clubs also belong to those associations makes no difference» (Opinion delivered on 20 September 1995, case C-415/93, *Bosman*, in *E.C.R.* 1995, I-4921, para. 256).

Therefore, according to the argument of Advocate General Lenz, UEFA is an association of associations of undertakings, acting as a instrument of professional clubs' cooperation. Advocate General Lenz did not provide any further discussion on this issue. As is well known, in the *Bosman* case the Court of Justice declined to rule on competition law issues (Judgement of 15 December 1995, *ibidem*, para. 138), and the previous sports cases decided by the Court did not involve competition rules either (Judgement of 12 December 1974, case 36/74, *Walrave*, in *E.C.R.* 1974, 1405; Judgement of 14 July 1976, case 13/76, *Donà*, in *E.C.R.* 1976, 1333; Judgement of 15 October 1987, 222/86, *Heylens*, in *E.C.R.* 1987, 4097). Therefore, no specific guidance can be found on this question in the European Court jurisprudence related to sport.

91. The Panel is not entirely persuaded by the assertion of Advocate General Lenz that it «makes no difference» that national federations encompass a large number of amateur or grassroots clubs. In fact, the amateur or grassroots clubs, truly not engaged in economic activities, may condition the will and the acts of national federations more than professional and semi-professional clubs. Due to the democratic voting and electoral systems prevailing within national federations, the majority of votes tend to be controlled by amateur or grassroots clubs, and federations' executive organs – the President and the Board – often tend to be the expression of such majority. In some national federations even athletes and coaches have some electoral standing. This deficit of representativeness *vis-à-vis* professional clubs is the main reason why such clubs have created national «leagues» as their own truly representative bodies and why there are often conflicts between leagues and federations (*see supra*, paras. 17-18). Through the leagues, which are their true trade associations, professional clubs tend to manage their championships by themselves, retaining all the related revenues (television rights, advertising, *etc.*), and in several countries have progressively acquired a noticeable degree of autonomy from federations (*e.g.* the Premier League in England or the «Lega Nazionale Professionisti» in Italy).
92. In other words, the executives of national federations formally represent *all* the clubs of their respective countries but their constituency is mostly composed of amateur or grassroots clubs. Also within UEFA, representatives of national federations should be regarded less as delegates of the clubs engaged in economic activities than as delegates of amateur or grassroots clubs. It should also be mentioned that federation posts are honorary, and individuals elected to such posts are not bound by instructions or orders coming from the electors. Obviously, professional clubs have their ways of influencing federations and federation executives much more than their mere electoral weight would suggest, but it would still seem inaccurate *sic et simpliciter* to regard national federations as associations of undertakings and, automatically, national federations' regulations as decisions by associations of undertakings within the meaning of Article 81.1. It should not be overlooked

that decisions by associations of undertakings are caught by Article 81.1 in order to prevent circumvention of the prohibition of restrictive agreements and concerted practices. Decisions by associations of undertakings are typically a medium for the coordination and cooperation of undertakings of a given sector. The Panel observes that national leagues (where they exist) rather than federations currently seem to be the actual medium for the coordination of professional clubs. Therefore, national leagues seem to be the true associations of «club undertakings», league executives seem to be the true delegates of such undertakings, and the acts and conduct of leagues seem to truly reflect the will of such undertakings. National leagues are not direct members of UEFA and, as mentioned (*supra*, para. 19), the most important of them have recently constituted their own independent association in order to have their interests truly represented at pan-European level.

93. The Panel notes that in the *BNIC/Clair* case, the Court of Justice held that BNIC – the French cognac industry board – was in fact an association of undertakings because its measures were negotiated and adopted by individuals who were (formally appointed by the competent Minister but in fact) designated by the undertakings or associations of undertakings concerned and had to be considered as their representatives (Judgment of 30 January 1985, case 123/83, *BNIC/Clair*, in *E.C.R.* 1985, 391, para. 19). In *Reiff*, the Court of Justice held that the individuals composing a German tariff commission for road freight, appointed by the Minister upon the proposal of the undertakings or associations of undertakings of the interested sector, could not be deemed as representatives of the industry because they were not bound by instructions or orders coming from those undertakings or associations; therefore, the Court concluded that the tariff commission was not an association of undertakings and that its decisions were not caught by Article 85 (now 81) of the EC Treaty (Judgment of 17 November 1993, case C-185/91, *Reiff*, in *E.C.R.* 1993, I-5801, para. 19).
  
94. In the light of this case law and in the light of the circumstances described above (*supra*, paras. 91-92), the Panel is quite doubtful as to whether UEFA can be truly characterized as an association of associations of undertakings and as to whether members of the UEFA Executive Committee or of the UEFA Congress can be seen as actually representing the «club undertakings». At the very least, before reaching any such conclusions, it would be necessary to examine in detail the process leading to the appointment or election of individuals to national federation posts and to the various UEFA bodies, to look into the links of those individuals with professional clubs, and to investigate case by case whether a UEFA measure is in fact the expression of an agreement by or with the professional clubs or whether it strengthens already existing agreements between these clubs. Neither the Claimants nor the Respondent have supplied any evidence which could help the Panel in any such analysis. Therefore, the Panel must content itself with the stated conclusion (*supra*, para. 87) that UEFA, with respect to the economic activities in which it is involved and in which national federations are involved, is surely an undertaking and an association of «federation undertakings», leaving the question open as to whether UEFA is also an association of «club undertakings» through which clubs coordinate their economic behaviour. In any event, despite underlying doubts on this issue, given that UEFA essentially advanced no arguments to counter the Claimants' assertion that UEFA is an

association of associations of undertakings, the Panel will assume for the purposes of the ensuing discussion of competition law that UEFA is in fact an association of «club undertakings» whose decisions and rules concerning club competitions constitute a medium of horizontal cooperation between the competing clubs (as asserted by Advocate General Lenz in his *Bosman* opinion; see *supra*, para. 90). As a result, in order to proceed with its analysis, the Panel assumes that the Contested Rule is a decision by an association of associations of undertakings and, as such, falls within the scope of Article 81.1 (*ex* 85.1).

e) Market definition

95. The Panel notes that, in order to examine whether the Contested Rule has the object or the effect of appreciably restricting competition (Article 81) or constitutes an abuse of dominant position (Article 82), it is necessary to identify and define the relevant market in both its product and geographic dimensions.
96. As to *product market* definition, the Panel observes that, according to EC law and practice, essentially «*a relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use*» (EC Commission Notice «on the definition of relevant market for the purposes of Community competition law», in *Official Journal EC*, 9 December 1997, C 372/5, para. 7).
97. The Claimants, referring to the economic report prepared by Mr. Boon upon their request, allege that the relevant product market is a «European football market». According to the Claimants, such market would comprise the supply of all football matches played in Europe and a variety of related «ancillary football services markets», such as the market for capital investment in football clubs, the players market, the media rights market, the sponsorship and advertising market and the merchandising market. In his written report, Mr. Boon includes within the boundaries of this general «European football market» all UEFA «matches played out before a paying public across Europe and in the wider world». At the hearing, the Panel asked Mr. Boon to better identify the product, the demand side (the consumers) and the supply side (the suppliers) in the alleged «European football market». Mr. Boon answered that the product is constituted by all matches played in UEFA club competitions, the consumers are all the football fans and supporters, and the suppliers are the clubs and the players together. The notion that clubs and players supply matches together on the market is clearly unfounded in terms of competition law (and inconsistent with Mr. Boon's several references in his report to a players' market where clubs are on the demand side and players on the supply side), and the Panel can thus discard it immediately without further discussion.
98. The Panel finds that the Claimants' definition of the product market is not a viable one in terms of competition law. The notion of a general European football market is too ample, and the other related markets are too heterogeneous to be included therein. Given that the definition of a market should be determined primarily by interchangeability (or

substitutability) from the consumers' viewpoint, it is implausible to regard all European football matches as interchangeable. Certainly, in terms of stadium attendance most of the matches are not interchangeable because of geographic constraints and of consumer preferences, notably constituted by the supporters' allegiance to a given team. Indeed, virtually every club playing in a UEFA competition can be deemed to hold a sort of «captive market» with regard to live attendance of its home matches. Even in terms of television audience, a UEFA Cup or Champions' League match between a Swiss and a German team would hardly be considered by British viewers as a substitute – possibly with the only exception of the final match of the competition or some other unusual circumstances (*e.g.* the presence of several renowned British players in the match), and even in such cases it would be a poor substitute – for a match involving a British team (*see* Monopolies and Mergers Commission, *British Sky Broadcasting Group plc and Manchester United plc. A report on the proposed merger*, London, 12 March 1999, hereinafter «MMC Report», paras. 2.16-2.24). Furthermore, if the products of the European football market are the European matches, most of the various other markets mentioned by the Claimants are certainly related in some way or another to the supply of such football matches, but they cannot be «comprised» within that market. A few examples suffice: the sale of merchandise can and does take place regardless of European matches; contracts for advertising on panels within a given stadium can be concluded regardless of any connection with football matches (*e.g.* in view of a series of rock concerts or of non-football sporting events) or regardless of any connection with *European* football matches; some of the mentioned products or services are not offered to the final consumers (in particular sponsorship contracts, free-to-air broadcasting rights and capital investment in clubs not listed on the stock exchange).

99. The Panel observes that in fact there appears to be no single «European football market» comprising various ancillary markets. Rather, there are several «football markets» in which professional football clubs operate, such as those referred to by the Claimants, but they are all separate markets for the purposes of competition law. Support for such proposition can be found in the already quoted recent report by the British Monopolies and Mergers Commission (now transformed into the Competition Commission) concerning the proposed acquisition of the football club Manchester United by the broadcasting company BskyB, where it is evidenced how Manchester United operates in several separate markets such as the supply of football matches, television rights to football matches, advertising and sponsorship, retailing of merchandise, and various services such as catering and hospitality associated with its stadium (MMC Report, para. 2.16).
  
100. Most of such football markets are clearly segmented in both their product and geographic dimensions. With regard to the television broadcasting market, there appears to be a growing consensus among competition authorities that pay (including pay-per-view) television and free-to-air television are separate product markets (*see* MMC Report, paras. 2.36 and 2.39; Office of Fair Trading, *The Director General's review of BskyB's position in the wholesale pay TV market*, London, December 1996, paras. 2.3 and 2.6; «Autorità garante della concorrenza e del mercato», that is the Italian competition authority, Decision no. 6999 of 26 March 1999, *Stream/Telepiù*, in *Bollettino* 12/1999, para. 9). Also from the geographic point of view, although sports broadcasting is becoming more and more international and cross-

border, competition authorities and courts throughout Europe tend to maintain that broadcasting markets are mostly national, even if some of the broadcasting companies are multi-national and some of the events are covered worldwide (see e.g. the Decision of 11 December 1997 by the «*Bundesgerichtshof*», that is the highest German court in civil matters, upholding the previous decisions of the German competition authority «*Bundeskartellamt*» and of the appellate court «*Kammergericht*» in a case concerning television rights to European matches). As mentioned (*supra*, para. 98), another example of extreme geographic segmentation is to be found in the market for gate revenues (including both season tickets and match tickets). The sale of a club's merchandise tends also to be geographically very defined, with the only possible exception of a few top European clubs.

101. Having found that separate football markets exist, rather than a single and comprehensive European football market, the Panel must establish the relevant product market within which to assess whether the Contested Rule restricts competition or not. It is undisputed that the Claimants' basic grievance in this case concerns UEFA's interference with their wish to keep owning (and even further acquiring) various football clubs capable of competing in UEFA competitions. Indeed, the Claimants repeatedly stressed in their written and oral submissions that the Contested Rule would restrict investments in European football clubs' stocks. Accordingly, the Panel finds that the market more directly related to, and potentially affected by, the Contested Rule appears to be a market which can be defined as the «*market for ownership interests in football clubs capable of taking part in UEFA competitions*». A market for ownership interests in professional clubs has been identified as the relevant market in some United States antitrust cases, particularly in cases related to league rules banning cross-ownership of clubs of other professional sports leagues or subjecting to authorization the sale of a club. See e.g. *NASL v. NFL*, 505 F.Supp. 659 (S.D.N.Y. 1980), reversed 670 F.2d 1249 (2d Cir. 1982); *Sullivan v. NFL*, 34 F.3d 91 (1st Cir. 1994); *Piazza v. MLB*, 831 F.Supp. 420 (1993). The Panel finds also, in the light of the content of the Contested Rule and on the basis of the available evidence, that the Contested Rule appears to be only indirectly related, if at all, to the various other markets suggested by the Claimants, such as the market for players, the sponsorship market, the merchandising market, the media rights market and the market for gate revenues. Therefore, the effects on these markets will be considered only on a subsidiary basis to the said principal relevant market, concerning ownership interests in European professional football clubs.
  
102. The Panel considers that the relevant market, as defined, would include on the supply side – that is, the potential sellers of ownership interests – all the owners of European football clubs which can potentially qualify for a UEFA competition. Mr. Boon has illustrated how an investment in clubs which can qualify for UEFA competitions (referring to the main UEFA competitions, the Champions' League and the UEFA Cup) is much more attractive than an investment in other football clubs because «*from a financial perspective, access to European club competition is disproportionately important to club success*». Therefore, according to this economic analysis, clubs which cannot hope to qualify for one of the main UEFA competitions should not be viewed as substitutes by investors interested in football clubs. In principle, only clubs competing in the top division of one of the fifty-one European national federations can hope to qualify (the only exception being the rare occurrence of a club from



a lower division winning the national cup). According to the Boon report, there are currently 737 clubs playing in the top divisions of the fifty-one UEFA countries. While the number of such clubs is basically the same every year, their identity varies slightly every football season because of the promotion/relegation system which has already been described (*see supra*, para. 18). Of those 737 clubs, however, probably less than a half – perhaps 350 clubs – have a realistic chance of qualifying for one of the two main UEFA competitions, given that less than 200 slots are available. It should also be considered that the number of clubs having a realistic chance of passing the first rounds is even smaller: as reported by Mr. Boon, over the five year period 1993/94-1997/98 only 66 clubs have achieved a place in the quarter final of one of the three main UEFA competitions.

103. The Panel observes that, because of the peculiarities of the football sector, investment in football clubs does not appear to be interchangeable with investments in other businesses, or even in other leisure businesses. The publicity and notoriety given by the ownership of a football club, besides the inherent excitement and gratification of running such a popular and emotional business, have always rendered such activity particularly attractive in terms of so-called VIP status and of high profile relationships with politicians and local communities. Indeed, ownership of a football club has often proved to be quite helpful, and sometimes expedient, to other business or political activities. Nowadays, because of the enormous increase in the amounts paid to clubs for television broadcasting rights, the profitability of professional clubs is also becoming interesting (*see MMC Report*, para. 3.79 *et seq.*). In particular, ownership of European professional football clubs appears to be an attractive strategic fit for media groups, given that football is a key media asset with further growth potential (*see MMC Report*, paras. 2.136-2.139 and 3.103). In economic terms, the circumstance that club ownership involves significant additional aspects to the mere profitability of a club means that the individual or corporate owner places on its club a significant instrumental and consumption value in addition to its possible investment value. This is not to be found in other business activities, which, therefore, are not interchangeable with the ownership of a football club. Moreover, given the largely leading position of football in European sports, clubs of other sports (*e.g.* a professional basketball club) can be deemed as potential substitutes only in few and very defined locations where such other sports enjoy popular success. Looking at Europe as a whole, other sports do not appear to offer a suitable alternative to the acquisition and ownership of football clubs.
  
104. In the light of the above, on the demand side (that is, the potential buyers of ownership interests) the market would include any individual or corporation potentially interested in an investment opportunity in a football club which could qualify for a UEFA competition. In this respect, the Claimants assert that availability of capital for investment in clubs is limited, that multi-club ownership is a rational economic investment strategy and, thus, multi-club owners are a key source of capital for football clubs within UEFA's jurisdiction. The Panel finds this argument unconvincing. As has already been said, ownership of football clubs has always been particularly attractive for reasons that go beyond mere economic considerations. Changes in clubs' ownership are notoriously quite common, and the Claimants have provided no substantial evidence proving that owners willing to sell a club of UEFA level encounter particular problems in finding suitable buyers. In fact, there is

even some empirical evidence that in some markets football clubs have been able to attract substantial capital investment from new sources, not from the historic owners of the clubs, despite the presence of a rule somewhat analogous to, or even stricter than, the Contested Rule (*see infra*, para. 120).

105. The Panel remarks that the possible profitability of a football club and its attractiveness to investors depends much more on its specific characteristics, particularly its location and its «brand», than on the identity of the potential buyers. The Boon report mentions that multi-club owners enjoy economies of scale and synergies such as sharing of information and expertise, single sourcing of supplies and centralized services. However, the extent to which football clubs located in different countries could share resources appears to be quite limited, particularly if clubs must be kept isolated from each other for sporting reasons as ENIC affirms it is doing (*see supra*, para. 32). Moreover, most of such economies of scale – such as headquarters costs, in-house expertise and common purchase of services of various kinds (*e.g.* computer consultancy) – would also be available to clubs belonging (as most often is the case) to entrepreneurs or groups involved in other non-football businesses. As to media rights, given the current negative attitude of most competition authorities and judges throughout Europe concerning the collective sale of television broadcasting rights (*see e.g.* the notorious Decision of 11 December 1997 by the *Bundesgerichtshof*, *supra* at para. 100), multi-club owners would conceivably be barred from collectively selling the rights to their clubs' matches and, therefore, no economies of scale could be enjoyed in this area. In any event, given the said separation of national television markets (*supra*, para. 100), the joint sale of broadcasting rights to matches of clubs located in different countries would appear not to afford a particular negotiating advantage.
106. The Panel observes that several of the benefits mentioned by the Claimants, which clubs allegedly attain when they are controlled by multi-club owners are, in fact, benefits that any clubs would derive from qualified and efficient management, regardless of the ownership structure. In this respect, the Panel is impressed by the improvements allegedly brought by ENIC to the management of its clubs, but it is not prepared to accept the proposition that multi-club owners are better owners than single club owners. In the Panel's view, it is changes in management rather than in ownership that affect the way football clubs are run. Moreover, the Panel remarks that, given the cost structure of football clubs, the savings due to the supposed economies of scale would be negligible compared to the current costs for players' (or even coaches') remuneration (*see supra*, paras. 32-33). In other terms, economies of scale do not yield what mostly matters in order to keep clubs successful on and off the field: good players and coaches. An instance of this can be given by the sporting results of the Italian club Vicenza; notwithstanding the supposed economies of scale and efficient management related to its being controlled by ENIC, at the end of the 1998/99 season Vicenza has been relegated to the Italian second division. Furthermore, the Panel finds the Claimants' argument (that there is a scarcity of potential buyers of clubs) particularly unconvincing in the light of the circumstance that the price for obtaining control of a club able to qualify for UEFA competitions – although not one of the top European clubs – appears to be affordable by a large number of corporate or individual entrepreneurs. For instance, in order to obtain control of the Claimants – clubs at the top of their countries and

able to achieve the quarter final of a UEFA competition – ENIC paid approximately £ 2.5 million for AEK and £ 2.2 million for Slavia, which are prices comparable to those of rather small enterprises in various European business sectors. As a result, the Panel concludes that there are countless potential buyers of ownership interests in football clubs which could qualify for a UEFA competition.

107. As to *geographic market* definition, the Panel observes that, according to EC law and practice, essentially «*a relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas*» (EC Commission Notice «on the definition of relevant market for the purposes of Community competition law», in *Official Journal EC*, 9 December 1997, C 372/5, para. 8).
108. The evidence provided by the Claimants shows how the geographic dimension of the market for ownership interests in football clubs potentially taking part in UEFA competition is pan-European. There are no impediments for clubs in attracting potential investors from all over Europe and, conversely, almost no obstacles for a potential investor in buying an ownership interest in any given club around Europe. The actual investments by ENIC confirm this pan-European dimension. Therefore, the Panel concludes that the relevant geographic market extends to Europe as a whole, or more precisely to the territories of the fifty-one European federations affiliated to UEFA (which in reality, for historical reasons, encompasses federations that do not correspond to States, such as Scotland or Wales, and goes beyond geographical Europe, insofar as it includes Israel). As mentioned, other football markets tend to be geographically more segmented (*see supra*, para. 99).
- f) Compatibility with Article 81 (*ex 85*) of the EC Treaty
109. For an agreement between undertakings or a decision by an association of undertakings to be caught by Article 81.1, it must have the «object or effect» of restricting competition (as is customary in EC case law and practice, reference is here made only to «restriction» of competition as the general term encompassing also prevention and distortion). Since the «object» and the «effect» are not cumulative but alternative requirements, as suggested by the conjunction «or» (*see* Court of Justice, Judgement of 30 June 1966, case 56/65, *Société Technique Minière*, in *E.C.R.* 1966, 235, at 249), the Panel needs first to consider the *object* of the Contested Rule, *i.e.* its purpose in the context in which it is to be applied. Then, if the purpose of the Contested Rule does not appear to be anti-competitive, the Panel needs to take into consideration its actual *effect* on the relevant market. Should the Contested Rule have either the object or the effect of hindering competition, the Panel would then be required by EC case law to assess the Contested Rule in its economic context in order to decide whether it affects competition and trade between Member States to an *appreciable* extent (*see e.g.* Court of Justice, Judgement of 9 July 1969, case 5/69, *Völk*, in *E.C.R.* 1969,

295, para. 3; Judgement of 8 February 1971, case 22/71, *Béguelin*, in *E.C.R.* 1971, 949, para. 16).

110. As to the *object* of the Contested Rule, the Claimants assert that UEFA's predominant purpose has been to preserve its monopoly control over European football competitions rather than to preserve the integrity of the game. The Claimants' argue that support for this assertion can be found in the UEFA internal memorandum of 25 February 1998, drafted by Mr. Marcel Benz after the meeting with ENIC representatives of the previous day, and in the rules of the UEFA Statutes providing for the monopoly power of UEFA over European competitions. In the UEFA internal memorandum, under the heading «possible problems, questions and risks», it is possible to read *inter alia*:

*«Does the ENIC group form the basis for a European league ... Couldn't a media mogul take advantage of ENIC's groundwork and create a European league with the ENIC clubs? Couldn't other investors (e.g. IMG) pursue the same strategy and buy up clubs on a large scale? ... Isn't it a risk for UEFA in the media sector if TV stations own the rights of clubs in the domestic competition? Won't central marketing by UEFA be infringed upon sooner or later? The search for UEFA Champions League sponsors could also become harder, as sponsors would also get a similar market presence throughout Europe with ENIC».*

111. The Respondent replies by asserting that, besides the endeavour to prevent a clear conflict of interest situation and thus to ensure that competition is genuine, there was no ulterior motive for the adoption of the Contested Rule. The Respondent finds support in the same UEFA internal memorandum of 25 February 1999, where questions are raised on *«how UEFA could guarantee sporting competition if two clubs of the ENIC group met in the same UEFA competition. Who would win? Would ENIC or its management decide, or would the winners be decided on the pitch, in a purely sporting encounter, as desired by UEFA and its public? ... UEFA must take all legal measures possible to guarantee clean competition. ... The interests of clean competition in sport are at stake».*

112. The Panel notes that both the title and the text of the Contested Rule appear *prima facie* to support the Respondent's assertion that the Contested Rule is only designed to ensure that competition is genuine. The title reads «Integrity of the UEFA Club Competitions: Independence of the Clubs», while Paragraph A declares the object of the Contested Rule as follows:

*«It is of fundamental importance that the sporting integrity of the UEFA club competitions be protected. To achieve this aim, UEFA reserves the right to intervene and to take appropriate action in any situation in which it transpires that the same individual or legal entity is in a position to influence the management, administration and/or sporting performance of more than one team participating in the same UEFA club competition».*

Moreover, the Panel points out that the Contested Rule is not limited to banning multi-club ownership within the same competition but also forbids any other type of structure or behaviour which could potentially enable a club (or a related person) to influence a competitor in the same competition (*see* Paragraphs B.1 and B.2 of the Contested Rule).

113. The Panel considers that the Claimants had the burden of rebutting such *prima facie* evidence by proving that the true object of the Contested Rule was an anti-competitive one. The

Panel finds that the Claimants have not satisfied this burden of proof, given that the only plausible evidence relied upon is the UEFA internal memorandum of 25 February 1998, which is at best ambiguous. Apart from the fact that it was drafted by an individual who is not a member of the body which adopted the rule, the memorandum appears to contain meeting notes rather than statements of policy and questions rather than answers. As a matter of fact, the memorandum lends support to contradictory arguments; therefore, it is of little avail for the rebuttal of the said *prima facie* evidence. As to the provisions of the UEFA Statutes mentioned by the Claimants, they simply confirm the notorious circumstance that UEFA is the institutional and regulatory authority over European football, as normally happens with all international sports federations: in no way do such provisions prove or disprove a particular object of the Contested Rule. The Panel finds, therefore, that in enacting the Contested Rule UEFA did purport to prevent the conflict of interest inherent in commonly owned clubs taking part in the same competition and to ensure a genuine athletic event with truly uncertain results. As a result, the Panel holds that the object of the Contested Rule is not to restrict competition within the meaning of Article 81.1 of the EC Treaty.

114. As to the *effect* of the Contested Rule, the Claimants assert that it appreciably restricts competition by preventing or restricting investment by multiple owners in European clubs, by changing the nature, intensity and pattern of competition between commonly controlled clubs and those having other ownership structures, and by enhancing the economic imbalance between football clubs leading to an increase in the market dominance of a few clubs over the majority of smaller and medium-sized clubs. On the other hand, the Respondent asserts that the Contested Rule has an overwhelmingly pro-competitive purpose and effect, namely to preserve the integrity of sporting competition between football clubs.
115. According to EC case law, in order to ascertain whether competition is in fact restricted to an appreciable extent, the Panel must essentially look at the competition which would occur on the relevant market *in the absence* of the Contested Rule (*see* Court of Justice, Judgement of 30 June 1966, case 56/65, *Société Technique Minière*, in E.C.R. 1966, 235, at 250; Judgement of 11 July 1985, case 42/84, *Remia*, in E.C.R. 1985, 2545, para. 18).
116. The Panel observes that the Contested Rule undoubtedly discourages to some extent any current owner of a club potentially capable of qualifying for UEFA competitions from buying ownership interests in another club having the same capability. In the absence of the Contested Rule, not only would there not be such discouragement but, according to the Boon report, multi-club control could be expected to expand. Assuming that Mr. Boon's conjecture is correct, single club owners would probably perceive that multi-club owners retain market advantages from their expanded dimension and might decide that the best way to improve their own position would be also to acquire additional clubs. With an expansion of multi-club ownership throughout Europe the total number of club owners, and thus the total number of undertakings on the market, would evidently decrease, even though the number of clubs realistically aspiring to a slot in a UEFA competition would probably remain the same because the number of talented players cannot be increased at will. As

mentioned (*supra*, para. 102), probably no more than 350 clubs can each year realistically aspire to a UEFA slot, of which substantially less than one hundred could realistically hope to pass the first rounds and achieve a satisfactory number of matches and sufficient television exposure. In economic terms, within the relevant market there would be a reduction of the number of actors on the supply side *vis-à-vis* an unvarying large number of actors on the demand side (*see supra*, para 104). In other words, there could be a process of concentration of club ownership into fewer hands, given that there is a sporting barrier to any sudden entry into the market. As is well known, an entry into the market is hindered by the circumstance that in the European sporting system a new club must go through the pyramidal structure of national championships for several years before attaining a top professional level (*see supra*, paras. 15 and 18). As nobody can suddenly create a new football club and apply to directly enter into a top national championship or a UEFA competition (as happens for instance when United States professional leagues expand and add new franchises), a viable entry into the market is possible only through the purchase of an already existing club playing at good level in one of the fifty-one European top divisions.

117. The Panel observes that, from an economic point of view, the said decrease in the number of club owners could be expected either not to have any effect on prices of ownership interests in clubs – because club owners willing to sell their club would still be quite numerous, and because price is determined not only by supply and demand but also by the mentioned instrumental and consumption value placed by owners on clubs (*see supra*, para. 103) – or to bring about an increase in prices once the decrease in owners becomes noticeable. If, stretching the argument to extremes, the said concentration trend led to there being only a few owners of clubs capable of qualifying for UEFA competitions, the market for ownership interests in such clubs would be characterized by an oligopoly – presenting inherent incentives for cartel behaviour – with which any interested buyer would have to deal. Even on other football markets mentioned by the Claimants, where clubs are on the supply side – gate revenues, media rights, merchandising –, the reduction of club owners and the potentially resulting oligopoly could eventually bring about increases in prices to the detriment of consumers (*e.g.* increase in prices of match tickets or of pay television subscriptions). The Panel finds such an oligopoly scenario to be probably too extreme. The fact that when the Contested Rule was enacted the total number of European clubs controlled by multi-club owners was very low – only 12 clubs, according to the Boon report – seems to demonstrate, first, that a rush towards multi-club ownership would be unlikely (at least in the short term) and, second, that the postulated concentration process would in any event need several years to develop. However, even without admitting all the way the oligopoly scenario, it must be acknowledged that in the absence of the Contested Rule the number of undertakings on the market would sooner or later decline while the effects on prices, although scarcely noticeable in the short term, would in due course tend to show an increase.
118. As a result of the foregoing analysis, the Panel finds that, in the absence of the Contested Rule, competition on the relevant market and on other football markets would initially probably remain unaffected and, when affected, it would be restricted. In the light of this *a contrario* test, the Panel finds that the actual effect of the Contested Rule is to place some

limitation on mergers between European high level football clubs, and thus to increase the number of undertakings on the relevant market and on other football markets; accordingly, the Contested Rule preserves or even enhances economic competition between club owners and economic and sporting competition between clubs. The Panel notes that, according to the Court of Justice, clauses restraining competitors' freedom which are indirectly conducive to increasing the number of undertakings on the relevant market must be deemed as pro-competitive (Judgement of 11 July 1985, case 42/84, *Remia*, in *E.C.R.* 1985, 2545, last sentence of para. 19).

119. The Panel observes, consequently, that either the Contested Rule does not affect the relevant market at all or, if it does, it exerts a beneficial influence upon competition, insofar as it tends to prevent a potential increase in prices for ownership interests in professional football clubs (and to prevent potential price increases in other football markets as well), and thus it tends to encourage investment in football clubs. As a result, the Panel finds that the Contested Rule, by discouraging merger and acquisition transactions between existing owners of clubs aspiring to participate in UEFA competitions, and conversely by encouraging investments in such football clubs by the many potential newcomers, appears to have the effect of preserving competition between club owners and between football clubs rather than appreciably restricting competition on the relevant market or on other football markets.
120. Empirical support for the proposition that the Contested Rule not only does not prevent or restrict investment in football clubs, but even favors it, can be found in the British market. There the Premier League has a rule not allowing any person or corporate entity, except with the prior written consent of the Board (which thus far has never been granted), to «*directly or indirectly hold or acquire any interest in more than 10 per cent of the issued share capital of a Club while he or any associate is a director of, or directly or indirectly holds any interest in the share capital of, any other Club*».

Despite a rule substantially stricter than the Contested Rule – 10% rather than a controlling interest – British clubs, as reported by Mr. Boon, have successfully attracted capital investment in recent years and a substantial proportion of such capital investment has been from new corporate investors, not from the historic owners of the clubs.

121. The Claimants also allege that the Contested Rule has the effects of altering the nature, intensity and pattern of competition between commonly controlled clubs and other clubs, and of enhancing the economic imbalance between football clubs, leading to an increase in the market dominance of a few big clubs over the majority of smaller and medium sized clubs. In other words, the Claimants argue that the Contested Rule favours the rich and strong clubs over the weak and poor ones. The Claimants base this argument on the assumption that multi-club owners would tend to own only small and medium clubs and to invest more in countries where football is economically less developed, and thus would mitigate the process of polarization of market power between the bigger clubs in the larger football countries and other clubs. The Claimants' evidence in support of this argument is basically the pattern of ENIC's own investments.

122. The Panel finds that the said assumption is unsupported by meaningful evidence and fails to discern the logic of the argument. Certainly, ENIC has thus far followed the strategy of acquiring medium-sized clubs; however, if such an investment strategy is convenient, nothing will prevent owners of big clubs from acquiring medium-sized clubs as well. As mentioned, it appears to be a reasonable strategy to control clubs of different sporting levels, and some big clubs are indeed doing it: Mr. Boon has mentioned the well known media magnate group controlling AC Milan which also owns Monza (a smaller Italian club not playing in the top Italian division) and Mr. Trijbits has testified with regard to the attitude of top Dutch clubs (*see supra*, para. 35). Therefore, in the absence of the Contested Rule, not only would the polarization of market power between bigger and smaller clubs continue but, in the light of the previous findings, it would probably even be enhanced. After all, polarization of market power is what usually happens in any business sector when mergers and acquisitions are completely left to market dynamics and dominant companies are free to acquire smaller competitors (which is why regulators enact rules such as the EC Merger Regulation no. 4064/89). Moreover, the problem with this scenario is that, while in other types of business it is economically desirable for consumers that marginal and less efficient undertakings disappear from the market, in the sports business consumer welfare requires that numerous clubs remain on the market and achieve the highest possible economic and sporting balance between them. The Panel is of the view that to provide incentives for actual or potential club owners to invest their resources in only one high level club, as the Contested Rule tends to do, is conducive to an economic and sporting balance, rather than an imbalance, between football clubs. Therefore, from this point of view as well, the Panel finds the Contested Rule to be beneficial to competition in football markets.
123. Furthermore, in terms of consumer welfare, the quality of the entertainment provided to European football fans – with reference to both live attendance and television audience – does not appear to be appreciably affected by the Contested Rule. The only conceivable effect of the Contested Rule is that a club which has qualified for a UEFA competition would be replaced by the club from the same country which, in the previous season's national championship, ranked immediately below the excluded club. Obviously, the replaced club would suffer a harm and its committed supporters would resent the replacement, but at the same time the substitute club and its committed supporters would enjoy a benefit exactly corresponding to the injury of the replaced club. The Panel observes in this respect that in principle competition law protects competition and the market as a whole, not individual competitors. Accordingly, in order to establish an injury to consumer welfare – *i.e.* that fans with a general interest in football are harmed – evidence should be provided that the substitute team would be less skilled and entertaining than the excluded one. This has not been proven by the Claimants and, in any event, it appears quite hard to prove, given that the quality and talent of the players and coach of two closely ranked teams are essentially analogous, and given that participation in UEFA competitions occurs one season later, when the coach or several players might have moved elsewhere and, in fact, the substitute team might well be more talented and entertaining than the replaced one. Therefore, the Panel finds that the Contested Rule does not appear to appreciably affect the quality of the sporting product offered to consumers.



- g) Objective necessity of regulating multi-club ownership and proportionality of the Contested Rule
124. The foregoing findings appear to suffice for rejecting the contention that the Contested Rule appreciably restricts competition, and thus appear to suffice for excluding it from the scope of the prohibition set forth by Article 81 (*ex* 85) of the EC Treaty. However, in order to further support those findings, the Panel deems it opportune to verify whether the limitation on multi-club ownership can also be regarded as an essential feature in order to ensure the proper functioning of a professional football competition. In this regard, the Panel notes that the EC Court of Justice has held in several judgements that restraints on competitors' conduct do not amount to restrictions on competition within the meaning of Article 81.1 (*ex* 85.1), provided that such restraints do not exceed what is necessary for the attainment of legitimate aims and remain proportionate to such aims (*see e.g.* Judgement of 11 July 1985, case 161/84, *Remia*, in *E.C.R.* 1985, 2545; Judgement of 28 January 1986, case 161/84, *Pronuptia*, in *E.C.R.* 1986, 353; Judgement of 19 April 1988, case 27/87, *Erauw*, in *E.C.R.* 1988, 1919; Judgement of 15 December 1994, case C-250/92, *DLG*, in *E.C.R.* 1994, I-5641; Judgement of 12 December 1995, case C-399/93, *Oude Luttikhuis*, in *E.C.R.* 1995, I-4515).
125. The Claimants assert that the means employed by UEFA are disproportionate to the objective of protecting the integrity of European football competitions and have submitted for consideration a variety of «less restrictive alternatives». In particular, the Claimants argue that criminal penalties provided by the various State laws, in addition to UEFA disciplinary powers, are sufficient to deal severely with match-fixing in any case where such wrongdoing is proved. In addition, according to the Claimants, a more proportionate approach could include the adoption by UEFA and by all clubs participating in UEFA competitions of a code of ethics, and more particularly of a draft document prepared by ENIC and by the Claimants entitled «Proposed measures to guarantee sporting integrity in European football competition organised by UEFA». The Claimants have also suggested that the Contested Rule could include a clause for a case by case examination of multi-club ownership in order to appraise particular circumstances, and have proposed a «fit and proper» test for every club owner as a condition for participation in UEFA competitions or even as a requirement for the purchase of a club. They have also proposed that UEFA enact rules limiting the number of clubs which the same owner can control, or that an independent trust be established to which control of commonly owned clubs could be transferred for the duration of UEFA competitions. Moreover, in order to avoid problems with bonuses and transfers, inevitably connected with multi-club ownership (*see supra*, paras. 39-40), suggestions were also advanced that UEFA enact schemes, either general or special to commonly owned clubs, limiting bonuses and transfers of players.
126. The Respondent replies by asserting that the Contested Rule corresponds to the minimum degree of regulation necessary to protect the integrity of football competition and is, therefore, fully compatible with the law. The Respondent argues that the Contested Rule does not prohibit multi-club ownership, but simply prevents commonly controlled clubs

from participating in the same UEFA club competition, and that any investor may acquire a shareholding of up to 50% in any two or more European football clubs participating in UEFA competitions without ever being affected by the Contested Rule. In this respect, the Respondent mentions the stricter regulations which may be found in the United Kingdom, such as the rules of the Premier League, the Football League and the Scottish Football Association, or in the United States, such as the rules of the NBA, the NFL, the NHL and the MLB. The Respondent also argues that preventive measures are necessary in order to avoid conflicts of interest, and cites in this respect the principles applicable to lawyers and arbitrators. The Respondent also criticizes the draft regulation submitted by the Claimants for proposing rules which already exist (such as the obligations to play always to win and to field the best available team, and the disciplinary proceedings for anyone suspected of match-fixing), or rules which are impractical and unrealistic to enforce (such as the obligation for any multi-club owner to ensure the autonomy of each club's coaching and playing staff and the limitation of contacts between the clubs in the event that they play against each other, or the obligation to include in any club at least one minority shareholder capable of exercising minority shareholder's rights), or measures hard to assess and which would probably be challenged in court (such as the exclusion from competition of clubs whose owner is not a fit and proper person).

127. The Panel has already analyzed the «integrity question» and has found that, when commonly controlled clubs participate in the same competition, the consumers would reasonably perceive this situation as a conflict of interest potentially affecting the authenticity of results (*supra*, paras. 22-48). Accordingly, the Panel has concluded that multiple ownership of clubs in the context of the same competition is a justified cause for concern by a sports regulator and organizer such as UEFA (*supra*, para. 48). The Panel has also already found that the intention of the Contested Rule is to prevent the conflict of interest inherent in commonly controlled clubs participating in the same UEFA competition and to preserve the genuineness of results (*supra*, para. 113). In this respect, the Panel is persuaded that this is a legitimate goal to pursue, and finds evident support for this proposition in the *Bosman* ruling, where the EC Court stated that the aim «*of maintaining a balance between clubs by preserving a certain degree of equality and uncertainty as to results ... must be accepted as legitimate*» (Judgement of 15 December 1995, case C-415/93, *Bosman*, in *E.C.R.* 1995, I-4921, para. 106).
128. The Panel observes that organizing sports leagues and competitions needs a certain amount of coordination and horizontal restraints between clubs in order to supply the «product» to the consumers. As was remarked by a leading United States antitrust scholar (and later federal judge) «some activities can only be carried out jointly. Perhaps the leading example is league sports» (R.H. BORK, *The antitrust paradox. A policy at war with itself*, 2<sup>nd</sup> edition, New York 1993, 278). Indeed, each professional club competing in a league or in a competition has an evident interest in combining sporting and economic rivalry with sporting and economic cooperation. In the words of the Supreme Court of the United States, sport is «*an industry in which horizontal restraints on competition are essential if the product is to be available at all. ... What the NCAA and its member institutions market in this case is competition itself – contests between competing institutions. Of course, this would be completely ineffective if there were no rules on which the competitors agreed to create and define the competition to be marketed. A myriad of rules affecting such*

*matters as the side of the field, the number of players on a team, and the extent to which physical violence is to be encouraged or proscribed, all must be agreed upon, and all restrain the manner in which institutions compete. ... And the integrity of the “product” cannot be preserved except by mutual agreement»* (Judgement of 27 June 1984, *NCAA v. Board of Regents of the University of Oklahoma*, in 468 U.S. 85, 101-102).

Advocate General Lenz basically espoused such line of reasoning when he stated that *«the field of professional football is substantially different from other markets in that the clubs are mutually dependent on each other»* and that *«certain restrictions may be necessary to ensure the proper functioning of the sector»* (Opinion delivered on 20 September 1995, case C-415/93, *Bosman*, in *E.C.R.* 1995, I-4921, para. 270).

129. The Panel is of the opinion that among the «myriad of rules» needed in order to organize a football competition, rules bound to protect public confidence in the authenticity of results appear to be of the utmost importance. The need to preserve the reputation and quality of the football product may bring about restraints on individual club owners' freedom. In this respect, the Panel sees an analogy with restraints which the Court of Justice has regarded as inherent in, and thus necessary for, franchising systems (Judgement of 28 January 1986, case 161/84, *Pronuptia*, in *E.C.R.* 1986, 353, para. 15 *et seq.*).
  
130. Given that the Panel has found that in multi-club ownership situations a problem of conflict of interest objectively exists (*supra*, para. 45), and that this has been found to affect the public perception of the authenticity of results (*supra*, para. 48), the Panel is persuaded that a rule concerning multi-club ownership is objectively necessary in order to provide the consumers with a credible sporting contest. The question is whether the Contested Rule is proportionate to the legitimate objective pursued or whether UEFA should have adopted a less restrictive means to achieve it. With regard to the principle of the «less restrictive alternative», however, the Panel is of the opinion that this does not necessarily mean that it is necessary to test the Contested Rule against any conceivable alternative. Judges should not substitute for legislators, and the former should always allow the latter to retain a certain margin of appreciation. In other words, «the principle of proportionality cannot be applied mechanically» and «the less restrictive alternative test is not an end in itself but simply facilitates the judicial enquiry» (T. TRIDIMAS, *The principle of proportionality in Community law: from the rule of law to market integration*, in *The Irish Jurist* 1996, 83, at 93-94). Such position is supported by some significant Court of Justice case law (*see e.g.* Judgement of 10 May 1995, case C-384/93, *Alpine Investment*, in *E.C.R.* 1995, I-1141, paras. 51-54).
  
131. With regard to proportionality, the Panel observes that the Contested Rule has been narrowly drawn to proscribe only the participation in the same UEFA competition of commonly controlled clubs and does not prohibit multi-club ownership as such. The Contested Rule does not proscribe the participation of commonly controlled clubs in two different UEFA competitions and does not prevent the acquisition of shares – up to 49% of the voting rights – in a large number of clubs participating in the same competition. As the scope of the Contested Rule is strictly limited to participation in the same UEFA competition, a multi-club owner can control clubs in several countries and obtain a good

return on the investments even if only one of its clubs is allowed to take part in a given UEFA competition. In this respect, the already quoted MMC Report contains some evidence – referred to the British market, but arguably representative of other national markets – suggesting that the top national championship (in England the Premier League) and the national cup (in England the FA Cup) are the football competitions most preferred by consumers and most economically rewarding, because of their unique combination of volume and popularity of matches (MMC Report, para. 2.22). Indeed, in response to a 1996 British survey, 71% of pay-television subscribers who watched football said that the Premier League was very important to them and 68% said the same of the FA Cup; only 50% said the same of UEFA matches involving British clubs (*ibidem*). Moreover, the number of UEFA matches played by a club (even achieving the final) is substantially fewer than the number of national championship and national cup matches. Accordingly, European football clubs still derive most of their revenues from national championship and cup matches; for example, about 75% of Manchester United’s profits come from Premier League matches (*ibidem*, para. 2.125). In the light of the foregoing data and remarks, and of the circumstance that participation in national competitions is not affected at all, the Panel finds that the Contested Rule appears *prima facie* to be limited to its proper objective and not to be disproportionate or unreasonable. This *prima facie* conclusion needs now to be examined in the light of the less restrictive alternative test.

132. Before proceeding with the less restrictive alternative test, the Panel remarks that, as a normative technique, rules which are applied *a priori* differ from rules which are applied *a posteriori*. Rules that are applied *a priori* tend to prevent undesirable *situations* which might prove difficult or useless to deal with afterwards, rather than imposing a penalty on someone guilty of something. On the other hand, rules that are applied *a posteriori* are bound to react to specific *behaviours*. For example, under EC law and several national laws, rules on mergers are applied *a priori*, whereas rules on abuses of dominant position are applied *a posteriori*. Merger operations are checked before they actually take place, and are blocked if the outcome of the merger would be the establishment of a dominant position because of the possible negative consequences on the market and not because the individuals owning or managing the merging undertakings are particularly untrustworthy and the company after the merger is expected to abuse of its dominant position. Among the myriad of possible examples, another obvious example of rules applied *a priori* can be found in provisions of company law restraining cross-ownership of shares (*see* Article 24a of the Second Council Directive of 13 December 1976, no. 77/91/EEC, in *Official Journal EC*, 31 January 1977, L 26/1, as subsequently amended by Council Directive of 23 November 1992, no. 92/101/EEC, in *Official Journal EC*, 28 November 1992, L 347/64). One can think also of all the rules providing for incompatibility between a given position and another (say, between membership of a company’s board of directors and membership of the same company’s board of auditors). All such *a priori* rules are applied on a preventive basis, with no appraisal of any specific wrongdoing and no moral judgement on the individuals or companies concerned. On the other hand, rules setting forth obligations and corresponding penalties or sanctions, such as criminal or disciplinary rules, can be applied only after someone has been found guilty of having violated an obligation. In summary, *a priori* and *a posteriori* rules respond to different legal purposes and are legally complementary rather than

alternative. Therefore, the Panel finds that the Contested Rule, which is clearly to be applied *a priori*, can be supplemented but cannot be substituted by any sporting rules establishing disciplinary sanctions or any State laws forbidding match-fixing. Therefore, such disciplinary and criminal rules cannot be «less restrictive alternatives» insofar as they are not truly «alternative» to the Contested Rule.

133. As to the other alternative means proposed by the Claimants, the Panel is not persuaded that they are viable or that they really can be considered as less restrictive. The Claimants have particularly relied on a draft document headed «*Proposed measures to guarantee sporting integrity in European football competition organised by UEFA*» (hereinafter «the Claimants' Proposal»). According to the Claimants' Proposal, *inter alia*, UEFA would be required in consultation with the relevant national association to control the ownership structure of every club wishing to participate in a UEFA competition and would be «*entitled to take appropriate steps in cases where it considers that a particular individual or legal entity is not a fit and proper person to be or become an owner of a club*», and could «*after giving that person or legal entity a reasonable opportunity to make representations, decide that the club or clubs owned or to be owned by him or it may, subject to giving one season's notice, become ineligible to participate in European competitions*».

At the hearing, the Claimants also proposed to extend this fit and proper test to clubs' directors and executives. Since one season's notice should be granted, the Claimants' Proposal would imply that every summer the UEFA offices should check the ownership structures of all the clubs (established in about fifty different legal systems) which can potentially qualify for the UEFA competitions of the following season – as said, in all the European top national divisions there are 737 clubs, of which perhaps 350 have a realistic chance of qualifying for UEFA competitions (*see supra*, para. 102) – and, after a legal hearing, pass moral judgements on the owners', directors' and executives' adequacy to run a football club. The Panel finds that, from a substantive point of view, it would be very difficult to come up with some objective requirements in order to fairly carry out a fit and proper test and, from a procedural point of view, the administrative costs involved and the legal risks of being sued for economic and moral damages after publicly declaring in front of the whole of Europe that someone is not a fit and proper person are practically incalculable (in this respect, as UEFA is a private body, no comparison can be made with fit and proper tests carried out by public authorities prior to granting bookmaking licences, because such public authorities are essentially immune from being sued for declaring that someone is not «fit and proper»). The Panel notes that the Court of Justice has stated, with reference to the fashion sector, that if it is too difficult to establish objective quality requirements and it is too expensive to control compliance with such requirements, some preventive restraints are acceptable and do not violate Article 81.1 (*ex* 85.1) of the EC Treaty (Judgement of 28 January 1986, case 161/84, *Pronuptia*, in *E.C.R.* 1986, 353, para. 21). Analogously, the Panel finds that the Claimants' Proposal would be very difficult and way too expensive to administer and cannot be regarded as a viable alternative to the Contested Rule. Moreover, hardly could a UEFA rule requiring an inherently intrusive ethical examination of clubs' owners, directors and executives be characterized as a «less restrictive» alternative.

134. The Claimants have also mentioned approvingly some of the rules adopted by national leagues with reference to multi-club ownership – in the United Kingdom: Section J.4.2 of the FA Premier League Rules, Paragraph 84.1 of the Football League Regulations, and Paragraph 13 of the Articles of Association of the Scottish Football Association; in the United States: Article 3 of the NBA Articles of Association, and Article 3, Section 3.11 of the MLB National League Constitution – because they have provision for derogation and for individual cases to be considered on their own merits. The Panel, however, upon reading such rules finds that they are in principle *more* restrictive than the Contested Rule, insofar as they forbid a holding of more than 10% of the shares of another club (the Premier League), or a holding of or dealing in *any* shares or securities of more than one club (Football League, Scottish Football Association), or a holding of *any* financial interest in more than one club (NBA, MLB National League). Admittedly, most of these rules provide for the possibility of trying to obtain the prior approval of the respective sports governing body. However, apart from the fact that in practice no such approval has ever been granted, it seems to the Panel that such possibility for derogation in individual cases is strictly linked to the extremely rigorous rules in force within those leagues. Support for this interpretation can be found in the NBA rules, which clearly distinguish between the mere holding of financial interests, where application for derogation is possible, and *control* of more than one club, which is absolutely forbidden with no provision for derogation. The Panel finds that control of more than one club taking part in the same football competition is so inherently conducive to a conflict of interest, and to the related public suspicions, that there is no scope for the examination of individual cases. In addition, any legal regime based on *ad hoc* authorizations would cause unpredictability and uncertainty, and every denial of authorization would in all likelihood bring about expensive litigation, such as the present one. In this respect, the Panel is of the opinion that, for the good of sports and of consumers, it is advisable that sports leagues and federations try to shape their regulations in such a way that organization and administration of sports are not permanently conditioned by the risk of being sued.
135. The Claimants have then proposed other miscellaneous measures as alternatives to the Contested Rule, but the Panel finds that they are not suitable options. One proposed measure is the enactment of rules limiting the number of clubs that the same owner can control but, as has been seen, even two commonly controlled clubs suffice to give rise to conflict of interest problems. Other proposals try to address the issue by requiring that multi-club owners divest their ownership interests in all but one of the owned clubs solely for the period of the UEFA competition. This would be done through the establishment of an independent trust to which control of commonly owned clubs could be transferred for the duration of UEFA competitions or through the appointment of an independent nominee who would exercise the owner's voting rights in its sole discretion. The Panel finds that this solution would be not only complex to administer but also quite intrusive upon the clubs' structure and management; in any event, the true problem would be that the interim suspension of control or voting rights does not modify the substantial ownership of a club, and thus does not exclude the underlying continuance of a conflict of interest. Lastly, the proposed regulations restricting bonuses and transfers of players in view of a game between two commonly owned clubs would only take care of some aspects of the conflict of interest but, in particular, would not avoid the objective problems related to the allocation of

resources by the multi-club owner among its clubs (*supra*, para. 33 *et seq.*) and to the interest of third clubs (*supra*, para. 43).

136. In conclusion, the Panel finds that the Contested Rule is an essential feature for the organization of a professional football competition and is not more extensive than necessary to serve the fundamental goal of preventing conflicts of interest which would be publicly perceived as affecting the authenticity, and thus the uncertainty, of results in UEFA competitions. The Panel finds the Contested Rule to be proportionate to such legitimate objective and finds that no viable and realistic less restrictive alternatives exist. As a result, also in the light of the previous findings that the Contested Rule does not appear to have the object or effect of restricting competition, the Panel holds that the Contested Rule does not violate Article 81 (*ex 85*) of the EC Treaty.

h) Compatibility with Article 82 (*ex 86*) of the EC Treaty

137. The Claimants assert that UEFA is the only body empowered to organize European competitions and, consequently, holds a dominant position in the various European football markets. According to the Claimants, UEFA enjoys a position of economic strength which enables it to behave to an appreciable extent independently of the other undertakings which operate in the relevant markets, including the football clubs which participate in European competitions, and ultimately independently of supporters and spectators. The Claimants also assert that UEFA and its member associations, which normally enjoy monopoly power in their respective countries, enjoy joint dominance by virtue of their economic and legal links. The Claimants argue that the adoption of the Contested Rule constitutes an abuse of UEFA's dominant position contrary to Article 82 (*ex 86*) of the EC Treaty because the Contested Rule restricts competition, is unnecessary and disproportionate, unfairly discriminates between commonly controlled clubs and other clubs, and is not objectively justified. In order to support their contention that UEFA's conduct amounts to an abuse, the Claimants expressly rely on essentially the same arguments already advanced in connection with Article 81 (*ex 85*) of the EC Treaty.

138. The Respondent replies by denying that UEFA is in a dominant position within the meaning of Article 82 (*ex 86*), and in particular by denying that UEFA is able to behave independently of the clubs. The Respondent remarks that adopting a rule to preserve the integrity of the UEFA club competitions cannot amount to an abuse of a dominant position. The Respondent also asserts that the allegations concerning proportionality, discrimination and anti-competitive behaviour contain nothing new, and thus relies on the arguments advanced with reference to previous grounds.

139. The Panel notes that currently UEFA is the only pan-European regulator and administrator of football in general. However, it is not enough to state that a federation enjoys a monopolistic role in regulating and administering its sport, because this is inherent in the current European sports structure and «is recognized to be the most efficient way of organising sport» (EC Commission, *The European model of sport*, Brussels 1999, para. 3.2; *see*

also CAS 96/166 *K. v. FEI*, preliminary award of 18 November 1997, in *Digest of CAS Awards 1986-1998*, *op. cit.*, p. 371, para. 38). The Panel observes that in order to establish whether an undertaking has a dominant position, it is necessary to evaluate such dominance not in the abstract but in relation to one or more specific relevant markets. In this respect, UEFA's activities as an undertaking are developed as the sole – thus far – organizer of pan-European football competitions, retaining the related revenues from the sale of television rights for Champions' League matches and for the final match of the UEFA Cup and from the Champions' League group of sponsors. UEFA also cooperates with local undertakings (national federations or other entities) in organizing the final matches of its competitions. Revenues derived from UEFA's organization of pan-European competitions are apportioned among UEFA, including therein member national associations, and the participating clubs. In substance, UEFA can exert a dominant market power in the market for the organization of pan-European football matches and competitions.

140. In order to find an abuse of dominant position, the Panel needs to find that UEFA is seeking to overcome rival competitors through its dominant market power. In this respect, the Panel observes that if UEFA were found to exploit its market power in order, for example, to obstruct the establishment of another entity organizing pan-European football matches, this should certainly be analyzed with particular attention being paid to Article 82 (*ex 86*) of the EC Treaty. A case of this kind was faced by the Italian competition authority, which held that the Italian sailing federation violated Article 3 of the Italian competition statute – essentially identical to Article 82 of the EC Treaty – insofar as it used its dominant position to obstruct and boycott in various ways an independent organizer of sailing regattas with the purpose of profiting more from the organization of its own regattas (*see Autorità garante della concorrenza e del mercato*, Decision no. 788 of 18 November 1992, *AICI/FIV*, in *Bollettino* 22/1992). However, these theoretical and actual examples appear to bear no analogy to the enactment of the Contested Rule. The Claimants are not trying to organize pan-European competitions, nor are they selling television rights to existing pan-European competitions organized in competition with UEFA (as Media Partners would have done if the planned new pan-European football competitions, the Super League and the Pro Cup, had in fact been created outside of UEFA; *see supra*, para. 19).
141. The Panel has already identified the relevant product market as the market for ownership interests in football clubs capable of taking part in UEFA competitions (*see supra*, para. 100). The Panel observes that UEFA does not own any football club, nor can it buy or run one. Accordingly, UEFA is not present at all on this market and cannot be held to enjoy a dominant position. With respect to the relevant market it appears that UEFA may act, and has acted, only as a mere regulator. The Panel also observes that the national federations are not on the relevant market either; therefore, UEFA and its member associations do not enjoy a joint dominant position on such market. The Panel finds that, as a United States court has recognized, «if a regulation is adopted by an independent sanctioning organization with no financial stake in the outcome, a court will have maximum assurance that the regulation is to protect fair competition within the sport», (*M&H Tire v. Hoosiers*, 733 F.2d 973, 1st Cir. 1984, at 982-983).



142. The Claimants have pointed out that, according to EC case law, in certain circumstances an undertaking dominant on one market can commit an abuse on a neighbouring market (*see* Court of Justice, Judgement of 6 March 1974, cases 6-7/73, *Commercial Solvents*, in *E.C.R.* 1974, 223; *AKZO*, Judgement of 3 July 1991, case C-62/86, in *E.C.R.* 1994, I-3439; Court of First Instance, Judgement of 1 April 1993, case T-65/89, *British Gypsum*, in *E.C.R.* 1993, II-392; Judgement of 6 October 1994, case T-83/91, *Tetra Pak II*, in *E.C.R.* 1994, II-762).
143. The Panel remarks, however, that in all such EC precedents the dominant undertakings were active on both the market of dominance and the neighbouring non-dominated market. Accordingly, in order to find an abuse of dominant position on a market other than the market of dominance it must be proven that, through the abusive conduct, the dominant undertaking – or the group of dominant undertakings in the event of joint dominance – tends to extend its presence also on the other market or tends to strengthen its dominant position on the market of dominance (or at least tends to undermine the competitors' competitiveness). In the present case, UEFA (or any national federation) is obviously not going to enter, let alone extend its presence, in the market for ownership interests in football clubs. Furthermore, the Claimants have not provided adequate evidence that UEFA, in adopting the Contested Rule, has tried to strengthen its monopolistic position on the market for the organization of pan-European football matches and competitions (nor have Claimants provided any evidence that there is conduct of this kind attributable to the national federations collectively). Besides such lack of evidence, the Panel fails to see any logical link between the rule on multi-club ownership and the alleged attempt or intent to hinder the entry into the market of a new competitor (which could be the group that has planned to establish a «Super League» or some other entity or individual who might try to create a football league in Europe modelled on United States leagues). The opposite would seem more logical, insofar as the Contested Rule tends to alienate multi-club owners and thus might eventually tend to facilitate their secession from UEFA in order to join alternative pan-European competitions or leagues (*see also supra*, paras. 110-113).
144. In any event, with regard to the various abuses alleged by the Claimants, the Panel observes that it has already dealt with them in connection with other grounds. The Panel has found above that the Contested Rule does not restrict competition (*see supra*, paras. 114-123), that it is necessary and proportionate to the objective pursued (*see supra*, paras. 125-136), that it does not unfairly discriminate between commonly controlled clubs and other clubs (*see supra*, para. 65), and that it is objectively justified (*see supra*, para. 130).
145. In conclusion, the Panel holds that the adoption by UEFA of the Contested Rule has not constituted an abuse of an individual or a collective dominant position within the meaning of Article 82 (*ex* 86) of the EC Treaty.

*Swiss competition law: articles 5 and 7 of the Federal Act on Cartels*

146. Article 5.1 of the «*Loi fédérale sur les cartels et autres restrictions à la concurrence*» of 6 October 1995 (*i.e.* the Swiss Federal Act on Cartels and Other Restraints of Competition, hereinafter «Swiss Cartel Act») reads as follows:

«*Les accords qui affectent de manière notable la concurrence sur le marché de certains biens ou services et qui ne sont pas justifiés par des motifs d'efficacité économique, ainsi que tous ceux qui conduisent à la suppression d'une concurrence efficace, sont illicites*» («All agreements which significantly affect competition in the market for certain goods or services and are not justified on grounds of economic efficiency and all agreements that lead to the suppression of effective competition are unlawful»).

It is a provision which essentially corresponds to Article 81 (*ex* 85) of the EC Treaty (*supra*, para. 71).

147. Article 7.1 of the Swiss Cartel Act reads as follows:

«*Les pratiques d'entreprises ayant une position dominante sont réputées illicites lorsque celles-ci abusent de leur position et entravent ainsi l'accès d'autres entreprises à la concurrence ou son exercice, ou désavantagent les partenaires commerciaux*» («Practices of undertakings having a dominant position are deemed unlawful when such undertakings, through the abuse of their position, prevent other undertakings from entering or competing in the market or when they injure trading partners»).

This provision essentially corresponds to Article 82 (*ex* 86) of the EC Treaty (*supra*, para. 71).

148. With respect to the relevance of the Swiss Cartel Act, the Claimants have remarked that the Contested Rule affects trade within Switzerland in that Swiss football clubs are eligible to compete in, and do compete in, UEFA competitions; moreover, the Swiss club FC Basel is currently controlled by ENIC. The Respondent has not objected to the possible relevance of the Swiss Cartel Act in the present dispute. Both the Claimants and the Respondent have essentially relied on the analysis developed with reference to Article 81 (*ex* 85) and 82 (*ex* 86) of the EC Treaty. The only alleged difference with EC law is that, according to the Claimants, there is no «sporting exception» in Switzerland but only a very narrow exemption (to be interpreted quite rigorously) for the «rules of the game» *vis-à-vis* the «rules of law», which cannot be applied in the present case. The Respondent agrees with the Claimants that the Contested Rule cannot be considered as a «rule of the game» under Swiss law, but contends that Swiss competition law is not more restrictive than EC competition law and, therefore, limitations which are introduced with the sole aim of guaranteeing or enhancing sporting quality of competitions can be justified by a sort of sporting exception.
149. With regard to the «sporting exception», the Panel notes that it has already excluded that it can serve the purpose of exempting the Contested Rule from the application of competition rules (*supra*, para. 83). Consequently, the Panel need not rule on whether such an exception exists under Swiss competition law or not. Furthermore, the Panel observes that, in the light

of the textual similarities and the conceptual correspondence of Swiss competition law to EC competition law, the above findings concerning Articles 81 (*supra*, paras. 109-136) and 82 of the EC Treaty (*supra*, paras. 137-145) are applicable *mutatis mutandis* to Articles 5 and 7 of the Swiss Cartel Act. With particular regard to Article 5, the Panel remarks that the envisaged oligopoly scenario (*supra*, para. 117) is much more likely within a small market such as Switzerland, where there are not many teams aspiring to participate in UEFA competitions; indeed, there are only twelve clubs in the Swiss first division. Therefore, the described pro-competitive effect of the Contested Rule is even amplified within the Swiss market. As a result, the Panel holds that, within the Swiss market, the Contested Rule does not significantly restrict competition within the meaning of Article 5 of the Swiss Cartel Act, nor does it constitute an abuse of dominant position within the meaning of Article 7 of the Swiss Cartel Act.

*European community law on the right of establishment and on free movement of capital*

150. Article 43 (*ex* 52) of the EC Treaty prohibits «restrictions on the freedom of establishment of nationals of a member State in the territory of another Member State». Under Article 56 (*ex* 73 B) all restrictions on movement of capital and on payments within the Community and between the Member States and third countries are prohibited. Both provisions are directly effective and can therefore be applied by national tribunals or arbitration courts.
151. The Claimants assert that the essence of the Contested Rule is to restrict the possibility of multi-club owners setting up subsidiaries in more than one EC Member State, in violation of Article 43 (*ex* 52) of the EC Treaty. The Claimants also assert that the Contested Rule restricts capital movements within the meaning of Article 56 (*ex* 73 B) of the EC Treaty. The Respondent replies that the Contested Rule, even if caught by such EC provisions, would not infringe them because it is a proportionate means to achieve a legitimate objective.
152. The Panel observes that the Contested Rule does not entail any discrimination based on a person's (or corporation's) nationality; therefore, under EC law jargon, it can be characterized as an «equally applicable measure». As a result, even assuming that the Contested Rule somewhat restricts the right of establishment or the free movement of capital, EC case law envisages the existence of justifications on grounds of reasonableness and public interest, provided that the requirements of necessity and proportionality are met (*see supra*, para. 130).
153. As the Panel has already noted, the Court of Justice has stated that «*in view of the considerable social importance of sporting activities and in particular football in the Community, the aims of maintaining a balance between clubs by preserving a certain degree of equality and uncertainty as to results ... must be accepted as legitimate*» (Judgement of 15 December 1995, case C-415/93, *Bosman*, in *E.C.R.* 1995, I-4921, para. 106).

Therefore, the aim of the Contested Rule of preserving the authenticity and uncertainty of results – by preventing the conflict of interest inherent in commonly owned clubs participating in the same football competition – is certainly to be considered in principle as a legitimate justification, as long as the aim is pursued through necessary and proportionate means.

154. The Panel has already found that the Contested Rule meets the requirements of objective necessity and of proportionality (*see supra*, paras. 125-136). Consequently, the Panel holds that the Contested Rule does not infringe Article 43 (*ex 52*) and Article 56 (*ex 73 B*) of the EC Treaty.

*General principle of law*

155. The Claimants assert that it is a general principle of law that a quasi-public body exercising regulatory powers, such as an international federation, must not abuse its powers. The Claimants argue that in adopting the Contested Rule UEFA has abused its powers because it has tried to protect its monopoly power over the organization of pan-European football competitions. The Respondent rejects this allegation.

156. The Panel is of the opinion that all sporting institutions, and in particular all international federations, must abide by general principles of law. Due to the transnational nature of sporting competitions, the effects of the conduct and deeds of international federations are felt in a sporting community throughout various countries. Therefore, the substantive and procedural rules to be respected by international federations cannot be reduced only to its own statutes and regulations and to the laws of the country where the federation is incorporated or of the country where its headquarters are. Sports law has developed and consolidated along the years, particularly through the arbitral settlement of disputes, a set of unwritten legal principles – a sort of *lex mercatoria* for sports or, so to speak, a *lex ludica* – to which national and international sports federations must conform, regardless of the presence of such principles within their own statutes and regulations or within any applicable national law, provided that they do not conflict with any national «public policy» (*«ordre public»*) provision applicable to a given case. Certainly, general principles of law drawn from a comparative or common denominator reading of various domestic legal systems and, in particular, the prohibition of arbitrary or unreasonable rules and measures can be deemed to be part of such *lex ludica*. For example, in the CAS award *FIN/FINA* the Panel held that it could intervene in the sanction imposed by the international swimming federation (FINA)

*«if the rules adopted by the FINA Bureau are contrary to the general principles of law, if their application is arbitrary, or if the sanctions provided by the rules can be deemed excessive or unfair on their face»* (CAS 96/157 *FIN v. FINA*, award of 23 April 1997, in *Digest of CAS Awards 1986-1998, op. cit.*, p. 358, para. 22; *see also* CAS OG 96/006 *M. v. AIBA*, award of 1 August 1996, *ibidem*, p. 415, para. 13).

157. The Panel, on the basis of previous remarks, finds that UEFA did not adopt the Contested Rule with the purpose of protecting its monopoly power over the organization of pan-

European football competitions (*see supra*, paras. 110-113 and 143), and finds that the Contested Rule is not arbitrary nor unreasonable (*see supra*, paras. 48 and 125-136). Therefore, with regard to the substantive content of the Contested Rule, the Panel holds that UEFA did not abuse its regulatory power and did not violate any general principle of law.

158. The Panel observes, however, that under CAS jurisprudence the principle of procedural fairness is surely among the unwritten principles of sports law to be complied with by international federations (*see CAS OG 96/001 US Swimming v. FINA*, award of 22 July 1996, in *Digest of CAS Awards 1986-1998, op. cit.*, p. 381, para. 15; *CAS 96/153 Watt v. ACF*, award of 22 July 1996, *ibidem*, p. 341, para. 10). The Panel has already found that UEFA violated its duty of procedural fairness because it adopted the Contested Rule too late, when the Cup Regulations for the 1998/99 season, containing no restriction for multiple ownership, had already been issued and communicated to the interested football clubs (*see supra*, para. 61). The Panel has also already remarked that such procedural defect by itself does not warrant the permanent annulment of the Contested Rule (*see supra*, para. 62). Therefore, as is going to be seen (*infra*, paras. 159-163), the said lack of procedural fairness will have some consequences only in connection with the temporal effects of this award.

### Temporal effects of this award

159. The Panel, approving the CAS interim order of 16 July 1998, has held that UEFA violated its duties of procedural fairness with respect to the 1998/99 season, insofar as it modified the participation requirements for the UEFA Cup at an exceedingly late stage, after such requirements had been publicly announced and the clubs entitled to compete had already been designated (*see supra*, paras. 60-62 and 158). This procedural defect caused the above-mentioned interim suspension of the Contested Rule, freezing the situation as it was before the enactment of the Contested Rule.
160. These proceedings then required more than one whole year to fully develop and come to an end with this award. The interim order appropriately remarked: «*At this preliminary stage, CAS is further of the opinion that the outcome of the Claimants' action is uncertain*» (CAS Procedural Order of 16-17 July 1998, para. 69). The number and complexity of the issues involved and the wide-ranging nature of the dispute have all along given the proceedings a state of uncertainty as to the outcome of the present case. With the release of the present award the CAS ends such state of uncertainty. However, the 1999/2000 football season has already begun and an immediate application of the Contested Rule for this season might involve for some clubs a sudden loss of their eligibility to participate in UEFA competitions (eligibility obtained on the basis of their results in 1998/99 national championships, at a time when the Contested Rule was not in force because of the interim order and there was uncertainty as to the outcome of this case).
161. Moreover, in their written briefs and oral arguments, the Claimants have drawn the Panel's attention to the harmful consequences which might ensue for them and for ENIC from an

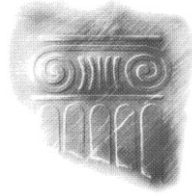
award rejecting their petitions. The interim order already stated (*see* CAS Procedural Order of 16-17 July 1998, para. 54) that an adjustment to the Contested Rule should not be arranged hurriedly, and commonly controlled clubs and their owners should have some time to determine their course of action, also taking into account possible legal questions (*e.g.* if shares are to be sold, minority shareholders may be entitled to exercise preemptive rights within given deadlines). There is an obvious need for a reasonable period of time before entry into force, or else the implementation of the Contested Rule may turn out to be excessively detrimental to commonly controlled clubs and their owners.

162. The Panel considers that an immediate application of the effects of the award could be unreasonably harmful to commonly owned clubs which during the recently terminated 1998/99 season have qualified for one of the 1999/2000 UEFA competitions. Such clubs, if any, would find themselves in the same situation as they were in when the CAS rightly stayed the implementation of the Contested Rule. If UEFA had announced in the Summer of 1998 that the Contested Rule was going to be implemented at the beginning of the 1999/2000 football season, no club could have later claimed to have legitimate expectations with respect to the treatment of multi-club ownership. In other words, without a ruling on the temporal effects of this award, the Panel would not give sufficient weight to the procedural defect which occurred in the adoption of the Contested Rule.
  
163. In conclusion, paramount considerations of fairness and legal certainty, needed in any legal system, militate against allowing UEFA to implement immediately the Contested Rule in the 1999/2000 football season which has already begun. Accordingly, the Panel partially upholds the Claimants' petition to extend the stay of the Contested Rule, and deems it appropriate to extend such stay until the end of the current 1999/2000 football season; for the remaining part, the petition for an indefinite extension of the stay is rejected. As a result, the Panel holds that the Contested Rule can be implemented by UEFA starting from the 2000/2001 football season.

### **The Court of Arbitration for Sport:**

1. Rejects the petitions by AEK Athens and Slavia Prague to declare void or to annul the resolution adopted by UEFA on 19 May 1998 on the «Integrity of the UEFA Club Competitions: Independence of the Clubs».
  
2. Partially upholding the petition by AEK Athens and Slavia Prague to extend indefinitely the interim stay ordered by the CAS on 16 July 1998, orders the extension of the stay until the end of the 1999/2000 football season and, accordingly, orders UEFA not to deny admission to or exclude clubs from the 1999/2000 UEFA club competitions on the ground that they are under common control; consequently, UEFA is permitted to implement its resolution of 19 May 1998 starting from the 2000/2001 football season.
  
3. Rejects all other petitions lodged by AEK Athens and Slavia Prague.

**CLA-011**



**Arbitration CAS 2001/A/317 A. / Fédération Internationale de Lutttes Associées (FILA), award of 9 July 2001**

Panel: Mr. Dirk-Reiner Martens (Germany), President; Mr. Odd Seim Haugen (Norway); Mr. Jean-Philippe Rochat (Switzerland)

*Wrestling*

*Doping (nandrolone)*

*Use of nutritional supplements*

*Strict Liability Rule*

*Mitigating circumstances*

1. The legal relations between an athlete and a federation are of a civil nature and do not leave room for the application of principles of criminal law. This is particularly true for the principles of *in dubio pro reo* and *nulla poena sine culpa* and the presumption of innocence as enshrined in Art. 6 ECHR.
2. It is perfectly proper for the rules of a sporting federation to establish that the results achieved by an athlete at a competition during which he was under the influence of a prohibited substance must be cancelled irrespective of any guilt on the part of the athlete. This conclusion is the natural consequence of sporting fairness against the other competitors. The interests of the athlete concerned in not being punished without being guilty must give way to the fundamental principle of sport that all competitors must have equal chances.
3. If the federation is able to establish the objective elements of a doping offence, there is a presumption of guilt against the athlete. The principle of presumed fault on the part of the athlete does not, however, leave him without protection because he/she has the right to rebut the presumption, i.e. to establish that the presence of the prohibited substance in his/her body was not due to any intent or negligence on his/her part.
4. An athlete cannot exculpate himself/herself by simply stating that the container of the particular product taken by him/her did not specify that it contained a prohibited substance. It is obvious that the sale of nutritional supplements, many of which are available over the internet and thus sold without an effective governmental control, would go down dramatically if they properly declared that they contain (or could contain) substances prohibited under the rules governing certain sports. Therefore, to allow athletes the excuse that a nutritional supplement was mislabelled would provide an additional incentive for the producers to continue that practice. In summary, therefore, it is no excuse for an athlete found with a prohibited substance in his/her body that he/she checked the label on the product he took and that the label did not specify that the product contained a prohibited substance.



A. participated in the XXVII Olympic Games in Sydney as a wrestler in the 85 kg weight category, Greco Roman Style. He finished fourth in his competition which took place on September 27, 2000.

After the end of his competition he underwent a doping control. The A sample (No. A403123) showed the presence of "metabolites of nandrolone, norandrostenedione or norandrostenediol (19-norandrosterone and 19-noretiocholanolone). The concentration of norandrosterone in the sample was more than twice the IOC threshold" (4 ng/ml). In his subsequent request for arbitration A. specified the concentration as having been 8 ng/ml.

By decision of the IOC Executive Board of October 1, 2000, A. was disqualified and excluded from the Games of the XXVII Olympiad for the use of prohibited substances (Chapter II, Article 2.2 of the Olympic Movement Anti-Doping Code). He did not challenge this disqualification.

Upon the request of the athlete's national delegation, the test of the B-sample (No. B403123) was carried on October 3, 2000 in the presence of Mr. J. Segura and Mr. S. Nolan. No member of the national delegation was present at the opening of the B-sample since the Chef de Mission and all physicians had already left. The test result of the B-sample confirmed the result of the A-sample.

The FILA Sport Judge suspended A. from all national and international wrestling competitions for a period of two years. On November 3, 2000 this decision was notified to the national Wrestling Federation and subsequently communicated by it to A. The athlete and his national Wrestling Federation unsuccessfully challenged this decision before internal FILA instances.

Over a period of several months prior to the Olympic Games in Sydney A. had taken 8 to 10 different vitamins/nutritional supplements in accordance with a schedule developed by his sponsor, the witness L. who is a wholesaler of health products in Sweden. During this period A. underwent several doping control tests which were always negative. Approximately 5 to 6 weeks before the Sydney Olympic Games A. began taking six tablets a day of Pyrovate 500, a nutritional supplement produced by the US-company Pinnacle and recommended and supplied to A. by L.. A. did not undergo a doping test after he began taking Pyrovate 500 until the positive test at the Olympic Games. When already in Australia in a training camp, the athlete's trainers heard that a weight-lifter had tested positive for nandrolone and that food supplements were suspected to be responsible for this result. As a consequence, the labels of every product taken by A., in particular the Pyrovate 500 label, were checked as to whether the products contained any prohibited substances. The label did not show any such substance and A. continued to take – inter alia – Pyrovate 500. Following the athlete's positive doping test in Sydney Pyrovate 500 was tested by the IOC accredited laboratory in Cologne. The test revealed the presence of anabolic androgenic steroids (nandrolone precursors) which were not declared on the label.

On January 4, 2001 Appellant filed a request for arbitration with the Court of Arbitration for Sport against the decision of FILA's Sport Judge of October 24, 2000.

By letter dated February 19, 2001 the Respondent filed its response to the request for arbitration.

The Appellant claims that his rights were infringed during the internal FILA-proceedings since he was not given the benefit of a fair hearing before the decision of the FILA Sport Judge. With respect to the merits of the case, the Appellant contends that the Respondent cannot rely on "strict liability". Athletes who have broken the rules without intent or negligence should not be punished. Moreover, since the FILA doping regulations required "use" of a forbidden substance, they themselves showed that an intentional element was required for a doping offence. Since Appellant took the forbidden substance neither intentionally nor negligently, the FILA decision should be annulled. Even if the FILA doping rules were considered to contain a strict liability regime the Panel should take into account that there was a case of exceptional circumstances which did not warrant a suspension in addition to disqualification from the Olympic Games. Regarding the product Pyrovate 500 the Appellant observes that neither he nor his trainer were aware of the fact that this supplement could contain a forbidden substance. Finally, A. adds that all his previous doping tests had been negative and that his clean record should also be considered. In conclusion, the Appellant requests that the FILA decision be declared invalid.

The Respondent requests the CAS to reject the appeal and to confirm the decision to suspend the Appellant for a duration of two years. Since in the case in hand it was not contested that a forbidden substance was found in the Appellant's body, in the Respondent's view the suspension was correct since the Appellant was unable to show that he had fulfilled all his duties of care. The Respondent submits that high level athletes have known for several years that nutritional supplements available from US-American producers may sometimes contain forbidden substances. In this respect Respondent cites press releases by the IOC issued in 1999 and at the beginning of 2000 as evidence of the level of awareness in the sports world. The fact that the Appellant tested positive after ingestion of a product which contained a prohibited substance not marked on the label could not in itself provide a valid excuse because this would open a wide door to any kind of abuse. However, the Respondent conceded that the special circumstances of the case might allow the sanction to be reduced.

A first hearing was held on April 3, 2001 and a second one on May 15, 2001, both in Lausanne.

## **LAW**

1. The Appellant alleges a violation of his right to be heard since he was not given the opportunity to present his case before the FILA Sport Judge rendered his decision on the suspension.
2. The CAS jurisdiction is based on the arbitration agreement reached by the parties at the hearing of 3 April 2001 but also results from FILA's rules and regulations (Article 37(c) of the FILA Constitution and Article 6 of the FILA Disciplinary Regulations).

3. Pursuant to Article R58 of the Code, the Panel is required to decide the dispute according to the applicable regulations of FILA and Swiss law since Respondent has its seat in Switzerland and the parties did not choose a different governing law.
4. Since the doping control and the analysis of the samples took place after the FILA Congress held on September 22, 2000 in Sydney the Panel will apply the FILA Constitution as amended at that Congress (FILA Official Bulletin No. 166-167/2001) and the FILA Doping Regulations as well as the Disciplinary Regulation in force at that time. For the interpretation of the FILA rules the Panel will have special regard to Swiss law in accordance with Article R58 of the Code.
5. Indeed, there is no evidence that the FILA Sport Judge heard the Appellant either personally or by written submissions. It seems that he rendered his decision without further inquiries, only on the basis of the documentation on the disqualification by the IOC, provided to him by FILA.
6. However, the Panel will not deal with this argument in detail. It observes that the CAS has always considered the right to be heard as a general legal principle which has to be respected also during internal proceedings of the federations (CAS 91/53 G. v/ FEI, award of January 15, 1992, Digest, p. 79, 86 f). Federations have the obligation to respect the right to be heard as one of the fundamental principles of due process.
7. However, according to Article R57 of the Code, the Panel will hear the case *de novo*. This means that, even if a violation of the principle of due process occurred in the first instance, any such violation may be cured by a full hearing following appeal to the CAS (CAS 94/129 USA Shooting & Q. v/ UIT, Digest, p. 187, 203).
8. The Panel is satisfied that the Appellant committed a doping offence under the relevant FILA Rules as interpreted pursuant to Swiss law.
9. Provisions on doping can be found in several places in FILA's regulations (the following quotes are based on the version of the regulations as applicable after the 22 September 2000 FILA Congress).
10. FILA Constitution  
*"Article 9. – Doping  
The absorption of any substance intended to artificially improve the performance of the athlete is strictly prohibited. The IOC's official list is authoritative."*  
[The French text reads: "L'absorption de toutes substances destinées à accroître artificiellement la performance..."].
11. The FILA Doping Regulations state the following:  
*"Art. 1 – Definition of doping in sport*

*Doping is defined as the use, intake or administration of any substance that may affect the mental state or the physical performance of the competitor in a positive or negative way.*

...

*Doping consists of*

- a) *the administration, intake and use of substances belonging to the classes of forbidden pharmacological agents and the use of forbidden methods by athletes...,*
- b) *resorting to substances or methods which are potentially dangerous for the athlete's health, or are capable of increasing his performance artificially,*
- c) *the presence in the athlete's organisation of forbidden substances or the certification of the use of methods which are not allowed, by referring to the list provided by the IOC and to its successive updates".*

12. Art. 27 of the FILA Doping Regulations then makes reference to the IOC Anti-Doping Code by stating:

*"Art. 27 Particular and Final Provisions*

...

2. *Concerning anything which is not indicated in these Regulations, the standards and provisions laid down by the IOC's anti-doping code are applicable.*

...

6. *Bearing in mind that the anti-doping code of the Olympic Movement has been drawn up in close cooperation with the International Federations, it must apply to ... the various Championships ..., to all other competitions organised by the FILA...  
Therefore, any problems of interpretation of any article in these Regulations or for any question not dealt with here, must be referred to the IOC's Anti-Doping Code Lausanne 2000."*

13. Finally, the IOC Anti-Doping Code to which the FILA Doping Regulations refer states that (Chapter II Art. 2 and Art. 3):

*"Article 2*

*Doping is:*

...

2. *the presence in the athlete's body of a Prohibited Substance or evidence of the use thereof or evidence of the use of a Prohibited Method.*

*Article 3*

1. *In a case of doping, the penalties for a first offence are as follows:*

...

- b) *If the prohibited substance is one other than those referred to in a) above:*

...

- III) *Suspension from any competition for a minimum period of two years. However, based on specific, exceptional circumstances to be evaluated in the first instance by the competent IF bodies, there may be a provision for a possible modification of the two-year sanction.*

2. *In case of*

- a) *intentional doping:*

...

*The sanctions are as follows: [sanctions of up to a life ban]"*

The notion of "intentional doping" is further defined in the IOC's Explanatory Memorandum (p. 9):

*"With regard to intentional doping, this is a new notion which is added to that of doping as a breach of these rules. The latter exists as soon as the presence of a banned substance has been detected in an athlete's body, independent of any element of intention. Therefore, the athlete has to be punished. Nothing has changed as far as this is concerned. However, in the rare cases where it can be proved that doping was intentional, the Code allows for the imposition of much stricter sanctions..."*

14. As to sanctions, Annex D of the FILA Anti-Doping Regulations provides:

*"Sanctions*

1. *In the event of proving responsibility, the sanctions laid down by the IOC and quoted in annexe 1 which is an integral part of the FILA anti doping regulations. Any updates by the Olympic Movements will be introduced following deliberation by the Executive Committee and defined as follows:*

*Constitutes a violation of the anti doping standards:*

A. *Administering or use of substances which are part of the following classes of forbidden medication:  
... anabolising agents ...*

B. *The use of doping practices ...*

C. *The absorption of substances belonging to the following classes of pharmaceutical classes whose use is subject to restriction: alcohol ...*

D. *The administration or absorption of the following substances: ephedrine ...*

2. *For violations mentioned in point 1, letters A, B, C, the following sanctions are applicable:*

- *two years for the first offence;*

- *life ban for the second offence."*

15. Finally, with regard to sanctions, Art. 26 of the FILA Doping Regulations provides the following:

*"Art. 26 Violations of the anti-doping standards and the relative sanctions*

*...*

4. *The FILA, depending on the case, for positive doping results, can apply heavier sanctions than those laid down in the Regulations.*

5. *The FILA, through its own justice bodies, can find specific and exceptional attenuating circumstances which will enable the sanctions to be reduced."*

16. The Panel finds the provisions on doping in the various FILA regulations rather confusing.

According to the Constitution, doping is the "absorption" of a "substance intended to artificially improve the performance". In turn Art. 1 of the FILA Anti Doping Regulations states that it is sufficient for the substance to "affect" the performance and the same Article declares that "the presence in the athlete's organism of forbidden substances" constitutes a doping offence.

The FILA Doping Regulations then confirm that the IOC Anti Doping Code "must apply" to all FILA competitions and this very IOC Anti-Doping Code states that "Doping is ... the

presence in the athlete's body of a Prohibited Substance" and the IOC's Explanatory Memorandum further explains that doping "exists as soon as the presence of a banned substance has been detected in an athlete's body, independent of any element of intention".

17. Finally, according to Annex D of the FILA Anti Doping Regulations there seems to be a requirement of "proving responsibility" in order for sanctions to be imposed. The same can be concluded from Art. 17.21 of the same regulations which provides for sanctions of a "wrestler at fault".

18. The Panel observes that this "cocktail" of definitions and legal principles in connection with the fight against doping certainly falls short of the clarity and certainty desirable in an area as sensitive as doping and as demanded by CAS (CAS 94/129, USA Shooting & Q. v/ UIT, Digest, p. 187, 203). However, in the opinion of the Panel, the lack of clarity in the FILA Regulations does not go quite far enough to justify rejecting them as a whole as being so unclear that they cannot be applied at all. The Panel will therefore apply these rules as they are but will, if necessary, interpret any uncertainties *contra stipulatorem*, i.e. against FILA.

19. The facts of the case in hand are more straight forward than in most other doping cases:

It is uncontested that a substance prohibited under Art. 6 of the FILA Doping Regulations (metabolites of nandrolone, norandrostenedione or norandrostenediol (19-norandrosterone and 19-noretiocholanolone)) in quantities in excess of that allowed under the FILA rules (2ng/ml according to Article 27.2 of the FILA Doping Regulations; indeed, the Appellant himself states "a level of 8ng/ml of nandrolone") were found in the Appellant's urine sample taken on 27 September 2000. The Appellant admits that he took Pyrovate 500 during the time preceding his doping test and that – according to the findings of the IOC accredited laboratory in Cologne – this product contained anabolic-androgenic-steroids although this was not declared on the label. No challenge has been brought forward with respect to the conduct of the doping test, the chain of custody of the sample or the laboratory analysis.

20. The parties differ in their interpretation of the FILA rules and the consequences to be drawn from them.

According to the Appellant

"(I)t is clear that athletes, who have not broke the rules of doping with intent or negligently, cannot be punished" (Statement of Appeal dated 5 December 2000),

while the Respondent is of the opinion that:

"(I)he doping definition resulting from the applicable FILA Regulations is a strict liability definition. If the presence of a doping agent is established, then the sanction applies. No intention has to be shown" (Answer dated 19 February 2000).

21. If, indeed, under the FILA rules no subjective element, i.e. no intent or negligence on the part of the athlete were required for a doping offence to have been committed the Panel would in principle have to apply the two-year sanction provided for in Annex D, Section 2 of the FILA Doping Regulations and would be limited to evaluating whether there are "specific and

exceptional attenuating circumstances which will enable the sanctions to be reduced" (Art. 26, Section 5 of the FILA Doping Regulations).

22. However, the Panel is of the opinion that as a matter of principle and irrespective of "specific and exceptional circumstances" an athlete cannot be banned from competition for having committed a doping offence unless he is guilty, i.e. he has acted with intent or negligence. Even if the rules and regulations of a sports federation do not expressly provide that the guilt of the athlete has to be taken into account the foregoing principle will have to be read into these rules to make them legally acceptable.
23. CAS panels have to interpret the rules in question in a way "which seeks to discern the intention of the rule maker, and not to frustrate it" (CAS 96/149 A.C. v/ FINA, award of March 13, 1997, Digest, p. 251, 259). In interpreting the FILA rules the Panel does not find any indication that they intended to ignore the subjective elements as such. Since the Panel is of the opinion that under Swiss law an athlete cannot validly be banned in the absence of any fault (see *infra*), an interpretation to the contrary would lead to the rules being void which would frustrate the objective of the fight against doping pursued by the entire sporting world.
24. Before explaining the reasons for the principle of guilt the Panel wishes to clarify that this principle does not apply to the disqualification of a "doped athlete" from the event at which the doping test was conducted. It is therefore perfectly proper for the rules of a sporting federation to establish that the results achieved by a "doped athlete" at a competition during which he was under the influence of a prohibited substance must be cancelled irrespective of any guilt on the part of the athlete. This conclusion is the natural consequence of sporting fairness against the other competitors. The interests of the athlete concerned in not being punished without being guilty must give way to the fundamental principle of sport that all competitors must have equal chances (CAS 94/129 USA Shooting & Q. v/ UIT, Digest, p. 187, 193 et seq.; CAS 95/141 C. v/ FINA, Digest, p. 215, 220; CAS 98/214 B. v/ FIJ, p. 17; CAS 94/126 N. v/ FEI, p. 8).
25. The Panel comes to a different conclusion with regard to the suspension of an athlete from future competition. The so-called "strict liability" rule, i.e. a rule as advocated by the Respondent according to which the mere presence of a prohibited substance in an athlete's body justifies his suspension, does not, in the Panel's opinion, sufficiently respect the athlete's right of personality ("*Persönlichkeitsrecht*") as established in Articles 20 and 27 et seq. of the Swiss Civil Code which CAS panels are required to apply (Art. 58 of the Code of Sports-related Arbitration). In fact, under Swiss law also sporting federations are under a duty to respect the framework established by Articles 20 and 27 et seq. Swiss Civil Code (BADDELEY M., *L'association sportive face au droit*, Basel et al. 1994, p. 227).
26. As a preliminary remark the Panel wishes to clarify that the legal relations between an athlete and a federation are of a civil nature and do not leave room for the application of principles of criminal law. This is particularly true for the principles of *in dubio pro reo* and *nulla poena sine culpa* and the presumption of innocence as enshrined in Art. 6 ECHR (Swiss Federal Tribunal, ASA Bull. 1993, p. 398, 409 et seq. [G. v/ FEI] and Swiss Federal Tribunal judgment of March

- 31, 1999 [5P. 83/1999], unreported, p. 12; see also BADDELEY M., op. cit., p. 220; SCHERRER U., in: FRITZWEILER J. (ed), *Doping-Sanktionen, Beweise, Ansprüche*, Bern et al. 2000, p. 119, 127).
27. When deciding whether a "strict liability" rule is proper under Swiss law, the Panel has to weigh the interests of the federation against those of the athlete, in particular his right of personality (see BADDELEY M., op. cit., p. 239).
  28. In recent times the fight against doping has become sport's most burning problem. At times, public attention and, in particular, that of the media is focused more on whether the athletes are under the influence of doping substances than on the sporting event itself and its results. This development is a very serious threat to the entire sporting movement and, indirectly, to an industry which accounts for an important percentage of the world economy.
  29. It is obvious that it would be an important weapon in the fight against doping if the federations were able to impose sanctions on athletes who have tested positive, without having to establish any element of guilt on the part of the athlete. However, this argument, which is one of prevention and deterrence, loses sight of the general objective of doping sanctions, namely the punishment of the athlete for having violated the rules (BADDELEY M., op. cit., p. 219).
  30. On the other hand, it has to be recognised that in professional sport doping sanctions have the effect of restraining the athlete from carrying out his chosen trade and thus from earning a living for a certain period of time. In addition, doping sanctions clearly affect the honour and social standing of the athlete concerned and are a stigma on his future.
  31. When weighing up the interests of both sides the Panel is of the view that the interests of the athlete take precedence over those of the federation to enforce a rule of "strict liability". The contrary view would only be acceptable if a strict liability rule were the only meaningful weapon in the fight against doping. (see BADDELEY M., in: FRITZWEILER J. (ed), op. cit., p. 9, 22; SCHERRER U., op. cit., p. 119, 127; see also CAS 95/142 L. v/ FINA, Digest, p. 225, 231). As will be shown below, there are other means, in particular when allocating the burden of proof, to ensure an effective fight against doping without accepting the risk of sanctioning an athlete who is not guilty of an offence or whose level of guilt does not justify the full extent of the sanction.
  32. The Panel further notes that in a recent decision the Court of Appeals of Frankfurt/Main, Germany also held that liability without fault was incompatible with the rights of the athlete and German law (OLG Frankfurt/Main, judgment of May 18, 2000, 13W29/00 [B. v/ DLV] p. 15).
  33. Having established the principle that the suspension of an athlete for a doping offence requires fault on his/her part, this does not, in the Panel's view, mean that it is for the federation to provide full proof of every element of the offence, as is necessary in respect of a criminal act for which a presumption of innocence operates in favour of the accused. There is



no doubt that the federation has to establish and – if contested – to prove the objective elements of the offence, in particular, for example, that the sample was taken properly, that there was a complete chain of custody of the sample on its way to the laboratory and that the analysis of the sample was state-of-the-art. This follows from the general rule that a person who alleges a fact has the burden of proof (CAS 98/208 N., J., Y., W. v/ FINA, Digest II, p. 247; CAS 99/A/234 & CAS 99/A/235 M.M. & M. v/ FINA, award of February 29, 2000, p. 14).

34. However, it would put a definite end to any meaningful fight against doping if the federations were required to prove the necessary subjective elements of the offence, i.e. intent or negligence on the part of the athlete (CAS 95/141 C. v/ FINA, Digest, p. 215, 220; CAS 98/214 B. v/ FIJ, Digest II, p. 318 et seq.). In fact, since neither the federation nor the CAS has the means of conducting its own investigation or of compelling witnesses to give evidence, means which are available to the public prosecutor in criminal proceedings, it would be all too simple for an athlete to deny any intent or negligence and to simply state that he/she has no idea how the prohibited substance arrived in his/her system (see CAS 96/156 F. v/ FINA).
35. For this reason the Panel believes that, with regard to the subjective elements of a doping offence, when weighing the interests of the federation to combat doping and those of the athlete not to be punished without fault, the scales tip in favour of the fight against doping. In fact, doping only happens in the sphere of the athlete: he/she is in control of his/her body, of what he/she eats and drinks, of who has access to his/her nutrition, of what medication he/she takes, etc. In these circumstances it is appropriate to presume that the athlete has knowingly or at least negligently consumed the substance which has led to the positive doping test (see also: BADDELEY M., *op. cit.*, p. 243; BELOFF M., *Drugs, Laws and Versapaks*, in O'LEARY J. (ed.), *Drugs and Doping in Sport*, London 2000, p. 39, 49; STEINER U., *Doping aus verfassungsrechtlicher Sicht*, in RÖHRICHT/VIEWEG (eds.), *Doping Forum*, Stuttgart et al. 2000, p. 125, 134; BADDELEY M., in: FRITZWEILER (ed.), *op. cit.*, p. 9, 22).
36. Therefore, if the federation is able to establish the objective elements of a doping offence, there is a presumption of guilt against the athlete.
37. The principle of presumed fault on the part of the athlete does not, however, leave him without protection because he/she has the right to rebut the presumption, i.e. to establish that the presence of the prohibited substance in his/her body was not due to any intent or negligence on his/her part (CAS 95/141 C. v/ FINA, Digest, p. 215, 220 et seq.; CAS 98/214 B. v/ FIJ, Digest II, p. 319). The athlete may for example provide evidence that the presence of the forbidden substance is the result of an act of malicious intent by a third party (CAS 91/56 S. v/ FEI, Digest, p. 93, 97; CAS 92/63 G. v/ FEI, Digest, p. 115, 121; CAS 92/73 N. v/ FEI, Digest, p. 153, 157).
38. It is noteworthy that the Swiss Federal Tribunal has accepted an interpretation of doping rules to the effect that it is admissible to presume an athlete's guilt if he/she has been tested positive for a prohibited substance. The athlete is then accorded the opportunity to rebut the

presumption (Swiss Federal Tribunal, Digest, p. 561, 575 [G. v/ FEI]; Swiss Federal Tribunal, 5P.83/1999 [W., C., Z., W. v/ FINA], p. 12).

39. The principle of presumption of guilt and rebuttal thereof by the athlete has also been applied by several CAS decisions, not only with respect of the rules of the FEI which expressly provide for a presumption of guilt, but also in connection with regulations which appear to follow a system of liability without fault (see CAS 91/56 S. v/ FEI, Digest, p. 93, 95; CAS 92/63 G. v/ FEI, p. 115, 120; CAS 92/73 N. v/ FEI, Digest, p. 153, 157; CAS 92/86 W. v/ FEI, Digest, p. 161, 163; CAS 98/204 R. v/ FEI, p. 8; CAS 91/53 G. v/ FEI, Digest, p. 79, 87; see especially: CAS 95/141 C. v/ FINA, Digest, p. 215, 220; CAS 96/156 F. v/ FINA, p. 40 et seq.; CAS 98/214 B. v/ FIJ, Digest II, p. 319; CAS 99/A/252 FCLP v/ IWF, p. 22 et seq.; CAS 2000/A/309 R. v/ RLVB, p. 5). On the other hand, the Panel is conscious of the fact that there have been CAS decisions where the Panel was prepared to apply a strict liability standard with respect to suspensions and was not willing to take into account the subjective elements of the case in questions (see: CAS 98/208 N., J., Y., W.. v/ FINA, Digest II, p. 25; CAS 98/222 B. v/ ITU, Digest II, p. 336-337; see also: CAS 95/150 V. v/ FINA, Digest, p. 265, 272). However, it should be noted that all these decisions took account of the level of "guilt" on the part of the athlete when establishing the duration of the suspension. It can also be taken from these awards that their reasoning was often based on arguments invoked to justify a simple disqualification. They did not consider the very purpose of suspensions as opposed to a mere disqualification and the differences between them. For these reasons the Panel is not prepared to follow these decisions.
40. The Panel recognises that the opinions of the courts and legal authorities differ as to whether the reversal of the burden of proof puts too much burden on the athlete. As an example the OLG Frankfurt in its decision of 18 May 2000 (see above) is in favour of a rule pursuant to which the presence of a prohibited substance in an athlete's body provides prima facie evidence of guilt on the part of the athlete; this leaves the athlete with the burden of proving that, in his/her particular case, the facts were different from the normal sequence of events. In many cases the practical results of both scenarios – a reversal of the burden of proof or the rebuttal of prima facie evidence – will be the same, but the Panel does recognise that the burden on the athlete is slightly less in the latter case. The Panel does, however, believe that, as a matter of principle, the reversal of the burden of proof and thus the burden being on the athlete to provide full proof of the absence of intent or negligence, is adequate and appropriate when weighing the interests of both sides.

In the case in hand, in which none of the objective elements of the offence is in dispute, the Appellant is thus presumed to have intentionally or negligently committed the offence.

41. As has been shown above, the burden is on the Appellant to prove that he is not guilty of a doping offence. To this end, the Panel took the testimony of several witnesses proffered by the Appellant.
42. It is the opinion of the Panel that the Appellant has not succeeded in proving that he was without fault.

43. The Appellant contends that he was not aware that Pyrovate 500 contained a substance which was the source of his positive doping test in Sydney.
44. In fact, the Panel accepts, in the Appellant's favour, that he did not intentionally take a prohibited substance, in other words, that he did not know that Pyrovate 500 contained precursors of nandrolone. The Panel further assumes, in the Appellant's favour, that his use of Pyrovate 500 was in fact the cause for his positive doping test in Sydney.
45. However, the Panel is of the opinion that under the circumstances the Appellant acted negligently when he took Pyrovate 500 without making certain that it did not contain a prohibited substance.
46. As a general remark, the Panel observes that the sporting world has, for quite some time even before the 2000 Sydney Games, been well aware of the risks in connection with using so called nutritional supplements, i.e. the risk that they may be contaminated or, in fact, "spiked" with anabolic steroids without this being declared on the labels of the containers. There have been several cases of positive tests for nandrolone which have been attributed to nutritional supplements and which have been widely publicised in the sports press. This fact was the likely motive for the IOC press releases in October 1999 and February 2000 which give an unequivocal warning about the use of imported and unlicensed nutritional supplements and their possible mislabelling.
47. Under these circumstances it is certainly not a valid excuse for an athlete to contend that he/she – personally – was not aware of these warnings. In fact, athletes are presumed to have knowledge of information which is in the public domain. In this context, the Panel notes that there is CAS case law to the effect that athletes are themselves solely responsible for, inter alia, the medication they take and that even a medical prescription from a doctor is no excuse for the athlete (CAS 92/73, N. v/ FEI, Digest, p. 153, 158). Furthermore an athlete cannot exculpate himself/herself by simply stating that the container of the particular product taken by him/her did not specify that it contained a prohibited substance. It is obvious that the sale of nutritional supplements, many of which are available over the internet and thus sold without an effective governmental control, would go down dramatically if they properly declared that they contain (or could contain) substances prohibited under the rules governing certain sports. Therefore, to allow athletes the excuse that a nutritional supplement was mislabelled would provide an additional incentive for the producers to continue that practice. In summary, therefore, it is no excuse for an athlete found with a prohibited substance in his/her body that he/she checked the label on the product he took and that the label did not specify that the product contained a prohibited substance.
48. The Panel can leave open the question whether a "doped athlete" can be sanctioned on the basis alone that he/she knew (or is presumed to have known) the risk involved in taking nutritional supplements which may contain a prohibited substance not declared on the label. In the case in hand there are additional elements which establish negligence on the Appellant's part:

49. In his statement before this Panel the Appellant admitted that during his training camp before the Olympic Games he had been informed that a weightlifter had tested positive for nandrolone and that nutritional supplements were suspected to be the cause of his positive test. At that point in time at the very latest the Appellant should have ceased taking a nutritional supplement which, it should be noted, was not prescribed to him by a medical doctor but was supplied by his "sponsor", a wholesaler of health products with a direct economic interest in marketing (and testing) these products in the sports world.
50. The rules and regulations of the Respondent (and of the IOC) provide for a two-year sanction in the case of a positive doping test for nandrolone. Even though it is well established that a two-year suspension for a first time doping offence is legally acceptable, there are several CAS decisions according to which a sanction may not be disproportionate and must always reflect the extent of the athlete's guilt (CAS 95/141 C. v/ FINA, Digest, p 215, 222; CAS 92/73 N. v/ FEI, Digest, p. 153, 159; CAS 96/156 F. v/ FINA, p. 48). Therefore, this Panel in its capacity as an appeals body enjoys the same discretion in fixing the extent of the sanction as the Respondent's internal instances (Art. 26.5 of the FILA Doping Regulations, see above). In fact, the Panel would enjoy this discretion even if there were no "exceptional attenuating circumstances".
51. When taking into consideration all the elements of this case, in particular the fact that the Appellant acted negligently but without intent to indulge in doping, the Panel is of the view that, based on the evidence produced, there are mitigating circumstances which warrant a reduction of the maximum penalty allowed under the rules and regulations of the Respondent. As a result, the Panel is of the opinion that it is adequate and appropriate to suspend the Appellant for 15 months. As regards the date upon which the suspension should begin, the Panel takes note of the fact that the sanction imposed by the Respondent started to run on the date the test was carried out (27 September 2000). The Panel sees no reason why it should change this date. Therefore, the Appellant's suspension will last until 26 December 2001.

#### **The Court of Arbitration for Sport rules:**

1. The appeal filed by A. on 3 January 2001 is partially upheld.
2. The decision of the FILA Sport Judge of 24 October 2000 shall be modified as follows:  
A. is suspended for a period of 15 months from 27 September 2000 to 26 December 2001.
3. (...).

**CLA-012**

# Federazione Italiana Nuoto (FIN) v Fédération Internationale de Natation Amateur (FINA), Award, CAS Case No. 1996/A/157, 23 April 1997

The Federazione Italiana Nuoto (hereinafter "FIN" or the appellant) whose seat is in Rome/ITA, is a member of the Fédération Internationale de Natation Amateur (FINA) and of the Ligue Européenne de Natation (LEN). The FINA, whose seat is in Lausanne/CH, is the international body governing Water Polo.

In July 1995, the Italian National Junior Team took part at the VIII Junior Men's World Water Polo Championships in Dunkerque/FRA. During these championships, the Italian team played against the Croatian team on July 27, 1995. Croatia won the match 8-7.

Certain incidents occurred immediately at the end of the match. As described by FIN these incidents were minor in nature: the Croatian [page "351"](#) players, still in the water, assaulted one Italian player, then other Italian players moved to the referee's table.

According to the FINA, a fight took place between players of both teams which began among players still in the pool. Then players from the benches, and, in particular, players from the Italian bench, joined in the fight.

Both departments of the incident concurred in stating that the coaches of the Croatian team dived into the water to separate the players. The referee's report of July 27, 1995 states that coaches of both teams intervened to calm down the players and make them leave the pool. The incident was then ended and no one suffered injury.

The Technical Water Polo Committee ("TWPC"), one of the Standing Committees of FINA, established its Report of the incident the following:

*Immediately after the match won by Croatia 9-8 an incident occurred which resulted in violence in the water and players leaving the benches of both teams and entering the water to join the fighting. The altercation occurred in front of the Croatian bench: the Italian players swimming and running the length of the pool. Coaches left the Croatian bench and entered the water in an attempt to stop the altercation. The players were then separated and the coaches shook hands, the altercation ending.*

On the morning of July 28, 1995, the TWPC met and considered the incident. It decided to apply the "Interim Guidelines for Disciplinary Action in Water Polo" to this case. These Interim Guidelines were approved by the FINA Bureau in March 1995 and were to be presented in the Extraordinary Water Polo Congress 1996.

In its report, the TWPC stresses the fact that copies of the Interim Guidelines had been specifically provided to each team at the technical meeting immediately before the beginning of the Junior World Water Polo Championships, adding that the TWPC Honorary Secretary had advised all teams to read them and to be aware of the harshness of the sanctions involved.

As a result of the violence following the match, the TWPC members unanimously decided to exclude both the Italian and the Croatian teams from the World Championships in Dunkerque on the basis of art. 5 of the Interim Guidelines.

The application of this provision entailed not only the exclusion of both teams from the event but also a suspension for the next FINA Event, in this case the IX Junior World Water Polo Championships. However, after hearing the referees of the match and the members of [page "352"](#) the TWPC present at the match, the TWPC considered that the Italian team was the instigator of the incident and that the Croatian team was "essentially".

Thus, in application of art. 7 of the Interim Guidelines the TWPC decided to recommend to the FINA Bureau that "the team of Italy not be allowed to participate in the IX Junior World Water Polo Championships but that the team from Croatia be allowed to if it qualifies." The report does not mention the result of the vote.

## Organization

- › Court of Arbitration for Sport

## Arbitrators/Judges

- › John Faylor, President
- › Massimo Cocchia
- › François Carrard

## Case date

- › 23 April 1997

## Case number

- › CAS Case No. 1996/A/157

## Parties

- › Claimant: Federazione Italiana Nuoto (FIN)
- › Respondent: Fédération Internationale de Natation Amateur (FINA)

## Key words

- › Disciplinary incident after a water polo match at the Junior World Championships
- › Suspension of one team from the next Junior World Championships
- › Absence of individual sanctions

## Source

- › **Federazione Italiana Nuoto (FIN) v Fédération Internationale de Natation Amateur (FINA), Award, CAS Case No. 1996/A/157, 23 April 1997** in Matthieu Reeb (ed) Digest of CAS Awards 1986-1998. Digest of CAS Awards Series Set Volume 1 (© Kluwer Law International, Kluwer Law International 1998) pp. 351-360.

In conclusion, the TWPC noted that *"its ability to identify the instigators either as individuals or as teams of the incident is limited by the prohibition on viewing videotape evidence and by the fact that many players had removed their hats"*

Finally, the TWPC served a written decision on both teams involved, pronouncing the exclusion from the 1995 Junior World Water Polo Championships. The decision is dated July 28, 1995 and does not mention the exclusion of the Italian team from participation in the next Junior World Water Polo Championships.

On the afternoon of July 28, 1995, the teams of Croatia and Italy submitted written appeals challenging the decision to exclude them from the event. In the evening, a Jury of Appeals composed of the Bureau Lausanne chairs and the members of the TWPC, rejected the appeals and upheld the decision pronounced in the morning.


After the end of the World Championships, the file of the FIN was forwarded to the FINA Bureau. The FINA Bureau summoned the FIN to a hearing which took place in Bern on February 9, 1996. On August 3, 1996, the FINA Bureau decided to confirm the suspension of the Italian Junior Water Polo team from the IX Men's World Water Polo Championships to be held in 1997. The decision was not fed to the FIN on August 8, 1996.

On September 6, 1996, the FIN lodged an appeal with the CAS against the decision of the FINA Bureau.

The appellant requests relief from the decision of the FINA Bureau as follows: *"The Italian Swimming Federation herewith demands the revocation of the decision of the FINA Bureau so that the Italian Junior Men's Water Polo Team may take part in the IX Junior Men's Water Polo World Championships"*.

 [page "353"](#)

#### **In Law**

1. According to art. C 10.5.3 of the FINA Rules, *"An appeal against a decision by the Bureau shall be referred to the Court of Arbitration for Sport (CAS) in Lausanne Switzerland within the same term as in C 10 5 2"* that is to say not later than one month after the member or individual has received the sanction.
2. The FINA Bureau decision is dated August 3, 1996. It was notified to the appellant on August 8, 1996. FIN filed its appeal with the CAS on September 6, 1996 and is thus within the time limit laid down by the FINA Constitution. Moreover, it complies with the requirements as to form stipulated in articles R48 and R51 of the Code of Sports related Arbitration (the Code). The appeal is therefore admissible.
3. Art. R47 of the Code provides that: *"a party may appeal from the decision of a disciplinary tribunal or similar body of a federation association or sports body insofar as the statutes or regulations of the said body so provide or as the parties have concluded a specific arbitration agreement and insofar as the appellant has exhausted the legal remedies available to him prior to the appeal in accordance with the statutes or regulations of the said sports body"*
4. Art. C 10.5.3 of the FINA Rules, quoted above, explicitly provides that the CAS is competent to hear appeals. This provision applies to a "Member of FINA", as well as an "Individual" (art. C 10.5.1 of FINA Rules). The "Member" is clearly defined as being the national body governing swimming (art. C 5.1 of FINA Rules). FIN is such a national body governing swimming and is a member of the FINA; consequently, art. C 10.5.3 applies to it. Moreover, all the judicial remedies granted by the FINA Constitution had been exhausted prior to the appeal to the CAS. We, therefore, conclude that the conditions laid down by art. R47 of the Code are met, and that the competence of the CAS must be accepted in this case.
5. In conformity with art. R58 of the Code, *"the Panel shall decide the dispute according to the applicable regulations and the rules of law chosen by the parties or in the absence of such a choice according to the law of the country in which the federation association or sports body is domiciled"* The FINA Rules contained in the "FINA Handbook", in force for the period 1994 to 1996, are thus applicable in this case, in the same manner as Swiss law. FIN indeed has its headquarters  [page "354"](#) in Lausanne, and the parties did not agree to apply the law of any other country.
6. The applicable procedure in this case is the appeal arbitration procedure stipulated under R47 ff. of the Code.

7. As expressly requested by the parties, the Panel agreed to waive the oral hearing and to rule on the basis of the written submissions.
8. The decision by the TWPC to exclude the teams of Italy and Croatia from the 1995 World Junior Water Polo Championships dated July 28, 1995 and is worded as follows:

*As a result of the incidents occurring at the end of the match Italy/Croatia, won by Croatia 9/8 the TWPC has applied paragraph 5 of the 'Interim Guidelines for Disciplinary Action in Water-Polo' which were approved by the FINA Bureau and were circulated to all teams at the beginning of the competition*

*Accordingly the teams of both Italy and Croatia are immediately ejected from the 1995 World Junior Water-Polo Championships.*

*As a result the schedule of matches for the last 2 days will be re-adjusted by deleting Italy and Croatia from the rankings of Groups A, B, and a teams will be not fed.*

9. The report and the decision of the TWPC refer to art. 5 and 7 of the Interim Guidelines which state:

**Art. 5.** *If the disciplinary incident involves any bench players of any team that team or teams will be immediately ejected from the event in question. Additionally that country will not be entitled to participate in the next FINA Event involving that team. For example if the team is a junior team it will be the next junior men's FINA Event. Likewise if it is a senior women's team it will be the next senior women's FINA Event*

**Art. 7.** *The FINA TWPC shall impose or recommend as the case may be action in accordance with these 'Interim Guidelines' provided that if extenuating circumstances dictate it shall be entitled to impose or recommend as the case may be a lesser sanction by a two-thirds majority vote*

Furthermore, art. 9 states that "A FINA Event shall mean the World Championships (senior and junior) the World Cups Olympic Games Olympic Games Qualification Tournaments and the Olympic Year Women's Tournament "

10. The decision confirming the suspension of the Italian Junior Team from the next Junior World Championships was taken by the FINA [page "355"](#) Bureau on August 3, 1996. The notification of the decision to FINA dated August 8, 1996 contains no statement of grounds but announces the following:

*At the meeting held in Atlanta on 3 August 1996 the FINA Bureau considered the appeal presented by the Italian Swimming Federation against the decision to suspend the Italian junior men's water polo team from the IX Junior Men's Water Polo World Championships to be held in Havana (CUB) in 1997*

*Please be informed that the FINA Bureau rejected the appeal*

11. In its Appeal Brief, the appellant considers that the incident which occurred during the game Italy - Croatia of "July 27, 1995" was not a real fight but only "movement in the water" and did not constitute a serious act of violence or brutality. Although the appellant does not challenge the application of a specific rule and has no objection regarding the proceedings before the authorities of FINA, it criticizes the harshness of the sanction. The FINA believes that the Italian Junior Team was a ready punishment enough with the immediate exclusion from the World Championships in Dunkerque. The appellant also asserts that the sanction will not affect the protagonists of the incident but other athletes who were absolutely not involved in this case and adds that, as a consequence of this, the sanction will have no educative effects on the athletes responsible for the aforesaid facts.



12. For its part, the respondent considers that the decision of the FINA Bureau is a correct application of the rules. In particular, it understands that it was clearly correct to apply only the art. 5 of the Interim Guidelines, taking into account the absence of extenuating circumstances for the Italian team which might have justified the application of the art. 7 of the Interim Guidelines.
13. The parties differ in their description of the facts. In particular, they do not share the same opinion about the gravity of the incident. Accordingly, the Panel chooses to rely on the facts reported by the TWPC, which refers to the referees' reports on the game.
14. On the basis of the referees' reports, the Panel considers as established the fact that several Italian and Croatian players in the water began fighting, that other players from both teams left the benches and jumped into the water to join the fight. These versions confirmed in the aforementioned reports, confirmed by FINA in its answer and not denied by the appellant in its Appeal Brief ("*while the other [page "356" Italian players were leaving the water [...] Finally almost the majority of both teams were in the water]*")
15. Given these facts, the validity of the decision challenged must be examined in the light of the applicable rules. The incident occurred during the Junior Men's World Water Polo Championship in 1995. Thus, the FINA Rules contained in the FINA Handbook 1994-1996 are applicable. The Junior Men's World Water Polo Championships are conducted by FINA (art. GR 12 of the Rules). According to the FINA Constitution, the FINA Bureau shall decide on and publish regulations for FINA events (art. C 14.11.6 of the Rules). In March 1995, the FINA Bureau approved the Interim Guidelines for Disciplinary Action in Water Polo and decided to present them in the Extraordinary Water Polo Congress 1996. Consequently, these Interim Guidelines were in force during the World Championships in Dunkerque and each team taking part in this competition was informed of these new regulations.
16. In view of the evidence presented to it, the Panel holds that the incident between the Italian and Croatian players constitutes a disciplinary incident involving bench players. Thus, the Panel holds that the TWPC was correct in applying art. 5 of the Interim Guidelines and, as a consequence, was justified in excluding both teams from the event. Pursuant to this provision, the countries sanctioned are automatically suspended from participating in the next Junior World Championships, except if the TWPC imposes or recommends a lesser sanction (art. 7 of the Interim Guidelines).
17. In the present case, the TWPC decided to recommend to the FINA Bureau that the Croatian team be entitled to participate in the next FINA event, notwithstanding. However, the TWPC did not find the same extenuating circumstances with regard to the Italian team. The TWPC properly exercised the authority granted to it in the Interim Guidelines to evaluate and to decide upon such facts which it has established. As a result, the Panel has no grounds upon which to raise objection.
18. The Panel also notes that the decision challenged does not violate the procedural rules provided by the Interim Guidelines, namely:

*1 The initial decision of the TWPC shall be made by the members of the TWPC present at the tournament whether they were present at the match or not*

(...)

 *page "357"*

*3 Sanctions shall be immediately imposed upon the decision of the FINA TWPC or FINA Bureau if present In the case of a decision by the FINA TWPC an appeal shall lie to the Bureau but in the interim the decision of the FINA TWPC shall stand*

19. Since 1996, the Interim Guidelines have been definitively adopted by the competent authorities of FINA and are now entitled "Regulations for Disciplinary Actions in Water Polo at FINA Events". These regulations are not merely the same as the former Interim Guidelines. In particular, the art. 5 of the new regulations is drafted as follows:

*5 If the disciplinary incident involves any bench players of any team that team or teams will be immediately ejected from the event in question. Additionally it may be recommended to the FINA Bureau to exclude the team(s) from the next FINA event relevant for the team(s)*

20. Even if the wording of the art. 5 of these new regulations is different from that of the art. 5 of the former Interim Guidelines, the Panel notes that the application of the new regulations would not have resulted in a different decision for the appellant. In its Report to the FINA Bureau, the TWPC expressly recommended to the Bureau that the team of Italy not be allowed to participate in the IX Jun or World Water Polo Championships, but that the team from Croatia be allowed to be so, if they qualify. Acting upon this recommendation, the FINA Bureau ejected both teams from further games of the 1995 World Jun or Water Polo Championships and barred the appellant from participating in the IX Jun or Men's Water Polo World Championships to be held in Havana in 1997. This decision was confirmed on appeal of FIN on August 3, 1996.
21. The appellant asserts that the sanction is not fair and appropriate punishment in light of the significance of the incident and that it will have no educative effects on the "personnel" involved in the fight. The athletes who are and who will ultimately be punished by the sanction are not the actors in the incident which took place on July 27, 1995, but rather on other athletes who have nothing to do with the present case.
22. It is the holding of the Panel that it can intervene in the sanction imposed only if the rules adopted by the FINA Bureau are contrary to the general principles of law, if the application is arbitrary, or if [page "358"](#) the sanctions provided by the rules can be deemed excessive or unfair on the face. To the extent the properly-constituted deciding body of the federation acts within the limits of the rules which have been validly laid down, it is the opinion of the Panel that the CAS cannot reopen an examination of the decision on the issue whether the measure of the sanctions imposed is fair and appropriate in light of the facts which the deciding body has established. It is the deciding body of the federation which is in the best position to decide which rules and which sanctions are fair and appropriate in light of the facts constituting the violation.
23. In the present case, the Panel holds that the sanction imposed by FINA on the appellant, although not provided of a thoroughly written motivation, is not subject to review or objection. In particular, the Panel wishes to point out that the decision challenged has indeed an educative purpose and effect vis-à-vis the FIN. It will encourage those in charge of the 1997 Italian Jun or Team (i.e. the coaches) to forewarn and educate the players that brutality will be met with swift and certain punishment similar to that which occurred during the 1995 Jun or Men's World Water Polo Championships held in Dunkerque.
24. It is indeed to be regretted that the players involved in the brutality which followed the Italian-Croatian match are not subject to individual punishment. It is these players who may now be permitted, despite their reprehensible conduct during the match in July 1995, to participate in the 1997 World Championships, not as members of the Jun or Water Polo Team, but rather as members of senior teams. In a general way, the Panel believes that the national federations should review the rules to determine whether provisions may not be adopted, on the individual level, to punish individual players for aggressive and violent conduct during play. Sanctions imposed on individual players would also contribute to combatting violence in water polo. However, the Panel observes that this solution will not be easy to apply, taking into account the decision of the FINA not to accept videotape evidence.

25. In conclusion, the Panel considers that the Interim Guidelines applicable to the 1995 Junior Men's World Water Polo Championships have been properly and validly enforced and that the sanction imposed is neither contrary to the general principles of law, as argued by the appellant, nor is it arbitrary, excessive or unfair in light of the [page "359"](#) facts as established through available evidence. Accordingly, the appeal by FINA shall be dismissed.

***The Court of Arbitration for Sport pronounces:***

1. The appeal by Federazione Italiana Nuoto of September 6, 1996 against the decision of August 3, 1996 taken by the FINA Bureau is dismissed;
2. (...) [page "360"](#)

© 2015 Kluwer Law International BV (All rights reserved)

Kluwer Arbitration is made available for personal use only. All contents protected by copyright and other intellectual property laws. No part of this service or the information contained herein may be reproduced or transmitted in any form or by any means or used for advertising or promotional purposes, general distribution, creating new collective works or for resale without prior written permission of the publisher.

If you would like to know more about this service visit [www.kluwerarbitration.com](http://www.kluwerarbitration.com) or contact our Sales staff at [sales@kluwerlaw.com](mailto:sales@kluwerlaw.com) or call +31 (0)172 64 1562

**CLA-013**

**F I N A L**

**A W A R D**

**F I N A L**

**A W A R D**

**IN THE MATTER OF AN UNCITRAL ARBITRATION**

between

**Ronald S. Lauder**

757 Fifth Avenue

Suite 4200

New York, New York 10153

United States of America

and

**The Czech Republic**

Letenská 15

118 10 Prague 1

The Czech Republic

The Claimant

The Respondent

*represented by:*

John S. Kierman, W. Friedman

and M. Ostrove

Debevoise & Plimpton

875 Third Avenue

New York, New York 10022

United States of America

*represented by :*

Vladimir Petrus and

Miroslav Dubovsky

Clifford Chance Pünder

Charles Bridge Centre

Krizovnicke Nam. 2

110 00 Prague 1

Czech Republic

and

Mr. Jeremy Carver CBE

Mr. Audley Sheppard

Clifford Chance

200 Aldersgate Street

GB-London EC1A 4JJ

## 1. Introduction

1. In 1989, the Czech and Slovak people overthrew the communist regime and adopted a democratic governance system embracing market economy. New laws had to be adopted, foreign investment was encouraged.
2. Various Bilateral Investment Treaties were concluded to create the necessary legal protection for new investments, among them the Treaty between the United States of America and the Czech and Slovak Federal Republic Concerning the Reciprocal Encouragement and Protection of Investment, entered into on 22 October 1991 (the Treaty).
3. On 30 October 1991, a new Act on Operating Radio and Television Broadcasting (the Media Law) was adopted. It provided for the creation of the Council of the Czech Republic for Radio and Television Broadcasting (the Media Council) to ensure the observance of the Media Law, the development of plurality in broadcasting, and the development of domestic and European audio-visual work. The Media Council was also competent to grant operating licences.
4. In 1992, the Media Council commenced the necessary licensing procedures for nationwide private television broadcasting, and, on 9 February 1993, it granted License No 001/1993 to Central European Television 21, CET 21 spol. s r.o. (hereafter „CET 21“), a company founded by a small number of Czech citizens.
5. During the license application proceedings, CET 21 had worked closely with a foreign group, Central European Development Corporation GmbH (hereafter “CEDC”), in which Mr. Ronald S. Lauder (hereafter the “Claimant” or “Mr. Lauder”), an American citizen, had an important interest. At that time and since then, Mr. Lauder has among other activities been an important player in the audio-visual media in the former communist States of Central and Eastern Europe.
6. The formula which was finally adopted envisaged the formation of a new joint company, Česká nezávislá televizní společnost , spol. s r.o. (hereafter”CNTS”), with

the participation of CET 21, a Czech bank and, as a majority shareholder, a company representing the foreign investors.

7. The key person was Dr. Vladimír Železný, a Czech citizen with a long experience in the media field, also a scriptwriter, etc. Mr. Železný became at the same time what amounted to the Chief Operating Officer of both CET 21 and CNTS. The new television station, TV Nova, immediately became very popular and very profitable.
8. The successful venture came to an end in 1999 when CNTS, on April 19, fired Mr. Železný from his functions with CNTS and when CET 21, on 5 August 1999, terminated its contractual relations with CNTS, after CNTS, on 4 August 4 1999, had not submitted the so-called Daily Log regarding the broadcasting for the following day.
9. During all this period the Media Council of the Czech Republic played an important role, especially during three periods. First, at the end of 1992 and the beginning of 1993, when it granted the License. Then, at the end of 1995 and in 1996, when a new Media Law became effective and the Media Council commenced administrative proceedings against CNTS, whereupon the agreements between CNTS and CET 21 were modified. Finally, during the Spring and Summer of 1999, when the final breach between CET 21 and CNTS occurred.
10. On 19 August 1999, Mr. Lauder commenced arbitration proceedings against the Czech Republic (hereafter the “Defendant”) under the Treaty, claiming that the Czech Republic, through its Media Council, had violated the Treaty. This Award examines the claims brought forward by Mr. Lauder.

## 2. Procedural History

11. On 19 August 1999, Ronald S. Lauder initiated these arbitration proceedings by giving Notice of Arbitration to the Czech Republic. The Notice submitted that the dispute is subject to arbitration pursuant to Articles VI(2) and (3) of the Treaty and should be



heard by a panel of three arbitrators pursuant to Article 5 of the UNCITRAL Rules. The Notice of Arbitration also stated that the Czech Republic had consented to submit the dispute to arbitration pursuant to Article VI(3)(b) of the Treaty. The Claimant sought the following relief:

*“[An] order [to] the Czech Republic to take such actions as are necessary to restore the contractual and legal rights associated with the claimant’s investments. Among other things, the Czech Republic should:*

- a) be ordered to impose conditions on the License that adequately reflect and secure CNTS's exclusive right to provide broadcast services and its right to obtain all corresponding income in connection with the operation of TV Nova;*
- b) be required to enforce such conditions, including by revoking the License and reissuing it to CNTS or to such other entity and under such other circumstances as would restore the initial economic underpinnings of Mr. Lauder’s investment; and*
- c) be held liable for the damages Mr. Lauder has incurred to date, in an amount to be determined by the Tribunal, taking into account, among other factors, the fair market value of Mr. Lauder’s investment prior to the breaches of the Treaty”.*

12. The Claimant appointed Mr. Lloyd N. Cutler as co-arbitrator. The Respondent appointed Mr. Bohuslav Klein as co-arbitrator. Both co-arbitrators chose Mr. Robert Briner as Chairman of the Arbitral Tribunal.
13. On 5 November 1999, the Arbitral Tribunal issued Procedural Order No 1 provisionally fixing Geneva, Switzerland, as the place of arbitration, and determining English as the language of arbitration.
14. On 13 December 1999, the Arbitral Tribunal issued Procedural Order No 2 taking note of the agreement of the Parties proposing London as the place of arbitration.
15. On 31 January 2000, the Czech Republic submitted a Statement of Defence in which it requested that reference to arbitration by Mr. Lauder be dismissed on the grounds that the Arbitral Tribunal has no jurisdiction over the claim; and/or no investment dispute contemplated by the Treaty exists; and/or Mr. Lauder’s Notice of Arbitration was premature or otherwise formally defective.

16. On 17 March 2000, a Procedural Hearing was held in London. The Arbitral Tribunal (i) decided that the issue of jurisdiction would be joined to the merits and that no separate decision on jurisdiction would be taken unless the Arbitral Tribunal would hold that a separate determination would shorten the proceedings; (ii) took note of the agreement of the Parties that they would make good faith efforts to agree by 30 April 2000 on a solution to the issue of the scope and timing of the production of documents required from the Respondent; (iii) took note of the agreement of the Parties that in general the IBA Rules on the Taking of Evidence in International Commercial Arbitration would be used; (iv) took note of the agreement of the Parties on the schedule for the submission of further briefs; (v) considered that a bifurcation of liability and remedy would not be helpful; (vi) took note of the agreement of the Parties with respect to the issues of confidentiality of the proceedings; (vii) took note of the absence of an agreement between the Parties to consolidate or coordinate the parallel UNCITRAL arbitration between CME and the Czech Republic; and (viii) addressed some other minor issues.
17. On 10 May 2000, the Claimant sent a letter to the Arbitral Tribunal regarding the production of further documents. The 14 March 2000 Declaration of Mr. Richard Bačėk was attached to this letter.
18. On 17 May 2000, the Arbitral Tribunal issued Procedural Order No 3 pursuant to which the Respondent was given a time limit until 23 May 2000 to answer the Claimant's request for production of further documents.
19. On 31 May 2000, after receipt of the Claimant's letter of 10 May 2000 requesting the production of further files, documents, minutes and other records in the possession of the Media Council, and of the Respondent's letter of 23 May 2000 requesting that the application be rejected, the Arbitral Tribunal issued Procedural Order No 4 rejecting the Claimant's request for production of further documents on the ground that it first needed to receive the Claimant's Memorial and the Respondent's Response.
20. On 30 June 2000, the Claimant filed his Memorial of Claimant. The following Witness Declarations were made in support of the Memorial:

- 29 June 2000 Declaration of Michel Delloye
- 29 June 2000 Declaration of Fred T. Klinkhammer
- 30 June 2000 Supplemental Declaration of Richard Baček
- 30 June 2000 Declaration of Laura DeBruce
- 30 June 2000 Declaration of Martin Radvan
- 30 June 2000 Declaration of Jan Vávra

21. On 16 October 2000, the Respondent filed its Response. The following Witness Declarations were made in support of the Response:

- 13 October 2000 Statement of Doc. Ing. Pavel Mertlík CSc
- 16 October 2000 Statement of Josef Josefík
- 16 October 2000 Statement of RNDR. Josef Musil
- 16 October 2000 Statement of PhDr. Helena Havíková

22. On 6 November 2000, the Arbitral Tribunal issued Procedural Order No 5 inviting the Respondent to respond by 10 November 2000 to the renewed request of the Claimant that the Respondent be ordered to produce documents and material identified in the Supplemental Statement in Support of the Claimant's Request for Documents of 30 June 2000.

23. On 13 November 2000, the Arbitral Tribunal issued Procedural Order No 6 inviting the Claimant to respond by 16 November 2000 to the letter of the Respondent of 10 November 2000.

24. On 17 November 2000, the Arbitral Tribunal issued Procedural Order No 7 pursuant to which it decided that the Claimant's request for production of general categories of documents was inappropriate, but that the Respondent was ordered to submit to the Claimant and to the Arbitral Tribunal copies of those documents which the Claimant had previously been able to inspect but had not been allowed to copy.

25. On 8 December 2000, the Claimant filed his Reply Memorial. The following Witness Declarations were made in support of this Reply Memorial:

- 14 November 2000 Declaration of Jacob Z. Schuster

- 5 December 2000 Supplemental Declaration of Jan Vávra
  - 5 December 2000 Statement of Ing. Jiří Brož
  - 5 December 2000 Declaration of OhDr Marína Landová
  - 7 December 2000 Declaration of Leonard M. Fertig
  - 7 December 2000 Declaration of Nicholas G. Trollope
  - 8 December 2000 Supplemental Declaration of Laura DeBruce
  - 8 December 2000 Supplemental Declaration of Fred T. Klinkhammer
  - 8 December Supplemental Declaration of Martin Radvan
  - 21 December 2000 Declaration of Ing. Miroslav Pýcha
26. On 31 January 2001, the Respondent filed its Sur-Reply. The following Witness Declarations were made in support of this Reply Memorial:
- 19 February 2001 Second Statement of Josef Josefík
  - 20 February 2001 Statement of Mgr. Milan Jakobec
27. On 19 February 2001, the Arbitral Tribunal issued Procedural Order No 8 in which the Respondent's Requests No 1 for an order for the Claimant to provide certain documents was denied; the Respondent's Request No 2, repeating the Request No 1 and asking in addition that Mr. Morgan-Jones be subpoenaed was denied; the Claimant's request that the Respondent be directed to cease its review of certain stolen and confidential documentation was denied; and the Respondent's Request No3 to submit pleadings, submission and evidence which had been submitted in other proceedings between other parties was denied.
28. On 20 February 2001, the Claimant filed the following additional Witness Declarations:
- 20 February 2001 Second Supplemental Declaration by Laura DeBruce
  - 20 February 2001 Supplemental Declaration of Jacob Z. Schuster
  - 20 February 2001 Declaration of Ira T. Wender
29. From 5 March to 13 March 2001, the Arbitral Tribunal held hearings in London. The Claimant presented the following witnesses:
- Mrs. Marina Landová

- Mr. Jan Vávra
- Mr. Martin Radvan
- Mrs. Laura DeBruce
- Mr. Leonard M. Fertig
- Mr. Fred T. Klinkhammer
- Mr. Michael Delloye

The Respondent presented the following witnesses:

- Mr. Josef Josefík
- Mr. Milan Jakobec
- Mrs. Helena Havlíková
- Mr. Josef Musil

Two witnesses, Mr. Jiří Brož and Mr. Josef Musil, did not attend the hearings. It was agreed by the Parties on 13 March 2001 that the Arbitral Tribunal would give these witnesses' recorded statements the weight the Tribunal believes to be appropriate (Transcript of 13 March 2001, p. 225-226).

On 13 March 2001, the Chairman declared that the proceedings were closed subject to the Parties' filing of their Written Closing Submissions by 30 March 2001 and their Replies by 6 April 2001, as well as the Parties' filing of their Statement of Costs and Expenses as agreed between the Parties (Transcript of 13 March 2001, p, 230-232).

30. On 30 March 2001, the Claimant filed a Summary of Summation, and the Respondent filed a Written Closing Submissions.
31. On 6 April 2001, the Claimant filed a Rebuttal to the Respondent's Written Closing Submission and the Respondent a Reply Written Closing Submissions.
32. On 17 April 2001, the Claimant filed a Statement of Costs, and the Respondent a Summary of the Costs.

33. On 19 April 2001 the Respondent filed an Amended Summary of Costs to include costs incurred between 1 April and 6 April 2001 and the advance on costs paid to the Tribunal. In this exchange, the Respondent also provided Comments on Costs of the Claimant.
34. On 18 June 2001, the Respondent, referring to an agreement of the Parties, asked for permission to submit pages from the transcript of the hearing held in Stockholm in the arbitration between CME and the Czech Republic (the Stockholm Hearing).
35. On 21 June 2001, the Claimant confirmed his agreement with respect to the submission of excerpts from the transcript of the Stockholm Hearing.
36. On 25 June 2001, the Arbitral Tribunal agreed that each Party may submit (i) by 3 July 2001 a maximum of 25 pages of excerpts from the Stockholm Hearing, together with a short brief not exceeding 10 pages, and (ii) by 10 July 2001 rebuttals not exceeding 5 pages.
37. On 3 July 2001, the Claimant filed Comments on Selected Excerpts from Testimony in Stockholm Proceedings and the Respondent a letter concerning submission of parts of the record from the Stockholm Hearing.
38. On 10 July 2001, both Parties filed their Replies to Submission of the other Party of 3 July 2001.
39. On 12 July 2001, the Respondent filed a larger excerpt of Mr. Klinkhammer's statements at the Stockholm hearing.
40. On 19 July 2001 the Claimant submitted, as proposed by the Respondent, a further excerpt from Mr. Klinkhammer's testimony.
41. The sole remaining dispute regarding discovery was with respect to specific communications (e-mails) from the Media Council, which the Respondent wanted the Claimant to provide along with the name of the person who had provided said communications to the Claimant (see Respondent's Request No 1 of 30 January 2001),

which request the Arbitral Tribunal had denied in Procedural Order No 8. On 1 March 2001, the Respondent declared that it accepted to participate in the arbitration under protest and reserved all its rights with respect to the denial of its request. At the 13 March 2001 hearing, the Chairman stated that the Respondent had not pointed out during the hearing that there was anything which would have impeded presentation of its defence but that due note was taken of the Respondent's reservation thereon (Transcript of hearing of 13 March 2001, p 232-233).

42. In the course of the proceedings, the Claimant withdrew his two first reliefs (see 1.1(a) and 1.1 (b) above), and maintained the relief for damages (see 1.1 (c)) above; Transcript of 5 March 2001, p. 57-58). The final relief sought by the Claimant is an award:

*(1) Declaring that Respondent has violated the following provisions of the Treaty:*

- a. The obligation of fair and equitable treatment of investments (Article II(2)(a));*
- b. The obligation to provide full protection and security to investments (Article II(2)(a));*
- c. The obligation to treat investments at least in conformity with principles of international law (Article II(2)(a));*
- d. The obligation not to impair investments by arbitrary and discriminatory measures (Article II(2)(b)); and*
- e. The obligation not to expropriate investments directly or indirectly through measures tantamount to expropriation (Article III);*

*(2) Declaring that Claimant is entitled to damages for the injury that he has suffered as a result of Respondent's violations of the Treaty, in an amount to be determined at a second phase of this arbitration; and*

*(3) Directing Respondent to pay the costs Claimant has incurred in these proceedings to date, including the costs for legal representation and assistance (Relief Sought By Claimant of 10 March 2001).*

43. The final relief sought by the Respondent is an award that:

- (1) *Mr. Lauder's claim be dismissed on grounds of lack of jurisdiction, namely (i) no "investment dispute" as contemplated by the Treaty exists; and/or (ii) Mr. Lauder's Notice was premature or otherwise formally defective.*
- (2) *And/or Mr. Lauder's claim be dismissed on grounds of lack of admissibility, namely it is an abuse of process*
- (3) *And/or Mr. Lauder's claim be dismissed on grounds that the Czech Republic did not violate the following provisions of the Treaty as alleged (or at all):-*
  - (a) *The obligation of fair and equitable treatment of investments (Article II(2)(a)).*
  - (b) *The obligation to provide full protection and security to investments (Article II(2)(a)).*
  - (c) *The obligation to treat investments at least in conformity with principles of international law (Article II(2) (a)).*
  - (d) *The obligation not to impair investments by arbitrary and discriminatory measures (Article II(2)(b)).*
  - (e) *The obligation not to impair investments directly or indirectly through measures tantamount to expropriation (Article III).*
- (4) *And/or Mr. Lauder's claim be dismissed and/or Mr. Lauder is not entitled to damages, on ground that the alleged injury to Mr. Lauder's investment was not the direct and foreseeable result of any violation of the Treaty.*
- (5) *And Mr. Lauder pay the costs of the proceedings and reimburse the reasonable legal and other cost of the Czech Republic (Relief Sought by the Czech Republic of 13 March 2001).*



### 3. Facts

#### 3.1 The 1992-1993 events

43. On 30 October 1991, the Czech and Slovak Federal Republic adopted the Act on Operating Radio and Television Broadcasting (hereinafter: the “Media Law”). The Media Law empowered the Federal Council for Radio and Television Broadcasting (hereinafter: “the Media Council”) to grant a license to broadcast radio and television programs (Exhibit R2).
44. Pursuant to the Act on the Czech Republic Council for Radio and Television Broadcasting of 21 February 1992, one of the duties of the Media Council is to supervise the observance of legal regulations governing radio and television broadcasting (Exhibit R6).
45. In 1992, the Media Council invited interested candidates to apply for a license for a new radio and television broadcasting on the third channel (hereinafter: “the License”) (Exhibit R53).
46. On 27 August 1992, CET 21, a Czech company originally owned by some individuals (hereinafter: “the Founders”), and whose General Director was Mr. Železný, a Czech citizen, filed an application for the License (Exhibit C63).
47. Prior to the filing of the application, CET 21 had held discussions with the CEDC, a German company over which Mr. Ronald S. Lauder (hereinafter: “Mr. Lauder” or “the Claimant”), an American citizen, had indirect voting control.
48. The original idea was that CEDC would participate in the broadcasting operation by acquiring stock of CET 21 (Exhibit C134). Such a participation would comply with the requirements of the Media Law, which expressly envisaged in Article 10.6 the applications for license *“from companies with foreign equity participation”* (Exhibit R2).

49. On 31 August 1992, CEDC and the Founders of CET 21 agreed on a draft document named "Terms of Agreement". This document provided that CEDC would invest a sum of at least USD 10,000,000 in the establishment of a commercial television station in Prague "*through an equity investment in CET21*" in the form of redeemable "*preferred stock or equivalent equal to 49% ownership of CET 21*" and of "*an equal amount of common stock*". The Founders would be entitled to 2% of CET 21 each, i.e. 14% in total. The remaining 37% of CET 21 would be held by the Founders in reserve for additional investors (Exhibit C139).
50. On 28 September 1992, CET 21 prepared a document named "Project of an Independent Television Station". This document stated that CEDC "*is a direct participant in CET21's application for the license*" (Exhibit C9).
51. On 21 December 1992, the Media Council held preliminary hearings for the granting of the License. Messrs. Mark Palmer, President of CEDC, and Len Fertig, then consultant with CEDC, were present at the portion of the hearings on CET 21's application. The record of this portion of the hearings, drafted by the Media Council, speaks of "*extensive share reserved for foreign capital*" and "*direct capital share, not credit*". It also states that "*they [CEDC] see themselves as a predominantly passive investor, we want a station independent of foreign influence and political influence*" (Exhibit R58).
52. On 5 January 1993, CEDC and the Founders of CET 21 signed a document named "Terms of Agreement". This document provided for the same participation of CEDC in CET 21 as the above mentioned draft agreement dated 31 August 1992, i.e. 49% of redeemable preferred stock and of common stock (Exhibit C61).
53. The same day, the Media Council held a hearing which was attended by Messrs. Palmer, Fertig and Železný. The participants addressed the issues of other possible partners besides CEDC in the CET 21 investments, mainly Česká spořitelna, a.s., the Czech Savings Bank (hereinafter: "CSB"), the scope of CEDC's investments in the project, and the programming (Exhibit C141).

54. On 22 January 1993, the Media Council held further preliminary hearings. The record of the portion of the hearings on CET 21 expressly referred to CEDC. It stated that *“the participation of foreign capital is expected”* and *“the combination of domestic and foreign capital is important, necessity of safeguard - diversification of the investments sources”* (Exhibit C64).
55. On 30 January 1993, the Media Council held a session on the issuance of the License. It was decided that CET 21 was awarded the License. The following statements were made by some members of the Media Council at this session: *“(...) it is very significant that this is a business which can not be financed only by credit”* (Mr. Brož); *“considers the Czech and foreign capital in CET 21 positive”* (Mr. Brož); *“positive in that there is a stabilisation factor, as far as foreign capital and its involvement is concerned”* (Mr. Pýcha) (Exhibit R54).
56. The same day, the Media Council issued a press release announcing that CET 21 had been awarded the License. The press release stated that *“A direct participant in the application is the international corporation CEDC (...)”* (Exhibit C11).
57. The same day, the Media Council sent a letter to CET 21 informing them of its decision on the award of the License. This document also referred to *“(...) a direct party to the application being the international corporation CEDC (...)”* (Exhibit R9).
58. The Media Council’s decision to award the License to CET 21 raised strong opposition, mainly from the political party ODS. The ODS blamed the Media Council for having hastily chosen a company, CET 21, whose representatives were bankrupt politicians and in which foreign capital prevailed (Exhibits R83, C144, and C145).
59. On 3 February 1993, CET 21 and CEDC submitted to the Media Council a document named *“Overall Structure of a New Czech Commercial Television Entity”*. This document stated that CET 21 and CEDC would jointly create a new Czech company, which would have the exclusive use of the License *“(...) as long as CET 21 and CEDC have such a license”*. The shareholders of the new company would be CET 21, CEDC and CSB, the last two of them providing the necessary funds (Exhibits C14 and C149).

60. At the oral request of Mr. Jakobec, director of the Programming and Monitoring Section of the Media Council, the above mentioned document of 3 February 1993, was significantly modified, mainly to reflect the fact that the License would be granted to CET 21 only, and not to CET 21 and CEDC jointly. The modified document was issued on 5 February 1993 (Exhibit C150; declaration of Mrs. Landová of 5 December 2000, p. 8).
61. The same day, the Media Council held a meeting to which representatives of CET 21 were invited. The latter submitted to the Media Council the modified version of the above mentioned document named "Overall Structure of a New Czech Commercial Television Entity" (Exhibit R55).
62. On 9 February 1993, CET 21 issued a document stating that its general assembly, which had met the previous day, approved the conditions of the Media Council for the legal confirmation of the License (Exhibit R78).
63. The same day, the Media Council rendered the decision to award the License to CET 21. This decision referred to CEDC as CET 21's "*contractual partner*" (Exhibits R10 and C16).
64. The same day, the Media Council issued the License for a period of 12 years, expiring on 30 January 2005. The Appendix to the License set forth 31 conditions (hereinafter: "the Conditions") that CET 21 had to observe. Condition 17 required among other matters that CET 21, CEDC and CSB submit a business agreement to the Media Council for approval within 90 days (Exhibit R5).
65. The same day, CET 21 accepted without reservation the License, including the Conditions (Exhibits R11 and R77).
66. The same day, CSB confirmed its intention to participate in the broadcasting company to be set up together with CET 21 and CEDC (Exhibit R81).
67. On 8 April 1993, Mr. Železný acquired a 16.66% participation in CET 21.

68. On 21 April 1993, after having held several sessions to discuss the draft business agreements between CET 21, CEDC and CSB, and after having had several contacts in this matter with the representatives of these companies, the Media Council issued a letter approving the last version of the business agreement (Exhibit C19).
69. On 4 May 1993, CET 21, CEDC and CSB signed the final version of the business agreement, named “Memorandum of Association and Investment Agreement” (hereinafter: “the MOA”). The MOA provided for the formation of the CNTS, a Czech company which would manage the television station. CEDC would contribute 75% of CNTS’s capital and obtain a 66% ownership interest (Article 1.4.3), CSB would contribute 25% of the capital and obtain a 22% ownership interest (Article 1.4.2). and CET 21 would contribute “*the right to use, benefit from, and maintain the License (...) on an unconditional, irrevocable and exclusive basis*” and obtain a 12% ownership interest (Article 1.4.1) (Exhibit R12).
70. On 12 May 1993, the Media Council rendered a decision amending and clarifying the License issued on 9 February 1993. The main amendment regarded Condition 17, which stated that the MOA was “*an integral part of the license terms*” (Exhibit C20).
71. On 8 July 1993, CNTS was incorporated in the Commercial Register administered by the District Court for Prague (Exhibit C89).
72. Mr. Železný was appointed General Director of the company.
73. CNTS then launched a television station named TV Nova, which soon became very successful.

### **3.2 The 1994-1997 events**

74. On 12 May 1994, the Czech Parliament’s Committee for Science, Education, Culture, Youth, and Physical Training PSP issued a statement that the Media Council had allowed television broadcasting by an unauthorized entity, i.e. CNTS.

75. In an undated opinion, the Media Council answered that CET 21 was the holder of the License, and CNTS was authorized by the former to perform all acts related to the development and operation of TV Nova. However, the License *“as such has not been contributed to CNTS and is separate from all other activities of CNTS”*. The Media Council added that, after having consulted *“with a number of leading legal experts, both Czech and foreign”*, this *“standard business procedure”* was discussed and approved, and did not violate any effective legal regulations (Exhibit C21).
76. On 4 July 1994, CNTS and CSB acquired 1.25% each of CET 21’s stock (Exhibit R107). As a result, the participation in CET 21 was as follows:
- Mr. Železný: 16,66%
  - The remaining Founders: 80.84%
  - CEDC: 1.25%
  - CSB: 1.25%.
77. On 28 July 1994, CEDC assigned all its capital interest in CNTS to CME Media Entreprises B.V. (hereinafter: “CME”), a Dutch company over which the Claimant also exercised control (Exhibit C128).
78. In the summer of 1994, the Czech Parliament replaced some members of the Media Council.
79. On 8 December 1995, the Czech Parliament amended the Media Law, effective 1 January 1996. Among the most relevant modification was the deletion of Article 12(3) of the original Media Law, which stated that *“In addition to conditions stated in paragraph 2, the decision to grant a license also includes conditions which the license-granting body will set for the broadcasting operator”*. The Media Law in Article 3 also contained a much narrower definition of the term “broadcaster” as the person to whom a license had been granted (see also the memorandum of Mrs. DeBruce of CME of 15 May 1996; Exhibit C111) (Exhibit R3).

80. On 2 January 1996, CET 21 applied to the Media Council for the cancellation of most of the Conditions set in the License (Exhibit R31).
81. On 18 January 1996, the Media Council asked the District Court for Prague 1, acting as authority for the Commercial Register, to re-examine CET 21's and CNTS's registrations and to submit a report thereon, being noted that such request had already been made on 2 February 1995, and was later repeated on 11 April 1996 (Exhibits R30, R32 and R33).
82. On 12 February 1996, the Media Council requested Mr. Bárta, at the State and Law Institute of the Academy of Science of the Czech Republic, to provide an expert opinion on CNTS's authority to operate television broadcasting (Exhibit C27).
83. On 19 February 1996, Mr. Bárta issued the requested expert opinion on the letterhead of the State and Law Institute of the Academy of Science of the Czech Republic. Based on the assumption that television broadcasting of TV Nova was operated by CNTS, the author came to the conclusion that administrative proceedings could be initiated to impose a fine for unauthorized broadcasting against CNTS. In addition, the Media Council could decide to cancel the License of CET 21 (Exhibit R14).
84. On 13 March 1996, a meeting was held between the Media Council and CET 21. Several issues were discussed, among them the relationship between CET 21 and CNTS regarding the operation of television broadcasting. The Media Council was concerned with the fact that CNTS was operating television broadcasting without being the holder - or the co-holder - of the License. Mr. Železný, acting on behalf of CET 21, argued that the current situation had been approved by the Media Council. At the Media Council's request, it was eventually agreed that a contract on the provision of performances and services between CET 21 and CNTS would be drafted and further discussed. It was also agreed that CET 21 would not require, in its application for cancellation of license conditions dated 2 January 1996, the cancellation of Condition 17. The application for cancellation of this specific condition would be the subject of further administrative proceedings (Exhibit C84).
85. On 21 March 1996, CET 21 applied for cancellation of Condition 17 (Exhibit R62).

86. At some time in April 1996 and as requested at the meeting of 13 March CET 21 and CNTS submitted to the Media Council two draft agreements setting forth their legal relationships (Exhibit R15).
87. On 2 May 1996, the State and Law Institute of the Academy of Science of the Czech Republic provided the Media Council with a legal opinion on the two above mentioned draft agreements between CET 21 and CNTS. It concluded that the situation of CET 21 was correctly resolved, the key point being that CET 21, and not CNTS, actually operated broadcasting on its own account (Exhibit R16).
88. On 15 May 1996, CME expressed its concern to Messrs. Železný and Fertig with respect to the contemplated changes to the MOA resulting from the above mentioned draft agreements. CME specifically referred to CET 21's envisaged power to withdraw CNTS's use of the License if CNTS allegedly breached the agreement (Exhibit C111).
89. On 23 May 1996, after two additional meetings between the Media Council and CET 21 (Exhibits R105 and C85), CNTS and CET 21 entered into a new agreement (hereinafter: "the May 1996 Agreement") setting forth their legal relationships. The Agreement stated in preamble that the MOA was not changed. In substance, it set forth that CET 21 was the holder of the License and the operator of television broadcasting, that the License was non-transferable, and was not the subject of a contribution from CET 21 to CNTS. CNTS's role was to arrange the television broadcasting (Exhibit R17).
90. On 4 June 1996, the Media Council informed CET 21 that the latter had breached the License by failing to timely announce changes in the registered capital, in the signing process, and in the company's registered office. It directed CET 21 and CNTS to change their registrations with the Commercial Registry, in particular to modify CNTS's business activity with respect to "*television broadcasting*" (Exhibit R95).
91. In June 1996, the Supreme State Attorney Office requested the Media Council to enable it to consult the files relating to the issue of the License to CET 21 and to CNTS's rights as the administrator of TV Nova. On this occasion, the Media Council



was informed that criminal investigations were pending with respect to CET 21's and CNTS's rights to administer TV Nova (Exhibit R89).

92. On 28 and 29 June 1996, the Media Council held a meeting during which it decided to cancel most of the Conditions to the License. The cancellation of Condition 17 was postponed in light of the court proceedings with respect to the registration in the Commercial Registry and the criminal investigation (Exhibit R56).
93. On 17 July 1996, CME purchased the 22% interest in CNTS held by CSB for a consideration in excess of USD 36,000,000 (declaration of Mrs. DeBruce of 30 June 2000, p. 5; declaration of Mr. Radvan of 30 June 2000, p. 5). As a result, CME held 88% of CNTS's stock, and CET 21 maintained its participation of 12% in CNTS.
94. On 22 July 1996, as its previous requests of 2 February 1995, 18 January and 11 April 1996, had been ignored, the Media Council asked the Regional Commercial Court in Prague to start proceedings on compliance of CET 21's and CNTS's registrations in the Commercial Register (Exhibit R36).
95. On 26 July 1996, the Media Council issued a decision regarding the cancellation of most of the Conditions to the License, as per its above mentioned meeting of 28 and 29 June (Exhibit R35).
96. The same day, the Media Council issued a decision to interrupt the administrative proceedings with respect to the envisaged cancellation of Condition 17 to the License because of the pending criminal investigation (Exhibit R34).
97. On 23 July 1996, the Media Council decided to commence administrative proceedings against CNTS for operating television broadcasting without authorization. CNTS was informed of said decision the same day (Exhibits R37 and R18).
98. On 1 August 1996, CME and Mr. Železný entered into a loan agreement pursuant to which the former would provide the latter with a loan of USD 4'700'000 for acquiring from the other individual shareholders 47% of CET 21's stock. The agreement provided for Mr. Železný to exercise all his voting rights as directed by CME until full

repayment of the loan (Exhibit R38). As a result, the participation in CET 21 was as follows:

- Mr. Železný: 60%
- The four remaining Founders: 37.5%
- CME: 1.25%
- CSB: 1.25%.

99. The Media Council was not informed of the change in CET 21's ownership.
100. On 13 August 1996, the Institute of the State and Law of the Academy of Sciences of the Czech Republic issued a legal opinion to CNTS pursuant to which the Media Council was obliged to meet CET 21's application to cancel the Conditions to the Licence (Exhibit C28).
101. On 21 August 1996, CET 21 requested the Media Council to cancel Condition 17 to the Licence (Exhibit R63).
102. On 4 October 1996, CET 21 and CNTS made proposals to the Media Council aimed at resolving the differences with respect to the legal relationships between the two companies. CET 21 and CNTS would enter into a new agreement providing that CET 21 is the operator of television broadcasting and is entirely responsible before the Media Council. Both companies would request that their registrations with the Commercial Register be modified. The Media Council, in turn, would continue the administrative proceedings on the cancellation of Condition 17 to the License, and would confirm that the arrangements between the two companies are in compliance with legal regulations. However, there was no mention of the administrative proceedings initiated by the Media Council against CNTS for unauthorized conducting of television broadcasting (Exhibit R19).
103. The same day, CNTS provided the Media Council with its position with respect to the initiation of the administrative proceedings against it. It denied the allegation of unauthorized television broadcasting (Exhibit C26).

104. The same day, CET 21 and CNTS signed an agreement (hereinafter: “the October 1996 Agreement”) specifying their legal relationships as set forth in the amended MOA. The October 1996 Agreement was similar to the May 1996 Agreement. The main difference was in the October 1996 Agreement’s statement that such agreement did not affect CET 21’s exclusive liability for the programming (Exhibit R21).
105. On 6 November 1996, the Media Council’s legal department issued an internal memorandum on the legal aspects of the October 1996 Agreement. It stated that said agreement “undoubtedly reacts to the commencement of administrative proceedings against CNTS for illegal broadcasting with the aim of making it seem that CNTS has not been committing such illegal acts”. The memorandum nevertheless expressed some doubts if the October 1996 Agreement fully achieved this purpose (Exhibit R96).
106. On 14 November 1996, CME issued a memorandum expressing its concern about the contemplated amendment of Article 1.4.1 of the MOA. CME’s main fear was that the draft amendment would allow CET 21 to chose another party to benefit from the License (Exhibit C112).
107. The same day, a meeting was held between CNTS’s shareholders, i.e. CME, CSB and CET 21. Article 1.4.1(a) of the MOA was amended and replaced as follows: “*the Company is granted the unconditional, irrevocable, and exclusive right to use and maintain the know-how and make it the subject of profit to the Company, in connection with the License, its maintenance, and protection*”. In addition CNTS was granted the right to acquire the License from CET 21 “*[i]n the case of change in the legal regulation and in the prevailing interpretation of the legal community*” (Exhibit C59).
108. On 20 November 1996, the Media Council expressed to the Police of the Czech Republic its opinion that none of the Media Council’s members could be criminally liable with respect to CNTS’s alleged illegal television broadcasting (Exhibit R66).
109. On 13 December 1996, the October 1996 Agreement was slightly amended (Exhibit R21).

110. On 17 December 1996, the Media Council decided to cancel Condition 17 to the Licence (Exhibits R57 and C30).
111. In December 1996, CME acquired from CET 21 a 5,2% participation in CNTS for a consideration of about USD 5,300,000. During the same period, the Founders of CET 21 transferred an additional 5,8% interest to Nova Consulting a.s. (hereinafter: “Nova Consulting”), a Czech company owned by Mr. Železný (declaration of Mrs. DeBruce of 30 June 2000, p. 5; declaration of Mr. Radvan of 30 June 2000, p. 5). As a result, the participation in CNTS was as follows:
- CME: 93,2%
  - Nova Consulting: 5,8%
  - The Founders: 1%.
112. On 29 January 1997, the Media Council, which had become aware of the loan agreement between CME and Mr. Železný, held a meeting with CET 21 for the purpose of obtaining information thereon from Mr. Železný (Exhibit R123).
113. On 5 February 1997, the October 1996 Agreement was amended to replace all previous agreements between CET 21 and CNTS with respect to their legal relationships (see Exhibit R21).
114. On 12 February 1997, CNTS’s registration in the Commercial Registry was modified as to delete, under the company’s business, the sentence “*operating television broadcasting under license no. 001/93*” (Exhibit R25).
115. On 21 April 1997, Mr. Radvan, counsel for CME, issued an affidavit stating that the loan agreement between CME and Mr. Železný had been terminated pursuant to an agreement entered into by the parties on 24 February 1997 (Exhibit C91).
116. On 15 May 1997, the criminal investigation against CNTS for alleged illegal operation of television broadcasting was suspended (Exhibit R25).
117. On 21 May 1997, CNTS and CET 21 entered into an agreement named “Contract on cooperation in ensuring service for television broadcasting,” together with a

supplement to this agreement (hereinafter: “the 1997 Agreement”), replacing all previous agreements between the parties. The 1997 Agreement confirmed that CET 21 was the holder of the License and the operator of television broadcasting and had the exclusive responsibility for programming. CNTS had the exclusive rights and obligations to arrange services for television broadcasting (Exhibits C29 and R22).

118. The same day, CME transferred all its interests in CNTS to CME Czech Republic B.V. (hereinafter: also “CME”), a Dutch company, for a consideration of USD 52,723,613 (Exhibit C130).
119. On 1 July 1997, the Czech Parliament passed the Act on the Czech Republic Council for Radio and Television Broadcasting, which represented a consolidated version of the statute (Exhibit R7).
120. In August 1997, CME purchased Nova Consulting, which owned a 5.8% participation in CNTS, from Mr. Železný for a consideration of USD 28,500,000. As a result, CME held 99% of CNTS’s stock and the founders of CET 21 were left with a 1% participation in CNTS (declaration of Mrs. DeBruce of 30 June 2000, p. 5; declaration of Mr. Radvan of 30 June 2000, p. 5).
121. On 16 September 1997, the Media Council decided to stop the administrative proceedings against CNTS for illegal operation of television broadcasting. The Media Council’s main reasoning was that CNTS had *“removed the inadequacies”* by modifying its registration with the Commercial Registry and by proceeding to *“amendments to the contractual relationship”* with CET 21 (Exhibit R25).

### **3.3 The 1998-2000 events**

122. On 31 January 1998, the Media Council issued its 1997 Report to the Czech Parliament. The report contained a long statement of the Media Council’s relationship with CNTS and CET 21. The Media Council explained that the legal relationship set up at the time the License was granted complied with the law as it then was in force

and the Conditions to the License, mainly Conditions 17 and 18 had been issued in accordance with the Law. When the Media Law was amended and provided for the cancellation of all the Conditions, the Media Council protested on the ground that it *"practically lost every possibility of checking on CNTS and its relationship to CET21. (...) The situation changed fundamentally when the amendment of the broadcasting law became effective. The licensing conditions that in principle guaranteed the legal character of the existing links between the license holder and the servicing firms were annulled and the Council had to solve the issue about how to attend, in the newly formed situation, to the sharp loosening up of the regulatory possibilities. The Council had an expertise made concerning the related issues and on the basis of it, initiated gradually negotiations with the affected Companies and opened up administrative proceedings in the subject of unauthorized broadcasting (...)"*. CET 21 and CNTS took the necessary steps to carry out the necessary adjustments, by changing their registrations in the Commercial Registry and the agreements setting forth their legal relationships. These actions led to the termination of the administrative proceedings for unauthorized television broadcasting. However, the Media Council's decision was not unanimous (5 in favor, 3 against and 1 abstention), and even reflected *"the big difference of opinions over this case"* (Exhibit C12).

123. On 21 June 1998, Mr. Radvan, counsel for CME, had lunch with Mrs. Hulová, Vice Chairman of the Media Council. According to Mr. Radvan, Mrs. Hulová said during lunch that CNTS had become *"the target for a group of disgruntled persons"* (Exhibit R102).
124. On 1 July 1998, the Media Council informed CET 21 that it was opening administrative proceedings against the latter to revoke the License on the ground that the television station was not providing information *"in an objective and balanced manner"* (Exhibit R124).
125. On 17 November 1998, the Media Council decided to stop the above mentioned administrative proceedings against CET 21, due to the fact that appropriate actions had been taken (Exhibit R125).

126. On 15 December 1998, CME and CET 21 amended the MOA so that all prior changes were incorporated (Exhibit C60).
127. On 24 February 1999, a Meeting of the Board of Representatives of CNTS took place during which the relationships between CET 21 and CME were discussed. The Minutes of the meeting indicate that Mr. Železný reported that at least one member of the Media Council had claimed that the actual situation contravened the law, and that *"the Council wants to change its original decision and to write a letter with the statement that the present relationship between CET 21 and CNTS is not correct"*. Mr. Železný asserted that in his view, which he claimed was confirmed by his lawyers, the 1997 Agreement was not exclusive and CET 21 could request any services then provided by CNTS from any other company. He informed CNTS that, based on this assertion, CET 21 would hire another advertising agency. He added that, *"in case he would be asked"*, he would resign from his function of executive as well as General Director of CNTS. He stated that *"his proposal was an ultimatum, which meant that CME could either accept or not"* (Exhibit C31).
128. On 2 March 1999, the Media Council held a meeting to which Mr. Železný was invited. According to the Minutes, CME's alleged financial difficulties were discussed. Mr. Železný, acting on behalf of CET 21, asked the Media Council to repeat some of its previous statements about exclusivity and the withdrawal of the License *"in relation to all steps within the logic of the development of the relationships between CET and the Council"*. It was then stated that *"[I]f Zelezny wants to affect the interests of CNTS, he will need to be supported by a formal or informal letter"* (Exhibit R97).
129. On 3 March 1999, Mr. Železný, on the letterhead of CET 21, sent a letter to the Media Council requesting that the latter issue an opinion defining the relationship between CET 21 and CNTS, to be used by CET 21 *"for discussions with our contractual partners"*. The opinion was to assert that *"[r]elations between the operator of broadcasting [CET 21] and its service organisations must be established on an nonexclusive basis"*. CET 21 *"should order services from service organizations at regular prices so as to respect rules of equal competition. (...) the licensed subject must have the ability to select relevant services anytime and anywhere at will"* (Exhibit C33).

130. On 15 March 1999, the Media Council issued a letter to CET 21 laying out, *inter alia*, the non-exclusive basis of the relations between the operator of broadcasting and the service organizations, the operator's responsibility for structuring and composing the program, and the allocation to the operator of the revenues from advertising (Exhibit C34).
131. In March 1999, CME set up an action plan to deal with the tense situation with CET 21 (Exhibit R132).
132. On 19 April 1999, Mr. Železný was dismissed from his position as General Director and Chief Executive of CNTS (Exhibit C68).
133. On 24 June 1999, CNTS requested the Media Council to give its position or to take measures aimed at resolving the current dispute between CNTS, CME and CET 21, resulting, among other reasons, from CET 21 entering into contracts with third parties, which "*were granted rights to trade benefits from the License*" (Exhibit C39).
134. On 28 June 1999, after CNTS had positioned two commercial spots into television broadcasting despite CET 21's disapproval, the Regional Commercial Court in Prague rendered a preliminary measure ordering CNTS to refrain from any interference with television broadcasting operated by CET 21 (Exhibit C13).
135. On 13 July 1999, in the context of the Media Council's opinion to the Permanent Media Commission of the Parliament of the Czech Republic, CNTS provided the Media Council with an analysis of its legal relationship with CET 21 (Exhibit C40).
136. On 26 July 1999, the Media Council sent a letter to CNTS calling it to stop its media campaign in connection with its dispute with CET 21. CNTS was also to inform the Media Council on the steps taken to minimize the risks described in its opinion to the above-mentioned Commission, mainly the risks of breaches of the Media Law, and on the actions taken to come to a final settlement of the dispute. Enclosed with this letter were Sections 7 and 8 of the Media Council's opinion to the Permanent Media Committee with respect to the dispute between CET 21 and CNTS (Exhibit C44).



137. On 2 August 1999, CNTS and CME sent a letter to the Permanent Media Committee of the House of Representatives of the Parliament of the Czech Republic in response to Sections 7 and 8 of the Media Council's opinion to the Permanent Media Committee, a copy of which had been provided to CNTS with the Media Council's letter of 26 July 1999 (Exhibit C41), raising the question that the acts of the Media Council might constitute violations of the Treaty.
138. On 5 August 1999, Mr. Rozehnal, counsel for CET 21, informed CNTS that CET 21 *"hereby withdraws from the Agreement on Cooperation in Provision of Services for Television Broadcasting, as amended, concluded on May 21, 1997"*. This decision was based on CNTS's failure on 4 August 1999 to submit to CET 21 within the usual deadline the Daily Log, which contains the daily programming, regarding the broadcasting for the following day (Exhibit C35).
139. On 6 August 1999, CNTS filed a request with the Media Council for the withdrawal of the License to CET 21 (Exhibit C42).
140. On 13 August 1999, CNTS informed the Media Council of its willingness to conduct negotiations with CET 21 to resolve their dispute, and requested that CNTS and CME be invited to the Media Council's ordinary session to be held on 17 August 1999 (Exhibit C43).
141. On 16 August 1999, CET 21 sent a letter to CME Ltd. detailing the business relationship between CET 21 and CNTS (Exhibit C13).
142. On 19 August 1999, Mr. Lauder initiated the present arbitration proceedings.
143. Numerous other court and arbitration proceedings opposing CNTS, CME, CET 21, Mr. Lauder and/or Mr. Železný were commenced in the context of the disputes between CNTS, CME and Mr. Lauder, on the one side, and CET 21 and Mr. Železný, on the other side. In particular:
- CME initiated parallel UNCITRAL arbitration proceedings against the Czech Republic on the basis of the bilateral investment treaty between the Netherlands and the Czech Republic;

- CME brought ICC arbitration proceedings against Mr. Železný (Exhibit R46);
- Numerous civil actions were commenced before the Czech courts, most of them opposing CNTS and CET 21 (Exhibit R49).

144. On 19 September 1999, the Media Council issued a written opinion for the Permanent Media Commission of the House of Deputies of the Parliament with respect to the dispute between CET 21 and CNTS. It was qualified as a “*typical commercial dispute*” related to the assessment of the real value of CME in the context of its merger with Scandinavian Broadcasting Services. Generally, this dispute could be identified as an issue of relations between the broadcaster, investors and service organizations, resulting from insufficiently transparent arrangements and leading to a dual broadcasting system. Similar problems were encountered with almost all nationwide broadcasters (Exhibit C68).
145. On 30 September 1999, the Standing Committee for Mass Media of the House of Representatives of the Czech Republic issued a resolution stating its serious dissatisfaction with the work of the Media Council in the context of the dispute between CNTS and CET 21 (Exhibit C108).
146. On 15 November 1999, the Media Council provided the Permanent Commission for the Media of the House of Representatives of the Czech Republic with a supplement to its position on the situation of TV Nova (Exhibit R126).
147. On 21 December 1999, the Media Council rendered a decision pursuant to which CME could be a party to the administrative proceedings regarding changes in the License at CET 21’s request (increase in the registered capital, changes in the participants and values of their capital contributions) (Exhibit C50).
148. As a result of the end of the relationships between CET 21 and CNTS, the latter had to take drastic measures to cut its spending, e.g. to lay off many employees (Exhibit C38).
149. On 4 May 2000, the Regional Commercial Court in Prague decided that CET 21 was obligated to procure all services for television broadcasting exclusively through

CNTS. However, the Court refused to decide that CET 21's withdrawal from the 1997 Agreement was invalid, nor to confirm the existence of CNTS's exclusive right on the basis of the 1997 Agreement (Exhibit C54).

150. On 1 June 2000, CET 21 filed an appeal against the above mentioned judgment with the High Court in Prague (Exhibit C55).
151. On 14 December 2000, the High Court in Prague granted CET 21's appeal and decided that CET 21 was not obligated to procure all services for television broadcasting exclusively through CNTS (Exhibit R134).
152. The case is now pending before the Czech Supreme Court.

#### **4. Jurisdiction and Admissibility**

##### **4.1 Introduction**

153. At various stages of the proceedings, the Respondent challenged the Arbitral Tribunal's jurisdiction on several grounds:
  - a) The Claimant has failed to prove that he owns or controls an investment within the Czech Republic;
  - b) The Claimants claim is not an investment dispute under the Treaty;
  - c) The Claimant already submitted the same dispute to the courts of the Czech Republic and to other arbitral tribunals (Article VI(3)(a) of the Treaty);
  - d) The Claimant may not concurrently pursue the same remedies in different fora;
  - e) The Claimant's claim constitutes an abuse of process;
  - f) The Claimant did not comply with the six-month waiting period (Article VI(2)(a) of the Treaty) (see Statement of Defence, p. 12-13; Response, p. 40-49; Sur-Reply, p. 14-17).
154. In the Written Closing Submissions of 30 March 2001, the Respondent stated that it did not dispute that:

- The Treaty is *prima facie* applicable to events occurring after 19 December 1992;
- Mr. Lauder is a national of the United States;
- CEDC's (and later CME's) shareholding in CNTS is an investment;
- The Claimant's allegations constitute an investment dispute for the purpose of the Treaty;
- For jurisdictional purpose only, the Claimant controlled the investment (see Written Closing Submissions, p. 4-5).

155. The Arbitral Tribunal therefore takes note that the Respondent has withdrawn the two grounds under a) and b) above. The Arbitral Tribunal will therefore only address the four remaining grounds under c), d), e) and f) above.

#### **4.2 The same dispute is submitted to state courts and to other arbitral tribunals**

156. The Respondent argues that Article VI(3)(a) of the Treaty precludes the Arbitral Tribunal from exercising jurisdiction on the ground that the same dispute was submitted to Czech courts and to another arbitral tribunal before the present proceedings were initiated. Those proceedings arise from the same circumstances and seek the same substantive remedy, so that the issue in dispute is the same in all cases. As a result, Mr. Lauder has removed the dispute from any arbitral tribunal under the Treaty (Response, p. 47-48).

157. The Claimant argues that the present proceeding is the only one in which he claims that the Czech Republic violated obligations under the Treaty. Article VI(3)(a) actually sets forth a limited form of the principle of *lis alibi pendens*, whose elements are not met (Reply Memorial, p. 50-62).

158. Article VI(3)(a) of the Treaty reads as follows:

*"(...) Once the national or company concerned has so consented, either party to the dispute may institute such proceeding provided:*

- (i) *the dispute has not been submitted by the national or the company for resolution in accordance with any applicable previously agreed dispute-settlement procedures; and*
- (ii) *the national of company concerned has not brought the dispute before the courts of justice or administrative tribunals or agencies of competent jurisdiction of the Party that is a party to the dispute. (...)*

159. The Arbitral Tribunal considers that the word “dispute” in Article VI(3)(a) of the Treaty has the same meaning as the words “investment dispute” in Article VI(1), which reads as follows:

*“For the purposes of this Article, an investment dispute is defined as a dispute involving (a) the interpretation or application of an investment agreement between a Party and a national or company of the other Party; (b) the interpretation or application of any investment authorization granted by a Party’s foreign investment authority to such national or company; or (c) an alleged breach of any right conferred or created by this Treaty with respect to an investment”.*

160. It is undisputed that the Claimant’s allegations concern an investment dispute under Article VI(1)(c) of the Treaty, i.e. *“an alleged breach of any right conferred or created by this Treaty with respect to an investment”.*

161. The purpose of Article VI(3)(a) of the Treaty is to avoid a situation where the same investment dispute (“the dispute”) is brought by the same the claimant (“the national or the company”) against the same respondent (a Party to the Treaty) for resolution before different arbitral tribunals and/or different state courts of the Party to the Treaty that is also a party to the dispute.

162. The resolution of the investment dispute under the Treaty between Mr. Lauder and the Czech Republic was not brought before any other arbitral tribunal or Czech court before – or after - the present proceedings was initiated. All other arbitration or court proceedings referred to by the Respondent involve different parties, and deal with different disputes.

163. In particular, neither Mr. Lauder nor the Czech Republic is a party to any of the numerous proceedings before the Czech courts, which opposed or are opposing CNTS or the various CME entities, on the one side, and CET 2.1 or Mr. Železný, on the other side. The Respondent has not alleged - let alone shown - that any of these courts would decide the dispute on the basis of the Treaty.
164. The ICC arbitration proceeding was between CME and Mr. Železný, and dealt with the latter's alleged breach of the 11 August 1997 Share Purchase Agreement pursuant to which CME acquired a 5.8% participation in CNTS held by Nova Consulting, a.s., an entity owned by Mr. Železný.
165. The parallel UNCITRAL arbitration proceeding (hereinafter: "the Stockholm Proceedings") is between CME and the Czech Republic, and is based on the bilateral investment treaty between the Netherlands and the Czech Republic.
166. Therefore, the Arbitral Tribunal holds that Article VI(3)(a) of the Treaty does not preclude it from having jurisdiction in the present proceedings.

#### **4.3 The same remedies are sought in different fora**

167. The Respondent argues that, independently of Article VI(3)(a) of the Treaty, the Claimant cannot seek the same remedies in multiple parallel actions.
168. At first the Respondent asserted that if the Claimant chooses to pursue a contractual remedy in the local courts or in an arbitral tribunal, he should not be allowed to concurrently pursue a remedy under the Treaty. The Claimant could indeed not complain of any mistreatment of his investment by the State until that State's courts had finally disposed of the case. In addition, by initiating proceedings under the Treaty, the Claimant deprives the other party to the court proceedings of the opportunity to argue its case before the Treaty tribunal. Here, the existence of multiple proceedings creates a risk of incompatible decisions, a prospect of disorder "*that the principle of lis alibi pendens is designed to avert*" (Response, p. 46-47).

169. Later the Respondent indicated that it was not seeking “*to rely upon technical doctrines of lis alibi pendens or res judicata*”, but on a new “*important issue of principle, not yet tested (...) in previous court or arbitral proceedings*”. The multiplicity of proceedings involving, directly or indirectly, the State “*amounts to an abuse of process*”, in that no court or arbitral tribunal would be in a position to ensure that justice is done and that its authority is effectively upheld. The Respondent added that there is “*an obvious risk of conflicting findings between the two Treaty tribunals*” (Sur-Reply, p. 14-15).
170. The Claimant argues that no principles of *lis alibi pendens* are applicable here. Should such principles apply, it would not deprive the Arbitral Tribunal of jurisdiction, since the other court and arbitration proceedings involve different parties, different claims, and different causes of action. However, if CNTS could obtain any recovery from the Czech courts, this may reduce the amount of damage claimed in the present proceedings (Reply Memorial, p. 50-62).
171. The Arbitral Tribunal considers that the Respondent’s recourse to the principle of *lis alibi pendens* to be of no use, since all the other court and arbitration proceedings involve different parties and different causes of action (see 4.2 above). Therefore, no possibility exists that any other court or arbitral tribunal can render a decision similar to or inconsistent with the award which will be issued by this Arbitral Tribunal, i.e. that the Czech Republic breached or did not breach the Treaty, and is or is not liable for damages towards Mr. Lauder.
172. It is to be noted that the risk of conflicting findings is even less possible since the Claimant withdrew his two reliefs on the imposition of conditions to the License and the enforcement of such conditions, and only maintained its relief for damages. Assuming that the Arbitral Tribunal would decide that the Respondent breached the Treaty and that the Claimant is entitled to damages, such findings could not be contradicted by any other court or arbitral decision. The damages which could be granted in the parallel proceedings could only be based on the breach by CET 21 and/or Mr. Železný of their contractual obligations towards CNTS or any CME entity (decision by Czech courts or the ICC arbitral tribunal) or on the breach by the Czech Republic of its obligations towards CME pursuant to the Dutch/Czech bilateral

investment treaty (decision by the parallel UNICTRAL arbitral tribunal). The only risk, as argued by the Claimant, is that damages be concurrently granted by more than one court or arbitral tribunal, in which case the amount of damages granted by the second deciding court or arbitral tribunal could take this fact into consideration when assessing the final damage.

173. There might exist the possibility of contradictory findings of this Arbitral Tribunal and the one set up to examine the claims of CME against the Czech Republic under the Dutch-Czech Bilateral Investment treaty. Obviously, the claimants in the two proceedings are not identical. However, this Arbitral Tribunal understands that the claim of Mr. Lauder giving rise to the present proceeding was commenced before the claims of CME was raised and, especially, the Respondent itself did not agree to a *de facto* consolidation of the two proceedings by insisting on a different arbitral tribunal to hear CME's case.
174. Finally, there is no abuse of process in the multiplicity of proceedings initiated by Mr. Lauder and the entities he controls. Even assuming that the doctrine of abuse of process could find application here, the Arbitral Tribunal is the only forum with jurisdiction to hear Mr. Lauder's claims based on the Treaty. The existence of numerous parallel proceedings does in no way affect the Arbitral Tribunal's authority and effectiveness, and does not undermine the Parties' rights. On the contrary, the present proceedings are the only place where the Parties' rights under the Treaty can be protected.
175. Therefore, the Arbitral Tribunal holds that the seeking of the same remedies in a different fora does not preclude it from having jurisdiction in the present proceedings.

#### **4.4 The abuse of process**

176. Besides the already addressed issue of alleged abuse of process in connection with the fact that the same remedies are sought in different fora (see 4.3 above), the Respondent argues that the Claimant commits an abuse of process (i) in pursuing his



claim in the present proceedings under the Treaty whereas it is alleged in the parallel arbitration proceedings that CME has a better claim, and (ii) in not disclosing a *prima facie* case that the Respondent has breached the Treaty (Response, p. 48-49).

177. The Arbitral Tribunal does not see any abuse of process by the Claimant's pursuit of his claim in the present proceedings and by CME's pursuit of its claim in the parallel arbitration proceedings. As already stated (see 4.3 above), the claimants and the causes of action are not the same in the two cases. Only this Arbitral Tribunal can decide whether the Czech Republic breached the Treaty towards Mr. Lauder, and only the arbitral tribunal in the parallel Stockholm Proceedings can decide whether the Czech Republic breached the Dutch/Czech bilateral investment treaty in relation to CME. As a result, CME has neither a better - nor a worse - claim in the parallel arbitration proceedings than Mr. Lauder's claim in the present arbitration proceedings. It only has a different claim.
178. It should furthermore be noted that the Respondent refused to allow the constitution of identical arbitral tribunals to hear both treaty cases. If the same tribunal would have been appointed in both cases the procedure could have been co-ordinated with the corresponding reduction in work and time and of cost to the Parties. The possibility of conflicting decisions would also have been greatly reduced.
179. There is also no abuse of process by the Claimant's alleged non-disclosure of a *prima facie* case that the Respondent has breached the Treaty. No such obligation derives from the Treaty or from the UNCITRAL Arbitration Rules. Even less would the absence of such disclosure result in the Arbitral Tribunal lacking jurisdiction. Furthermore, as stated hereunder, the Claimant actually disclosed more than just a *prima facie* case against the Respondent.
180. Therefore, the Arbitral Tribunal holds that there is no abuse of process on the part of the Claimant which would preclude it from having jurisdiction in the present proceedings.

#### 4.5 The six-month waiting period

181. The Respondent argues that the Claimant did not comply with the waiting period set forth in Article VI(3)(a) of the Treaty pursuant to which arbitration can be initiated only six months after the dispute arose. For the purpose of this provision, the dispute arises when the State is advised that a dispute exists. Here, the Czech Republic was first advised of Mr. Lauder's complaints under the Treaty by CNTS's and CME's letter to the Media Committee of the Czech Parliament of 2 August 1999. Therefore, the Notice of Arbitration served only 17 days later is defective, and the Arbitral Tribunal lacks jurisdiction (Statement of Defence, p. 13; Written Closing Submissions, p. 5).
182. The Claimant argues that the Respondent has waived or abandoned this objection by not having advanced it between its Statement of Defence of 31 January 2000 and its Written Closing Submissions of 30 March 2001 (Rebuttal to The Respondent's Written Closing Submission, p. 4-5).
183. Article VI(3)(a) of the Treaty reads as follows:
- "At any time after six months from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by conciliation or binding arbitration (...)"*
184. The Arbitral Tribunal considers that, as stated above with respect to the Respondent's other objection based on Article VI(3)(a) of the Treaty (see 4.2 above), the word "dispute" in the context of the six-month waiting period shall have the same meaning as the words "investment dispute" in Article VI(1), i.e. in this case *"an alleged breach of any right conferred or created by this Treaty with respect to an investment"*.
185. However, the waiting period does not run from the date at which the alleged breach occurred, but from the date at which the State is advised that said breach has occurred. This results from the purpose of the waiting period, which is to allow the parties to enter into good-faith negotiations before initiating arbitration.

186. Here, the Respondent's alleged violations of the Claimant's rights under the Treaty occurred during the period from February 1993, when the License was granted, until 15 March 1999, when the Media Council sent a letter to CET 21 expressing its opinion on the requirements of television broadcasting (see Summary of Summation, p. 1-9). No evidence was, however, put forward that the Czech Republic was advised of said alleged Treaty violations before CNTS's and CME's 2 August 1999 letter to the Media Committee of the Czech Parliament. Only 17 days lie between said letter and the filing of the Notice of Arbitration on 19 August 1999.
187. However, the Arbitral Tribunal considers that this requirement of a six-month waiting period of Article VI(3)(a) of the Treaty is not a jurisdictional provision, i.e. a limit set to the authority of the Arbitral Tribunal to decide on the merits of the dispute, but a procedural rule that must be satisfied by the Claimant (Ethyl Corp. v. Canada, UNCITRAL June 24, 1998, 38 I.L.M. 708 (1999), paragraphs 74-88). As stated above, the purpose of this rule is to allow the parties to engage in good-faith negotiations before initiating arbitration.
188. Here, although there were only 17 days between CNTS's and CME's letter to the Media Committee of the Czech Parliament of 2 August 1999 and the filing of the Notice of Arbitration on 19 August 1999, there is no evidence that the Respondent would have accepted to enter into negotiation with Mr. Lauder or with any of the entities he controlled and which were involved in the dispute during the waiting period. On the contrary, the Media Council did not react at all to CNTS's letter of 13 August 1999 requesting that CNTS and CET 21 be invited to the Media Council's ordinary session to be held on 17 August 1999 in order to try to find a solution to their dispute (Exhibit C43).
189. Furthermore, the Respondent did not propose to engage in negotiations with the Claimant following the latter's statement in his Notice of Consent of 19 August 1999, filed together with the Notice of Arbitration, that he remained "*open to any good faith efforts by the Czech Republic to remedy this situation*". Had the Respondent been willing to engage in negotiations with the Claimant, in the spirit of Article VI(3)(a) of the Treaty, it would have had plenty of opportunities to do so during the six months after the 19 August 1999 Notice of Arbitration.

190. To insist that the arbitration proceedings cannot be commenced until 6 months after the 19 August 1999 Notice of Arbitration would, in the circumstances of this case, amount to an unnecessary, overly formalistic approach which would not serve to protect any legitimate interests of the Parties.
191. Therefore, the Arbitral Tribunal holds that the requirement of the six-month waiting period in Article VI(3)(a) of the Treaty does not preclude it from having jurisdiction in the present proceedings.

## 5. **Findings**

### 5.1 **Introduction**

192. The Claimant alleges that the Respondent, through the Media Council actions, has breached five independent obligations under the Treaty within three separate time periods.
193. The five obligations are the followings:
- a) the prohibition against arbitrary and discriminatory measures;
  - b) the obligation to provide fair and equitable treatment;
  - c) the obligation to provide full protection and security;
  - d) the obligation of treatment in accordance with general principles of international law;
  - e) the obligation not to expropriate unlawfully (Reply Memorial, p. 62; Summary of Summation, p. 13-14).
194. The three time periods are the followings:
- a) the 1993-1994 period;
  - b) the 1996-1997 period;
  - c) the 1998-1999 period (see Mr. Kiernan's oral opening submission, 5 March 2001, p. 18).

195. The Arbitral Tribunal feels it appropriate to address the issues in the following order:
- a) the obligation not to expropriate unlawfully with respect to all time periods;
  - b) the obligation of treatment in accordance with the general principles of international law with respect to all time periods;
  - c) all remaining alleged violations of the Treaty within the 1992-1993 time period;
  - d) all remaining alleged violations of the Treaty within the 1994-1997 and 1998-1999 time periods.

## 5.2 The obligation not to expropriate unlawfully (all time periods)

196. The Claimant alleges that the Media Council committed unlawful expropriation by instituting administrative proceedings against CNTS in 1996 and by other actions that forced CNTS to amend the MOA, as well as by the accumulation of actions and inactions over the period from 1996 through 1999 to which the Claimant never consented voluntarily or otherwise. The Claimant precisely referred to (i) the 1996 administrative and criminal proceedings, (ii) the indication by the Media Council in 1998 and thereafter that it did not accept an exclusive business relationship between CET 21 and CNTS, coupled with the Media Council's continued pressures to restructure said relationship, (iii) the Media Council's 15 March 1999 letter to CET 21, and (iv) the Media Council's refusal to take action against CET 21 when the latter severed all dealings with CNTS (Reply Memorial, p. 73-77).
197. The Claimant argues that the Treaty protects foreign investors from direct and indirect expropriation, i.e. not only from the taking of tangible property, but also from measures tantamount to expropriation. Expropriation includes interference by the State in the use of property or with the enjoyment of its benefits, even if legal title to the property is not affected. There is even heightened protection against deprivations resulting from regulatory actions when the acquired rights have obtained legal approval on which investors justifiably rely. The intent of the State to deprive the investor of property is not a necessary element of expropriation. There is no regulatory exception (Memorial, p. 50-52; Reply Memorial, p. 63-73).

198. The Respondent argues that, although the Treaty includes both direct and indirect forms of expropriation, interference with property rights has to be so complete as to amount to a taking of those rights. Detrimental effect on the economic value of property is not sufficient. Parties to the Treaty are not liable for economic injury that is the consequence of bona fide regulation within the accepted police powers of the State. The Respondent asserts that the lawful commencement of administrative proceedings against CNTS in 1996 in respect of a suspected violation of the law did not constitute expropriation. Furthermore, there is no evidence that the Media Council threatened to revoke the License. In addition, CNTS and/or Mr. Lauder made no mention of expropriation before the Notice of Arbitration was filed on 19 August 1999. Finally, Mr. Lauder failed to prove that the Czech Republic caused CET 21 to withdraw from its contractual relationship with CNTS, the acts of the latter's contractual counter-party not constituting expropriation by the State (Response, p. 50-55; Written Closing Submissions, p. 9-10).

199. Article III(1) of the Treaty provides:

*"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 nondiscriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with the general principles or treatment provided for in Article II(2) ".*

200. The Bilateral Investment Treaties (hereinafter: "BITs") generally do not define the term of expropriation and nationalization, or any of the other terms denoting similar measures of forced dispossession ("dispossession", "taking", "deprivation", or "privation"). Furthermore, the practice shows that although the various terms may be used either alone or in combination, most often no distinctions have been attempted between the general concept of dispossession and the specific forms thereof. In general, expropriation means the coercive appropriation by the State of private property, usually by means of individual administrative measures. Nationalization involves large-scale takings on the basis of an executive or legislative act for the

purpose of transferring property or interests into the public domain. The concept of indirect (or “*de facto*”, or “*creeping*”) expropriation is not clearly defined. Indirect expropriation or nationalization is a measure that does not involve an overt taking, but that effectively neutralizes the enjoyment of the property. It is generally accepted that a wide variety of measures are susceptible to lead to indirect expropriation, and each case is therefore to be decided on the basis of its attending circumstances (Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties, p. 98-100 (1995); Georgio Sacerdoti, Bilateral Treaties and Multilateral Instruments on Investment Protection, 379-382 (1997)). The European Court of Human Rights in *Mellacher and Others v. Austria* (1989 Eur.Ct.H.R. (ser. A, No. 169)), held that a “*formal*” expropriation is a measure aimed at a “*transfer of property*”, while a “*de facto*” expropriation occurs when a State deprives the owner of his “*right to use, let or sell (his) property*”.

201. The Arbitral Tribunal holds that the Respondent did not take any measure of, or tantamount to, expropriation of the Claimant’s property rights within any of the time periods, since there was no direct or indirect interference by the Czech Republic in the use of Mr. Lauder’s property or with the enjoyment of its benefits.
  
202. The Claimant has indeed not brought sufficient evidence that any measure or action taken by the Czech Republic would have had the effect of transferring his property or of depriving him of his rights to use his property or even of interfering with his property rights. All property rights of the Claimant were actually fully maintained until the contractual relationship between CET 21 and CNTS was terminated by the former. It is at that time, and at that time only, that Mr. Lauder’s property rights, i.e. the use of the benefits of the License by CNTS, were affected. Up to that time, CNTS had been in a position to fully enjoy the economic benefits of the License granted to CET 21, even if the nature of the legal relationships between the two companies had changed over the time. Because the Claimant has not alleged – and even less proved – that the action which seriously interfered with the Claimants property rights, i.e. CET 21’s decision to withdraw from the 1997 Agreement on 5 August 1999, was one of the State, and not one of a private entity completely independent of the State, there can be no expropriation under the Treaty.

203. In addition, even assuming that the actions taken by the Media Council in the period from 1996 through 1999 had the effect of depriving the Claimant of his property rights, such actions would not amount to an appropriation - or the equivalent - by the State, since it did not benefit the Czech Republic or any person or entity related thereto, and was not taken for any public purpose. It only benefited CET 21, a independent private entity owned by private individuals.
204. Finally, the Claimant, directly or through CNTS or any other entity controlled by himself, did not complain of *any* action taken by the Media Council and which allegedly constituted an expropriation, or a measure tantamount to expropriation, before CME's and CNTS's letter to the Czech Parliament of 2 August 1999, after Mr. Železný had been dismissed of his functions with CNTS and at a time of great tensions between CNTS and CET 21. This failure by the Claimant to invoke the Treaty or to advance any violation of the obligations of the Czech Republic when the now disputed actions were taken, tends to show that no violations of his property rights were committed at that time.

### **5.3 The obligation of treatment in accordance with general principles of international law (all time periods)**

205. The Claimant alleges that the Media Council violated its obligations arising under international law when it withdrew its prior approval of CNTS's activities, and by committing "*the same wrongs that establish its breach of other individual protections under the Treaty*" (Reply Memorial, p. 89; Mr. Kiernan's oral closing submissions, p. 177-178).
206. The Claimant argues that the general principles of international law include, among others, a variant of *pacta sunt servanda*, the protection of acquired rights, the treatment of foreign investment in good faith, the principle of estoppel, and recognized standards relating to the protection of property. These general standards refer exclusively to international law, to the exclusion of domestic law (Reply Memorial, p. 88-89; Mr. Kiernan's oral closing submissions, p. 177-178).



207. The Respondent argues that the Claimant has not identified any obligation of treatment in accordance with general principles of international law which is distinct to the other obligations (Written Closing Submissions, p. 14).
208. Article II(2)(a) of the Treaty provides that "[i]nvestment (...) shall in no case be accorded treatment less than that which conforms to principles of international law".
209. The Arbitral Tribunal considers that the Claimant has not identified any specific obligation of international law which would provide the foreign investor with a broader protection than the other four Treaty obligations on which he otherwise relies. In particular, the Claimant does not allege that either the variant of the principle *pacta sunt servanda*, which would create under certain circumstances a *sui generis* investor-state relationship, or the general obligation of good faith goes further in the protection of the foreign investor than the Respondent's obligation to provide fair and equitable treatment (see below 5.5.3) or the Respondent's obligation to provide full protection and security (see below 5.5.4). On the contrary, by stating that the Respondent's alleged "*breach of the obligation to adhere to general international law arises from the same wrongs that establish its breach of other individual protections under the Treaty*", the Claimant himself recognizes that there is no action or inaction by the Czech Republic which could amount exclusively to a violation of the obligation of treatment in accordance with general principles of international law, without also constituting a violation of other obligations under the Treaty.
210. Therefore, the Arbitral Tribunal will refer to the developments made in the other sections of the present award.

## **5.4 The 1992-1993 time period**

### **5.4.1 Introduction**

211. Because the Claimant, in his more general statement about the "*totality of other actions and inactions by the Media Council*", expressly refers to the rights provided to

CNTS, the Arbitral Tribunal considers that his allegation of unfair and inequitable treatment does not cover the events leading to the creation of CNTS and the replacement of the Media Council, i.e. the first time period in 1993-1994, but includes only the second and third time periods in 1996-1997 and 1998-1999.

212. With respect to the separate obligation to provide fair and equitable treatment, the Claimant alleged that the Respondent breached said obligation through the Media Council's reversal of critical prior approvals, i.e. when the Media Council directed in 1996 the removal in the MOA of the provision giving CNTS the exclusive right to use, benefit from and maintain the License, and through its hostile conduct towards CNTS, i.e. the totality of other actions and inactions by the Media Council that undermined the rights which had been provided to CNTS (Reply Memorial, p. 77-83; Summary of Summation, p. 13).
213. The only identified alleged violation of specific Treaty obligations within the 1992-1994 time period concerns the prohibition against arbitrary and discriminatory measures. Such measures occurred when the Media Council insisted on CEDC not becoming a direct shareholder of CET 21 in 1993 (Reply Memorial, p. 87; Mr. Kiernan's oral closing submissions, 12 March 2001, p. 175).

#### **5.4.2 The prohibition against arbitrary and discriminatory measures**

214. The Claimant alleges that the Respondent took arbitrary and discriminatory measures when the Media Council insisted in 1993 on CEDC not becoming a direct shareholder of CET 21. The Claimant argues that the prohibition against arbitrary and discriminatory measures must be inferred from the circumstances. It is not necessary that a measure be founded on a violation of domestic law for such a measure to be arbitrary and/or discriminatory. Arbitrary action may actually include regulatory actions without good-faith governmental purpose (Memorial, p. 54; Reply Memorial, p. 85-88; Mr. Kiernan's closing submissions, Transcript of 12 March 2001, p. 175-176; Summary of Summation, p. 14).

215. The Respondent argues that Article II(2)(b) of the Treaty, in comparison with Article II(1), requires the Claimant to prove that the Respondent's conduct was both arbitrary and discriminatory. Only an illegal act under domestic law can be - but is not necessarily - arbitrary, and the Claimant did not even prove that the Czech Republic behaved unlawfully. For an act to constitute discrimination, it must first result in actual injury and, second, it must be done with the intention to harm the aggrieved party. In particular, there is no discrimination in the requirement that foreign investors invest in the State through the medium of a locally-incorporated company, since it is only a regulation on how foreign investment is to be organized. Here, the Media Council awarded the License on the precise terms of CET 21's application, pursuant to which CEDC would become a minor shareholder in CET 21. The CNTS structure was proposed by CEDC (Response, p. 56-57; Written Closing Submissions, p. 12-13).

216. Article II(2)(b) of the Treaty provides:

*“Neither Party shall in any way impair by arbitrary and discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investment. For the purpose of dispute resolution under Articles VI and VII, a measure may be arbitrary and discriminatory notwithstanding the fact that a party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party”.*

217. Article II(1) of the Treaty reads as follows:

*“Each Party shall permit and treat investment, and activities associated therewith, on a nondiscriminatory basis, subject to the right of each Party to make or maintain exceptions falling within one of the sectors or matters listed in the Annex to this Treaty. (...)”.*

218. Clause 3 of the Annex to the Treaty provides:

*“Consistent with Article II, paragraph 1, the Czech and Slovak Federal Republic reserves the right to make or maintain limited exceptions to national treatment in the sectors or matters it has indicated below:*

*ownership of real property; and insurance*".

219. The Arbitral Tribunal considers that a violation of Article II(2)(b) of the Treaty requires both an arbitrary and a discriminatory measure by the State. It first results from the plain wording of the provision, which uses the word "and" instead of the word "or". It then results from the existence of Article II(1) of the Treaty, which sets forth the prohibition of any discriminatory treatment of investment, except in the sectors or matters expressly listed in the Annex to the Treaty. If Article II(2)(b) prohibited only arbitrary *or* discriminatory measures, it would be partially redundant to the prohibition of discriminatory measure set forth in Article II(1).
220. A discriminatory measure is defined in Article II(1) and the Clause 3 of the Annex to the Treaty. It is one that fails to provide the foreign investment with treatment at least as favorable as the treatment of domestic investment ("*national treatment*": see Annex 3 to the Treaty). For a measure to be discriminatory, it does not need to violate domestic law, since domestic law can contain a provision that is discriminatory towards foreign investment, or can lack a provision prohibiting the discrimination of foreign investment. It is only in the sectors or matters for which it has reserved the right to make or maintain an exception in the Annex to the Treaty that the State may treat foreign investment less favorably than domestic investment. Due to the fact that the Czech Republic has not made any reserve in the matter of broadcasting television, contrary to the reserve made by the United States of America in the matter of "*ownership and operation of broadcast or common carrier radio and television stations*" (Clause 1 of the Annex to the Treaty; Exhibits R1 and C1), the Czech Republic is bound to provide U.S. investment in the field of broadcasting with a treatment at least as favorable as Czech investment.
221. The Treaty does not define an arbitrary measure. According to Black's Law Dictionary, arbitrary means "*depending on individual discretion; (...) founded on prejudice or preference rather than on reason or fact*" (Black's Law Dictionary 100 (7th ed. 1999)).

#### **5.4.2.1 CEDC not becoming a shareholder in CET 21**

222. The Arbitral Tribunal holds that the Czech Republic took a discriminatory and arbitrary measure against Mr. Lauder in violation of Article II(2)(b) of the Treaty when the Media Council, after having accepted the idea of a direct investment in CET 21 by CEDC , a company which Mr. Lauder controlled, eventually did not allow such investment, and required that a third company, CNTS, be created.
223. There is clear evidence that CEDC intended to acquire a direct participation in CET 21, should the latter be awarded the License. The draft “Terms of Agreement” prepared by CEDC and CET 21 in August 1992 (Exhibit C139) as well as the final version of this document signed by both companies in January 1993 (Exhibit C61) expressly referred to *“an equity investment in CET 21”* from CEDC. The document named “Project of an Independent Television Station” drafted by CET 21 in September 1992 stated that CEDC is *“a direct participant in CET 21's application for the license”* (Exhibit C9).
224. There is also clear evidence that the Media Council was aware of such intention. The Minutes of the preliminary hearings held on 21 December 1992 by the Media Council with the various bidders for TV Nova stated, as regards CET 21, that *“extensive share [is] reserved for foreign capital; (...) direct capital share, not credit”*(Exhibit R58). The Minutes of the further preliminary hearings held on 22 January 1993 provided that *“[t]he participation of foreign capital is expected”* and that *“the combination of domestic and foreign capital is important, necessity of safeguard - diversification of the investments sources”* (Exhibit C64). The Minutes of the session of the Media Council of 30 January 1993, where the decision to award the License to CET 21 was made, stated some member’s of the Media Council’s words that *“(...) it is very significant that this is a business which can not be financed only by credit”, “the Czech and foreign capital in CET 21 [is] positive”, and it is “positive in that there is a stabilisation factor, as far as foreign capital and its involvement is concerned”* (statements of Messrs. Brož and Pýcha; Exhibit R54).

225. The above mentioned statements also clearly indicate that the Media Council had accepted, and even was satisfied with, the fact that CEDC would be a shareholder of CET 21. As a result, this Tribunal Arbitral considers that there can be no doubt that when the Media Council informed CET 21 in its letter of 30 January 1993 (Exhibit R9) and the public in its press release of the same day (Exhibit C11) that the License had been granted to CET 21 and that "[a] direct participant in the application is the international corporation CEDC", the Media Council agreed and approved meant that CEDC would be a shareholder of CET 21.
226. Even assuming that the Media Council thought of another form of participation of CEDC at the time it made the decision to award the License to CET 21, CEDC could reasonably believe that its project of becoming a shareholder in CET 21 had been properly understood and accepted by the Media Council. At no time until the decision was made did the Media Council express any misunderstanding or dissatisfaction with such project.
227. The various statements of the members and staff of the Media Council in the beginning of 1993 submitted in the present proceedings, the immediate rising of strong political opposition to the Media Council's choice in favor of CET 21, and the overall circumstances of the case show that the Media Council realized immediately after the decision on the award of the License had been made that it had to bring some modifications to the project of CET 21 and CEDC. In particular, the Media Council could no longer accept CEDC as a shareholder of CET 21, as it became clear from the political reactions to the recent decision to award the License to CET 21 that even stronger political opposition would arise, opening the way for an attack on the entire selection process. The Media Council therefore gave CET 21 and CEDC the task of proposing an acceptable structure (declaration of Mrs. Landová of 5 December 2000, p. 6-7; declaration of Mr. Brož of 5 December 2000, p. 2-3; declaration of Mr. Pýcha of 21 December 2000, p. 1-3; Exhibits R83, C144 and C145).
228. As a result, CET 21 and CEDC prepared a document named "Overall Structure of a New Czech Commercial Television Entity" pursuant to which CET 21 and CEDC would jointly create a new Czech company which would have the exclusive use of the License. The shareholders of the new company would be CET 21, CEDC and CSB,

the last two of them providing the necessary funds. There was no mention anymore of any direct participation of CEDC in CET 21 (Exhibits C14 and C149). After some modifications were made at the request of the director of the Programming and Monitoring Section of the Media Council, the final version of the document was submitted to the Media Council on February 5, 1993 (Exhibits C150 and R55). On the basis of this document, the Media Council rendered its decision to award the License to CET 21, which stated that CEDC was a "*contractual partner*" of CET 21 (Exhibits R10 and C16).

229. The 1997 Report of the Media Council to the Czech Parliament actually provides a good summary of the actions and their motivations which took place between 30 January and 9 February 1993: "*When granting the license to the Company CET 21, for fear that a majority share of foreign capital in the license holder's Company might impact the independence of full-format broadcasts, the Council assumed a configuration that separates the investor from the license holder himself. That is how an agreement came into existence (upon a series of remarks from the Council) by which the Company CNTS was established the majority owner of which is CEDC/CME*".
230. The Arbitral Tribunal holds that the Media Council decision to move from a direct participation by CEDC, a German company controlled by Mr. Lauder, an American citizen, to a contractual relationship providing for the creation of a third company amounted to an arbitrary and discriminatory measure.
231. The measure was discriminatory because it provided the foreign investment with a treatment less favorable than domestic investment. It indeed results from the above mentioned circumstances that the Media Council changed its mind because of its fear that the strong and rising political opposition to the granting of the License to an entity with significant foreign capital could lead to an attack on the entire selection process. It is probable that if CEDC had been a Czech investor, there would have been no political outcry, and the original plan of becoming a shareholder in CET 21 could have been carried out.

232. The measure was arbitrary because it was not founded on reason or fact, nor on the law which expressly accepted "*applications from companies with foreign equity participation*" (Exhibit R2), but on mere fear reflecting national preference.
233. However, there is no single piece of evidence that CEDC opposed, or protested against, or even less fought against, this measure. On the contrary, it results from the circumstances that CEDC immediately proposed a new structure in which it would become a contractual partner of, rather than a shareholder in, CET 21. CEDC and its successor CME actually accepted the measure without reservation for the next six years, as long as it was able to conduct the joint venture profitably. It is only in the context of the present proceedings, after CET 21 had terminated the contractual relationship with CNTS, which was by that time fully controlled by CME, that CME complained about the measure. Even the Notice of Arbitration did not refer to the measure, which was first mentioned in the Memorial (p. 1-2).
234. The question therefore arises if the breach by the Respondent of its Treaty obligations gives rise to any damages to be paid to the Claimant. It is most probable that if in 1993 Mr. Lauder's investment in the Czech television could have been made directly in CET 21, the Licence holder, the possible breach of any exclusive agreements in 1999 could not have occurred in the way it did. Even if the breach therefore constitutes one of several "*sine qua non*" acts, this alone is not sufficient. In order to come to a finding of a compensable damage it is also necessary that there existed no intervening cause for the damage. In our case the Claimant therefore has to show that the last, direct act, the immediate cause, namely the termination by CET 21 on 5 August 1999 (and the preceding conclusions by CET 21 of service agreements with other service providers) did not become a superseding cause and thereby the proximate cause. In other words, the Claimant has to show that the acts of CET 21 were not so unexpected and so substantial as to have to be held to have superseded the initial cause and therefore become the main cause of the ultimate harm. This the Claimant has not shown. First of all, the Claimant itself in 1993 did not protest against the change imposed by the Media Council. Furthermore, it was completely impossible at that time to envisage that the Claimant itself would actively participate in all those later steps which allowed Mr. Železný to disengage himself from CNTS and to acquire control of CET 21 in order to be able to pursue his own interests without having to rely on CME. These acts



of CET 21, and through it by Mr. Železný, are the real cause for the damage which apparently has been inflicted to the Claimant.

235. The arbitrary and discriminatory breach by the Respondent of its Treaty obligations constituted a violation of the Treaty. The alleged harm was, however, caused in 1999 by the acts of CET 21, controlled by Mr. Železný. The 1993 breach of the Treaty was too remote to qualify as a relevant cause for the harm caused. A finding on damages due to the Claimant by the Respondent would therefore not be appropriate.

## **5.5 The 1994-1997 and 1998-1999 time periods**

### **5.5.1 Introduction**

236. Within the 1994-1997 and 1998-1999 time periods, the Claimant alleges that the Respondent violated all five obligations under the Treaty (see above 5.1). As the Arbitral Tribunal has already addressed the alleged violations of the obligation not to expropriate unlawfully (see above 5.2) and of the obligation of treatment in accordance with general principles of international law (see above 5.3) with respect to all time periods, it will address the three other alleged violations in the context of the events which occurred in the period from 1994 through 1999, i.e.:
- a) the prohibition against arbitrary and discriminatory measures;
  - b) the obligation to provide fair and equitable treatment;
  - c) the obligation to provide full protection and security (Reply Memorial, p. 62-89; Summary of Summation, p. 13-14).

### **5.5.2 The prohibition against arbitrary and discriminatory measures**

237. The Claimant alleges that the Respondent took arbitrary and discriminatory measures (i) when the Czech Parliament replaced the Media Council in 1994, (ii) when the Media Council initiated in 1996 the administrative proceedings against CNTS for

unauthorized television broadcasting, (iii) when the Media Council stated in its 1996 and 1998 reports that the target of its investigations was CNTS, and that the others did not receive any attention: (iv) through ongoing efforts to eliminate the original structure between CET 21 and CNTS in favor of non-exclusive contractual arrangements; (v) by statements of a Media Council's member, Mr. Štěpánek, that CNTS was promoting flight of Czech capital abroad; and (vi) when Mr. Josefík admitted that it did not even occur to him to consider the interest of foreign investor after Mr. Železný's request of March 2, 1999 (Reply Memorial, p. 87-88; Mr. Kiernan's closing submissions, Transcript of 12 March 2001, p. 175-176).

238. The Respondent mainly alleges that the Media Council did not discriminate in the treatment of the Claimant's investment. The administrative proceedings were initiated because there were objective grounds for suspecting a breach of the law, especially when similar proceedings were commenced against others in a similar situation. Furthermore that the existence of anti-American feelings within the Czech Republic was the result of a democratic freedom of expression (Response, p. 56-57; Written Closing Submissions, p. 12-14).
239. As regards the content of the prohibition against discriminatory and arbitrary measures, the Arbitral Tribunal refers to the developments made in the context of the 1992-1993 time period (see above 5.4.2).

#### **5.5.2.1 The replacement of the Media Council**

240. The Arbitral Tribunal holds that the replacement of the Media Council in 1994 did not amount to an arbitrary and discriminatory measure of the Czech Republic.
241. There is indeed no evidence that this replacement was in any direct relation to the involvement of Mr. Lauder in TV Nova, nor that it constituted in any manner a discriminatory and arbitrary measure vis-a-vis the Claimant and his investment in CNTS.

242. Furthermore, any country is entitled to organize its own organs as it pleases as long as this does not result in a discriminatory and arbitrary measure against a foreign investor, protected by the investment Treaty.
243. The replacement of the Media Council in 1994 as such did not cause any harm to Mr. Lauder's investment in the Czech Republic.

**5.5.2.2 The Media Council's 1996 and 1998 reports, and Messrs. Štěpánek 's and Josefik's statements**

244. The Arbitral Tribunal holds that the Claimant's allegations of discriminatory and arbitrary measures with respect to the Media Council statements in its 1996 and 1998 reports that the target of its efforts was CNTS; to Mr. Štěpánek's statements that CNTS was promoting flight of Czech capital abroad; and to Mr. Josefik admission that it did not even occur to him to consider the interest of foreign investor after Mr. Železný's request of 2 March 1999, are clearly unfounded for similar reasons. Therefore, the Arbitral Tribunal will examine these three allegations together.
245. First, the Media Council alleged statement in its 1996 and 1998 reports that its target effort was CNTS does not constitute a "measure" under the Treaty. Such a statement did indeed not have any direct effect on the Claimant's investment, and it is not alleged that it had such an effect. In the light most favorable to the Claimant, it may only have been evidence of the Media Council's intent to treat CNTS as a target in the context of a measure contemporaneously taken by the Media Council. Therefore, such a statement in itself cannot amount to an arbitrary and discriminatory measure.
246. Then, the alleged statements of Mr. Štěpánek that CNTS was promoting flight of Czech capital abroad does not constitute a "measure" under the Treaty either. Furthermore, a statement by a member of the Media Council is not attributable as such to the Media Council, and to the Czech Republic. On the contrary, it must be considered as a personal opinion of said member, which may or may not reflect the Media Council's opinion on the subject. Therefore, it cannot amount to an arbitrary

and discriminatory measure. It apparently also did not occur to the Claimant that this alleged measure would constitute a violation of the Treaty at the time the statement was made, as this allegation of a violation of the Treaty was raised for the first time in the course of the present arbitration proceedings.

247. Finally, the alleged admission by Mr. Josefík that it did not even occur to him to consider the interest of foreign investor after Mr. Železný's request of 2 March 1999 is also a personal statement, and, as such, does not constitute a "measure" under the Treaty. In addition, it is not attributable to the Czech Republic. Therefore, it cannot amount to an arbitrary and discriminatory measure. Apparently it did also not occur to the Claimant until the August 2, 1999 letter of CNTS and CME (Exhibit C41)!

### **5.5.2.3 The initiation of the administrative proceedings**

248. The Arbitral Tribunal holds that the initiation in 1996 of the administrative proceedings against CNTS for unauthorized television broadcasting did not constitute an arbitrary and discriminatory measure of the Czech Republic.

249. There is indeed sufficient evidence that the Media Council thought – or could think – that CNTS was violating the Media Law. The Media Council had indeed received complaints from the public on the content of the programs of TV Nova. As regulatory body for radio and television broadcasting, it was responsible, among other duties, for ensuring the observance of the Media Law (Article 16(2)).

250. Article 3(l) of the Media Law, as amended with effect on 1 January 1996, set forth that a broadcasting operator was one who had "*acquired authorization to broadcasting on the basis of law (a "broadcaster by law") or being granted a license under this Act (a "licensed broadcaster") or by registration under this Act (a "registered broadcaster")*". According to Article 2(1)(a), broadcasting "*means dissemination of program services or pictures and sound information by transmitters, cable systems, satellites and other means intended to be received by the public*" (Exhibit R3).

251. Here, the License had been granted to CET 21, and not to CNTS (Exhibits R10 and C16). CNTS actually did not enter into any of the three categories of broadcaster under Article 3(1) of the Media Law (broadcaster by law, licensed broadcaster and registered broadcaster).
252. Several objective facts existed which could cast the doubt on whether CET 21 or CNTS was actually operating the broadcasting of TV Nova. For instance, CNTS's entry into the Commercial Registry stated that its business activity was "*operating television broadcasting on the basis of the license no. 001/1003*" (Exhibits R10 and C16). CNTS had also directly entered into agreements with other companies for the dissemination of broadcasting. In addition, Mr. Železný held at that time the position equivalent to that of a Chief Operating Officer of both companies. Finally, most activities in connection with TV Nova were performed from CNTS's large premises in Prague with an important staff, whereas CET 21 had a much smaller organization.
253. All these facts lead to a confusion of the roles actually played by CNTS and CET 21, and the Media Council could legitimately fear that a situation had arisen where there had been a *de facto* transfer of the License from CET 21 to CNTS.
254. Furthermore, the Media Council, upon its request, had been provided with an expert opinion from Mr. Jan Bárta from the State and Law Institute of the Academy of Science of the Czech Republic stating that the License was issued to CET 21, and therefore this company had to itself operate the broadcasting activities. Assuming that broadcasting was actually operated by CNTS, administrative proceedings to impose a fine could be initiated against the latter (Exhibits C27 and R14). In this respect, the Arbitral Tribunal considers that this opinion was issued by the State and Law Institute of the Academy of Science of the Czech Republic and not only by Mr. Bárta personally, since the Media Council's letter requesting the opinion had been sent to Mr. Bárta at the Institute, and the opinion was issued on the Institute's letterhead.
255. The commencement of the administrative proceedings against CNTS for alleged unauthorized broadcasting constituted the normal exercise of the regulatory duties of the Media Council. Therefore, this measure was not arbitrary.

256. In addition, administrative proceedings for unauthorized broadcasting were not only initiated against CNTS, a company controlled by a foreign investor, but also against two other companies, Premiera TV a.s. and Radio Alfa a.s. (Exhibits R37 and C22). Although Radio Alfa was also controlled by CME in 1996 and thus can equally be qualified as a foreign investor, Premiera TV was controlled by a domestic investor.
257. The Arbitral Tribunal considers that the Media Council decision to initiate administrative proceedings against CNTS was objectively not discriminatory, since the same measure was taken against Premiera TV, which was controlled by a domestic investor. The foreign investment of Mr. Lauder was therefore not provided a treatment less favourable than the domestic investment controlling Premiera TV. In this respect, the Arbitral Tribunal is of the opinion that the Claimant's allegation that the consequences of the administrative proceedings were less serious for Premiera TV than for CNTS is not relevant, because the measure itself is the same in both cases, i.e. the existence of administrative proceedings for unauthorized broadcasting. Discrimination can only occur when the measure against foreign investment and the measure against domestic investment are of a different nature, and the former is less favourable than the latter.
258. Therefore, the initiation of the administrative proceedings against CNTS was also not discriminatory.
259. This being said, the Arbitral Tribunal notes that neither CNTS nor CME raised any objection at the time the administrative proceedings were initiated that this action was in violation of any Czech law let alone that they violated the Treaty or any obligation of the Czech Republic.

#### **5.5.2.4 The Media Council's ongoing efforts to eliminate the original structure between CET 21 and CNTS**

260. The Arbitral Tribunal also considers that the alleged ongoing efforts by the Media Council to eliminate the original structure between CET 21 and CNTS in favor of non-

exclusive contractual arrangements did not constitute an arbitrary and discriminatory measure of the Czech Republic.

261. It is first to be noted that this allegation is rather vague. The Arbitral Tribunal understands that the alleged ongoing efforts to eliminate the original structure between CET 21 and CNTS refer both to the changes in their contractual relationships, i.e. the amendment to the MOA and the conclusion of the various agreements, and to the issuance by the Media Council of its 15 March 1999 letter, in response to CET 21's request of 3 March 1999 (Exhibit C34).
262. For the sake of clarity, the Arbitral Tribunal will examine these two sets of facts separately.

#### **5.5.2.4.1 The changes to the contractual relationships between CET 21 and CNTS**

263. The Arbitral Tribunal considers that the Media Council's actions leading to the changes to the MOA and the conclusion of the various agreements between CET 21 and CNTS did not constitute arbitrary and discriminatory measures.
264. The Arbitral Tribunal is of the opinion that the main reason for the Media Council to direct CME, CET 21 and CNTS to bring some modifications to their legal relationships was the same as the ground for initiating the administrative proceedings against CNTS for unauthorized broadcasting, i.e. the fear that the unclear legal and factual situation could actually amount to a *de facto* transfer of the License from CET 21 to CNTS, in violation of the Media Law.
265. Article 1.4.1(a) of the original MOA stated that "*CET shall contribute to the Company unconditionally, unequivocally, and on an exclusive basis the right to use, exploit and maintain the License held by CET*". The MOA did not contain any definition of the words "*use, exploit and maintain*", which remained open for interpretation.

266. This legal uncertainty, reinforced by the doubts about the factual allocation of responsibilities between CET 21 and CNTS, led the Media Council to ask the two companies to enter into a service contract setting forth their respective roles in the operation of TV Nova. This process was initiated at the meeting between the Media Council and CET 21 of 13 March 1996. The first conclusion of this meeting was that "*[l]awyers of the Council and CET 21 will prepare the first version of a contract on provision of performances and services between CET 21 and CNTS (...)*" (Exhibit C84).
267. As a result, CET 21 and CNTS concluded the May 1996 Agreement. This agreement expressly set forth in the preamble that its "*purpose (...) is to specify the mutual rights and mutual obligations which arise to CET 21 as the party making and CNTS as the party accepting a contribution made under the memorandum of association of May 4, 1993, by which CNTS was established. The memorandum of association is not changed by this agreement*". The agreement stated that CNTS had the authorization to "*arrange*" the television broadcasting operated on the basis of the License (Article 2(1); Exhibit R17).
268. The amendment to the MOA in November 1996 (Exhibit C59), as well as the conclusions of the October 1996 Agreement (Exhibit R21) and of the 1997 Agreement (Exhibits C29 and R22), were further steps of the same process consisting in specifying the legal relationship between CET 21, CME and CNTS in order to ensure the creation of a clear situation in observance of the Media Law.
269. In this respect, the October 1996 Agreement was mainly similar to the May 1996 Agreement, except for the new Article 1(3) providing that said agreement "*does not affect the exclusive liability of CET 21 for the programming*" under the Media Law. The amended Article 1.4.1(a) of the MOA stated that "*the Company is granted the unconditional, irrevocable, and exclusive right to use and maintain the know-how and make it the subject of profit to the Company, in connection with the License, its maintenance, and protection*". Finally, the 1997 Agreement further specified CNTS's activities by listing the scope of its business (Article 1(3)), and expressly stated that the contracts on the provision of services would be concluded by CNTS on behalf of CET 21 (Article 5(1) and (2)).



270. As they were based on an objective ground, i.e. the efforts to create a clear legal situation in compliance with the Media Law, and as there is no sufficient evidence that they were specifically targeted against foreign investment, the Media Council's actions leading to the changes to the MOA and the conclusion of the various agreements between CET 21 and CNTS did not constitute arbitrary and discriminatory measures.
271. This being said, neither CNTS nor CME raised any objections to this process to the Media Council. On the contrary, both CET 21 and CNTS fully collaborated. The letter sent by both companies to the Media Council on 4 October 1996 indeed constituted a proposal to take several steps "*(...) for how to best and most quickly meet the parliamentary commission's demands and thus how to amicably resolve the prolonged differences which arose in addressing the legal situation concerning the arrangement of legal relationships between [CNTS] and CET 21 s.r.o., as well as around the cancellation of license conditions (...)*" (Exhibit R19). These steps were, among others, the above mentioned amendment to the MOA and conclusion of the agreements between CET 21 and CNTS.
272. This collaboration took place despite the CME's awareness that their legal situation vis-à-vis CET 21 might be affected. In an memorandum dated 15 May 1996, Mrs. DeBruce of CME indeed expressed her concern with respect to the contemplated amendment to the MOA. All proposed amendments to the MOA and contracts between CET 21 and CNTS should be reviewed by legal counsel prior to be entered into (Exhibit C111).
273. Therefore, the Arbitral Tribunal holds that the Claimant acquiesced to the Media Council's above mentioned actions, and is in any event barred from making a claim deriving therefrom.
274. Finally, the Arbitral Tribunal notes that no sufficient evidence was offered that the damage claimed by Mr. Lauder in the present arbitration proceedings, i.e. the termination of the contractual relationship between CET 21 and CNTS on 5 August 1999 on the initiative of the former, was caused by the insistence of the Media Council on the respect of the Media Law in 1996 and 1997. On the contrary, such damage was

the direct result of Mr. Železný's own behavior, which was not backed in 1996 or 1997 by the Media Council or any other organ of the Respondent. Regarding further the question of causality between the alleged acts of the Media Council and the damage claimed see above § 234 and 235.

#### **5.5.2.4.2 The 15 March 1999 opinion of the Media Council**

275. The Claimant especially draws the attention of the Arbitral Tribunal to the visit by Mr. Železný to the Media Council on 2 March 1999 (R97), the following letter of CET 21, signed by Mr. Železný to the Media Council on 3 March 1999 (C33) and the answer to the Media Council by its Chairman Josef Josefík of 15 March 1999, addressed to Mr. Železný “CEO of TV NOVA and Executive Director of CET 21” (C34). According to these documents, and especially the description of the oral discussion which took place between Mr. Železný and the Media Council, it is clear that the Media Council was informed of the differences between Mr. Železný as master of CET 21 and CNTS. It was clear that Mr. Železný wanted the support of the Media Council in his struggle to free CET 21, and therefore himself, from the restrictions of the arrangements with CNTS. Although not in all points but at least in one of the key issues, namely the exclusive nature of the agreements between CET 21 and CNTS, the Media Council clearly expressed its opinion that in the context of television broadcasting the *“business relations between the operator of broadcasting and service organizations are built on a non-exclusive basis.”*
276. This view would seem to be contrary to what the 1996 Agreements, which were discussed and agreed with the Media Council in 1996, with the very active participation of Mr. Železný, then wearing the two hats of CEO of both CNTS and CET 21 have stipulated. The question which this Arbitral Tribunal, however, has to decide is not whether the Media Council was allowed to send such a letter, but whether the sending of the letter constituted a breach of the Treaty obligations of the Respondent.

277. The Arbitral Tribunal considers that the issuance of the Media Council's 15 March 1999 letter does not constitute an arbitrary measure and therefore cannot be considered as a breach of the Treaty.
278. As stated above (see 5.5.2.3 and 5.5.2.4.1), the Media Council was concerned with the fact that the unclear legal and factual situation may lead to a *de facto* transfer of the License to CNTS, in violation of the Media Law. The exclusive relationship between CET 21, the licensed broadcaster, and CNTS, its partner in the operation of TV Nova, was regarded with suspicion, because the Media Council was of the opinion that it presented the inherent danger of a *de facto* transfer of the License.
279. The Media Council's view on this issue was expressed, for instance, in its opinion to the Permanent Media Commission of the House of Deputies of the Parliament of 19 September 1999 with respect to the dispute between CET 21 and CNTS. Chapter 4 reads as follows: "*Each party has its own version of the heart of the issue based on a different interpretation of concluded agreements. CME insists on exclusivity and claims that CET 21 is obliged to broadcast exclusively through CNTS whereas CET 21 denies exclusivity and claims its right to conclude service agreements with any companies it pleases. As in the past, the Council's position in this matter is closer to the opinion that an exclusive relationship between the license holder and a service company is not desirable as it gives an opportunity to manipulate with the license*" (Exhibit C68). The Media Council also expressed its view on this issue in the supplementary report of 15 November 1999 to the same Commission: "*Administrative proceedings to revoke a license can be started only in the event of serious violation of the Broadcasting Act, and there must be provable reasons for them. Interrupting the cooperation of two private companies is not such a reason, and in addition, the council considers the exclusive relationship between the broadcaster and the only service organization as undesirable, due to the danger of a hidden transfer of the license*" (Exhibit R126).
280. The disputed 15 March 1999 letter to CET 21 contained the following statement: "*Business relations between the operator of broadcasting and service organizations are built on a nonexclusive basis. Exclusive relations between the operator and the service organization may result in de facto transfer of some functions and rights*

*pertaining to the operator of broadcasting and, in effect, a transfer of the license”*  
(Exhibit C34).

281. This statement is to be replaced in the context of the letter, which expressed the Media Council’s opinion on the requirements of the Media Law with respect to television broadcasting: *“Because the Council was also asked by the Parliamentary Media Committee to issue an opinion on whether commercial television broadcasting complies with the Act on Broadcasting and valid licenses, we would like to summarize requirements that, in our opinion, express the contents of television broadcasting: (...).”* Beside the list of said requirements, among them the above mentioned statement on regarding the exclusive relationship, the letter also explained the reason for terminating the administrative proceedings against CNTS for unauthorized broadcasting, and requested CET 21 to inform the Media Council about the implementation of the various changes with respect to the legal relationships between CET and CNTS, and to submit the current program composition and broadcasting schedule.
282. Although the statement about the non exclusive basis of the relationship between the holder of the license and the service organization might be viewed as a change of the previous position of the Media Council with respect to this issue, because the Media Council had been satisfied with the amendment of the MOA and the various 1996 and 1997 agreements between CET 21 and CNTS, which all stated the exclusive basis of the relationship between the two companies, the Arbitral Tribunal considers that it does not constitute a “measure” within the meaning of the Treaty, but merely expresses the general opinion of a regulatory body regarding the proper interpretation which should be given to the Media Law.
283. This letter was not aimed at having, and could not have, any legal effect. Condition 17 to the License, which required CET 21 to submit to the Media Council for approval any change in the MOA, had been cancelled end of 1996 (Exhibits R57 and C30). Since then, the Media Council had no authority to approve or disapprove any modification to the relationship between CET 21 and CNTS.

284. Since the Media Council's 15 March 1999 letter to CET 21 did not amount to a "measure", the Respondent did not violate the prohibition against arbitrary and discriminatory measures.
285. The Arbitral Tribunal also considers that said letter was neither arbitrary nor discriminatory. There indeed existed reasonable grounds, even if not necessarily conclusive, for the Media Council to view the existence of an exclusive relationship between CET 21 and CNTS as a danger of a de facto transfer of the License.
286. In addition, the Media Council remained independent from the dispute between CET 21 and CNTS. The 15 March 1999 letter was indeed significantly different from the request for said letter filed by CET 21 on 3 March 1999. In particular, the Media Council's letter did not reproduce CET 21's statement that the operator, i.e. CET 21, *"should order services from service organizations at regular prices so as to respect rules of equal competition "*, nor the statement that *"[f]or the level of provided services to agree with the terms of the license and Czech regulatory requirements, the licensed subject must have the ability to select relevant services anytime and anywhere at will"* (Exhibit C33). Those differences between CET 21's request and the Media Council's letter show that the latter did not just follow the wishes Mr. Železný, who controlled CET 21 at that time.
287. In this respect, the Arbitral Tribunal notes that the Claimant or the entities he controls did not commence any administrative or other proceedings before the appropriate courts of the Czech Republic in the course of which the issue of the overall attitude of the Media Council in this affair, mainly its alleged contradictory interpretation of the Media Law, could be addressed and decided. The Arbitral Tribunal considers that these proceedings do not constitute the appropriate forum to decide on hypothetical questions of the interpretation of the Media Law.
288. The Arbitral Tribunal also considers that the issuance of the Media Council's 15 March 1999 letter was not the cause of the damage incurred by the Claimant. Although this letter might have strengthened the resolve of Mr. Železný to break up the relationship between CET 21 and CNTS, it was not used to achieve this purpose. CET 21 did not terminate the 1997 Agreement on the basis that it provided for an

exclusive relationship with CNTS whereas the Media Council expressed the view such a relationship was undesirable. The legal reason for the termination was that CNTS had failed to submit a television program (Daily Log) on time, a requirement under the 1997 Agreement. Furthermore, there is no evidence that even if the Media Council had not written the 15 March 1999 letter, CET 21 would not have tried to terminate the 1997 Agreement on the ground of breach of contract.

### **5.53. The obligation to provide fair and equitable treatment**

289. The Claimant alleges that the Respondent breached the obligation to provide fair and equitable treatment to the Claimant's investments through the Media Council's reversal of critical prior approvals. This concerns the Media Council's proceedings in 1996 aimed at removing in the MOA the provision giving CNTS the exclusive right to use, benefit from and maintain the License. Furthermore the Claimant asserts that the Media Council demonstrated hostile conduct towards CNTS, by the totality of its other actions and inactions that undermined the rights which had been provided to CNTS (Reply Memorial, p. 81; Summary of Summation, p. 13).
290. The Claimant argues that the obligation to provide fair and equitable treatment has its basis in the general principle of good faith. The State bound by the Treaty must indeed pursue the stated goal of achieving a stable framework for investment. The minimum requirement is that the State not engage in inconsistent conduct, e.g. by reversing to the detriment of the investor prior approvals on which he justifiably relied. Such a requirement is independent of the State's domestic law, i.e. the obligation to provide fair and equitable investment can be violated even if the State complied with the requirements under its domestic law. In addition, it is not relevant whether domestic investors in the same field received the same treatment as the foreign investor, since the level of protection may be different under domestic law and under the Treaty (Reply Memorial, p. 77-83; Mr. Kiernan's oral closing submissions, p. 161-168).

291. The Respondent argues that there exists no precise definition of the obligation to provide fair and equitable treatment. What is fair and equitable is to be determined on the basis of the facts in each individual case. Anyway, this obligation is concerned with the conduct of the State, not with the results of the investments. Therefore, the fact that the investor loses money does not indicate that the State has breached the obligation to provide fair and equitable treatment. There is no evidence of a violation of this obligation by the Czech Republic. Up to 1997, the Media Council was indeed seeking to monitor and enforce the Media Law in the face of growing concern that CNTS was breaching it. The Media Council did not discriminate against the Claimant in favor of nationals, did not reverse prior express permissions, and did not maliciously misapply the law. Between 1997 and 1999, the Media Council did not want to take sides with respect to the dispute between CET 21 and CNTS, which was considered a commercial dispute. In particular, the Media Council's letter of March 15, 1999, whose wording is different from the one requested by Mr. Železný, expressed the Media Council's policy in a lawful and non-discriminatory manner (Response, p. 55; Written Closing Submissions, p. 10-11).
292. Article II(2)(a) of the Treaty sets forth that "*[i]nvestments shall at all times be accorded fair and equitable treatments, (...)*". As with any treaty, the Treaty shall be interpreted by reference to its object and purpose, as well as by the circumstances of its conclusion (Vienna Convention on the Law of Treaties, Articles 31 and 32). The preamble of the Treaty states that the Parties agree "*that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources*". The Arbitral Tribunal notes that there is no further definition of the notion of fair and equitable treatment in the Treaty. The United Nations Conference On Trade And Development has examined the meaning of this doctrine. Fair and equitable treatment is related to the traditional standard of due diligence and provides a "*minimum international standard which forms part of customary international law*" (U.N. Conference On Trade & Development: Bilateral Investment Treaties In The Mid-1990s at 53, U.N. Doc. UNCTAD/ITE/IIT/7, U.N. Sales No. E.98.II.D.8 (1998) (English version). In the context of bilateral investment treaties, the "fair and equitable" standard is subjective and depends heavily on a factual context. It "*will also prevent discrimination against the beneficiary of the standard, where discrimination would amount to unfairness or*

*inequity in the circumstances*” (U.N. Conference On Trade & Development: Fair And Equitable Treatment, Vol. III at 10,15, U.N. Doc. UNCTAD/ITE/IIT/II, U.N. Sales No. E.99.11.D.15 (1999) (English version)).

293. The Arbitral Tribunal holds that none of the actions and inactions of the Media Council, which have already been examined with respect to the prohibition against arbitrary and discriminatory measures (see above 5.5.2), constitutes a violation of the duty to provide fair and equitable treatment.
294. In order to avoid redundancy, the Arbitral Tribunal mainly refers to the developments made under the chapter addressing the issue of the prohibition against arbitrary and discriminatory measures, for most of the arguments denying the existence of any arbitrary and discriminatory measure from the Czech Republic as from 1996 also apply to the Respondent’s compliance with the obligation to provide fair and equitable treatment.
295. This being said, the Arbitral Tribunal does not see any inconsistent conduct on the part of the Media Council which would amount to an unfair and inequitable treatment.
296. In particular, the initiation of the administrative proceedings for unauthorized broadcasting in 1996 was not inconsistent with any prior conduct of the Media Council. At that time, the Media Council had objective reasons to think that CNTS was violating the Media Law, i.e. that it was the broadcaster of TV Nova in lieu of CET 21, the holder of the License. The Media Council’s duties were, among others, to ensure the observance of the Media Law.
297. There can not be any inconsistent conduct in a regulatory body taking the necessary actions to enforce the law, absent any specific undertaking that it will refrain from doing so. No such undertaking was given by the Media Council or any other organ of the Czech Republic.
298. The prior approval by the Media Council of the MOA, in the context of the License being granted to CET 21, contained no commitment to allow CET 21 and CNTS to violate the Media Law. On the contrary, the License expressly stated that “[t]he



*license holder (...) also agrees to observe the conditions stated in the appendix to this license*". Condition 1 to the License set forth that "[t]he license holder agrees (...) that its broadcasting will be in accordance with the laws of the Czech Republic and the international obligations of the Czech Republic. Broadcasting will, in particular, observe (...) the provisions of Act no. 468/1991 Coll., on operating radio and television (...)" (Exhibit R5). The amendment to the Media Law did not change anything with respect to CET 21's obligation to comply with the Media Law.

299. The administrative proceedings against CNTS for unauthorized broadcasting was not initiated on the ground that CNTS would have abided by the previously approved MOA, which would itself then be considered as violating the Media Law. As already stated, the reason for commencing such proceedings was the Media Council's concern that CNTS was operating the broadcasting of TV Nova in violation of the License and of the Media Law.
300. Regarding the changes to the legal relationships between CET 21 and CNTS, i.e. the amendment to the MOA and the conclusion of the various agreements between the two companies, there was also no inconsistent conduct on the part of the Media Council.
301. At no time did the Media Council decide that the approval of the original MOA was deemed null and void, and that any guarantee given to CET 21 and CNTS at that time had to be withdrawn. As stated above (see 5.5.2.4.1), all changes to the legal relationships between CET 21 and CNTS made in 1996 and 1997 were aimed at *specifying*, not altering, the content of said relationships in order to ensure a clear situation in observance of the Media Law.
302. Furthermore, CET 21, CNTS and CME fully cooperated to this process, after being given proper legal advice on the various issues addressed.
303. Finally, the issuance of the 15 March 1999 letter by the Media Council, although in some way in contradiction with the previously approved MOA on the question of the exclusive nature of the contractual relationship between CET 21 and CNTS, was nothing more than an opinion without any legal effect. It did not alter - and was not

aimed at altering – the contractual relationships between the two companies, which remained governed by the 1997 Agreement then in force.

304. In addition, the Arbitral Tribunal is of the opinion that the 15 March 1999 letter was not the direct cause of the damage allegedly suffered by the Claimant. Any damage resulted from the decision of CET 21, controlled by Mr. Železný, to terminate the 1997 Agreement with CNTS. CET 21 made no use of the 15 March 1999 letter. There is no evidence that CET 21 would not have terminated the contractual relationships with CNTS if the Media Council had not issued the 15 March letter, or, for argument's sake, had stated that it was of the opinion that an exclusive relationship between the two companies fully complied with the Media Law. With respect to causality in general see above § 234 and 235.

#### **5.5.4 The obligation to provide full protection and security**

305. The Claimant alleges that the Respondent failed to provide full protection and security to his investment (i) by forcing a change in the Media Law, (ii) by initiating the administrative proceedings against CNTS in 1996, (iii) by subsequent pressures to bring about the restructuring of CNTS, (iv) by issuing the 15 March 1999 letter, (v) by refusing all CNTS's requests to halt CET 21's dismantling of all dealings with the former, and (vi) by authorizing a share capital increase in CET 21 with knowledge that it would frustrate the ICC arbitral panel's interim order and would defy an express contrary request from Parliament (Reply Memorial, p. 85).

306. The Claimant argues that the obligation of full protection and security requires that the State take all steps necessary to protect foreign investments whatever the requirements of domestic law are and regardless of whether the threat to the investment arises from the State's own actions. The State has an obligation of vigilance under which it must take all measures necessary to ensure the full enjoyment of protection and security of the foreign investment (Memorial, p. 55; Reply Memorial, p. 83-85).

307. The Respondent argues the obligation of full protection and security is not an absolute obligation. A State is only obliged to provide protection which is reasonable under the circumstances. Furthermore, the obligation is limited to the activities of the State itself, and does not extend to the activities of a private person or entity. There can also be no legitimate expectation that there will not be any regulatory change (Response, p. 57-59).
308. Article II(2)(a) of the Treaty provides that "*[i]nvestment (...) shall enjoy full protection and security*". There is no further definition of this obligation in the Treaty. The Arbitral Tribunal is of the opinion that the Treaty obliges the Parties to exercise such due diligence in the protection of foreign investment as reasonable under the circumstances. However, the Treaty does not oblige the Parties to protect foreign investment against any possible loss of value caused by persons whose acts could not be attributed to the State. Such protection would indeed amount to strict liability, which can not be imposed to a State absent any specific provision in the Treaty (Dolzer and Stevens, *Bilateral Investment Treaties*, p. 61).
309. The Arbitral Tribunal holds that none of the facts alleged by the Claimant constituted a violation by the Respondent of the obligation to provide full protection and security under the Treaty.
310. Here again, in order to avoid redundancy, the Arbitral Tribunal refers to the findings made under the chapter addressing the issue of the prohibition against arbitrary and discriminatory measures (see above 5.5.2), for most of the arguments denying the existence of any arbitrary and discriminatory measure from the Czech Republic as from 1996 also apply to the Respondent's compliance with the obligation to provide full protection and security.
311. In particular, as regards the amendment to the Media Law in late 1995, effective on 1 January 1996, there is no evidence that such amendment, enacted by the Czech Parliament, was forced by the Media Council. Furthermore, the change in the Media Law did not constitute a danger for the Claimant's investment in the Czech Republic. In particular, the deletion of Article 12(3) authorizing the Media Council to include conditions to the grant of a license was not aimed at, nor suited to, destroying

Mr. Lauder's investment. On the contrary, such a change was favorably viewed by the entities operating TV Nova, since CET 21, represented by Mr. Železný, who was at that time on the side of the Claimant, immediately applied to the Media Council for the cancellation of most of the Conditions set in the License, among others Condition 17 (Exhibit R31).

312. Furthermore, the Arbitral Tribunal considers that it is not the Media Council's role to halt the alleged dismantling by CET 21 of all its dealings with CNTS, nor to enforce an ICC arbitral tribunal interim order. In any event, if the Media Council had acted in violation of its own obligations in respect of these two issues, the present arbitration proceedings are not the proper forum to seek relief. The Claimant should have and in fact did initiate action before the competent administrative or civil courts of the Czech Republic.
313. In addition, the Arbitral Tribunal considers that none of the actions or inactions of the Media Council caused a direct or indirect damage to Mr. Lauder's investment. The action which actually caused the Claimant to lose part of his investment was the termination by CET 21 of its contractual relationship with CNTS in 1999. In other words, the business relationship between CET 21 and CNTS survived all the alleged actions and inactions of the Media Council. It so did until Mr. Železný changed sides and decided to act in favor of CET 21, which by 1999 he controlled, against CNTS in which he no longer had any direct or indirect control. Regarding the issue of causality for the alleged loss suffered by the Claimant see especially § 234 and 235 above.
314. The investment treaty created no duty of due diligence on the part of the Czech Republic to intervene in the dispute between the two companies over the nature of their legal relationships. The Respondent's only duty under the Treaty was to keep its judicial system available for the Claimant and any entities he controls to bring their claims, and for such claims to be properly examined and decided in accordance with domestic and international law. There is no evidence - not even an allegation - that the Respondent has violated this obligation. On the contrary, the numerous Czech court proceedings initiated by CNTS, CME and Mr. Lauder against CET 21 and Mr. Železný show that the Czech judicial system has remained fully available to the Claimant. In particular, the 4 May 2000 decision by the Regional Commercial Court in

Prague that CET 21 was obligated to procure all services for television broadcasting exclusively through CNTS (Exhibit C54) is conclusive evidence of this availability. While this decision was later annulled by the High Court in Prague (Exhibit R134) an appeal is now pending before the Czech Supreme Court, which may still rule in favor of CNTS.

## 6. Costs

315. Article 38 of the UNCITRAL Rules states that the Arbitral Tribunal shall fix the costs of arbitration in its Award and defines the term “costs”.
316. At the Hearing of 17 March 2000 the Parties and the Arbitrators agreed on the formula for the fees of the Arbitral Tribunal. The fees and travel and other expenses incurred by the Arbitrators are herewith fixed at United States Dollars 501'370.20
317. According to Article 40 of the UNCITRAL Rules, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the Arbitral Tribunal may apportion such costs between the Parties if it determines that apportionment is reasonable, taking into account the circumstances of the case. The same applies according to Article 40(2) with respect to the costs of legal representation and assistance. The Arbitral Tribunal can take into account the circumstances of the case and is free to determine which Party shall bear such costs or may apportioned such costs between the Parties if it determines that apportionment is reasonable.
318. Among the circumstances the Tribunal has taken into account is its finding that the Respondent, at the very beginning of the investment by the Claimant in the Czech Republic, breached its obligations not to subject the investment to discriminatory and arbitrary measures when it reneged on its original approval of a capital investment in the licence holder and insisted on the creation of a joint venture. Furthermore, various steps were taken by the Media Council, especially, but not only, the 15 March 1999 letter to CET 21. Although the Arbitral Tribunal came to the conclusion that such acts did not constitute a violation of the Treaty obligations of the Respondent, the Claimant

*bona fide* could nevertheless feel that he had to commence these arbitration proceedings. Furthermore, the behaviour of the Respondent regarding the discovery of documents, which the Claimant could rightly feel might shed more light on the acts of the Respondent, needs to be mentioned in this context.

319. Taking all these circumstances of the case into account, the Arbitral Tribunal comes to the decision that each Party shall pay one half of the fees and expenses of the Arbitral Tribunal and the hearing cost and bear its own costs for legal representation and assistance and the costs of its witnesses.

## **NOW THEREFORE THE ARBITRAL TRIBUNAL**

### **DECIDES**

1. It has jurisdiction to hear and decide this case.
2. The Respondent committed a breach of its obligation to refrain from arbitrary and discriminatory measures when in the Winter of 1993 it changed its original position, which had been made known to the Claimant and to the public at large, allowing an equity investment of the Claimant in CET 21, the holder of the licence to broadcast, and insisted that the participation of the Claimant could not be made in the form of an equity participation but only through a joint venture company.
3. The claim for a declaration that the Respondent committed further breaches of the Treaty are denied and all claims for damages are denied.

4. Each Party shall pay one half of the fees and expenses of the Arbitral Tribunal which are fixed at US\$ 501'370.20
5. Each Party shall pay one half of the direct costs involved in the London Hearings, including room hire, cost of court reporters, etc.
6. Each Party shall carry its own costs for legal representation and assistance, including the travel and other expenses of witnesses presented by the respective Party.
7. All other claims are herewith dismissed.

Place of arbitration: London

Date of this Arbitral Award: 3 September 2001

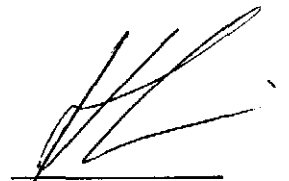
The Arbitral Tribunal



Lloyd Cutler  
Arbitrator



Robert Briner  
Chairman



Bohuslav Klein  
Arbitrator

**CLA-014**



CASE No. ARB(AF)/97/1

INTERNATIONAL CENTRE FOR  
SETTLEMENT OF INVESTMENT DISPUTES  
(ADDITIONAL FACILITY)

B E T W E E N:

METALCLAD CORPORATION  
Claimant

and

THE UNITED MEXICAN STATES  
Respondent

---

A W A R D

---

Before the Arbitral Tribunal constituted  
under Chapter Eleven of the North  
American Free Trade Agreement, and  
comprised of:

Professor Sir Elihu Lauterpacht, QC, CBE  
President  
Mr Benjamin R. Civiletti  
Mr José Luis Siqueiros

*Date of dispatch to the parties: August 30, 2000*

## TABLE OF CONTENTS

	<b>Paragraph</b>
I. INTRODUCTION	1
II. THE PARTIES	2–5
A. The Claimant	2–4
B. The Respondent	5
III. OTHER ENTITIES	6
IV. PROCEDURAL HISTORY	7–27
V. FACTS AND ALLEGATIONS	28–69
A. The Facilities at Issue	28–29
B. Metalclad’s Purchase of the Site and Its Landfill Permits	30–36
C. Construction of the Hazardous Waste Landfill	37–44
D. Metalclad is Prevented from Operating the Landfill	45–69
VI. APPLICABLE LAW	70–71
VII. THE TRIBUNAL’S DECISION	72–112
A. Responsibility for the conduct of state and local governments	73
B. NAFTA, Article 1105: fair and equitable treatment	74–101
C. NAFTA, Article 1110: Expropriation	102–112

VIII.	QUANTIFICATION OF DAMAGES OR COMPENSATION	113–129
	A. Basic elements of Valuation	113–125
	B. “Bundling”	126
	C. Remediation	127
	D. Interest	128
	E. Recipient	129
IX.	COSTS	130
X.	AWARD	131

## I. INTRODUCTION

1. This dispute arises out of the activities of the Claimant, Metalclad Corporation (hereinafter “Metalclad”), in the Mexican Municipality of Guadalcazar (hereinafter “Guadalcazar”), located in the Mexican State of San Luis Potosi (hereinafter “SLP”). Metalclad alleges that Respondent, the United Mexican States (hereinafter “Mexico”), through its local governments of SLP and Guadalcazar, interfered with its development and operation of a hazardous waste landfill. Metalclad claims that this interference is a violation of the Chapter Eleven investment provisions of the North American Free Trade Agreement (hereinafter “NAFTA”). In particular, Metalclad alleges violations of (i) NAFTA, Article 1105, which requires each Party to NAFTA to “accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security”; and (ii) NAFTA, Article 1110, which provides that “no Party to NAFTA may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (‘expropriation’), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6”. Mexico denies these allegations.

## II. THE PARTIES

### A. The Claimant

2. Metalclad is an enterprise of the United States of America, incorporated under the laws of Delaware. Eco-Metalclad Corporation (hereinafter “ECO”) is an enterprise of the United States of America, incorporated under the laws of Utah. ECO is wholly-owned by Metalclad, and owns 100% of the shares in Ecosistemas Nacionales, S.A. de C.V. (hereinafter “ECONSA”), a Mexican corporation. In 1993, ECONSA

purchased the Mexican company Confinamiento Tecnico de Residuos Industriales, S.A. de C.V. (hereinafter "COTERIN") with a view to the acquisition, development and operation of the latter's hazardous waste transfer station and landfill in the valley of La Pedrera, located in Guadalcazar. COTERIN is the owner of record of the landfill property as well as the permits and licenses which are at the base of this dispute.

3. COTERIN is the "enterprise" on behalf of which Metalclad has, as an "investor of a Party", submitted a claim to arbitration under NAFTA, Article 1117.

4. In these proceedings, Metalclad has been represented by:

Clyde C. Pearce, Esq.  
Law Offices of Clyde C. Pearce  
1418 South Main Street  
Suite 201  
Salinas, California 93908  
USA.

#### **B. The Respondent**

5. The Respondent is the Government of the United Mexican States. It has been represented by:

Lic. Hugo Perezcano Diaz  
Consultor Juridico  
Subsecretaria de Negociaciones Comerciales Internacionales  
Direccion General de Consultoria Juridica de Negociaciones  
Secretaria de Comercio y Fomento Industrial  
Alfonso Reyes No.30, Piso 17  
Colonia Condesa  
Mexico, Distrito Federal, C.P. 06149  
Mexico.

### III. OTHER ENTITIES

6. The Town Council of Guadalcazar, SLP, is the municipal government of Guadalcazar, the site of the landfill project. While neither Guadal-

cazar nor SLP are named as Respondents, Metalclad alleges that Guadalucazar and SLP took some of the actions claimed to constitute unfair treatment and expropriation violative of NAFTA.

#### IV. PROCEDURAL HISTORY

7. On October 2, 1996, Metalclad delivered to Mexico a Notice of Intent to Submit a Claim to Arbitration in accordance with NAFTA, Article 1119, thereby instituting proceedings on behalf of its wholly owned enterprise, COTERIN, for purposes of standing under NAFTA, Article 1117. On December 30, 1996, Metalclad delivered to Mexico a written consent and waiver in compliance with NAFTA, Article 1121(2)(a) and (b).

8. On January 2, 1997, and pursuant to the NAFTA, Article 1120, Metalclad filed its Notice of Claim with the International Centre for Settlement of Investment Disputes (hereinafter “ICSID”),<sup>1</sup> and requested the Secretary-General of ICSID to approve and register its application and to permit access to the ICSID Additional Facility.

9. On January 13, 1997, the Secretary-General of ICSID informed the parties that the requirements of Article 4(2) of the ICSID Additional Facility Rules had been fulfilled and that Metalclad’s application for access to the Additional Facility was approved. The Secretary-General of ICSID issued a Certificate of Registration of the Notice of Claim on that same day.

10. On May 19, 1997, the Tribunal was constituted. The Secretary-General of ICSID informed the parties that the Tribunal was “deemed to have been constituted and the proceedings to have begun” on May 19, 1997, and that Mr. Alejandro A. Escobar, ICSID, would serve as Secretary to the Tribunal. All subsequent written communications between the Tribunal and the parties were made through the ICSID Secretariat.

---

<sup>1</sup> Under NAFTA, Article 1120(1)(b), a disputing investor may submit its claim to arbitration under the Additional Facility Rules of ICSID provided that either the disputing Party whose measure is alleged to be a breach referred to in Article 1117 (in this case, Mexico) or the Party of the investor (in this case, the United States of America), but not both, is a party to the ICSID Convention. The United States of America is a party to the ICSID Convention; Mexico is not. Hence the Additional Facility Rules of ICSID appropriately govern the administration of these proceedings.

11. The first session of the Tribunal was held, with the parties' agreement, in Washington, D.C. on July 15, 1997. In accordance with Article 21 of the ICSID Arbitration (Additional Facility) Rules (hereinafter "the Rules"), the Tribunal then determined that the place of arbitration would be Vancouver, British Columbia, Canada. The parties accepted that determination by the Tribunal.

12. Numerous requests for production of documents were exchanged by the parties, some of which were allowed, and some of which were disallowed, particularly those that came later in the proceedings. Through instructions given by its President,<sup>2</sup> the Tribunal issued a ruling on April 27, 1999, relating to Mexico's April 14, 1999 Request for Production of Documents. The President of the Tribunal indicated that he could not, at that stage of the case, decide the extent to which the requested documents and materials might be relevant to the case, but ordered Metalclad to produce the documents at issue and noted that Metalclad might seek an award of costs related to the production should the requests be adjudged unreasonable or improper. No such finding has been made.

13. On September 10, 1997, pursuant to NAFTA, Article 1134 providing for interim measures of protection and Article 28 of the Rules providing for Procedural Orders, Mexico filed a Request for a Confidentiality Order seeking a formal order that the proceedings be confidential. Metalclad filed its response on October 9, 1997. On October 27, 1997, the Tribunal issued a determination, which in its material part reads as follows:

"There remains nonetheless a question as to whether there exists any general principle of confidentiality that would operate to prohibit public discussion of the arbitration proceedings by either party. Neither the NAFTA nor the ICSID (Additional Facility) Rules contain any express restriction on the freedom of the parties in this respect. Though it is frequently said that one of the reasons for recourse to arbitration is to avoid publicity, unless the agreement between the parties incorporates such a limitation,

---

<sup>2</sup> At the first session of the Tribunal, of July 15, 1997, the parties agreed that the President of the Tribunal should have the power to determine procedural matters.

each of them is still free to speak publicly of the arbitration. It may be observed that no such limitation is written into such major arbitral texts as the UNCITRAL Rules or the draft Articles on Arbitration adopted by the International Law Commission. Indeed, as has been pointed out by the Claimant in its comments, under United States security laws, the Claimant, as a public company traded on a public stock exchange in the United States, is under a positive duty to provide certain information about its activities to its shareholders, especially regarding its involvement in a process the outcome of which could perhaps significantly affect its share value.

“The above having been said, it still appears to the Arbitral Tribunal that it would be of advantage to the orderly unfolding of the arbitral process and conducive to the maintenance of working relations between the Parties if during the proceedings they were both to limit public discussion of the case to a minimum, subject only to any externally imposed obligation of disclosure by which either of them may be legally bound”.

14. On October 14, 1997, Metalclad filed its Memorial. On December 17, 1997, Mexico filed a Request for an Extension of Time for the filing of its Counter-memorial. Metalclad filed an Opposition to the requested extension, Mexico filed a Reply and Metalclad filed a Rejoinder. On January 7, 1998, the Tribunal granted Mexico’s request for an extension and ordered that Mexico’s Counter-Memorial be filed February 17, 1998.

15. On February 17, 1998, Mexico filed its Counter-Memorial without objection. Certain exhibits of Mexico’s Counter-Memorial were filed May 22, 1998, and Mexico’s translations of certain exhibits were filed with the Claimant on July 17, 1998 and with the Secretariat on July 20, 1998.

16. On February 20, 1998, Metalclad filed a Motion for Sanctions regarding Mexico’s “untimely” filing of its Counter-Memorial. Metalclad objected to Mexico’s failure to submit translations of all pertinent documents with the Counter-Memorial on the date due and set by previous



Order of the Arbitral Tribunal. Mexico filed an Opposition to the Motion for Sanctions, to which Metalclad filed a Reply and Rejoinder, to which Mexico filed an additional Opposition. On March 31, 1998, the Tribunal denied Metalclad's Motion for Sanctions and stated that non-acceptance of the Counter-Memorial and/or the exclusion of certain documents from consideration would be excessive under the circumstances. The Tribunal further stated that it had been "unable to identify significant, if any, harm suffered by the Claimant by reason of the delay in the filing of the translations".

17. On April 6, 1998, Metalclad filed a Request to Submit a Reply to Mexico's Counter-Memorial, to which Mexico filed an Opposition. On April 20, 1998, the Tribunal granted Metalclad's Request to Submit a Reply, and ordered Metalclad to file the same by June 30, 1998. In its Order, the Tribunal noted that the date for Mexico's Rejoinder would be set after the Tribunal had considered the Reply.

18. On June 22, 1998, Metalclad filed a Motion for Additional Time to File its Reply, to which Mexico filed a Response. On June 29, 1998, the Tribunal granted Metalclad's Motion for Additional Time and ordered the Reply to be filed August 6, 1998. On July 28, 1998, the Tribunal granted the Claimant's request for a further extension of the time period for filing its Reply until August 21, 1998.

19. On August 21, 1998, Metalclad filed its Reply without objection. Transcriptions of portions of the American Appraisal Associate's ("AAA") Expert Report were filed September 3, 1998. Translations of the Reply were filed September 22, 1998 and translations of the AAA Expert Report were filed September 28, 1998.

20. On October 5, 1998, Mexico filed Observations regarding Metalclad's Reply. Metalclad filed a Reply to the Observations, to which Mexico filed a Reply. On November 13, 1998, the Tribunal denied Mexico's requests for exclusion of certain information submitted with the Reply and for the award of costs at that point in time. The Tribunal ordered Mexico to file its Rejoinder by March 19, 1999.

21. On February 22, 1999, Mexico filed a Request for an Extension of Time for the Filing of its Rejoinder. On March 4, 1999, the Tribunal granted Mexico's Request for an Extension of Time and ordered Mexico to

file the Rejoinder by April 19, 1999. In the same Order, the Tribunal set the pre-hearing conference for the marshalling of the evidence for July 6, 1999 in Washington, D.C. The Tribunal also ordered the parties' witness lists to be filed by June 11, 1999, together with an outline of each witness's testimony and an estimate of time for each party's presentation of its case and for the examination of witnesses. The Tribunal further set the hearing on the merits for August 30, 1999.

22. On March 11, 1999, Mexico filed a Request for Production of Documents. Metalclad filed a Response to Mexico's Request, to which Mexico filed a Reply. On April 14, 1999, Mexico then filed a request for an extension of one month in the time for filing its Rejoinder. On April 16, 1999, the Tribunal granted in part Mexico's Request for an Extension and ordered that the Rejoinder be filed by May 3, 1999. The Tribunal further extended the time for the parties to submit their marshalling of the evidence briefs to June 18, 1999. On May 3, 1999, Mexico filed its Rejoinder.

23. During the written phase of the pleadings, statements from the following persons were submitted by the Parties: **by Metalclad** – American Appraisal Associates, Augustina Armijo Bautista, Kevin C. Brennan, Gustavo Carvajal Isunza, Francisco Castillo Ayala, Centro JURICI, Ramon Chavez Quirarte, Anthony Dabbene, Daniel de la Torre, Jorge de la Torre, Lee A. Deets, William E. Gordon, Javier Guerra Cisneros, Bruce H. Haglund, Jaime E. Herrera, Ambassador James R. Jones, Grant S. Kesler, Ariel Miranda Nieto, Paul Mitchener, T. Daniel Neveau, Herbert L. Oakes Jr., Sandra Ray-Baucom, David Robinson, Sergio Reyes Lujan, Humberto C. Rodarte Ramon, Mario Salgado de la Sancha, Leland E. Sweetser, Anthony Talamantez, Mike Tuckett, Roy Zanatta; **by Mexico** – Luis Manuel Abella Armella, Sergio Aleman Gonzalez, Rene Altamirano Perez, Salomon Avila Perez, Antonio Azuela de la Cueva, Fernando Bejarano, Alan Borner, John C. Butler III, Julia Carabias Lillo, Juan Carrera Mendoza, José Ramón Cossío Díaz, Pablo Cruz Llañez, Kevin Dages, Jaime de la Cruz Noguera, Jose Mario de la Garza Mendizabal, Carlos de Silva, Fernando Diaz-Barriga Martinez, Hector Raul Garcia Leos, Jorge Adolfo Hermosillo Silva, Francisco Enrique Hernandez Sanchez, Sergio Lopez Ayllon, Joel Milan, Pedro Medellin Milan, Hermilo Mendez Aguilar, Angelina Nunez, Santiago Oñate Laborde, Rogelio Orta Campos, Jose Antonio Ortega Rivero, Praxedis Palomo Tovar, Officials of PRODIN, Leonel Ramos Torres, Ronald E. Robertson, Aurelio Romo Navarro, Juan

Antonio Romo, Horacio Sanchez Unzueta, Leonel Serrato Sanchez, Ulises Schmill Ordonez, Marcia Williams, Ramiro Zaragoza Garcia, Mark Zmijewski.

24. As permitted by NAFTA, Article 1128, Canada made a written submission to the Tribunal on July 28, 1999. Although Canada does not have any specific commercial interest in the dispute in this case, the submission addressed the interpretation of NAFTA, Article 1110 relating to expropriation and compensation. Specifically, Canada rejected Metal-clad's suggestion that NAFTA, Article 1110 is a codification of the United States' position on the rules of international law regarding expropriation and compensation.

25. With the agreement of the parties, a hearing was held in Washington, D.C. from August 30, 1999 through September 9, 1999, at which both parties appeared and presented witnesses. The Tribunal directed that only those portions of the written submissions that were disputed were to be introduced at the hearing. Witnesses called by Metal-clad for cross-examination were Julia Carabias Lillo, Horacio Sanchez Unzueta, Pedro Medellin Milan, Leonel Ramos Torres, Marcia Williams and John Butler III; witnesses called for cross-examination by Mexico were Grant S. Kesler, Gustavo Carvajal Isunza, Anthony Dabbene, Lee A. Deets and Daniel T. Neveau.

26. The Tribunal posed questions to the parties, which were addressed by the parties in their post-hearing briefs submitted on November 9, 1999. Full verbatim transcripts were made of the hearing and distributed to the parties.

27. As permitted by NAFTA, Article 1128, the United States made a written submission to the Tribunal on November 9, 1999. Although the United States does not have any specific commercial interest in the dispute in this case, the submission set forth the United States' position that the actions of local governments, including municipalities, are subject to NAFTA standards. The United States also submitted that the NAFTA, Article 1110, term "tantamount to expropriation" addressed both measures that directly expropriate and measures tantamount to expropriation that thereby indirectly expropriate investments. The United States rejected the suggestion that the term "tantamount to expropriation" was intended to

create a new category of expropriation not previously recognized in customary international law.

## V. FACTS AND ALLEGATIONS

### A. The Facilities at Issue

28. In 1990 the federal government of Mexico authorized COTERIN to construct and operate a transfer station for hazardous waste in La Pedrera, a valley located in Guadalucazar in SLP. The site has an area of 814 hectares and lies 100 kilometers northeast of the capital city of SLP, separated from it by the Sierra Guadalucazar mountain range, 70 kilometers from the city of Guadalucazar. Approximately 800 people live within ten kilometers of the site.

29. On January 23, 1993, the National Ecological Institute (hereinafter “INE”), an independent sub-agency of the federal Secretariat of the Mexican Environment, National Resources and Fishing (hereinafter “SEMARNAP”), granted COTERIN a federal permit to construct a hazardous waste landfill in La Pedrera (hereinafter “the landfill”).

### B. Metalclad’s Purchase of the Site and its Landfill Permits

30. Three months after the issuance of the federal construction permit, on April 23, 1993, Metalclad entered into a 6-month option agreement to purchase COTERIN together with its permits, in order to build the hazardous waste landfill.

31. Shortly thereafter, on May 11, 1993, the government of SLP granted COTERIN a state land use permit to construct the landfill. The permit was issued subject to the condition that the project adapt to the specifications and technical requirements indicated by the corresponding authorities, and accompanied by the General Statement that the license did not prejudice the rights or ownership of the applicant and did not authorize works, constructions or the functioning of business or activities.

32. One month later, on June 11, 1993, Metalclad met with the Governor of SLP to discuss the project. Metalclad asserts that at this meeting it obtained the Governor’s support for the project. In fact, the

Governor acknowledged at the hearing that a reasonable person might expect that the Governor would support the project if studies confirmed the site as suitable or feasible and if the environmental impact was consistent with Mexican standards.

33. Metalclad further asserts that it was told by the President of the INE and the General Director of the Mexican Secretariat of Urban Development and Ecology (hereinafter “SEDUE”)<sup>3</sup> that all necessary permits for the landfill had been issued with the exception of the federal permit for operation of the landfill. A witness statement submitted by the President of the INE suggests that a hazardous waste landfill could be built if all permits required by the corresponding federal and state laws have been acquired.

34. Metalclad also asserts that the General Director of SEDUE told Metalclad that the responsibility for obtaining project support in the state and local community lay with the federal government.

35. On August 10, 1993, the INE granted COTERIN the federal permit for operation of the landfill. On September 10, 1993, Metalclad exercised its option and purchased COTERIN, the landfill site and the associated permits.

36. Metalclad asserts it would not have exercised its COTERIN purchase option but for the apparent approval and support of the project by federal and state officials.

### **C. Construction of the Hazardous Waste Landfill**

37. Metalclad asserts that shortly after its purchase of COTERIN, the Governor of SLP embarked on a public campaign to denounce and prevent the operation of the landfill.

38. Metalclad further asserts, however, that in April 1994, after months of negotiation, Metalclad believed it had secured SLP’s agreement to support the project. Consequently, in May 1994, after receiving an eighteen-month extension of the previously issued federal construction

---

<sup>3</sup> SEDUE is the predecessor organization to SEMARNAP.

permit from the INE, Metalclad began construction of the landfill. Mexico denies that SLP's agreement or support had ever been obtained.

39. Metalclad further maintains that construction continued openly and without interruption through October 1994. Federal officials and state representatives inspected the construction site during this period, and Metalclad provided federal and state officials with written status reports of its progress.

40. On October 26, 1994, when the Municipality ordered the cessation of all building activities due to the absence of a municipal construction permit, construction was abruptly terminated.

41. Metalclad asserts it was once again told by federal officials that it had all the authority necessary to construct and operate the landfill; that federal officials said it should apply for the municipal construction permit to facilitate an amicable relationship with the Municipality; that federal officials assured it that the Municipality would issue the permit as a matter of course; and that the Municipality lacked any basis for denying the construction permit. Mexico denies that any federal officials represented that a municipal permit was not required, and affirmatively states that a permit was required and that Metalclad knew, or should have known, that the permit was required.

42. On November 15, 1994, Metalclad resumed construction and submitted an application for a municipal construction permit.

43. On January 31, 1995, the INE granted Metalclad an additional federal construction permit to construct the final disposition cell for hazardous waste and other complementary structures such as the landfill's administration building and laboratory.

44. In February 1995, the Autonomous University of SLP (hereinafter "UASLP") issued a study confirming earlier findings that, although the landfill site raised some concerns, with proper engineering it was geographically suitable for a hazardous waste landfill. In March 1995, the Mexican Federal Attorney's Office for the Protection of the Environment (hereinafter "PROFEPA"), an independent sub-agency of SEMARNAP, conducted an audit of the site and also concluded that, with proper engi-

neering and operation, the landfill site was geographically suitable for a hazardous waste landfill.

#### D. Metalclad is Prevented from Operating the Landfill

45. Metalclad completed construction of the landfill in March 1995. On March 10, 1995, Metalclad held an “open house,” or “inauguration,” of the landfill which was attended by a number of dignitaries from the United States and from Mexico’s federal, state and local governments.

46. Demonstrators impeded the “inauguration,” blocked the entry and exit of buses carrying guests and workers, and employed tactics of intimidation against Metalclad. Metalclad asserts that the demonstration was organized at least in part by the Mexican state and local governments, and that state troopers assisted in blocking traffic into and out of the site. Metalclad was thenceforth effectively prevented from opening the landfill.

47. After months of negotiation, on November 25, 1995, Metalclad and Mexico, through two of SEMARNAP’s independent sub-agencies (the INE and PROFEPA), entered into an agreement that provided for and allowed the operation of the landfill (hereinafter “the *Convenio*”).

48. The *Convenio* stated that an environmental audit of the site was carried out from December, 1994 through March, 1995; that the purpose of the audit was to check the project’s compliance with the laws and regulations; to check the project’s plans for prevention of and attention to emergencies; and to study the project’s existing conditions, control proceedings, maintenance, operation, personnel training and mechanisms to respond to environmental emergencies. The *Convenio* also stated that, as the audit detected certain deficiencies, Metalclad was required to submit an action plan to correct them; that Metalclad did indeed submit an action plan including a corresponding site remediation plan; and that Metalclad agreed to carry out the work and activities set forth in the action plan, including those in the corresponding plan of remediation. These plans required that remediation and commercial operation should take place simultaneously within the first three years of the landfill’s operation. The *Convenio* provided for a five-year term of operation for the landfill, renewable by the INE and PROFEPA. In addition to requiring remediation, the *Convenio* stated that Metalclad would designate 34 hectares of its property as a buffer zone for the conservation of endemic species. The

*Convenio* also required PROFEPA to create a Technical-Scientific Committee to monitor the remediation and required that representatives of the INE, the National Autonomous University of Mexico and the UASLP be invited to participate in that Committee. A Citizen Supervision Committee was to be created. Metalclad was to contribute two new pesos per ton of waste toward social works in Guadalcazar and give a 10% discount for the treatment and final disposition of hazardous waste generated in SLP. Metalclad would also provide one day per week of free medical advice for the inhabitants of Guadalcazar through Metalclad's qualified medical personnel, employ manual labor from within Guadalcazar, and give preference to the inhabitants of Guadalcazar for technical training. Metalclad would also consult with government authorities on matters of remediation and hazardous waste, and provide two courses per year on the management of hazardous waste to personnel of the public, federal, state and municipal sectors, as well as social and private sectors.

49. Metalclad asserts that SLP was invited to participate in the process of negotiating the *Convenio*, but that SLP declined. The Governor of SLP denounced the *Convenio* shortly after it was publicly announced.

50. On December 5, 1995, thirteen months after Metalclad's application for the municipal construction permit was filed, the application was denied. In doing this, the Municipality recalled its decision to deny a construction permit to COTERIN in October 1991 and January 1992 and noted the "impropriety" of Metalclad's construction of the landfill prior to receiving a municipal construction permit.

51. There is no indication that the Municipality gave any consideration to the construction of the landfill and the efforts at operation during the thirteen months during which the application was pending.

52. Metalclad has pointed out that there was no evidence of inadequacy of performance by Metalclad of any legal obligation, nor any showing that Metalclad violated the terms of any federal or state permit; that there was no evidence that the Municipality gave any consideration to the recently completed environmental reports indicating that the site was in fact suitable for a hazardous waste landfill; that there was no evidence that the site, as constructed, failed to meet any specific construction requirements; that there was no evidence that the Municipality ever required or issued a municipal construction permit for any other construction project



in Guadalucazar; and that there was no evidence that there was an established administrative process with respect to municipal construction permits in the Municipality of Guadalucazar.

53. Mexico asserts that Metalclad was aware through due diligence that a municipal permit might be necessary on the basis of the case of COTERIN (1991, 1992), and other past precedents for various projects in SLP.

54. Metalclad was not notified of the Town Council meeting where the permit application was discussed and rejected, nor was Metalclad given any opportunity to participate in that process. Metalclad's request for reconsideration of the denial of the permit was rejected.

55. In December 1995, shortly following the Municipality's rejection of Metalclad's permit application, the Municipality filed an administrative complaint with SEMARNAP challenging the *Convenio*. SEMARNAP denied the Municipality's complaint.

56. On January 31, 1996, the Municipality filed an *amparo* proceeding in the Mexican courts challenging SEMARNAP's dismissal of its *Convenio* complaint. An injunction was issued and Metalclad was barred from conducting any hazardous waste landfill operations. The *amparo* was finally dismissed, and the injunction lifted, in May 1999.

57. On February 8, 1996, the INE granted Metalclad an additional permit authorizing the expansion of the landfill capacity from 36,000 tons per year to 360,000 tons per year.

58. From May 1996 through December 1996, Metalclad and the State of SLP attempted to resolve their issues with respect to the operation of the landfill. These efforts failed and, on January 2, 1997, Metalclad initiated the present arbitral proceedings against the Government of Mexico under Chapter Eleven of the NAFTA.

59. On September 23, 1997, three days before the expiry of his term, the Governor issued an Ecological Decree declaring a Natural Area for the protection of rare cactus. The Natural Area encompasses the area of the landfill. Metalclad relies in part on this Ecological Decree as an additional element in its claim of expropriation, maintaining that the Decree effectively and permanently precluded the operation of the landfill.

60. Metalclad also alleges, on the basis of reports by the Mexican media, that the Governor of SLP stated, that the Ecological Decree “definitely cancelled any possibility that exists of opening the industrial waste landfill of La Pedrera”.

61. Metalclad also asserts that a high level SLP official, with respect to the Ecological Decree and as reported by Mexican media, “expressed confidence in closing in this way, all possibility for the United States firm Metalclad to operate its landfill in this zone, independently of the future outcome of its claim before the Arbitral Tribunals of the NAFTA treaty”.

62. The landfill remains dormant. Metalclad has not sold or transferred any portion of it.

63. Mexico denies each of these media accounts as they relate to the Ecological Decree.

64. Mexico also maintains that consideration of the Ecological Decree is outside the jurisdiction of the Tribunal because the Decree was enacted after the filing of the Notice of Intent of Arbitration. More particularly, Mexico argues that NAFTA, Article 1119, entitled “Notice of Intent to Submit a Claim”, precludes claims for breaches that have not yet occurred, relying on the language in that Article which states that:

“The disputing investor shall deliver to the disputing Party written notice of its intention to submit a claim to arbitration at least 90 days before a claim is submitted, which notice shall specify:

...

- (b) The provisions of [the NAFTA] alleged to have been breached and any other relevant provisions.
- (c) The issues and factual basis for the claim.”

Mexico further invokes NAFTA, Article 1120 which requires that six months elapse between the events giving rise to a claim and the submission of the claim. On the basis of these two Articles, Mexico argues that a claimant must ensure its claim is ripe at the time it is filed. At the same time, Mexico does not exclude the possibility that amendments to a claim

may be made. Rather, Mexico initially asserted that in order to ensure fairness and clarity, amendment of a claim or the presentation of an ancillary claim within Article 48 of the Additional Facility Rules should be the subject of a formal application and the required amendment should be stated clearly. Later, Mexico adjusted its position in its post-hearing brief in which it argues that Section B of Chapter Eleven does not contemplate the amendment of ripened claims to include post-claim events. Mexico contends that Section B of Chapter Eleven modifies the Additional Facility Rules as regards the amendment of claims and the filing of ancillary claims, making Article 48 of the Additional Facility Rules inapplicable.

65. Metalclad's position is that Mexico's analysis of Articles 1119 and 1120 is artificial, and that the six month rule merely sets forth an initial rule for claim eligibility designed to foster exhaustion of pre-arbitral methods of dispute resolution. In support of its position, Metalclad invokes NAFTA, Article 1118, which provides that disputing parties should first attempt to settle a claim through consultation or negotiation. Metalclad further adduces policy reasons in support of its right to base its claim on acts occurring after submission of its Notice of Claim. First, Metalclad argues that policies related to the administration of justice support its position. In particular, it argues that an inability to rely on post-Notice of Claim acts would deprive parties of redress concerning a period during which a State might be most inclined to disregard its treaty obligations. Second, Metalclad argues that requiring a claimant to forego or defer the airing of subsequent, related, breaches would be inconsistent with NAFTA's stated aim of creating effective procedures for the resolution of its disputes. Such an interpretation, Metalclad suggests, would create serious inefficiencies by requiring the claimant to bring related actions *seriatim* and that those actions would be subject to *res judicata* principles to a Claimant's detriment. Metalclad also argues that injustice would result because claimants will choose, for financial and other reasons, not to start a fresh NAFTA action and tribunals would be unable to consider acts of bad faith occurring during the arbitration. Third, Metalclad maintains that its view is consistent with the ICSID Arbitral Tribunal's broad jurisdiction. Metalclad points out that the texts mentioned in NAFTA, Article 1120, allow for amendment of claims and cites Article 48 of the Rules as allowing for incidental or additional claims provided that such claims are within the scope of the arbitration agreement of the parties. Metalclad concludes that the policies underlying NAFTA, Articles 1119 and 1120, are fulfilled once

the appropriate periods have passed prior to submission of the claim and that the Respondent is not prejudiced by the amendments, provided that they are made no later than the Claimant's Reply and that the Respondent is permitted a Rejoinder.

66. The Tribunal accepts Mexico's contention that a case may not be initiated on the basis of an anticipated breach. However, the Tribunal cannot accept Mexico's interpretation and application of the time limits set out in the NAFTA. Metalclad properly submitted its claim under the Additional Facility Rules as provided under NAFTA, Article 1120. Article 1120(2) provides that the arbitration rules under which the claim is submitted shall govern the arbitration except to the extent modified by Section B of Chapter Eleven. Article 48(1) of the Rules clearly states that a party may present an incidental or additional claim provided that the ancillary claim is within the scope of the arbitration agreement of the parties.

67. The Tribunal does not agree with Mexico's post-hearing position that Section B of Chapter Eleven modifies Article 48 of the Rules. The Tribunal believes it was not the intent of the drafters of NAFTA, Articles 1119 and 1120, to limit the jurisdiction of a Tribunal under Chapter Eleven in this way. Rather, the Tribunal prefers Mexico's position, as stated in its Rejoinder, that construes NAFTA Chapter Eleven, Section B, and Article 48 of the Rules as permitting amendments to previously submitted claims and consideration of facts and events occurring subsequent to the submission of a Notice of Claim, particularly where the facts and events arise out of and/or are directly related to the original claim. A contrary holding would require a claimant to file multiple subsequent and related actions and would lead to inefficiency and inequity.

68. The Tribunal agrees with Mexico that the process regarding amendments to claims must be one that ensures fairness and clarity. Article 48(2) of the Rules ensures such fairness by requiring that any ancillary claim be presented not later than the Claimant's Reply. In this matter, Metalclad presented information relating to the Ecological Decree and its intent to rely on the Ecological Decree as early as its Memorial. Mexico subsequently filed its Counter-Memorial and Rejoinder. The Ecological Decree directly relates to the property and investment at issue, and Mexico has had ample notice and opportunity to address issues relating to that Decree.

69. The Tribunal thus finds that, although the Ecological Decree was issued subsequent to Metalclad's submission of its claim, issues relating to it were presented by Metalclad in a timely manner and consistently with the principles of fairness and clarity. Mexico has had ample opportunity to respond and has suffered no prejudice. The Tribunal therefore holds that consideration of the Ecological Decree is within its jurisdiction but, as will be seen, does not attach to it controlling importance.

## VI. APPLICABLE LAW

70. A Tribunal established pursuant to NAFTA Chapter Eleven, Section B must decide the issues in dispute in accordance with NAFTA and applicable rules of international law. (*NAFTA Article 1131(1)*). In addition, NAFTA Article 102(2) provides that the Agreement must be interpreted and applied in the light of its stated objectives and in accordance with applicable rules of international law. These objectives specifically include transparency and the substantial increase in investment opportunities in the territories of the Parties. (*NAFTA Article 102(1)(c)*). The Vienna Convention on the Law of Treaties, Article 31(1) provides that a treaty is to 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 the treaty's object and purpose. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes, any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty. (*Id.*, *Article 31(2)(a)*). There shall also be taken into account, together with the context, any relevant rules of international law applicable in the relations between the parties. (*Id.*, *Article 31(3)*). Every treaty in force is binding upon the parties to it and must be performed by them in good faith. (*Id.*, *Article 26*). A State party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform the treaty. (*Id.*, *Article 27*).

71. The Parties to NAFTA specifically agreed to "ENSURE a predictable commercial framework for business planning and investment". (*NAFTA Preamble, para. 6 (emphasis in original)*). NAFTA further requires that "[e]ach Party shall ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in

such a manner as to enable interested persons and Parties to become acquainted with them”. *Id. Article 1802.1.*

## VII. THE TRIBUNAL’S DECISION

72. Metalclad contends that Mexico, through its local governments of SLP and Guadalcazar, interfered with and precluded its operation of the landfill. Metalclad alleges that this interference is a violation of Articles 1105 and 1110 of Chapter Eleven of the investment provisions of NAFTA.

### A. Responsibility for the conduct of state and local governments.

73. A threshold question is whether Mexico is internationally responsible for the acts of SLP and Guadalcazar. The issue was largely disposed of by Mexico in paragraph 233 of its post-hearing submission, which stated that “[Mexico] did not plead that the acts of the Municipality were not covered by NAFTA. [Mexico] was, and remains, prepared to proceed on the assumption that the normal rule of state responsibility applies; that is, that the Respondent can be internationally responsible for the acts of state organs at all three levels of government”. Parties to that Agreement must “ensure that all necessary measures are taken in order to give effect to the provisions of the Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments”. (*NAFTA Article 105*). A reference to a state or province includes local governments of that state or province. (*NAFTA Article 201(2)*). The exemptions from the requirements of Articles 1105 and 1110 laid down in Article 1108(1) do not extend to states or local governments. This approach accords fully with the established position in customary international law. This has been clearly stated in Article 10 of the draft articles on state responsibility adopted by the International Law Commission of the United Nations in 1975 which, though currently still under consideration, may nonetheless be regarded as an accurate restatement of the present law: “The conduct of an organ of a State, of a territorial government entity or of an entity empowered to exercise elements of the Governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to internal law or contravened instructions concerning its activity”. (*Yearbook of the International Law Commission, 1975, vol. ii, p.61*).

## B. NAFTA Article 1105: Fair and equitable Treatment

74. NAFTA Article 1105(1) provides that “each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security”. For the reasons set out below, the Tribunal finds that Metalclad’s investment was not accorded fair and equitable treatment in accordance with international law, and that Mexico has violated NAFTA Article 1105(1).

75. An underlying objective of NAFTA is to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives. (*NAFTA Article 102(1)*).

76. Prominent in the statement of principles and rules that introduces the Agreement is the reference to “transparency” (*NAFTA Article 102(1)*). The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.

77. Metalclad acquired COTERIN for the sole purpose of developing and operating a hazardous waste landfill in the valley of La Pedrera, in Guadalucazar, SLP.

78. The Government of Mexico issued federal construction and operating permits for the landfill prior to Metalclad’s purchase of COTERIN, and the Government of SLP likewise issued a state operating permit which implied its political support for the landfill project.

79. A central point in this case has been whether, in addition to the above-mentioned permits, a municipal permit for the construction of a hazardous waste landfill was required.

80. When Metalclad inquired, prior to its purchase of COTERIN, as to the necessity for municipal permits, federal officials assured it that it had all that was needed to undertake the landfill project. Indeed, following Metalclad's acquisition of COTERIN, the federal government extended the federal construction permit for eighteen months.

81. As presented and confirmed by Metalclad's expert on Mexican law, the authority of the municipality extends only to the administration of the construction permit, ". . .to grant licenses and permits for constructions and to participate in the creation and administration of ecological reserve zones . . .". (*Mexican Const. Art. 115, Fraction V*). However, Mexico's experts on constitutional law expressed a different view.

82. Mexico's General Ecology Law of 1988 (hereinafter "LGEEPA") expressly grants to the Federation the power to authorize construction and operation of hazardous waste landfills. Article 5 of the LGEEPA provides that the powers of the Federation extend to:

- V. [t]he regulation and control of activities considered to be highly hazardous, and of the generation, handling and final disposal of hazardous materials and wastes for the environments of ecosystems, as well as for the preservation of natural resources, in accordance with [the] Law, other applicable ordinances and their regulatory provisions.

83. LGEEPA also limits the environmental powers of the municipality to issues relating to non-hazardous waste. Specifically, Article 8 of the LGEEPA grants municipalities the power in accordance with the provisions of the law and local laws to apply:

[l]egal provisions in matters of prevention and control of the effects on the environment caused by generation, transportation, storage, handling treatment and final disposal of solid industrial wastes which are not considered to be hazardous in accordance with the provisions of Article 137 of [the 1988] law. (Emphasis supplied).

84. The same law also limits state environmental powers to those not expressly attributed to the federal government. *Id.*, Article 7.



85. Metalclad was led to believe, and did believe, that the federal and state permits allowed for the construction and operation of the landfill. Metalclad argues that in all hazardous waste matters, the Municipality has no authority. However, Mexico argues that constitutionally and lawfully the Municipality has the authority to issue construction permits.

86. Even if Mexico is correct that a municipal construction permit was required, the evidence also shows that, as to hazardous waste evaluations and assessments, the federal authority's jurisdiction was controlling and the authority of the municipality only extended to appropriate construction considerations. Consequently, the denial of the permit by the Municipality by reference to environmental impact considerations in the case of what was basically a hazardous waste disposal landfill, was improper, as was the municipality's denial of the permit for any reason other than those related to the physical construction or defects in the site.

87. Relying on the representations of the federal government, Metalclad started constructing the landfill, and did this openly and continuously, and with the full knowledge of the federal, state, and municipal governments, until the municipal "Stop Work Order" on October 26, 1994. The basis of this order was said to have been Metalclad's failure to obtain a municipal construction permit.

88. In addition, Metalclad asserted that federal officials told it that if it submitted an application for a municipal construction permit, the Municipality would have no legal basis for denying the permit and that it would be issued as a matter of course. The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA.

89. Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. In following the advice of these officials, and filing the municipal permit application on November 15, 1994, Metalclad was merely acting prudently and in the full expectation that the permit would be granted.

90. On December 5, 1995, thirteen months after the submission of Metalclad's application – during which time Metalclad continued its open and obvious investment activity – the Municipality denied Metalclad's application for a construction permit. The denial was issued well after construction was virtually complete and immediately following the announcement of the *Convenio* providing for the operation of the landfill.

91. Moreover, the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear.

92. The Town Council denied the permit for reasons which included, but may not have been limited to, the opposition of the local population, the fact that construction had already begun when the application was submitted, the denial of the permit to COTERIN in December 1991 and January 1992, and the ecological concerns regarding the environmental effect and impact on the site and surrounding communities. None of the reasons included a reference to any problems associated with the physical construction of the landfill or to any physical defects therein.

93. The Tribunal therefore finds that the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility.

94. Moreover, the Tribunal cannot disregard the fact that immediately after the Municipality's denial of the permit it filed an administrative complaint with SEMARNAP challenging the *Convenio*. The Tribunal infers from this that the Municipality lacked confidence in its right to deny permission for the landfill solely on the basis of the absence of a municipal construction permit.

95. SEMARNAP dismissed the challenge for lack of standing, which the Municipality promptly challenged by filing an *amparo* action. An injunction was issued, and the landfill was barred from operation through 1999.

96. In 1997 SLP re-entered the scene and issued an Ecological Decree in 1997 which effectively and permanently prevented the use by Metalclad of its investment.

97. The actions of the Municipality following its denial of the municipal construction permit, coupled with the procedural and substantive deficiencies of the denial, support the Tribunal's finding, for the reasons stated above, that the Municipality's insistence upon and denial of the construction permit in this instance was improper.<sup>4</sup>

98. This conclusion is not affected by NAFTA Article 1114, which permits a Party to ensure that investment activity is undertaken in a manner sensitive to environmental concerns. The conclusion of the *Convenio* and the issuance of the federal permits show clearly that Mexico was satisfied that this project was consistent with, and sensitive to, its environmental concerns.

99. Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.

100. Moreover, the acts of the State and the Municipality – and therefore the acts of Mexico – fail to comply with or adhere to the requirements of NAFTA, Article 1105(1) that each Party accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment. This is so particularly in light of the governing principle that internal law (such as the Municipality's stated permit requirements) does not justify failure to perform a treaty. (*Vienna Convention on the Law of Treaties, Arts. 26, 27*).

101. The Tribunal therefore holds that Metalclad was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105.

---

<sup>4</sup> The question of turning to NAFTA before exhausting local remedies was examined by the parties. However, Mexico does not insist that local remedies must be exhausted. Mexico's position is correct in light of NAFTA Article 1121(2)(b) which provides that a disputing investor may submit a claim under NAFTA Article 1117 if both the investor and the enterprise waive their rights to initiate or continue before any administrative tribunal or court under the law of any Party any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in NAFTA Article 1117.

### C. NAFTA, Article 1110: Expropriation

102. NAFTA Article 1110 provides that “[n]o party shall directly or indirectly . . . expropriate an investment . . . or take a measure tantamount to . . . expropriation . . . except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation . . . .” “A measure” is defined in Article 201(1) as including “any law, regulation, procedure, requirement or practice”.

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

104. By permitting or tolerating the conduct of Guadalcazar in relation to Metalclad which the Tribunal has already held amounts to unfair and inequitable treatment breaching Article 1105 and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110(1).

105. The Tribunal holds that the exclusive authority for siting and permitting a hazardous waste landfill resides with the Mexican federal government. This finding is consistent with the testimony of the Secretary of SEMARNAP and, as stated above, is consistent with the express language of the LGEEPA.

106. As determined earlier (see above, para 92), the Municipality denied the local construction permit in part because of the Municipality’s perception of the adverse environmental effects of the hazardous waste landfill and the geological unsuitability of the landfill site. In so doing, the Municipality acted outside its authority. As stated above, the Municipality’s denial of the construction permit without any basis in the proposed physical construction or any defect in the site, and extended by its subsequent administrative and judicial actions regarding the *Convenio*,

effectively and unlawfully prevented the Claimant's operation of the landfill.

107. These measures, taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.

108. The present case resembles in a number of pertinent respects that of *Biloune, et al. v. Ghana Investment Centre, et al.*, 95 I.L.R.183, 207-10 (1993) (Judge Schwebel, President; Wallace and Leigh, Arbitrators). In that case, a private investor was renovating and expanding a resort restaurant in Ghana. As with Metalclad, the investor, basing itself on the representations of a government affiliated entity, began construction before applying for a building permit. As with Metalclad, a stop work order was issued after a substantial amount of work had been completed. The order was based on the absence of a building permit. An application was submitted, but although it was not expressly denied, a permit was never issued. The Tribunal found that an indirect expropriation had taken place because the totality of the circumstances had the effect of causing the irreparable cessation of work on the project. The Tribunal paid particular regard to the investor's justified reliance on the government's representations regarding the permit, the fact that government authorities knew of the construction for more than one year before issuing the stop work order, the fact that permits had not been required for other projects and the fact that no procedure was in place for dealing with building permit applications. Although the decision in *Biloune* does not bind this Tribunal, it is a persuasive authority and the Tribunal is in agreement with its analysis and its conclusion.

109. Although not strictly necessary for its conclusion, the Tribunal also identifies as a further ground for a finding of expropriation the Ecological Decree issued by the Governor of SLP on September 20, 1997. This Decree covers an area of 188,758 hectares within the "Real de Guadalcázar" that includes the landfill site, and created therein an ecological preserve. This Decree had the effect of barring forever the operation of the landfill.

110. The Tribunal is not persuaded by Mexico's representation to the contrary. The Ninth Article, for instance, forbids any work inconsistent

with the Ecological Decree's management program. The management program is defined by the Fifth Article as one of diagnosing the ecological problems of the cacti reserve and of ensuring its ecological preservation. In addition, the Fourteenth Article of the Decree forbids any conduct that might involve the discharge of polluting agents on the reserve soil, subsoil, running water or water deposits and prohibits the undertaking of any potentially polluting activities. The Fifteenth Article of the Ecological Decree also forbids any activity requiring permits or licenses unless such activity is related to the exploration, extraction or utilization of natural resources.

111. The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal's finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.

112. In conclusion, the Tribunal holds that Mexico has indirectly expropriated Metalclad's investment without providing compensation to Metalclad for the expropriation. Mexico has violated Article 1110 of the NAFTA.

## VIII. QUANTIFICATION OF DAMAGES OR COMPENSATION

### A. Basic Elements of Valuation

113. In this instance, the damages arising under NAFTA, Article 1105 and the compensation due under NAFTA, Article 1110 would be the same since both situations involve the complete frustration of the operation of the landfill and negate the possibility of any meaningful return on Metalclad's investment. In other words, Metalclad has completely lost its investment.

114. Metalclad has proposed two alternative methods for calculating damages: the first is to use a discounted cash flow analysis of future profits to establish the fair market value of the investment (approximately \$90 million); the second is to value Metalclad's actual investment in the landfill (approximately \$20–25 million).

115. Metalclad also seeks an additional \$20–25 million for the negative impact the circumstances are alleged to have had on its other business operations. The Tribunal disallows this additional claim because a variety of factors, not necessarily related to the La Pedrera development, have affected Metalclad’s share price. The causal relationship between Mexico’s actions and the reduction in value of Metalclad’s other business operations are too remote and uncertain to support this claim. This element of damage is, therefore, left aside.

116. Mexico asserts that a discounted cash flow analysis is inappropriate where the expropriated entity is not a going concern. Mexico offers an alternative calculation of fair market value based on COTERIN’s “market capitalization”. Mexico’s “market capitalization” calculations show a loss to Metalclad of \$13-15 million.

117. Mexico also suggests a direct investment value approach to damages. Mexico estimates Metalclad’s direct investment value, or loss, to be approximately \$3-4 million.

118. NAFTA, Article 1135(1)(a), provides for the award of monetary damages and applicable interest where a Party is found to have violated a Chapter Eleven provision. With respect to expropriation, NAFTA, Article 1110(2), specifically requires compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. This paragraph further states that “the valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value”.

119. Normally, the fair market value of a going concern which has a history of profitable operation may be based on an estimate of future profits subject to a discounted cash flow analysis. *Benvenuti and Bonfant Srl v. The Government of the People’s Republic of Congo*, 1 ICSID Reports 330; 21 I.L.M. 758; *AGIP SPA v. The Government of the People’s Republic of Congo*, 1 ICSID Reports 306; 21 I.L.M. 737.

120. However, where the enterprise has not operated for a sufficiently long time to establish a performance record or where it has failed to make a profit, future profits cannot be used to determine going concern or fair

market value. In *Sola Tiles, Inc. v. Iran* (1987) (14 Iran-U.S.C.T.R. 224, 240-42; 83 I.L.R. 460, 480-81), the Iran-U.S. Claims Tribunal pointed to the importance in relation to a company's value of "its business reputation and the relationship it has established with its suppliers and customers". Similarly, in *Asian Agricultural Products v. Sri Lanka* (4 ICSID Reports 246 (1990) at 292), another ICSID Tribunal observed, in dealing with the comparable problem of the assessment of the value of good will, that its ascertainment "requires the prior presence on the market for at least two or three years, which is the minimum period needed in order to establish continuing business connections".

121. The Tribunal agrees with Mexico that a discounted cash flow analysis is inappropriate in the present case because the landfill was never operative and any award based on future profits would be wholly speculative.

122. Rather, the Tribunal agrees with the parties that fair market value is best arrived at in this case by reference to Metalclad's actual investment in the project. Thus, in *Phelps Dodge Corp. v. Iran* (10 Iran-U.S. C.T.R. 121 (1986)), the Iran-U.S. Claims Tribunal concluded that the value of the expropriated property was the value of claimant's investment in that property. In reaching this conclusion, the Tribunal considered that the property's future profits were so dependent on as yet unobtained preferential treatment from the government that any prediction of them would be entirely speculative. (*Id.* at 132-33). Similarly, in the *Biloune* case (see above), the Tribunal concluded that the value of the expropriated property was the value of the claimant's investment in that property. While the Tribunal recognized the validity of the principle that lost profits should be considered in the valuation of expropriated property, the Tribunal did not award lost profits because the claimants could not provide any realistic estimate of them. In that case, as in the present one, the expropriation occurred when the project was not yet in operation and had yet to generate revenue. (*Biloune*, 95 I.L.R. at 228-229). The award to Metalclad of the cost of its investment in the landfill is consistent with the principles set forth in *Chorzow Factory (Claim for Indemnity) (Merits), Germany v. Poland, P.C.I.J. Series A., No. 17 (1928) at p.47*, namely, that where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed (the *status quo ante*).



123. Metalclad asserts that it invested \$20,474,528.00 in the landfill project, basing its value on its United States Federal Income Tax Returns and Auditors' Workpapers of Capitalized Costs for the Landfill reflected in a table marked Schedule A and produced by Metalclad as response 7(a)A in the course of document discovery. The calculations include landfill costs Metalclad claims to have incurred from 1991 through 1996 for expenses categorized as the COTERIN acquisition, personnel, insurance, travel and living, telephone, accounting and legal, consulting, interest, office, property, plant and equipment, including \$328,167.00 for "other".

124. Mexico challenges the correctness of these calculations on several grounds, of which one is the lack of supporting documentation for each expense item claimed. However, the Tribunal finds that the tax filings of Metalclad, together with the independent audit documents supporting those tax filings, are to be accorded substantial evidential weight and that difficulties in verifying expense items due to incomplete files do not necessarily render the expenses claimed fundamentally erroneous. *See Biloune*, 95 I.L.R. at 223-24.

125. The Tribunal agrees, however, with Mexico's position that costs incurred prior to the year in which Metalclad purchased COTERIN are too far removed from the investment for which damages are claimed. The Tribunal will reduce the Award by the amount of the costs claimed for 1991 and 1992.

#### **B. "Bundling"**

126. Some of the subsequent costs claimed by Metalclad involve what has been termed "bundling". "Bundling" is an accounting concept where the expenses related to different projects are aggregated and allocated to another project. Metalclad has claimed as costs related to the development at La Pedrera earlier costs incurred on certain other sites in Mexico. While not taking any decision in principle regarding the concept of bundling as it may be applicable to other situations (for example in the oil industry where the costs in relation to a "dry hole" may in part be allocated to the cost of exploring for and developing a successful well), the Tribunal does not consider it appropriate to apply the concept in the present case. The Tribunal has reduced accordingly the sum payable by the Government of Mexico.

### C. Remediation

127. The question remains of the future status of the landfill site, legal title to which at present rests with COTERIN. Clearly, COTERIN's substantive interest in the property will come to an end when it receives payment under this award. COTERIN must, therefore, relinquish as from that moment all claim, title and interest in the site. The fact that the site may require remediation has been borne in mind by the Tribunal and allowance has been made for this in the calculation of the sum payable by the Government of Mexico.

### D. Interest

128. The question arises whether any interest is payable on the amount of the compensation. In providing in Article 1135(1) that a Tribunal may award "monetary damages and any applicable interest", NAFTA clearly contemplates the inclusion of interest in an award. On the basis of a review of the authorities, the tribunal in *Asian Agricultural Products v. Sri Lanka* (4 ICSID Reports 245) held that "interest becomes an integral part of the compensation itself, and should run consequently from the date when the State's international responsibility became engaged" (*ibid.* p.294, para. 114). The Tribunal sees no reason to depart from this view. As has been shown above, Mexico's international responsibility is founded upon an accumulation of a number of factors. In the circumstances, the Tribunal considers that of the various possible dates at which it might be possible to fix the engagement of Mexico's responsibility, it is reasonable to select the date on which the Municipality of Guadalupe wrongly denied Metalclad's application for a construction permit. The Tribunal therefore concludes that interest should be awarded from that date until the date 45 days from that on which this Award is made. So as to restore the Claimant to a reasonable approximation of the position in which it would have been if the wrongful act had not taken place, interest has been calculated at 6% p.a., compounded annually.

### E. Recipient

129. As required by NAFTA, Article 1135(2)(b), the award of monetary damages and interest shall be payable to the enterprise. As required by NAFTA, Article 1135(2)(c), the award is made without prejudice to any right that any person may have in the relief under applicable domestic law.

## IX. COSTS

130. Both parties seek an award of costs and fees. However, the Tribunal finds that it is equitable in this matter for each party to bear its own costs and fees, as well as half the advance payments made to ICSID.

## X. AWARD

131. For the reasons stated above, the Tribunal hereby decides that, reflecting the amount of Metalclad's investment in the project, less the disallowance of expenses claimed for 1991 and 1992, less the amount claimed by way of bundling of certain expenses, and less the estimated amount allowed for remediation, plus interest at the rate of 6% compounded annually, the Respondent shall, within 45 days from the date on which this Award is rendered, pay to Metalclad the amount of \$16,685,000.00. Following such period, interest shall accrue on the unpaid award or any unpaid part thereof at the rate of 6% compounded monthly.

Made as at Vancouver, British Columbia, Canada, in English and Spanish.

Professor Sir Elihu Lauterpacht, CBE, QC

Date: [August 25, 2000]

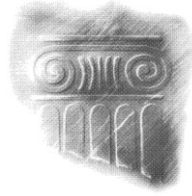
Mr Benjamin R. Civiletti

Date: [August 22, 2000]

Mr José Luis Siqueiros

Date: [August 21, 2000]

**CLA-015**



**Arbitration CAS 2004/A/725 United States Olympic Committee (USOC) v. International Olympic Committee (IOC) & International Association of Athletics Federation (IAAF), award of 20 July 2005**

Panel: Mr. Kaj Hobér (Sweden), President; Mr. L. Yves Fortier QC (Canada); Mr. David A.R. Williams QC (New Zealand)

*Athletics*

*Disqualification of a relay team further to the suspension of an individual member of the team*

*Interpretation of the IAAF Rules*

- 1. Rule 59.4 of the IAAF Rules in force at the time of the Sydney Games concerns the disqualification, ineligibility and annulment of performance results of *individual* athletes, in cases where an athlete has been found guilty of a doping offence; it does not concern teams or team results. One should not take a rule that plainly concerns individual ineligibility and the annulment of individual results, and then stretch and complement and construe it in order that it may be said to govern the results achieved by teams.**
- 2. Clarity and predictability of the rules are required so that the entire sport community are informed of the normative system in which they live, work and compete, which requires at the very least that they be able to understand the meaning of rules and the circumstances in which those rules apply.**

This case, in its essence, concerns the interpretation of relevant IAAF Rules and their application to five members of the gold medal-winning U.S.A. team (the “U.S.A. team”) in the men's 4 x 400m relay event at the 2000 Sydney Olympic Games (the “relay event”). It is a most peculiar case, arising in most unusual circumstances.

As explained more fully in this Award, the results of the relay event and the fate of the medals awarded to the U.S.A. team at the 2000 Sydney Games have, five years later, been called into question as a result of two occurrences.

First, on 28 June 2004, a Panel of the Court of Arbitration for Sport (CAS) found that a Doping Appeals Board of USA Track & Field (USATF), the national federation that governs the sport of athletics in the United States of America, had misdirected itself and reached an erroneous conclusion when, on 10 July 2000, it exonerated Mr. Jerome Young (a sixth member of the U.S.A. team, who is not one of the Appellants in this arbitration) of having committed a doping offence on 26 June 1999, just prior to the Sydney Games. The CAS Panel found that Mr. Young had

committed a doping offence, that the resulting period of ineligibility extended through the Sydney Games, and that Mr. Young should therefore not have participated in those Games (CAS 2004/A/628, award of 28 June 2004).

Second, on 18 July 2004, the IAAF Council determined that “as a consequence of Jerome Young’s ineligibility to have competed at the Sydney Olympic Games in 2000 [by virtue of having committed a doping offence on 26 June 1999], the result of the USA Men’s 4 x 400m relay event is annulled and the final placings are revised accordingly”.

It is the subject matter of the second of these decisions – that is, whether under IAAF Rules in force at the time of the Sydney Games, the results of the relay event should be annulled and the final placings revised accordingly – that is the primary issue in the present appeal.

First Appellant, USOC, is the body to which all US Olympic sports federations are affiliated and is responsible, among other duties, for the selection and registration of athletes in the Olympic Games. USOC has its seat in Colorado Springs, Colorado, U.S.A.

Second, third, fourth, fifth and sixth Appellants, Messrs. Michael Johnson, Antonio Pettigrew, Angelo Taylor, Alvin Harrison and Calvin Harrison (the “Athletes”) are five of the six athletes who were members of the U.S.A. team awarded gold medals in the 4 x 400 men’s relay event at the 2000 Sydney Olympic Games. The sixth member of that team, Mr. Jerome Young, is not a party in these proceedings.

First Respondent, the International Olympic Committee (IOC) is the governing body of the Olympic Movement. One of its missions is to ensure the regular celebration of the Olympic Games. The IOC has its seat in Lausanne, Switzerland.

Second Respondent, the International Association of Athletics Federations (IAAF) is the international federation that governs the sport of athletics throughout the world. The IAAF has its seat in the Principality of Monaco. On 18 July 2004, the IAAF Council made the decision (the “IAAF decision”) that is the subject of the present appeal.

IAAF Rule 59.4 is in the following terms:

If an athlete is found to have committed a doping offence and this is confirmed after a hearing or the athlete waives his right to a hearing, he shall be declared ineligible. In addition, where testing was conducted in a competition, the athlete shall be disqualified from that competition and the result amended accordingly. His ineligibility shall begin from the date of suspension. Performances achieved from the date on which the sample was provided shall be annulled.

(emphasis added)

Bye-law 1.2 to Rule 57 of the Olympic Charter provides:

1. Technical provisions relating to IFs at the Olympic Games:  
The IFs have the following rights and responsibilities:

[...]

1.2 To establish the final results and ranking of Olympic competitions.

In addition, it is relevant to note articles 6.11 (d) and (e) of the IAAF Constitution in force as from 1 November 2003 (the version of the IAAF Constitution that is relevant here), which provide:

The Council's powers shall include the following:

[...]

- (d) to make decisions in urgent matters relating to all Rules. Any such decisions may be notified to the members by the IAAF Office and shall be reported to the next Congress.
- (e) to make decisions regarding the interpretation of the Rules. Any such decisions may be notified to the members by the IAAF Office and shall be reported to the next Congress.

(emphasis added)

Although this case concerns essentially a pure question of law, an appreciation of its lengthy and complicated history is relevant to an understanding both of the context in which the present appeal arises and of the issues addressed in this Award. That history has been thoroughly traversed by the parties in their written and oral submissions, and is summarized here.

On 26 June 1999, Mr. Young provided a urine sample while competing at the United States National Outdoor Championships in Eugene, Oregon. The IOC-accredited laboratory in Indianapolis, Indiana reported that the sample was positive for nandrolone metabolites.

On 11 March 2000, a USATF Doping Hearing Panel found Mr. Young guilty of a doping offence. That decision was reversed on 10 July 2000 by a USATF Doping Appeals Board, thus exonerating Mr. Young and rendering him eligible to enter and compete in the Sydney Games. The USATF, IAAF and IOC accordingly allowed Mr. Young to compete in the Sydney Games as a member of the U.S.A. team, which eventually won the gold medal.

During the Sydney Games, Mr. Young competed in the semi-final heat for the relay event, on 29 September 2000. He did not compete in the final race on 30 September 2000, which four members of the U.S.A. team (Michael Johnson, Antonio Pettigrew, Alvin Harrison and Calvin Harrison) won.

There is no evidence and there has been no suggestion that any member of the U.S.A. team (including Mr. Young) used or ingested any prohibited substance or committed any doping offence during the Sydney Games. Nor is there any evidence, and there has been no suggestion, that any member of the U.S.A. team even knew of Mr. Young's case at the time.

The reason for this lay in USATF's rules (since amended) concerning athletes' privacy and the confidentiality of information pertaining to doping cases in which athletes were ultimately exonerated. In July 2002, the IAAF submitted its concerns about the USATF's confidentiality policy to arbitration before a CAS Panel. On 10 January 2003, that Panel held that although IAAF Rules

did obligate the USATF to disclose information regarding its drug tests to the IAAF, and that information should have been disclosed, given the passage of time and the equities, including the IAAF's familiarity with the USATF rules in question, the USATF should not in the circumstances be required to disclose the identity, or any information about the drug tests, of athletes who had been exonerated<sup>1</sup>.

In August 2003 – three years after the Sydney Games – the United States media (*Los Angeles Times*) reported Mr. Young's June 1999 doping offense and subsequent exoneration by the USATF Doping Appeals Board.

On 30 September 2003, the IOC Executive Board formed a Disciplinary Commission to investigate the circumstances surrounding Mr. Young's entry and participation in the Sydney Games.

In early February 2004, USATF released the unredacted decision of its Appeals Board that had exonerated Mr. Young and sent it to the USOC. The USOC forwarded the decision to the IOC and IAAF.

On 18 February 2004, the IAAF referred the matter to arbitration before the CAS, requesting that the decision exonerating Mr. Young be overturned.

On 29 June 2004, a CAS Panel ruled, *inter alia*, that (1) the USATF Doping Appeals Board had acted erroneously in overturning the 11 March 2000 decision finding Mr. Young guilty of a doping offence; (2) Mr. Young should have been ineligible to compete in international competition for the 2-year period from 26 June 1999 (the date of his urine sample) to 25 June 2001; and (3) Mr. Young therefore should not have been allowed to compete in the Sydney Games.

On 5 July 2004, the IAAF convened an Extraordinary Council Meeting for 18 July 2004, to consider the action which it should take in the light of the decision in the Jerome Young case and further to the correspondence received from the IOC Disciplinary Commission.

By letter dated 17 July 2004, USATF sent the IAAF a written submission in the matter, stating, *inter alia*, that fairness demanded that Jerome Young alone, and not his innocent teammates, should forfeit the gold medal won by the U.S.A. team.

Two days prior to the Extraordinary Council Meeting, a "Briefing Note to Council" was prepared for the assistance and use of the Council members at their 18 July 2004 meeting (the "IAAF briefing note"). The IAAF briefing note set out the history of the Jerome Young case, the action required of the IAAF Council, the relevant IAAF Rules, and how relevant previous cases had been dealt with.

On 18 July 2004, the Extraordinary Council Meeting was held in Grosseto, Italy.

The IAAF Legal Counsel stated:

[...]

---

<sup>1</sup> See CAS 2002/O/401, in: REEB M. (ed.), *Digest of CAS Awards III 2001-2003*, The Hague 2004, p. 36 ff.



(x) (...) all the IAAF Council was required to do was to interpret the relevant IAAF Rules in 1999 as regards the consequences of Jerome Young's ineligibility on the USA Relay Team. The IAAF Council was not being asked to reach a decision on the withdrawal of the gold medals of the USA Relay Team Members. This was a matter exclusively for the IOC.

There then ensued a general discussion among Council members. As stated at paragraph 9 of the General Secretary's note:

The broad views of the council were:

(i) That the spirit and intent of the relevant IAAF Rules was to annul all Jerome Young's results in the 2-year period of his ineligibility, including the USA 4x400m Relay Team result at the Sydney Olympic Games.

(ii) That the natural consequence under the relevant IAAF Rules of the annulment of an individual's results was the annulment of any relay result in which the athlete had competed. Every member of a winning relay team is awarded a gold medal whether they participate only in the preliminary rounds or in the final. This shows that a relay is one event composed of the preliminary rounds and a final. If an athlete is ineligible to compete as part of the team in a preliminary round, the team's performance in the overall event must be affected.

[...]

(v) Jerome Young's appearance in the Sydney Games was caused by the fault of USATF; USATF had, [despite reminders from the IAAF Council,] failed to comply with IAAF Rules in notifying the IAAF of its doping decisions; had they done so, Jerome Young would never had been allowed by the IAAF to compete in Sydney.

The IAAF President then summed up the discussion and called for a vote to be taken as to whether the results of the USA team should be modified. In a secret ballot, the meeting voted 16 - 1 in favour of annulling the result (with one abstention). The motion was therefore passed.

On 18 July 2004, the IAAF President wrote to the Secretary of the IOC Disciplinary Commission. His letter reads:

[...]

Further to the request of the IOC Disciplinary Commission by letter dated 2 July 2004, the IAAF Council has interpreted the relevant IAAF Rules that were in force at the time that Mr. Young committed a doping offence on 26 June 1999. Its interpretation is that, as a consequence of Jerome Young's ineligibility to have competed at the Sydney Olympic Games in 2000, the result of the USA Men's 4x400m Relay Team is annulled and the final placings are revised accordingly.

[...]

The present arbitration was commenced by the filing of Appellants' Statement of Appeal with the CAS on 27 September 2004.

The hearing of the appeal took place in London, on 10 May 2005.

## LAW

1. As stated by Appellants in their Statement of Appeal, this appeal is brought pursuant to both IAAF Rule 21 (IAAF Handbook 2002-2003) and more particularly, because the matter concerns the Olympic Games, Article 61 of the Olympic Charter, which provides:

*Any dispute arising on the occasion of, or in connection with, the Olympic Games, shall be submitted exclusively to the Court of Arbitration for Sport, in accordance with the Code of Sports-Related Arbitration.*

2. For its part, the IAAF acknowledges that the Athletes, who are the subject of the IAAF decision, have standing to appeal that decision to the CAS in virtue of IAAF Rule 60.13 (IAAF Handbook 2004-2005)<sup>2</sup>. However, the IAAF contends that USOC enjoys no such standing and should be removed as a party to these proceedings. For the reasons set forth below, and in view of the Panel's findings in respect of the substantive issues in this appeal, the IAAF's request that USOC be struck as a party to these proceedings need not be determined; and the Panel thus refrains from doing so.
3. The question to be answered is whether, under IAAF Rules in force at the time of the 2000 Sydney Olympic Games, the results obtained by the U.S.A. team in the relay event should be annulled. It is the unanimous opinion of the Panel that they should not be annulled.
4. IAAF Rule 59.4, which the IAAF puts before the Panel as the principal governing rule in the circumstances, is set out in full above. For ease of reference, it is reproduced here:

*If an athlete is found to have committed a doping offence and this is confirmed after a hearing or the athlete waives his right to a hearing, he shall be declared ineligible. In addition, where testing was conducted in a competition, the athlete shall be disqualified from that competition and the result amended accordingly. His ineligibility shall begin from the date of suspension. Performances achieved from the date on which the sample was provided shall be annulled.*

---

<sup>2</sup> IAAF Rule 60.13 (IAAF Handbook 2004-2005) reads as follows:

***Parties entitled to appeal decisions***

In any case involving International-Level athletes (or their athlete support personnel) or arising from an International Competition, the following parties shall have the right to appeal a decision to CAS:

- a. the athlete or other person who is the subject of the decision being appealed;
- b. the other party to the case in which the decision was rendered;
- c. the IAAF;
- d. the IOC (where the decision may have an effect on eligibility in relation to the Olympic Games; and
- e. WADA (in doping-related matters only).

5. It was urged upon the Panel with great conviction and eloquence by the IAAF's counsel that IAAF Rule 59.4 provides a clear statement of a rule providing for the annulment of the results of the U.S.A. team in the circumstances of this case – that is, a rule to the effect that *where an athlete tests positive in an earlier competition and is subsequently declared ineligible, and his results from the date of the provision of his sample through to the imposition of his ineligibility are annulled* (as in the case of Mr. Young), *the result of any relay team in which he has competed during such period* (e.g., the results of the U.S.A. team at the Sydney Olympic Games) *shall also be annulled*.
6. The IAAF argues that the express provisions of IAAF Rule 59.4 must be “complemented” by anything which is necessarily to be implied in them, and that they must be construed “purposively”. It maintains that Rule 59.4 is to be complemented, for example, by provisions such as those contained in IAAF Rules 170 (17) and (18), which govern the composition of a relay team and the nature and timing of permitted substitutions to a team. It contends that the annulment of the U.S.A. team's winning results “follows inexorably” from the last sentence of Rule 59.4, which states that “[p]erformances achieved from date the sample was provided shall be annulled,” in that:

There is no distinction drawn between performance in individual or in relay results. Young’s performance in the first round and semi-final stage of the 4 x 400 men’s relay (which occurred ... during his period of ineligibility) are annulled. It follows inexorably that (i) the other results of the squad in which he [Mr. Young] ran (the qualification round squads) are annulled, since the squad had to compete 4 not 3 legs (in qualification) (ii) the results of the squad in which he did not run (the final squad) are also annulled, since that squad's right to participate and participation in other final depended upon the results of the earlier squad being valid.

Alternatively since the word “performances” is not limited to the athlete's own performances it should be construed as applying to the performances of a team in which the athlete participated.
7. More broadly, the IAAF contends that the applicability of the relevant rules in the circumstances of the present case, and the consequent annulment of the results obtained by the U.S.A. team in the relay event is implicit in order to give efficiency to the Olympic Movement Anti-doping Code and related rules. In the submission of the IAAF, “it would be perverse and undermine the force of the Anti-doping Code if results achieved through reliance on an ineligible athlete, whether [results] of the athlete or of his team, should stand”.
8. In sum, the IAAF takes the position that both a purposive and even a literal interpretation of IAAF Rules require that the results of the gold medal-winning U.S.A. team be annulled. The proposition, it says, is straightforward: Jerome Young was ineligible to compete at the Sydney Olympic Games; his results are annulled; therefore the results of the four-some in which he ran must also be annulled; and the results achieved by the four U.S.A. team members who ran in the final race of the relay event must similarly be annulled, since they only made it to the finals due to the results achieved by the U.S.A. team in earlier heats, in which Mr. Young ran. “In team sports,” the IAAF submits (with reference to the CAS award OG 1998/004-005, published in the Digest of CAS Awards I 1986-1998, p. 435ss.), “the chain is no stronger than its weakest link”.

9. As stated above, the argument is not without force or logic. However, in the view of the Panel, even when articulated in its most simple and compelling fashion, its shortcomings are apparent.
10. On its face, Rule 59.4 concerns the disqualification, ineligibility and annulment of performance results of *individual* athletes, in cases where that athlete has been found guilty of a doping offence; it does not concern teams or team results (in fact, as explained below, the IAAF Rules did not contain any express provisions covering the sort of situation at issue in this case until they were amended in 2004-2005.)
11. IAAF Rule 59.4 plainly deals with, and is plainly intended to deal *only* with, the situation of “an athlete” who is found to have committed a doping offence. It speaks to “the athlete” being disqualified and to the period of “his” ineligibility as well as to the annulment of his performances achieved as from the date on which his positive sample was provided.
12. To take a rule that plainly concerns individual ineligibility and the annulment of individual results, and then to stretch and complement and construe it in order that it may be said to govern the results achieved by teams, is the sort of legal abracadabra that lawyers and partisans in the fight against doping in sport can love, but in which athletes should not be required to engage in order to understand the meaning of the rules to which they are subject.
13. In seeking a proper interpretation of relevant IAAF Rules and their application in the circumstances of this case, one returns inevitably to the observations contained in the IAAF briefing note prepared for IAAF Council members in advance of their 18 July 2004 deliberations and decision. Whereas the alleged clarity of the relevant IAAF Rules is much to be doubted, this much *is* crystal clear and is stated, correctly, in the IAAF briefing note: “In the 2000 Rules, there was ... no specific provision for what should happen when a competitor who had been a member of a team (either of a relay team or otherwise) was found guilty of doping”.
14. As explained in the IAAF briefing note, it is not until their amendment in 2004-2005 that IAAF Rules provide expressly for what happens when an athlete who is a member of a relay team is found guilty of doping. According to the briefing note, Rule 39.4 of the 2004-2005 IAAF Rules makes it clear “*for the first time*” that:  
  
*[I]f an athlete tests positive in an earlier competition or admits doping (and is subsequently declared ineligible) and his results from the date of the provision of his sample through to the imposition of his suspension or ineligibility are annulled, the result of any relay team in which he has competed during such period shall also be annulled.*
15. It is immediately apparent that this is in essence the very rule which the IAAF contends existed, whether literally or by implication, at the time of the 2000 Sydney Olympic Games. This is the rule which it attempts to tease out of IAAF Rule 59.4.

16. In fact, IAAF Rule 39.4 says more than even the IAAF briefing note suggests. While it is true that the 2004-2005 IAAF Rules are the “the first time” that the implication for teams whose members may have committed doping offences is spelled out, Rule 39.4 also introduces the concept of *fairness* as a consideration. It reads as follows:

*[W]here an athlete has been declared ineligible under R40 below, all competitive results obtained from the date the positive sample was provided (whether in competition or out of competition) or other anti-doping rule violation occurred, through to the commencement of the period of provisional suspension shall, unless fairness dictates otherwise, be annulled, with all resulting consequences for the athlete (and, where applicable, any team in which the athlete has competed) including the forfeiture of all titles, awards, medals, points and prize and appearance money.*

(emphasis added)

17. The relevant IAAF Rules in force at the time of the Sydney Games contained no such “fairness consideration”. And of course, to construe those Rules, in particular Rule 59.4, in the manner contended for by the IAAF in this arbitration would entail an automatic disqualification or annulment of the results of the entire USA team, without any consideration of fairness to the members of that team. In the view of the Panel, the absence of a “fairness consideration” in Rule 59.4 makes it even less likely that it was intended to apply, by implication, to teams as well as to individuals.
18. The IAAF contends that “this is not a Q.<sup>3</sup> case”. In a sense, however, this is very much “a Q. case”. Firstly, the clarity of the relevant anti-doping rules related to team results in force at the time of the Sydney Olympic Games is manifestly in doubt. This explains why the main issue before this Panel is, as the IAAF recognises, the merits of the IAAF decision interpreting those rules.
19. Secondly, the principles underlying the approach adopted by the CAS in CAS 94/129 and similar cases cannot be ignored, as the IAAF suggests they should be, on the basis that, because the Athletes were entirely ignorant of their teammate's doping offence (given that he had been exonerated at the time, and that exoneration was not overturned until many years later), their behaviour was in no way affected by those rules or their understanding of them.
20. The rationale for requiring clarity of rules extends beyond enabling athletes in given cases to determine their conduct in such cases by reference to understandable rules. As argued by the Appellants at the hearing, clarity and predictability are required so that the entire sport community are informed of the normative system in which they live, work and compete, which requires at the very least that they be able to understand the meaning of rules and the circumstances in which those rules apply.
21. There was simply no express rule in force at the time of the Sydney Games which provided for the annulment of results obtained by a team, one of whose members later was found to have been ineligible to compete at the time. As became apparent in these proceedings, such a

---

<sup>3</sup> CAS 94/129, published in the Digest of CAS Awards I 1986-1998, p. 187ss.

rule could only be said to have been produced by what the Panel in the CAS 94/129 case referred to as “an obscure process of accretion” – here, as the IAAF would have it, a process of complementation and inference. The Panel consider that the following oft-cited passage from the CAS 94/129 decision is apposite:

The fight against doping is arduous, and it may require strict rule. But the rule-makers and the rule-appliers must begin by being strict with themselves. Regulations that may affect the careers of dedicated athletes must be predictable. They must emanate from duly authorised bodies. They must be adopted in constitutionally proper ways. They should not be the product of an obscure process of accretion. Athletes and officials should not be confronted with a thicket of mutually qualifying or even contradictory rules that can be understood only on the basis of the de facto practice over the course of many years of a small group of insiders.

(emphasis added)

22. In *A.C. v. FINA*,<sup>4</sup> in which, as in this case, the International Federation in question argued for a “purposive construction” of the relevant rules, the CAS nonetheless granted the Appellant’s appeal in part (as to the sanction). In doing so it cited with approval the approach taken in CAS 94/129 and further stated that the federation in question bore the responsibility:

[T]o take every step to ensure that competitors under their jurisdiction were familiar with all rules, regulations, guidelines and requirements in such a sensitive area as doping control.

[...]

It is important that the fight against doping in sport, national and international, be waged unremittingly. The reasons are well known ... It is equally important that athletes in any sport ... know clearly where they stand. It is unfair if they are to be found guilty of offences in circumstances where they neither knew nor reasonably could have known that what they were doing was wrong (to avoid any doubt we are not to be taken as saying that doping offences should not be offences as a strict liability, but rather that the nature of the offence [as one of strict liability] should be known and understood).

For this purpose, it is incumbent both upon the international and the national federation to keep those within their jurisdiction aware of the precepts of the relevant codes.

(emphasis added)

23. IAAF Rule 59.4 applies plainly to Mr. Young. The same simply cannot be said with respect to the Athletes who are Appellants in this case.
24. For these reasons, the Panel is unanimously of the opinion that the decision taken by the IAAF Council on 18 July 2004 interpreting its rules is incorrect, and should be overturned.

---

<sup>4</sup> CAS 96/149, published in the Digest of CAS Awards I 1986-1998, p. 251 at 261-262.

The Panel reaches this conclusion with all due respect to the IAAF Council and its role under the IAAF Constitution as the primary decision-maker regarding the interpretation of its Rules.

25. On the basis of IAAF rules applicable at the time of the 2000 Sydney Olympic Games, the results obtained by the Athletes in the men's 4 x 400m relay event at the Sydney Games shall not be amended. Those results therefore stand. Furthermore, it is the understanding of the Panel that only Jerome Young in the US relay team should be stripped of his gold medal pursuant to the CAS award 2004/A/628 of 28 June 2004.
26. Having so found, the Panel considers it unnecessary for it to consider the other issues raised by the parties in these proceedings. In particular, the Panel considers that there is no need for it to determine, and it refrains from determining:
  - Whether the IAAF has the jurisdiction, power or authority to annul the results of the relay event (the Panel having determined that, even assuming (without deciding) that the IAAF has such jurisdiction, its decision in this case was incorrect);
  - Whether the IAAF decision should be overturned on grounds unrelated to the merits of that decision (for example, whether modification of the results of the relay event is time-barred, or whether the IAAF decision is vitiated by a lack of due process);
  - Whether or not USOC, as distinct from the Athletes, has standing to appeal the IAAF decision.
27. The Panel also refrains from determining, because it need not in the circumstances determine, the IOC's Request for a Stay of the proceedings as against it.

#### **The Court of Arbitration for Sport rules:**

1. The appeal filed by Michael Johnson, Antonio Pettigrew, Angelo Taylor, Alvin Harrison and Calvin Harrison on 27 September 2004 is upheld.
2. The IAAF Council decision of 18 July 2004 is hereby overturned.
3. On the basis of IAAF Rules in force and applicable at the time of the 2000 Sydney Olympic Games, the results of the men's 4 x 400m relay event at those Games shall not be amended; those results stand.

(...)

**CLA-016**



THE MATTER OF AN ARBITRATION  
UNDER THE UNCITRAL ARBITRATION RULES 1976

**SALUKA INVESTMENTS BV (THE NETHERLANDS)**

Claimant

v

**THE CZECH REPUBLIC**

Respondent

---

**PARTIAL AWARD**

---

*Arbitral Tribunal*

Sir Arthur Watts KCMG QC (Chairman)

Maître L. Yves Fortier CC QC

Professor Dr Peter Behrens

*Representing Claimant*

Mr. Jan Paulsson  
Mr. Peter J. Turner  
Freshfields Bruckhaus Deringer  
69 boulevard Haussmann  
75008 Paris  
France

and

Professor James Crawford  
Lauterpacht Research Centre  
for International Law  
5 Cranmer Road  
Cambridge CB3 9BL  
United Kingdom

*Representing Respondent*

Mr. George von Mehren  
Squire, Sanders & Dempsey L.L.P.  
4900 Key Tower  
127 Public Square  
Cleveland, Ohio 44114-1304  
USA

and

Dr. Luboš Tichý  
Squire, Sanders & Dempsey, v.o.s.  
Advokátní kancelář  
Václavské náměstí 57/813  
110 00 Prague 1  
Czech Republic

*Registry*

Permanent Court of Arbitration

## TABLE OF CONTENTS

I.	INTRODUCTION .....	5
A.	Commencement of the Arbitration .....	5
B.	Constitution of the Tribunal .....	5
C.	Procedural Timetable .....	6
D.	The Written Pleadings .....	6
E.	The Respondent’s Counterclaim .....	7
F.	Subsequent Procedural Timetable .....	9
G.	Oral Hearings .....	9
II.	THE FACTS .....	10
A.	The Banking System in Czechoslovakia during the Period of Communist Rule .....	10
B.	The Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic 1991 .....	10
C.	The Separation of the Czech Republic and Slovakia .....	10
D.	The Reorganisation and Privatisation of the Banking System in the Czech Republic .....	11
E.	The Czech Banking Sector’s “Bad Debt” Problem .....	12
F.	Nomura’s Acquisition of Control over IPB on 8 March 1998 .....	13
G.	Acquisition and Sale of Pilsner Urquell Brewery .....	17
H.	The Transfer of Nomura Europe’s IPB Shares to Saluka .....	18
I.	The Government’s Assistance to the Banking Sector (1998-2000) .....	19
J.	Developments in Respect of IPB (August 1999-end May 2000) .....	21
K.	Developments in Respect of IPB (end May 2000-7 June 2000) .....	26
L.	The Second Bank Run on IPB and its Aftermath .....	27
M.	The Forced Administration of IPB and its Aftermath .....	29
III.	THE PARTIES’ ARGUMENTS AND SUBMISSIONS .....	33
IV.	THE TRIBUNAL’S JURISDICTION .....	35
A.	The Parties’ Arguments .....	35
B.	Relevant Terms of the Treaty .....	40
C.	The Respondent’s Challenges to the Tribunal’s Jurisdiction .....	41
D.	The Purchase of IPB Shares as an Investment and Compliance with Legal Requirements .....	42
E.	Saluka’s Qualification as an “Investor” Entitled to Initiate the Arbitration Procedures under the Treaty .....	46
1.	The Corporate Relationship between Saluka and Nomura .....	46
2.	The Alleged Lack of Good Faith and Abuse of Rights .....	47
3.	Saluka’s Lack of Factual Links with The Netherlands .....	49
F.	The Tribunal’s Conclusions as to Jurisdiction .....	50
V.	SALUKA’S CLAIMS UNDER ARTICLE 5 OF THE TREATY .....	50
A.	The Treaty .....	50
B.	The Parties’ Principal Submissions .....	51
C.	The Law .....	52
D.	Analysis and Findings .....	54
E.	Conclusion .....	59
VI.	SALUKA’S CLAIMS UNDER ARTICLE 3 OF THE TREATY .....	60
A.	The Content of the Czech Republic’s Obligations under Article 3 of the Treaty .....	60
B.	Fair and Equitable Treatment .....	61
1.	Meaning of the Standard .....	61

a)	The Parties' Arguments .....	61
b)	The Tribunal's Interpretation .....	63
i)	The Ordinary Meaning .....	63
ii)	The Context .....	64
iii)	The Object and Purpose of the Treaty .....	64
iv)	Conclusion .....	66
2.	Application of the Standard .....	67
a)	The Czech Republic's Discriminatory Response to the Bad Debt Problem.....	67
i)	Comparable Position of the Big Four Banks regarding the Bad Debt Problem.....	68
ii)	Differential Treatment of IPB Regarding State Assistance .....	69
iii)	Lack of a Reasonable Justification.....	70
b)	Failure to Ensure a Predictable and Transparent Framework.....	74
i)	Nomura's Expectation that IPB would not be Treated Differently .....	74
ii)	The Unpredictable Increase of the Provisioning Burden for Non-Performing Loans .....	75
iii)	Nomura's Expectation regarding the Legal Framework for the Enforcement of Loan Security .....	75
c)	Refusal to Negotiate in Good Faith .....	76
i)	The Developments during the First Half of 2000 .....	77
(a)	The Government's Role in CSOB's Acquisition of IPB .....	77
(b)	The Government's Role in IPB's and Saluka's/Nomura's Attempts to Negotiate a Cooperative Solution .....	79
ii)	The Tribunal's Finding .....	84
(a)	The Lack of Even-Handedness .....	85
(b)	The Lack of Consistency .....	86
(c)	The Lack of Transparency .....	87
(d)	The Refusal of Adequate Communication.....	88
d)	Provision of Financial Assistance to IPB after Acquisition by CSOB .....	89
e)	Unjust Enrichment of CSOB at the Expense of Saluka .....	92
C.	Non-Impairment.....	93
1.	Meaning of the Standard.....	93
2.	Application of the Standard .....	94
a)	The Facts Underlying the Violations of the "Fair and Equitable Treatment" Standard (Article 3.1 of the Treaty).....	95
b)	The Facts Underlying the Deprivation Claim (Article 5 of the Treaty) .....	95
c)	The Czech Government's Alleged Triggering of the Second Run on IPB .....	96
D.	Full Security and Protection.....	98
1.	Meaning of the Standard.....	98
2.	Application of the Standard .....	99
a)	The Suspension of Trading in IPB Shares .....	99
b)	The Prohibition of Transfers of Saluka's Shares .....	100
c)	The Police Searches .....	100
E.	Conclusion .....	100
VII.	OTHER MATTERS.....	102
VIII.	DECISIONS.....	103

## DEFINED TERMS

Allianz	Allianz AG
Bankovní	Bankovní Holding a.s. (see also Bivalence and České pivo)
Big Four banks	Česká spořitelna, a.s. (“CS”); Komerční banka, a.s. (“KB”); Ceskoslovenská obchodní banka a.s. (“CSOB”); and Investiční a Poštovní banka a.s. (later known as IP banka a.s., or “IPB”)
CI	Česká inkasní, s.r.o.
CNB	Czech National Bank
CS	Česká spořitelna, a.s., one of the Big Four banks
CSC	Czech Securities Commission
CSOB	Ceskoslovenská obchodní banka a.s., one of the Big Four banks
CZK	Czech Republic Koruny
GDP	Gross Domestic Product
Hypo- Vereinsbank	Hypo-und Vereinsbank AG
IPB	Investiční a Poštovní banka a.s./IP banka a.s., one of the Big Four banks
KB	Komerční banka, a.s., one of the Big Four banks
KBC	KBC Bank of Belgium NV
KoB	Konsolidační banka, s.p. ú v likvidaci, State-owned debt consolidation agency
NPF	National Property Fund
OJ	Official Journal of the European Communities
OPC	Office for the Protection of Economic Competition
PCA	Permanent Court of Arbitration
Saluka	Saluka Investments BV
SI	Slovenská Inkasna, spol, s.r.o.
Treaty	Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of The Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991
UniCredito	UniCredito Italiano Group

## I. INTRODUCTION

### A. Commencement of the Arbitration

1. This arbitration arises out of events consequent upon the reorganisation and privatisation of the Czech banking sector as it had formerly existed under the centralised banking system of the Communist period, which ended in 1990. The Czech Government privatised one of the major Czech banks, known as IPB (see below, paragraph 33), by selling the State's shareholding to a company within the Nomura group of companies. The Nomura Group (see below, paragraph 42) is a major Japanese merchant banking and financial services group of companies, which typically operates also through subsidiaries set up in various countries. The Nomura company which bought the shares in IPB transferred them to another Nomura subsidiary, Saluka Investments BV ("Saluka"), a legal person constituted under the laws of The Netherlands.

2. By a Notice of Arbitration dated 18 July 2001 Saluka initiated arbitration proceedings against the Czech Republic as the Respondent, under Article 8 of the Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of The Netherlands and the Czech and Slovak Federal Republic, signed on 29 April 1991 ("the Treaty"). The Czech and Slovak Federal Republic was dissolved on 31 December 1992, and its two constituent parts became independent States as the Czech Republic and the Slovak Republic. The Czech Republic confirmed to the Kingdom of The Netherlands that, upon the separation of the Czech and Slovak Federal Republic into two separate Republics, the Treaty remained in force between the Czech Republic and the Kingdom of The Netherlands.

3. In accordance with Article 8(5) of the Treaty, the arbitration tribunal ("the Tribunal"), in determining its own procedure, has to apply the arbitration rules of the United Nations Commission for International Trade Law ("the UNCITRAL Rules"). Although, inevitably, at the time when the Notice of Arbitration was served the Tribunal had not been constituted, the Claimant's Notice of Arbitration was, as is usual in these circumstances, given to the Respondent pursuant to Article 3.1 of those Rules.

### B. Constitution of the Tribunal

4. Article 8 of the Treaty provides that the Tribunal will consist of three persons, each party appointing one member and those two members appointing a third person as Chairman of the Tribunal. Within the time-limits set out in that Article the three appointments were made, Mr Daniel Price being appointed by the Claimant, Professor Dr Peter Behrens being appointed by the Respondent, and Professor Sir Elihu Lauterpacht CBE QC being appointed as Chairman by agreement between the two previously-appointed members.

5. On 5 June 2002 Mr Price tendered his resignation. On 20 June 2002 the Claimant appointed in his place Maître L. Yves Fortier CC QC as a member of the Tribunal.

6. On 24 February 2003 Professor Sir Elihu Lauterpacht tendered his resignation. The two party-appointed members of the Tribunal agreed upon the appointment of Sir Arthur Watts KCMG QC in his place as Chairman of the Tribunal, and the parties were notified of this on 25 March 2003.

### C. Procedural Timetable

7. At a Procedural Meeting held in London on 2 November 2001:

a. it was agreed that the UNCITRAL Rules were the applicable rules of procedure in this arbitration;

b. the parties accepted the Tribunal's proposal that registry services for the arbitration should be provided by the Permanent Court of Arbitration ("PCA"), and the PCA agreed to provide such services;

c. Geneva, Switzerland, was selected as the place of arbitration, although this did not preclude the Tribunal from holding meetings at any other place, including The Hague, for the sake of convenience;

d. English was agreed as the language of the arbitration;

e. arrangements were made for the discovery of certain documents;

f. the following timetable for the submission of written pleadings by the parties was laid down (it being agreed that it would be more appropriate to use the international nomenclature for the parties' written submissions rather than the terms used in the UNCITRAL Rules):

Claimant's Memorial – 5 March 2002, and  
Respondent's Counter-Memorial – 17 May 2002;

g. the possibility of there being a second round of written submissions was reserved for future decision by the Tribunal, but tentative deadlines were set as follows:

Claimant's Reply – 19 July 2002, and  
Respondent's Rejoinder – 13 September 2002; and

h. arrangements were made regarding questions of confidentiality.

8. The timetable laid down for the first round of written pleadings was subsequently amended from time to time, by agreement of the parties.

### D. The Written Pleadings

9. Two days before the amended date fixed for the submission of the Claimant's Memorial, the Respondent on 13 August 2002 filed a Notice to Dismiss, by which it requested that the Tribunal dismiss the Claimant's claims.

10. At a Procedural Meeting in London on 10 September 2002 to consider this request, the Tribunal ruled that because the facts alleged in the Respondent's Notice to Dismiss were so closely related to the facts involved in the principal claim, the dismissal issue should be joined to the merits and ruled upon in the Tribunal's final award.

11. Meanwhile, in accordance with the amended timetable, the Claimant filed its Memorial on 15 August 2002.

#### E. The Respondent's Counterclaim

12. Before the amended deadline set for the filing of its Counter-Memorial, the Respondent submitted on 4 December 2002 a Notice of Counterclaim, setting forth a counterclaim against the Claimant in which it stated that it would elaborate in its Counter-Memorial.

13. By a letter dated 16 December 2002 the Claimant informed the Respondent of its view that the Tribunal lacked jurisdiction under the Treaty to hear a Counterclaim by the Czech Republic. In a subsequent exchange of correspondence, the Claimant proposed that the Tribunal hear its objections to jurisdiction prior to the filing of the Respondent's Counter-Memorial, while the Respondent suggested that any objections to the jurisdiction of the Tribunal to consider the Counterclaim be raised, and resolved by the Tribunal, after the filing of the Counter-Memorial.

14. In a "Direction by the Tribunal" ("Direction") issued on 15 January 2003 the Tribunal permitted the Respondent to proceed in the manner set out in its Notice of Counterclaim, by elaborating such claims within its Counter-Memorial (then due to be filed by 21 February 2003), and ordered the Claimant to respond by 31 March 2003 to the parts of the Counter-Memorial dealing with the Counterclaim by Objections limited to the question of the Tribunal's jurisdiction in that respect.

15. The Tribunal added that it expected the Respondent's elaboration to cover comprehensively the questions of the Tribunal's jurisdiction over the Counterclaim, and whether any connection is required between the Counterclaim and the Claimant's claim as submitted in its Memorial of 15 August 2002 and, if so, the nature and extent of such connection. The Direction reserved the question whether oral proceedings would be necessary on this issue, and suspended the proceedings in respect of the rest of the case until the question of the Tribunal's jurisdiction over the Counterclaim had been decided.

16. The Tribunal set, and at the request of the parties varied from time to time, a timetable for the submission by the parties of their pleadings on the issue of jurisdiction, and the parties duly complied with that timetable as amended.

17. In its Counter-Memorial, submitted on 7 March 2003, the Respondent both set out its response to the Claimant's claims and dealt with the question of counterclaims.

18. As regards its Counterclaim, the Respondent set out the various heads of its Counterclaim in the Counter-Memorial, and addressed separately the question of the

Tribunal's jurisdiction over the Counterclaim. On 15 May 2003 the Claimant filed its "Objections to Jurisdiction over the Czech Republic's Counterclaims" ("the Objections"). This was followed, on 29 September 2003, by the Respondent's "Response to the Claimant's Objections to Jurisdiction over the Czech Republic's Counterclaims" ("the Response"), and on 10 November 2003 by the Claimant's "Reply to the Czech Republic's Response to the Claimant's Objections to Jurisdiction over the Czech Republic's Counterclaims" ("the Reply").

19. On 11 November 2003 the Respondent requested a hearing on the issue of the Tribunal's jurisdiction over its Counterclaim. The Tribunal fixed 6 March 2004 for the hearing, and the Tribunal and the parties met in London on that date for the purpose of hearing oral argument on this issue.

20. On 7 May 2004 the Tribunal handed down its *Decision on Jurisdiction over the Czech Republic's Counterclaim* ("Decision on Jurisdiction over Counterclaims"). For the reasons set out in that Decision, the Tribunal decided

- a. that it was without jurisdiction to hear and determine the Counterclaim put forward by the Respondent in its Counter-Memorial;
- b. that that Decision was without prejudice to the issue raised by the Respondent's Notice to Dismiss of 15 August 2002, which had been joined to the merits by the Tribunal's ruling of 10 September 2002;
- c. that questions of costs arising as a result of the presentation by the Respondent of the Counterclaim set out in its Counter-Memorial were reserved until final consideration could be given to questions of costs in this arbitration as a whole; and
- d. that the Tribunal would separately set out a revised timetable for the remaining written pleadings of the parties.

21. In a letter dated 9 June 2004 the Claimant subsequently raised a question as to the effect of the Tribunal's Decision on Jurisdiction over Counterclaims, contending that Part IV of the Respondent's Counter-Memorial (in which the Respondent had set out its arguments on its counterclaims) was to be treated as struck out and that in consequence the Claimant need not in its Reply deal with the matters contained in that Part IV. After obtaining the views of the parties the Tribunal on 26 July 2004 conveyed to the parties its view that its Decision on Jurisdiction over Counterclaims had the consequence that Part IV of the Respondent's Counter-Memorial was no longer relevant to the arbitration in so far as it concerned the question of counterclaims, but that it did not necessarily follow that Part IV was also irrelevant to other questions which might still arise in the arbitration. Since the possible relevance of Part IV to such other questions was a matter to be argued by the parties as part of the further proceedings on the merits, the Tribunal was unable to agree to the Claimant's request that the Tribunal should now order that Part IV be struck out of the pleadings altogether.





## II. THE FACTS

26. Saluka claims in this arbitration that the Czech Republic acted in relation to Saluka and its investment in a manner inconsistent with the Czech Republic's obligations under the bilateral investment treaty ("BIT") between The Netherlands and the Czech Republic. In particular, Saluka claims that it was deprived of its investment contrary to Article 5 of that treaty, and that, contrary to Article 3, its investment was not treated fairly and equitably.

27. While the parties differed as to some of the facts and as to the interpretation to be made of the facts (those differences will emerge later in this Award), it appears to the Tribunal that the essential facts underlying this dispute were as follows.

### A. The Banking System in Czechoslovakia during the Period of Communist Rule

28. As was the case in many sectors of the economy, the banking sector in Communist Czechoslovakia – more formally, the Czech and Slovak Federal Republic – was highly centralised: it was an integral part of central State economic planning. That Communist era came to an end in 1990.

### B. The Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic 1991

29. As a step towards encouraging the development of a market economy in this former Communist State, a number of Western States concluded BITs with the Czech and Slovak Federal Republic. One such treaty was the Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic 1991 concluded with The Netherlands on 29 April 1991. The Treaty entered into force on 1 October 1992.

### C. The Separation of the Czech Republic and Slovakia

30. Following the end of the Communist era, the Czech and Slovak Federal Republic separated into its two constituent parts on 31 December 1992, and in its place the two independent States of the Czech Republic and Slovakia were created.

31. The Treaty had been concluded with the former State, the Czech and Slovak Federal Republic. By letter of 8 December 1994, the Minister of Foreign Affairs of the Czech Republic confirmed to the Minister of Foreign Affairs of the Kingdom of The Netherlands that the Treaty remained in force between the two States. No question of State succession in relation to the Treaty has been raised by the parties in this arbitration. The Tribunal, and the parties, have therefore proceeded on the basis that the Treaty applies to the situation which has given rise to the present dispute.

#### D. The Reorganisation and Privatisation of the Banking System in the Czech Republic

32. With the end of the period of Communist rule in 1990 and the subsequent establishment of the Czech Republic, the Czech authorities also took various steps to transform the economy into a more market-based system. This involved amongst other things attracting investment from abroad in order to provide the expertise to assist with this transformation. In particular it was necessary to reorganise the previously centralised banking sector.

33. By about 1994, the distinct segments of the former centralised banking system which revolved around the State Bank of Czechoslovakia had separated into four large State-owned commercial banks which dominated the banking sector in the Czech Republic. These “Big Four” banks were Česká spořitelna, a.s. (“CS”), Komerční banka, a.s. (“KB”), Československá obchodní banka a.s. (“CSOB”), and Investiční a Poštovní banka a.s. (later known as IP banka a.s., or “IPB”). The Czech banking sector was administered and regulated by the Czech National Bank (“CNB”).

34. IPB was the result of a merger in December 1993 between a bank known as “IB” (which had been formed in 1990 from part of the State Bank of Czechoslovakia) and the Post Office Bank: this merger gave IPB a right to provide banking services at 3,500 branches of Czech Post Offices until 2008 – the country’s largest retail banking network. IPB, however, did not just conduct a banking operation. By early 1996 it also managed a varied industrial portfolio, which included a substantial (83%) holding of shares in Plzeňský Prazdroj, the company that produces Pilsner Urquell beer. IPB’s corporate structure involved a Management Board of Directors (responsible for the day-to-day management of the bank) and a Supervisory Board (appointed and/or elected by IPB’s shareholders and employees, and responsible for general supervision and control), together with a General Assembly of shareholders. There was also a Chief Executive Officer.

35. With the end of the Communist period of control, the Czech Republic sought to transfer large parts of its hitherto State-owned economy into private ownership. It wanted to do this as rapidly as possible, and embarked upon a system of “mass voucher” privatisation – a system whereby State-owned firms were converted into joint stock companies, the shares in which were sold to Czech citizens for vouchers which they purchased for a nominal price. This process was substantially completed in two waves, and was concluded by 1995. In the case of larger and more strategic enterprises, however, only part of the share ownership was distributed through this mass privatisation procedure. A State agency known as the National Property Fund (“NPF”) retained a significant stake in these strategic enterprises, which included the Big Four banks – IPB, CSOB, CS and KB. The Czech State retained (directly or indirectly) a significant minority stake in and control over these banks: while the precise degree of the State’s shareholdings varied over time, at the times relevant to these proceedings, the State’s stake in CS amounted approximately to 45%, in KB to 48.75%, in IPB to 36%, and in CSOB to 46%. The final sale of the State’s remaining stakes in the banks and their privatisation was to follow in the period 1998-2001.

## E. The Czech Banking Sector's "Bad Debt" Problem

36. One of the legacies from the Communist era was a large level of outstanding debt, much of which included non-performing loans granted to large State enterprises which were insolvent. A large proportion of this bad debt problem found its way to the balance sheets of the Big Four banks. From them it was passed to the State-owned debt consolidation agency, Konsolidační banka, s.p. ú v likvidaci ("KoB"), which bought specific loans from the banks, whereby the purchase price exceeded the value of the loans. By 1995 most Communist-era bad debts had fed through the system.

37. However, economic practices in the post-Communist period created a substantial further bad debt problem in relation to new loans. It was government policy to continue the supply of credit to newly privatised firms, not necessarily on commercial terms, in order to keep the firms operating while they undertook the necessary restructuring; this liberal credit policy was applied even when, in truth, the firms being assisted were floundering and had ceased to service their loans. The Big Four banks (in which the State retained a significant stake) assisted in the carrying out of this policy. The balance sheets of the Big Four banks were once again seriously affected. By the end of 1999 the stock of non-performing loans in the portfolios of commercial and special institutions associated with the transformation of the economy amounted to one third of total loans or the equivalent of 26% of the Czech Republic's gross domestic product ("GDP"): a World Bank study in 2000 noted that this was one of the highest ratios in the new market economies of Central and Eastern Europe.

38. The problem was exacerbated by the absence at the time in the Czech legal system of an effective procedure to enable creditors to enforce payment of debts owing to them: moreover, collateral security for loans could not be sold without the debtor's consent. The CNB reported in 1997 that "[t]he balance between the rights and obligations of debtors and creditors is, on the long-term basis, tilted in favour of the debtors."<sup>1</sup> Some improvements in the legal regime regarding creditors' rights were made by new legislation, but this only entered into force on 1 May 2000.

39. This combination of relatively liberal credit policies and inadequate creditors' rights created a new "bad debts" or "bad loans" problem for the Czech banking system. By 1998 the Big Four banks again had a large non-performing loan problem, estimated at 34% for KB, 23.3% for CS, 16.6% for CSOB, and 21.75% for IPB.

40. A new Social Democratic Government which came to power in June 1998 sought to address these problems by action directed at business enterprises, through what was referred to as a "Revitalisation Programme"; both the Prime Minister and Minister of Finance expressly rejected the provision of further State aid directly to the banks. The new Government also claimed that it would improve creditors' rights, thereby helping creditor banks to recover their loans, but these promises either were not fulfilled, or were only fulfilled belatedly.

41. Given the continuing inadequacies in the legal regime of creditors' rights, the CNB felt obliged to take tough regulatory action in mid-1998 to protect the stability of the banking system. This action seriously affected the performance of the major banks, which had to

allocate a substantial part of their operating profits to additional provisions and reserves, causing some to return substantial losses for 1998.

#### F. Nomura's Acquisition of Control over IPB on 8 March 1998

42. Meanwhile, from mid-1996, Nomura began negotiations for the purchase of the State's shares in IPB. At this point the Tribunal must observe that "Nomura" is, in these proceedings, something of a *portmanteau* term. The Nomura Group, as a major international provider of banking and financial services, operates through a complex of associated and subsidiary companies, and it is not always easy to distinguish the separate capacities in which they act. For present purposes, it is convenient to distinguish between (1) the overall Nomura enterprise (which will be referred to as "the Nomura Group", "Nomura International" or sometimes simply "Nomura"), (2) an English-incorporated Nomura subsidiary known as Nomura Europe plc ("Nomura Europe" or sometimes simply "Nomura"), and (3) the Dutch-incorporated Nomura subsidiary known as Saluka Investments BV ("Saluka") and the Claimant in these arbitration proceedings. It is not, however, always possible to distinguish between these various emanations of Nomura, particularly since neither party has consistently made the necessary distinctions, much of the correspondence tendered in evidence is on writing paper headed "Nomura International PLC" even when dealing with the consequences of the Nomura/Saluka shareholding in IPB, and the Respondent indeed avowedly uses the term "Nomura" and "Saluka" interchangeably, in keeping with its view that as a practical matter Saluka is a mere shell used by Nomura for its own purposes.

43. The Nomura Group had had considerable direct experience of the Czech economy since about 1990, including advising the Czech Government on the privatisation of Czech breweries, and experience of the Czech banking sector, having previously advised both the Government and the Big Four banks in general as well as IPB in particular (with whom it had a long-standing relationship); it had also invested in Czech enterprises, and had an office in Prague since 1992.

44. In April 1996 IPB appointed Nomura to manage an equity offering, but ultimately this offering was abandoned. On 26 September 1996 Nomura offered to purchase the Government's shareholding in IPB at the price of CZK 300 per share, and to provide CZK 9 billion of new capital to the bank. The Government's shareholding consisted of 31.5% of IPB's shares held through the NPF, and a further 4.8% through other sources, in particular Czech Post – a total Government holding of some 36.3%.

45. A Nomura delegation led by Mr Yoshihisa Tabuchi (a Director and Counsellor at Nomura) met Mr Václav Klaus (Prime Minister), Mr Ivan Kočárník (Minister of Finance), Mr Josef Tošovský (Governor of the CNB) and others, including the management of IPB, at the end of October 1996 to discuss Nomura's offer. By about that time, Nomura reached an understanding with IPB's management that control over IPB would be exercised through shareholders agreements between Nomura and the management of IPB.

46. On 27 November 1996 the Government announced its intention to sell its shareholding in IPB through a public tender process, and therefore rejected Nomura's offer to buy the shares.

47. An internal Nomura analysis of December 1996 concluded that the viability of IPB as an investment depended on State support. Even so, on 23 December 1996, Nomura, through various subsidiaries, purchased approximately 5% of IPB shares (and by April 1997 had acquired almost 10% of IPB's shares). In or about December 1996 Nomura retained the firm later known as Price Waterhouse Coopers (after the merger of Price Waterhouse and Coopers & Lybrand in July 1998) to conduct due diligence of IPB: previously Nomura, as an "insider" working for IPB's management, had conducted extensive due diligence in connection with the abandoned equity offering of April 1996.

48. On 24 March 1997 the tender for the sale of up to 36% of the shares in IPB was announced by the NPF. The next day, Nomura International wrote to the Vice-Chairman of the NPF to declare its interest (the only other bidder to respond was ING Financial Services International). On 17 April 1997 Nomura presented a proposal to the Government for the purchase of the NPF's minority stake at CZK 300 per share (subject to due diligence and documentation).

49. As it was already a (minority) shareholder in IPB, Nomura then on 16 April 1997 entered into a shareholders agreement with other IPB shareholders whereby Nomura affiliates would offer to purchase the State's interest in IPB, and Nomura and the IPB management would jointly exercise control of IPB. On the same day, a second shareholders agreement which gave certain employment benefits to some of IPB's senior officials was also concluded.

50. On the next day, 17 April 1997, Nomura presented the NPF with a proposal to purchase its IPB shares and strengthen IPB's capital, and it informed the NPF that it had entered into shareholders agreements which gave it a strong position in IPB.

51. On 29 April 1997 Mr Jiří Tesař and Mr Libor Procházka, two senior members of IPB's Managing Board, were detained on charges of embezzlement. They were subsequently released, but nevertheless (and against a background of generally low public confidence in the banking sector) IPB's share price fell and clients began withdrawing funds. The NPF suggested to Nomura that, as a mark of confidence in IPB, a Nomura employee should join IPB's Management Board. Accordingly, in May 1997, Mr Eduard Onderka, a Director within Nomura's Merchant Banking Group, was appointed to IPB's Management Board; Nomura also provided a CZK 5 billion liquidity line to IPB following the drain on its liquidity caused by the outflow of deposits.

52. After receiving a provisional report on IPB from Price Waterhouse Coopers in June 1997, and a further Nomura internal analysis, both of which drew attention to IPB's poor financial position, Nomura International submitted a further proposal to the Government on 16-17 June 1997 whereby Nomura and the NPF would together have a controlling majority of IPB's shares. The Government rejected this proposal as not being consistent with Government policy, and requested Nomura to submit a further proposal on the lines of an outright purchase of the NPF's shareholding.

53. On 7 July 1997 Nomura submitted a new proposal for the purchase of up to 36.29% of IPB's share capital at CZK 285 per share (subject to due diligence and documentation); Nomura also proposed to subscribe a new issue of not more than 60,000,000 shares in IPB

(totalling CZK 6 billion), and an issue of 10-year subordinated bonds with a total face value not exceeding CZK 6 billion, with another similar issue if needed; and Nomura required a 10-year extension of IPB's franchise agreement with the Czech Post Office.

54. On 23 July 1997 this proposal was accepted by the Government. The purchase price was subject to adjustment based on IPB's net asset value (with the transaction capable of being unwound if the adjusted share price was below CZK 100 per share).

55. Matters appear to have rested there for several months. During that time (and particularly in July and August 1997) Nomura conducted further studies of IPB's financial position. These forecast that Nomura's anticipated profit from its IPB transaction would be US\$50-88 million, but also made it clear that IPB was in a serious financial state and without a large and immediate injection of capital, IPB could face forced administration, and that there were serious risks to investing in IPB.

56. In September-October 1997 Nomura sought an assurance from Mr Ivan Pilip (then Minister of Finance) that others of the Big Four banks would not be privatised under conditions more favourable to their investors than the conditions being offered to Nomura. Mr Pilip said that if he remained Finance Minister he would privatise other large banks in the same way as IPB, *i.e.* sell them in the condition they were in and without helping them to solve their debt problems prior to their sale, but added that he could not give Nomura any assurance that the privatisation of the other banks would proceed in the same way as the privatisation of IPB, since he could not bind a different future government which might adopt a different policy. Nor was any such assurance included in the eventual Share Purchase Agreement.

57. On 18-19 January 1998 Nomura and the NPF agreed to submit two alternative versions of their prospective share purchase agreement to the Government for approval, each based on different valuations of IPB's shares. The first provided for a share price of CZK 117 plus a commitment by Nomura to subscribe to CZK 6 billion of new share capital in IPB and an underwriting commitment for CZK 6 billion of subordinated debt; the second provided for a share price of CZK 147 and the same commitment to subscribe to CZK 6 billion of new share capital but only a "reasonable efforts" commitment for the issue of the CZK 6 billion of subordinated capital for the bank. On 2 February 1998 IPB's auditors Ernst & Young (on the basis of whose audit the Government insisted on working) confirmed that the net asset value of IPB shares was (as at 31 July 1997) CZK 147 per share. Price Waterhouse Coopers were unable to finalise a parallel audit of IPB on behalf of Nomura. The Government, in choosing between the two alternative versions of the prospective share purchase agreement, selected the alternative with the higher purchase price, namely CZK 147 per share.

58. From 3-4 February 1998, a Nomura International representative, Mr David Thirsk, met with a representative of IPB's senior managers to discuss Nomura's plans for IPB, which linked Nomura's purchase of IPB shares with Nomura's purchase of a shell company to hold IPB's Pilsner Urquell shares (as to which, see below, paragraphs 68-69). On 6 February 1998 Nomura wrote to the NPF emphasizing that Nomura was not entering into IPB as a strategic partner (*i.e.* an investor who acquires a company with a view to integrating the acquisition into its operations), but rather that it intended its role to be that of a limited recourse equity investor in IPB, or portfolio investor (*i.e.* an investor who acquires shares in a company as an investment, with a view to their eventual sale at, it would be hoped, a profit). Consistent with

this view of its position, Nomura Europe limited its shareholding in IPB to less than 50%, holding most (and eventually all) of its shares through Saluka, and allowing Nomura personnel to act only as shareholder representatives on IPB's Supervisory Board, and not as executive directors on IPB's Management Board.

59. At about this time, Nomura had agreed with certain significant counterparties an option – the so-called “Put Option” – whereby Nomura Europe could put its shares in IPB (at an initial price of CZK 115 per share) towards the purchase of other assets (notably IPB's holding of Pilsner Urquell shares), clearing the way for Nomura Europe's eventual acquisition in March 1998 of the NPF's shares in IPB. During this period the complex series of transactions regarding the acquisition and sale of Pilsner Urquell shares taking place (see below, paragraphs 68-69).

60. On 16 February 1998 and 2 March 1998 Nomura Europe submitted to the Czech authorities a paper on a “Strategy of Nomura Europe plc for IPB” in support of its application for CNB approval for its purchase of IPB shares: that approval was required by section 16 of the Czech Banking Act 1998. Nomura Europe did not disclose in this paper the Put Option which it had negotiated, nor its objectives in relation to the Pilsner Urquell shares. On 20 February 1998 Nomura filed for approval by the Office for the Protection of Economic Competition (“OPC”) of its acquisition of IPB shares; it did not inform the OPC that Nomura indirectly controlled the Radegast brewery and that IPB indirectly controlled the Pilsner Urquell brewery (the OPC's approval was given on 13 May 1998).

61. On 4 March 1998 the Government approved the sale of the IPB shares held by the NPF to Nomura Europe. On 7 March 1998 Nomura entered into a new shareholders agreement with the other parties to the shareholders agreement of 16 April 1997.

62. On 8 March 1998 Nomura Europe signed a Share Purchase Agreement with the NPF for the purchase of its approximately 36% holding of 20,620,083 IPB shares for about CZK 3 billion. The Agreement contemplated that Nomura Europe could transfer its shares to any special purpose company, trust, foundation, *Anstalt* or other entity, and provided also for a capital increase in IPB by a subscription of 60,000,000 further shares at CZK 100 per share, and for Nomura to reasonably endeavour to procure the underwriting of CZK 6,000,000 of subordinated debt. The total strengthening of IPB's balance sheet was thus some CZK 12 billion (about US\$348 million). The Agreement also gave the NPF pre-emption rights for a period of 5 years over the shares sold to Nomura Europe. The issue of the 60,000,000 shares was approved the next day at an extraordinary general meeting of IPB. Nomura Europe subscribed to all of those shares, at CZK 100 per share.

63. Certain important personnel changes were also made at the same time: Mr Randall Dillard and Mr Eduard Onderka were appointed to the Supervisory Board of IPB, Mr Jiří Tesař resigned as Chairman of the Board of Directors and moved to the advisory level of the Supervisory Board, Mr Libor Procházka resigned as Chief Executive Officer and became Deputy Chief Executive responsible for investment banking, and Mr Jan Klacek was appointed Chairman and Chief Executive Officer. Later, on 12 June 1998, Mr Daniel Jackson was appointed to the Supervisory Board of IPB.



64. On 10 July 1998 Nomura provided IPB with access to a US\$70 million revolving credit facility.

65. With its existing holding of about 10%, Nomura Europe now held, as a result of these transactions and the acquisition of the further 36%, some 46% of IPB's shares, thus giving Nomura Europe effective (although still minority) control over IPB.

66. The sale to Nomura Europe of the NPF's shareholding in IPB was the first situation in which the Czech Republic had fully disposed of its holding in a major bank. To some extent, therefore, it was a precedent for the projected privatisation of the whole banking sector.

#### G. Acquisition and Sale of Pilsner Urquell Brewery

67. In September 1997 IPB filed a merger notification with the OPC regarding Radegast and Pilsner Urquell breweries, but the merger was disapproved by the OPC on 10 December 1997 – a decision against which IPB appealed on 17 December 1997, and in which Nomura itself intervened on 19 January 1998 in support of IPB's appeal. That 10 December decision was cancelled on 5 June 1998. Further enquiries were ordered, but the merger was again disapproved on 12 August 1998, and again Nomura appealed but the merger notification was withdrawn on 22 November 1998, and the OPC closed the proceeding on 23 December 1998.

68. An internal "Transaction Structure" paper was prepared on 3 February 1998 by Nomura for its proposed purchase of IPB shares. In that paper IPB's shareholding in the company producing Pilsner Urquell beer was identified as IPB's most valuable strategic holding, and the paper indicated an intention, first, to buy 62.8 million shares in IPB for an amount which would be equal to the purchase price of the Pilsner Urquell shares, and, second, to sell those shares later to an international brewery company for a much greater price. On 3-4 February 1998, a Nomura International representative, Mr David Thirsk, met with a representative of IPB's senior managers to discuss Nomura's plans for IPB, which linked Nomura's purchase of IPB shares with Nomura's purchases of a shell company to hold IPB's Pilsner Urquell shares. On 5 February 1998 Nomura concluded a Cooperation Agreement with IPB's management. Under this agreement IPB would contribute its Pilsner Urquell shares, and Nomura would contribute its substantial (59.22%) interest in Radegast Brewery (which a Nomura affiliate had purchased from IPB on 19 September 1997) to a new entity. As already noted (above, paragraph 60), in its paper on a "Strategy of Nomura Europe plc for IPB" which Nomura Europe submitted to the Czech authorities in support of its application for CNB approval for its purchase of IPB shares, Nomura Europe did not disclose the Put Option which it had negotiated, nor its objectives in relation to the Pilsner Urquell shares. Similarly, in filing on 20 February 1998 for the OPC's approval of its acquisition of IPB shares, Nomura did not inform the OPC that Nomura indirectly controlled Radegast and that IPB indirectly controlled Pilsner Urquell. The OPC's approval was given on 13 May 1998. On 25 February 1998 Bankovní Holding a.s. ("Bankovní" – an affiliate of and controlled by IPB) purchased Bivalence, renamed the next day České pivo, a special purpose company whose only shareholder was Bankovní and whose only assets proved to be the Pilsner Urquell shares it purchased (with deferred payment) from IPB on 26 February 1998 and which it was to administer (Nomura appears never to have transferred its Radegast brewery shares to České pivo as originally planned). On 26 February 1998 České pivo signed an agreement with IPB to buy the bank's majority shareholding in Pilsner Urquell brewery.

69. On about 4 March 1998 Nomura set in motion a complex series of transactions which by June 1998 resulted in Pembridge Investments BV (“Pembridge”), a Nomura controlled entity, having the right to pay for the České pivo shares (*i.e.* holding Pilsner Urquell) with IPB shares. A further series of complex transactions between 31 May 1999 and 3 June 1999 involving three Cayman Islands companies – referred to as Torkmain, Levitan and Tritton – led to Nomura acquiring 84% of the shares of the Pilsner Urquell brewery with the right to pay for them by the delivery of IPB shares. These various transactions successfully operated the Put Option which Nomura had negotiated earlier (above, paragraph 59). In December 1999 Nomura International entered into an agreement which combined the Pilsner Urquell shares and Radegast shares, and then transferred all of those shares to a Dutch company, Pilsner Urquell Investments BV, and then sold that company to South African Breweries for a sum greatly in excess of the amount originally paid by Nomura for the Pilsner Urquell shares.

#### H. The Transfer of Nomura Europe’s IPB Shares to Saluka

70. Meanwhile, Saluka Investments BV (“Saluka”) had been established on 3 February 1998 as a special-purpose vehicle for the express purpose of holding the shares in IPB the purchase of which Nomura Europe was contemplating at the time. Saluka was incorporated in The Netherlands on 3 February 1988, and was owned by a Dutch charitable trust, Stichting Saluka Investments, and was managed by Nationwide Management Services BV

71. With its purchase of IPB shares completed, Nomura Europe, pursuant to the Share Purchase Agreement and with the approval of the CNB, transferred its IPB shares to Saluka in two tranches. In this way Saluka acquired ownership of 51,315,283 shares of Nomura Europe’s IPB shareholding on 2 October 1998, and Nomura Europe’s remaining 10,465,421 shares on 24 February 2000. Saluka bought these shares by issuing promissory notes to Nomura Europe, those notes being secured by a pledge over the shares; that pledge provided that Nomura Europe had the right to vote on the IPB shares. At the same time, Saluka entered into an agreement with Nomura International plc whereby the latter became Saluka’s sole sales agent for the IPB shares.

72. Saluka thus became the registered holder of the 61,780,704 shares in IPB which are the subject matter of this arbitration. Saluka subsequently agreed with Nomura Europe in June 2000 to sell the shares in return for the cancellation of the promissory notes which had been issued to pay for them. However, by the time of the hearings in this arbitration and still, so far as the Tribunal is aware, at the date of this Award, Saluka continues to hold the shares pending an instruction from Nomura Europe as to whom to transfer them: no such instruction has been given because of certain unresolved disputes. Consequently, at the time this arbitration was initiated, Saluka continued to be the registered holder of the IPB shares.

73. It is thus apparent that ownership of the controlling shares in IPB – and with it control over IPB’s other assets – vested in Saluka. In reality and in substance, however, it is equally apparent that Saluka’s rights of ownership seem to have been exercised in accordance with directions given by Nomura Europe or other elements of the Nomura Group. This duality of ownership and control is reflected in the parties’ pleadings, which in general do not distinguish carefully or consistently between Saluka and Nomura (whether Nomura Europe or other elements of the Nomura Group).

74. Upon acquiring effective control of IPB, Nomura set about various reorganizations of IPB's senior personnel, its banking strategy, its portfolio activities, its customer relations, its loan and loan recovery strategies, and its operational arrangements – all in the interests of strengthening IPB's market position in the Czech banking sector. These measures had considerable success, and IPB's position improved markedly.

#### I. The Government's Assistance to the Banking Sector (1998-2000)

75. While IPB is the Czech bank of principal importance for this arbitration, it was, as already noted, just one of the Big Four Czech banks, together with CSOB, CS and KB. In addition was the State-owned bad debt agency, KoB.

76. By mid-1998 the Czech banking sector was in serious difficulties, mainly as a combined result of the existence of a large bad debt problem, inadequate provision for creditors to enforce the rights to recover their loans, and the tough new regulatory steps taken by the CNB. One of the banks' particular problems was their ability or otherwise to maintain a capital adequacy ratio above the 8% minimum limit fixed by the CNB; if the ratio fell below that level, the CNB would have to take remedial measures, possibly involving revocation of a bank's banking licence.

77. The Czech Government embarked on a process of finally privatizing the Big Four banks which had previously only been partially privatised (above, paragraph 35). From early 1998 onwards the Government took a number of steps to assist one or other of the Big Four banks to overcome the difficulties with which they were faced. These varied forms of assistance mainly included, but were not necessarily limited to, those types mentioned hereunder.

78. As regards KB, the CNB at first saw no need for State participation in efforts to resolve KB's bad debt problem. However, in October 1998, the CNB itself proposed State participation in the light of recent developments in the financial markets. State participation in strengthening KB's capital participation was seen as necessary, especially given KB's dominant position in the Czech banking sector and the wider economic destabilisation to which serious weakening in its position could lead. The Czech Government decided by Resolution No. 820 of 28 July 1999 to arrange the purchase of major stocks of non-performing loans which were on KB's balance sheet. Accordingly, in August 1999, KoB purchased CZK 23.1 billion of KB's non-performing loans (at 60% of their face value) amounting to a capital injection into KB of CZK 9.5 billion. From December 1999-January 2000 the NPF subscribed to an increase of CZK 6.77 billion in the share capital of KB, thereby increasing the NPF's shareholding in KB from 48.74% to 60%. Despite these injections of State funds, KB reported a loss of CZK 9.2 billion for 1999. On 16 February 2000 the Government resolved to transfer a further CZK 60 billion of KB's non-performing loans, this time to a subsidiary of KoB but again at 60% of face value, amounting to a capital injection into KB of CZK 36 billion. By 2000 its share price had nearly trebled compared with its low point in 1999. The Government renewed its attempt fully to privatise KB by selling its now-majority stake in the bank. To facilitate a sale, KoB guaranteed a portfolio of KB's classified loans up to CZK 20 billion: this guarantee was signed on 29 December 2000, thereby avoiding the need for approval by the Czech Parliament under a new law which came into force on 1 January 2001. The net value of State assistance to KB in the period 1998-2000 thus amounted to some CZK 75 billion (with a further tax break to KB of CZK 4 billion

which only recently came to light). On 28 June 2001 the Czech Republic sold its 60% share in KB to Société Générale S.A. for CZK 40 billion (or EUR 1.19 billion).

79. CS, too, had a major bad debt problem. Its significance as a major element in the Czech banking sector made its continued viability important to the Czech Government. Its ability on its own to maintain the required 8% capital ratio was in doubt, but its private investors were unwilling to participate in any capital injections. The Government stepped into the breach. On 27 May 1998 the Government resolved to transfer CZK 4.1 billion to CS to cover losses of CS related to its deposits in the failed “AB banka.” On 9 December 1998 the Government resolved that CZK 10.5 billion of CS’ classified loans should be transferred to KoB at a price of CZK 4 billion (although their security value was much less). In December 1998 CS and KoB concluded an agreement for a ten-year loan for subordinated debt amounting to CZK 5.5 billion, which was fully funded by KoB on 23 December 1998. On 10 March 1999 the Government resolved to double CS’ share capital from CZK 7.6 billion to CZK 15.2 billion. On 8 November 1999 the Government approved the purchase of CZK 33 billion of CS’ non-performing loans by KoB at 60% of their face value, up to a maximum of CZK 20 billion. Meanwhile, in October 1999, the Government had embarked on the privatisation of CS by way of a sale of the NPF’s substantial stake in CS to Erste Bank of Austria, to whom the Government gave an exclusive negotiating position. To facilitate the conclusion of this sale the Government gave on 2 February 2000 a State guarantee until 2005 against losses from non-performing loans which were on the balance sheet of CS at the end of 1999 (the guarantee covered a portfolio of loans with a book value of CZK 88 million) and sold its (the NPF’s) shares in CS to Erste Bank for CZK 19 billion.

80. In relation to CSOB, the situation was for various largely historical reasons somewhat different from that at the other Big Four banks; in particular it did not suffer in quite the same way from the bad debt problem which afflicted the other banks. CSOB’s ability to ride out the economic crisis which affected the other banks was in considerable part due to various Government guarantees which had earlier been given to CSOB in relation to Česká inkasní, s.r.o. (“CI”), and then, on 14 April 1998, in relation to Slovenská Inkasná, spol, s.r.o. (“SI”), for which the Government indemnified CSOB from any liability resulting from Slovakia’s refusal to continue to fund that company. On 24 February 1999 the Government resolved to compensate CSOB for loans to industrial borrowers worth CZK 2.3 billion. On 31 May 1999 the Government resolved to assume CSOB’s liability on a loan made to failed Banka Bohemia in 1994. CSOB was privatised by virtue of the Government’s approval on 31 May 1999 of the sale, for CZK 40 billion, of the State’s 65.69% shareholding in CSOB (held through the NPF, the CNB, and the Ministry of Finance) to KBC Bank of Belgium NV (“KBC”) (which would eventually come to acquire 80% of CSOB).

81. In addition to these various forms of State assistance to CSOB, the relationship between CSOB and IPB gave rise to a special series of events involving further assistance to CSOB. In circumstances which will become apparent below (paragraph 143 and following), and which lie at the heart of the Claimant’s claims in this arbitration, IPB was sold to CSOB in June 2000. That transaction was complex, but a major element of it was the need for CSOB to be “held harmless” for any negative value associated with its purchase of IPB. The Tribunal sees no need for present purposes to set out the relevant provisions in all their complexity, since the main elements are clear and uncontested. These are that (1) CSOB had to pay a symbolic CZK 1 for its purchase of IPB; (2) CSOB benefited from arrangements which enabled it to avoid any downside risks arising from its purchase of any particular

assets of IPB; and (3) a substantial element of State aid was involved in the transaction, estimated at CZK 160-200 billion by the Ministry of Finance in June 2000 and audited by KPMG on 1 June 2001 at 159.9 billion. The acquisition of IPB made CSOB the leading bank in the Czech Republic.

82. Various measures of State assistance to KB, CS and CSOB have been described in the preceding paragraphs. With respect to IPB, assistance given to it by the State appears to have involved certain loss-producing loans worth CZK 16.1 billion being transferred to KoB in early 1998 (before Nomura Europe's purchase of IPB shares in March 1998), and the extension of IPB's past post office franchise when Nomura Europe bought the IPB shares, thereby giving it exclusive access to over 1,000 sales counters across the country. However, when the Government's Revitalization Programme (above, paragraph 40) for industrial enterprises finally received formal approval by the Government on 14 April 1999, its terms excluded IPB from the Programme, and IPB was excluded as a beneficiary.

83. The Big Four banks were of comparable strategic importance for the Czech economy as a whole; they also shared exposure to the bad debt problem, and to the inadequacies of the legal regime relating to creditors' rights. Collectively, these problems threatened the collapse of the Big Four banks, but they were too big to be allowed to fail: State assistance to avert collapse was necessary. The State assistance provided to KB, CS and CSOB amounted to 19% of the Czech Republic's GDP for 1999. It appears from various statements made by the banks and by the Government and the NPF in April-May 1998 that State assistance was given to KB, CS and CSOB on the basis that they were banks in which the State had a major shareholding interest, while IPB was not given such assistance as (after Nomura's investment in March 1998) it was regarded as a private institution whose fate was a matter for its private shareholders.

#### J. Developments in Respect of IPB (August 1999-end May 2000)

84. Following growing concerns at the CNB during 1998 with regard to IPB's banking practices, and CNB information-finding visits to IPB from mid-April 1999 to end-June 1999, the CNB began a regulatory inspection of IPB on 30 August 1999 which lasted until 5 November 1999. Serious financial deficiencies and irregularities were apparent.

85. In October 1999 Nomura began the search for a strategic partner for IPB. The involvement of the Czech Government was needed in this connection, in order to ensure the necessary level of State support for IPB's financial position (without which private sector investors would not find IPB an attractive proposition). In any event, the Czech Government would need to be involved since the approval of the Czech regulatory authorities would be required for any strategic partnership, and in the event of a merger with any other of the Big Four banks, the Government, as (directly or indirectly) a shareholder in those banks, would also have to give its consent.

86. During the autumn of 1999 it was clear that IPB needed an increase of capital to provide for its bad loans. In October, the CNB requested a significant increase in IPB's equity capital.

87. On 16 November 1999 IPB's General Assembly resolved to increase IPB's share capital, but this resolution was subsequently blocked by a minority shareholder on technical grounds. Another General Meeting was called for 19 February 2000 to seek approval for a capital increase of CZK 2.6 billion, to CZK 13.3 billion.

88. As a result of the CNB's August-November 1999 inspection of IPB, the CNB concluded both that IPB was not performing prudently, and that IPB needed to create at least CZK 40 billion of provisions – an amount the size of which made it clear that a major crisis was possible.

89. Discussions subsequently took place between representatives of the CNB and Ministry of Finance and representatives of IPB and Nomura to seek to identify possible solutions.

90. Meanwhile, IPB's management focussed on securing State aid, while Nomura concentrated on seeking a foreign strategic partner for IPB. A number of institutions showed interest, including in particular Allianz AG ("Allianz") and Hypo-und Vereinsbank AG ("Hypo-Vereinsbank"), with which Nomura signed a confidentiality agreement on 24 November 1999. However, on 26 January 2000 Hypo-Vereinsbank pulled out of the consortium with Allianz, and was later replaced by the UniCredito Italiano Group ("UniCredito").

91. In December 1999 Nomura (with reservations on the part of IPB's management) proposed a merger with CS. Nomura was able to make progress with an offer from Allianz for both IPB and CS, and the parties agreed on a framework for the transaction by 21 January 2000. These arrangements, however, came to nothing: the State had already issued a public tender for its interest in CS, the deadline for bids had passed, the proposal to merge IPB with CS was not specific enough in any event to comply with the rules of the tender, and the State was in the final stages of negotiations with Erste Bank of Austria (to which CS was eventually sold) (above, paragraph 79).

92. IPB's bid for CS attracted some media publicity and in January 2000 this led in turn to media criticism of the CNB, its Governor (Mr Josef Tošovský), and the Minister of Finance (Mr Pavel Mertlík). Mr Tošovský and Mr Mertlík blamed IPB's management for instigating these criticisms, which IPB's management strongly denied. On 4 January 2000 Mr Tošovský informed Mr Mertlík of the gravity of the situation at IPB.

93. On 10 January 2000 Mr Pavel Kavánek of CSOB met Mr Mertlík and expressed CSOB's interest in an acquisition to expand its share of the retail banking market, with IPB amongst possible targets.

94. On 20 January 2000 media reports of a statement by a CNB official, Mr Pavel Racocha, relating to the CNB's investigation of IPB, raised speculation as to the possibility of IPB being subjected to forced administration. Ten days later, on 30 January 2000, the CNB issued a press release stating that the inspection was a routine regulatory matter and had not yet been completed, and that suggestions that IPB's forced administration was under discussion were unfounded.

95. During February and March 2000 IPB and Nomura developed a proposal for a merger between IPB and KB, and later made presentations regarding it to the Government and the CNB, but this proposal came to nothing and was rejected.

96. In mid-February 2000 representatives of Nomura had several meetings with officials from the CNB. During these meetings, the CNB is said to have requested the resignation of two people from their senior positions on IPB's Supervisory and Management Boards – respectively, Mr Jiří Tesař (Chairman of the Supervisory Board) and Mr Libor Procházka (Deputy CEO of the Management Board) (they both resigned on 25 April 2000) – and also asked Nomura to provide the additional capital which IPB needed (*i.e.* for Nomura to take on the role of a strategic investor at IPB), failing which the CNB would seek to denigrate Nomura internationally. For his part, Mr Randall Dillard (Nomura's representative on IPB's Supervisory Board, and Vice-Chairman of that Board) and his colleagues claimed that, in the Share Purchase Agreement, the Czech Republic had agreed not to sell the State's interest in the other major banks on more favourable terms than its sale of IPB shares (a claim denied by the Respondent) (above, paragraph 56), and consequently that Nomura would not act to rescue IPB (*i.e.* provide the necessary additional capital) without State assistance (a position repeated in April 2000) – assistance which the Czech Republic was in the circumstances unwilling to provide.

97. Also during February 2000 Mr Daniel Jackson (Deputy Managing Director, Nomura, and member of the IPB Supervisory Board) began negotiations with Mr Luděk Niedermayer (Vicegovernor of the CNB) for a Memorandum of Understanding intended to establish a framework for their future. Although by the first week in March agreement had seemed close, ultimately the initiative came to nothing.

98. On 19 February 2000 IPB's General Assembly approved a capital increase of CZK 2.6 billion to CZK 13.3 billion.

99. On 25 February 2000 the CNB delivered its formal report regarding its previous year's inspection of IPB and, in March and April 2000, IPB, in accordance with the law, submitted written objections to specific parts of the report. Subsequent legal procedures could not be concluded because IPB's financial condition deteriorated too quickly.

100. In late February 2000 there was renewed and sustained media speculation about the CNB's review of IPB. The earlier rumours of IPB's possible forced administration (above, paragraph 94) persisted. In the week of 28 February 2000 IPB suffered a run on the bank (which was to prove to be the first of two major runs on IPB), and customers withdrew CZK 30 billion in deposits. Banks cut their credit lines to IPB, and froze or restricted their dealings with it. Meetings with high-level official Czech personnel during the week of the bank run led to a statement by IPB denying rumours of forced administration and emphasizing the strength of the bank, and the Minister of Finance, Mr Pavel Mertlík, and a senior official of the CNB, Mr Pavel Racoča, also made public statements seeking to calm depositors. The bank run stopped.

101. It seems that, at about this time, the course of the discussions between Czech officials and Nomura led to the Ministry of Finance and the CNB asserting their loss of trust in Nomura. The Minister of Finance refused to meet Nomura representatives. In mid-March

2000 the Minister of Finance and the Governor of the CNB appointed deputies (respectively, Mr Jan Mládek and Mr Luděk Niedermayer) to deal with Saluka/IPB. Thereafter, it appears that Czech officials had only a “soft mandate” in dealing with Saluka/IPB, and Mr Randall Dillard (then Head of the Merchant Banking Group at Nomura International, and who would later become Chairman of IPB’s Supervisory Board upon the resignation of Mr Jiří Tesař) could only have unofficial meetings off Ministry premises with the Deputy Finance Minister, Mr Mládek.

102. On 6 March 2000 the CNB obtained an expert study which showed that the macroeconomic costs which would be associated with IPB’s collapse (if it were to occur) would directly lead to a fall of about 4% in nominal GDP, and would probably cause a systemic crisis in the Czech financial sector.

103. On 14 March 2000 Mr Miloš Zeman, the Prime Minister of the Czech Republic, told Mr Dillard that discussions on the provision of State aid to IPB and on a merger between IPB and KB were conditional on Nomura injecting new capital into IPB.

104. Also in March 2000 CSOB approached Nomura for discussions with respect to IPB.

105. On 22 March 2000 Ernst & Young (IPB’s auditors) informed the CNB of the possibility that IPB might not comply with the required capital adequacy requirements, as a result of which the CNB formally asked IPB to prepare alternative methods for strengthening its capital should the minority shareholders block an increase in equity capital.

106. On 25 April 2000 the personnel changes at IPB requested by the CNB in February 2000 were made (above, paragraph 96). Mr Jiří Tesař resigned as Chairman of the IPB Supervisory Board and became instead Vice-Chairman, and Mr Libor Procházka resigned from his position as Deputy CEO of the IPB Board of Directors. Mr Randall Dillard took over as Chairman of the Supervisory Board.

107. In mid-April 2000 IPB submitted to the CNB some draft proposals to stabilise IPB, and submitted a further draft to the Government in May 2000, but the proposals were not acceptable as they did not give the State sufficient control over the restructuring process.

108. Nomura continued its attempts to find a strategic partner for IPB. Progress was made with the Allianz/UniCredito consortium. On 4 April 2000 a term sheet was signed providing for a capital increase for IPB and UniCredito’s entry as a strategic partner for the bank. By the middle of May active steps were being taken to follow through with this arrangement and on 22 May 2000 UniCredito began its due diligence enquiries on IPB. On 26 May 2000 UniCredito was in a position to propose the purchase of IPB at an opening bid of CZK 25-30 billion (twice its book value, subject to agreement on that book value) with a possibility of paying more.

109. At the same time as these discussions were taking place, Nomura’s representatives had since March 2000 also been meeting with representatives of CSOB to discuss CSOB’s potential entry into IPB as a Czech domestic partner. These discussions did not proceed smoothly, with CSOB, for example, refusing to sign a confidentiality agreement as a condition for access to IPB’s commercially-sensitive information, and insisting on taking



over IPB first and only thereafter negotiating the acquisition. CSOB's attitude by 5 May 2000 was that if IPB wanted Government support, then IPB needed CSOB.

110. The Government had also in April 2000 begun discussions with the potential investors in IPB which had been identified by Nomura, namely Allianz/UniCredito and CSOB. Both wanted to purchase IPB's assets rather than its shares, and both were unwilling to take over IPB without a guarantee and promise of indemnity from the State. Allianz/UniCredito moreover wanted several months to conduct due diligence, so only CSOB was able to take over IPB and continue its banking operations immediately.

111. Discussions between the Government and CSOB led to the preparation of a written presentation of CSOB's plans for IPB, dated 26 April 2000.

112. In May 2000 IPB, at the CNB's request, submitted a revised draft document to the CNB entitled "Measures for the stabilisation of IPB, a.s." This document became available to the press, leading ultimately to a second bank run in June 2000 (below, paragraph 126 and following).

113. On 2 May 2000 the Governor of the CNB, Mr Josef Tošovský, wrote to the Minister of Finance, Mr Pavel Mertlík, indicating the seriousness of IPB's capital position, its need for new capital, the impossibility of finding a strategic investor without State support, IPB's inability (as set out in the "Measures for the stabilisation of IPB, a.s.") to address the problem of capital adequacy without State assistance, and the imminence of the bank's collapse. The Governor saw the options as either stabilising the bank with a private investor and with State support, or nationalising the bank, or imposing forced administration, or revoking the bank's licence.

114. On 5 May 2000 (with follow-up letters on 8 and 9 May), and at the request of the CNB, Nomura wrote to the Ministry of Finance requesting discussions on the entry of a strategic partner into IPB, and stated its willingness to arrange for up to CZK 13.2 billion of new capital on reasonable commercial terms. No reply to these letters was received.

115. On 18 May 2000 Mr Jan Mládek, the Deputy Finance Minister, informed Mr Randall Dillard that the Ministry of Finance wanted to nationalise IPB, and proposed to buy Nomura's shares (*i.e.* by this time, Saluka's shares) at a symbolic price of 1 euro: to this end Mr Mládek wanted Nomura to obtain an additional 5% in IPB.

116. On 24 May 2000 Nomura informed the CNB that, because of the timing of IPB's auditor's statement and the IPB's General Assembly in late June 2000, the deadline for finding a solution was mid-June. Mr Pavel Racoča, for the CNB, explained that if neither IPB nor IPB's shareholders resolved IPB's problems, the CNB would have to impose forced administration on IPB. On 26 May 2000 Ernst & Young, IPB's auditors, informed the CNB that IPB needed provisions of CZK 21 billion.

117. Also on 24 May 2000 Mr Dillard submitted to the Prime Minister a further proposal entitled "Securing future for IPB", involving Nomura assuring a CZK 20 billion capital increase, a sale of 51% of IPB shares to Allianz/UniCredito and CSOB/KBC, and a KoB guarantee of IPB's balance sheet; on 25 May 2000 he gave the same presentation to the

Deputy Finance Minister, Mr Mládek. On 29 May 2000 Mr Mládek replied, rejecting that proposal (because it involved direct aid to IPB without the State having any control over the use of the funds), and reiterating the Government's offer to buy Nomura/Saluka's shares in IPB for a symbolic price of 1 euro. Nomura responded by asking how its proposal might be made acceptable. By 31 May the Ministry of Finance had refused to meet officially with Nomura or to consider any solution relating to IPB.

118. While those various developments were taking place, and despite the Government's appearance of co-operation with Nomura and IPB, the discussions between the Government and CSOB which began earlier in the year (above, paragraphs 109-111) to explore the possibility of CSOB gaining control of IPB should IPB run into serious difficulties, continued. These discussions were to lead to important developments at a meeting at which Mr Mertlík (Minister of Finance) and Mr Tošovský (Governor of the CNB) agreed to meet Mr Pavel Kavánek (CEO and Chairman of the Board of CSOB, aided by Mr Zdeněk Bakala, a well-known political lobbyist) and Mr Remi Vermeiren (President/CEO of KBC, a Belgian bank which was CSOB's largest shareholder): this meeting was to be held on 30 May 2000 in Paris where those concerned would be attending a banking conference.

#### K. Developments in Respect of IPB (end May 2000-7 June 2000)

119. In anticipation of that Paris meeting on 26 May 2000 Mr Kavánek wrote to Mr Tošovský and Mr Mertlík with certain proposals regarding the future of IPB, describing CSOB's proposed takeover of IPB and CSOB's readiness to act immediately. He enclosed two documents which emphasised the potential advantages of a merger between IPB and CSOB, and setting out CSOB's plan for the integration of IPB and CSOB. Further documents were to be delivered personally on the evening of 29 May 2000. These various documents have been together referred to by the Claimant as "the Paris Plan". It envisaged two possible alternatives for CSOB's takeover of IPB – a negotiated solution, or forced administration. The forced administration solution was presented as having fewer risks (although it appears that later the CNB would have preferred the more co-operative, negotiated solution, while also preparing for forced administration in case of an emergency). A detailed proposal for the carrying out of the forced administration solution was set out in the documents provided by Mr Kavánek, involving only a limited role for the Forced Administrator over the business activities of IPB and a transfer of IPB's day-to-day business to CSOB as quickly as possible.

120. On 30 May 2000 that meeting took place in Paris, to discuss CSOB's entry into IPB, or at least to allow the Government representatives the opportunity to listen to CSOB's proposals as part of their efforts to explore possible solutions to the IPB crisis. Mr Mertlík denied at the time that he participated in the meeting, and denied it also to the Czech Parliamentary Commission which subsequently investigated these matters. He also denied that KBC's entry into IPB was on the agenda of the Paris talks, and stated that, at the meeting, issues related to CSOB were primarily discussed.

121. On 1 June 2000 Ernst & Young, IPB's auditor, informed Mr Dillard that IPB was not a going concern because it was not meeting the CNB's capital adequacy requirements, and this triggered the CNB's obligation to revoke IPB's banking licence. On the same day the Government informed Nomura that State assistance would only be forthcoming if Nomura acquired a 51% stake in IPB (*i.e.* if it acquired a further 5%, since, as already explained, Nomura, through Saluka, already owned 46% of IPB's shares).

122. On 2 June 2000 the Government again repeated its 1 euro proposal. Nomura investigated ways of accommodating that proposal and, on 4 or 5 June 2000, presented three alternative proposals for the sale of IPB to the Government. None of these proposals was acceptable to the Government.

123. By about 6 June 2000 Nomura was focussing on asset sale as a solution.

124. On 7 June IPB's auditor informed the CNB that IPB needed to create provisions of at least CZK 20 or 21 billion, and possibly as much as CZK 40 billion. This meant that IPB could not meet capital adequacy requirements without external support. On 7 June 2000 Mr Mládek told Mr Dillard that IPB would be "toast" if it did not accept the 1 euro offer.

125. At about this time, Mr Mertlík met representatives of Allianz and UniCredito, who made proposals which, in their basic principles, were similar to that made by CSOB. Both banks wished to purchase IPB's assets, and both required a guarantee.

#### L. The Second Bank Run on IPB and its Aftermath

126. Statements apparently made by CNB officials and reported in the media on 8 June 2000, and a statement on 9 June 2000 by Mr Ladislav Zelinka, Deputy Finance Minister, raised speculation that IPB might be put into forced administration, and media speculation increased the following day (10 June 2000 – a Saturday). On Monday, Tuesday and Wednesday, 12-14 June 2000, there were mass withdrawals from IPB, amounting to CZK 17 billion. Reassuring statements by Government officials that were reported on 15 June had little or no effect.

127. The Parliamentary Commission which later enquired into these matters (below, paragraphs 144-147) found that by Monday, 12 June, documents before the CNB already set out a detailed time schedule of the steps to be taken to sell the enterprise, and that the Friday to Sunday period was essential to avoid the risk of legal actions being filed against the Forced Administrator. The Commission also noted that the CNB had already indicated the need to identify an individual to accept the appointment as Forced Administrator, and to ensure that he was familiar with the proposed measures and the proposed timetable as well as his contemplated role.

128. On 14 June 2000 Mr Kavánek (CSOB) wrote to Mr Niedermayer (CNB) with a detailed proposal for accepting the operations of IPB, which he had been asked to submit at a meeting held the previous day. A written proposal was also received on the same day from Allianz/UniCredito.

129. During the run on IPB, Nomura (on behalf of Saluka) had been involved in intensive negotiations regarding the stabilisation of IPB with strategic investors, officials at the CNB and Ministry of Finance, and the Prime Minister. On 14 June 2000 IPB submitted a proposal to the Ministry of Finance, the CNB and the Prime Minister. The proposal involved a transfer of IPB's banking business to KoB for CZK 1 for on-sale to a long-term commercial banking partner acceptable to the Government (with arrangements for the distribution of such sale proceeds), accompanied by an expressed readiness on IPB's part to execute the proposal on or before Friday, 16 June 2000.

130. Representatives of the CNB and Ministry of Finance met on 15 June 2000 to discuss the 14 June proposal. Discussions lasted into the evening and, after the meeting closed, there was an e-mail exchange. The final e-mail (to IPB's lawyer, Mr Tomáš Brzobohatý) concluded by saying that the Ministry of Finance team was "now leaving for home and will continue tomorrow in the morning". With that e-mail, Nomura's representatives were under the impression (which proved to be mistaken) that the detailed heads of terms to implement their proposal had been substantially agreed and that negotiations would continue the following day. IPB notified both the Ministry of Finance and the CNB that its Supervisory Board had approved, and had recommended the Management Board to approve, this transaction. However, the proposal was seen by the Czech authorities to involve serious economic, legal and organizational risks for the Czech Republic.

131. After the bank run had started the Government and CNB held meetings with Allianz/UniCredito and CSOB on proposals for the takeover of IPB. Allianz/UniCredito's proposal was such that it was not in a position to take over IPB's enterprise quickly.

132. On Wednesday, 14 June 2000, the CNB prepared a report for the Government on IPB's situation and possible solutions, which included forced administration and, in that eventuality, the need for any subsequent sale to a strategic investor to be accompanied by a State guarantee, since otherwise no investor would be interested.

133. Also on that day, IPB wrote to the CNB (the letter being received on 15 June) stating that IPB's liquidity had seriously deteriorated and that its solvency was threatened. On Thursday, 15 June, withdrawals from IPB continued. Representatives of the Government and CNB met those from IPB and Nomura, who were told that, if IPB did not immediately get CZK 10 billion from the State, it would revoke IPB's banking licence. That afternoon Mr Petr Staněk – the prospective Forced Administrator (*i.e.* a sort of trustee in bankruptcy) – was approached by the CNB.

134. On the night of Thursday, 15 June 2000, the Government met to consider the IPB situation. The Governor of the CNB and the Minister of Finance explained the gravity of the situation, with Nomura unwilling to invest the necessary capital and unable to identify a strategic partner and with IPB's failure to comply with capital adequacy requirements leading to the withdrawal of its banking licence with consequential threat to the stability of the banking sector. They presented as solutions either a cooperative solution involving IPB's shareholders, or forced administration coupled with a quick sale accompanied by State guarantees. The Government decided not to adopt the IPB proposal but instead to impose forced administration coupled with a quick sale to a strategic investor, with CSOB as the only bank which could quickly take over IPB. Resolution No. 622 of 15 June 2000 approved the forced administration of IPB with the objective of a subsequent sale to CSOB as the strategic investor, the provision of a government guarantee for the assets of IPB in favour of CSOB, and the issue of guarantees by the CNB to CSOB.

135. Also on 15 June, the Czech Securities Commission ("CSC") applied a preliminary injunction which imposed an immediate suspension of trading in IPB shares.

## M. The Forced Administration of IPB and its Aftermath

136. On Friday, 16 June 2000, the CNB put IPB into forced administration. Although IPB considered that it had sufficient liquidity to survive a bank run, the CNB's stated reasons for imposing forced administration were that there was a considerable risk of the bank not being able to make payments (*i.e.* to survive a bank run) and that the CNB had to avoid a situation where panic among the bank's depositors permanently destabilised its operations. Moreover, the CNB explained that IPB's financial situation threatened the stability of the Czech banking system, and that the CNB was entitled to impose forced administration to remedy the bank's shortcomings which the bank's shareholders had failed to take the necessary measures to correct.

137. Late on the morning of Friday, 16 June 2000, the CNB informed IPB of its decision to introduce forced administration upon IPB and appointed Mr Petr Staněk as the Forced Administrator of IPB. The Forced Administrator thereupon assumed the powers of IPB's Board of Directors (*i.e.* took over the management of IPB), and all the powers of all corporate governing bodies of IPB were immediately suspended. The Forced Administrator was to do what was necessary to secure its unproblematic operations and to achieve an accelerated sale of IPB to CSOB, being its strategic partner. His monthly remuneration was also specified, with mention of a special bonus ("extraordinary reward") for the implementation of the sale to CSOB (the figures for the remuneration and the bonus were, however, removed by the Respondent from the copy of the document submitted in evidence). The CNB issued an irrevocable guarantee for all IPB creditors on that day, to prevent any panic.

138. Also on Friday, 16 June, IPB requested a short-term loan of CZK 10 billion from the CNB to maintain its liquidity – a request which was received after the appointment of the Forced Administrator. On that same day, CSOB also informed the Forced Administrator of its interest in purchasing IPB's enterprise.

139. Armed police entered IPB's headquarters and effected the physical removal from the premises of all bank managers.

140. On Saturday, 17 June 2000, and Sunday, 18 June 2000, the Forced Administrator discussed IPB's financial situation with Ernst & Young, IPB's auditor, who, on 18 June, told the CNB that IPB's capital adequacy ratio was in fact negative. The Forced Administrator informed the CNB of this (as required by the Czech Banking Act), whereupon the CNB (also as required by that Act) began the process of revoking IPB's banking licence.

141. In response to an expression of interest by CSOB in purchasing IPB's enterprise, the Forced Administrator engaged in extensive discussions with CSOB and its majority shareholder, KBC (a Belgian bank), on 17-18 June 2000; CSOB and KBC also had discussions with the CNB and the Ministry of Finance. The Forced Administrator, who had only limited options, decided to pursue the sale of IPB's enterprise to CSOB, for which on 18 June 2000 he sought the CNB's approval, which was granted. CSOB, however, had insisted on receiving a State guarantee from the Ministry of Finance, and a promise of indemnity from the CNB.

142. As the State guarantee and the CNB's promise of indemnity to CSOB involved State aid, the approval of the OPC was required. The OPC was accordingly involved in the final stages of the transaction, and reached a preliminary conclusion that State aid under the Sale Agreement and State Guarantee should be exempted from the general prohibition against State aid, characterised as restructuring aid and aid to remedy a serious disturbance in the Czech economy. On around 14 June Mr Kamil Rudolecký (Director of State Aid Department of the OPC) was first officially informed by his superior, Dr Jiří Buchta, of the plans to offer financial assistance to IPB, and, on Sunday, 18 June, he and Dr Buchta met with representatives of CSOB, including Mr Kavánek, to discuss the aid package about to be given to IPB. Subsequently, on the evening of Sunday, 18 June 2000, the OPC informed the Ministry of Finance of its approval of the aid packages under certain conditions, and delivered its formal decision to that effect on Monday, 19 June 2000. This decision (which was in some respects in terms identical with elements in the Paris Plan) had the appearance of retrospectively granting an exemption for the aid given to CSOB in the sale agreed over the weekend.

143. IPB was transferred to CSOB on Monday, 19 June 2000, and the Ministry of Finance signed the State guarantee to CSOB while the CNB signed its promise of indemnity to CSOB.

144. On 3 July 2000 the Ministry of Finance and the CNB prepared a report which was submitted to the Czech Parliament (Chamber of Deputies) to inform the public about the circumstances leading to the forced administration of IPB and its sale to CSOB. The next day the Chamber, at the instigation of the opposition parties, set up an Investigation Commission to clarify the State's decisions. The opposition parties had eight of the ten seats on the Commission. Its findings were summarised in a report submitted to the Chamber of Deputies on 11 August 2001.

145. The circumstances in which the sale of IPB to CSOB was effected were such as to raise questions as to its lawfulness under Czech law. The Parliamentary Investigation Commission appointed a legal expert to consider the matter who, in his report of 10 May 2001, concluded that the CNB was not entitled to put IPB into forced administration, that the Forced Administrator had not (particularly at the speed with which he disposed of IPB) fulfilled his responsibilities correctly, that the CNB's irrevocable guarantee for all IPB creditors of 16 June 2000 was null and void, and that CSOB had provided no consideration for IPB's banking business and accompanying State aid. The Commission itself found that by instructing the Forced Administrator to sell IPB's business to CSOB as quickly as possible the CNB had exceeded its legal powers, and that the way in which the strategic partner had been selected between 16 and 19 June was "unprecedented and non-transparent". The Commission also found that the CSOB Transaction Document signed on 19 June 2000 gave IPB to CSOB "effectively as a gift", that CSOB "obtained an undeserved benefit of many tens of billions of Czech crowns to the detriment of the state budget", and that the Minister of Finance, had he acted as he should have done, would have ensured that CSOB paid an appropriate price.

146. The Commission further found that the CNB had issued instructions to the Forced Administrator and in so doing had acted unlawfully, and that his testimony, in denying that he was acting under the instructions of the CNB, was false. In mid-September 2000 the Chairman of the Parliamentary Commission filed a criminal complaint against Mr Mertlík

and the Forced Administrator in respect of false testimony. The Commission concluded that the Forced Administrator “did not administer the bank. He only fulfilled his task to take over and sell the bank without having an idea of what he was actually selling”. In several respects it appears that the Forced Administrator, in selling IPB to CSOB as quickly as possible, may have acted inconsistently with his statutory and fiduciary duties under Czech law. The Commission did not, however, conclude that the Ministry of Finance or the CNB had done anything illegal. Its findings, in the view of the Respondent, were largely speculative and a politically motivated attempt to discredit the Government.

147. Apart from raising questions as to the lawfulness of the transaction under Czech law relating to aspects of the forced administration, the circumstances also raised similar questions as regards the granting of State aid in connection with the transaction. Under Czech law the Public Assistance Act generally prohibited the grant of State aid unless the aid had been notified to the OPC and granted a formal exemption by it: that Act came into force on 1 January 2000, and brought Czech domestic law on State aid into line with the Czech Republic’s international obligations under the Agreement of 4 October 1993 establishing an Association between the European Communities and their Member States, of the one part, and the Czech Republic, of the other (“the Europe Agreement”).<sup>2</sup> The various guarantees and indemnities which formed part of the transaction whereby CSOB acquired IPB could be regarded as State aid, under both the relevant Articles of the Treaty Establishing the European Community (“EC”) (“EC Treaty”)<sup>3</sup> and the parallel provisions of the Public Assistance Act.

148. In various respects, it was questionable whether the legal requirements for the granting of State aid were complied with in respect of, in particular, the guarantee announced on 19 June 2000, the Ministry of Finance’s non-compliance by the stipulated deadline with certain conditions imposed by the OPC in relation to the exemption granted for that guarantee, the indemnity given by the CNB to CSOB, the agreement of 19 June 2000 between the Ministry of Finance and CSOB whereby the Ministry undertook to compensate CSOB for all of the purchase price which CSOB would become obligated to pay to IPB for the IPB enterprise, and the conclusion, without the OPC’s approval, of a restructuring agreement of 31 August 2001 granting to CSOB an asset management contract over IPB’s former assets.

149. Nevertheless, the sale of IPB to CSOB went ahead on the basis of the Forced Administrator’s actions.

150. On 21 June 2000 the Government approved the provision of a State guarantee to CSOB for the assets of IPB provided that that guarantee would be replaced by a restructuring agreement whereby KoB would assume the security for IPB’s assets, and also approved the Ministry of Finance’s guarantee to the CNB to cover losses ensuing from the CNB’s promise to indemnify CSOB.

151. On 23 June 2000 Ernst & Young, IPB’s auditor, reported to the CNB that it had been unable to complete IPB’s audit for 1999 because IPB had failed to provide the auditor with necessary information.

152. On 30 June 2000 Saluka transferred 61,780,694 IPB shares back to Nomura. On 7 July 2000 Saluka submitted a Transfer Notice to the NPF, but on 21 July 2000 the NPF informed Saluka that it did not consider the document served to have been a proper Transfer Notice.

153. On 24 August 2000 the OPC approved the exemption of the State aid arising from the indemnity given to CSOB by the CNB.

154. On 6 September 2000 the CSC made a decision on the merits of the suspension of trading in IPB shares which hitherto had been based only on a preliminary injunction (above, paragraph 135). This decision became binding on 25 September 2000 and extended the suspension in trading which had previously been based on the preliminary injunction. The reasons given by the CSC for the actions it took were in the Claimant's view of questionable accuracy but, in the Respondent's view, were in no way improper. So far as the Tribunal is aware, the suspension of trading in IPB's shares still continues, as a result of further successive "temporary" injunctions issued by the CSC. Saluka's appeal to the Presidium of the CSC against the CSC's decision of 6 September 2000 and its imposition of a "new" temporary suspension on 11 October 2000 were rejected by two decisions of 18 January 2001.

155. On 16 January 2001 the CSC, acting under a new amendment to the Czech Securities Act, issued a Notice of Loss of Position as a Participant against Saluka, having the effect that Saluka was no longer considered a party to the "new" suspension proceedings commenced on 11 October 2000, or any other suspension proceedings commenced after 1 January 2001. Shareholders were thereby excluded from challenging suspensions of trading in shares owned by them.

156. On 26 October 2000 a Police Order was issued, at the request of CSOB, which required the CSC permanently to suspend Saluka's right to dispose of its shares in IPB. Saluka appealed against this Police Order to the State Prosecutor and this challenge was upheld on 5 February 2001. However, the Czech police issued a new suspension Order over IPB's shares, which the Securities Centre registered on 31 January 2001. Following a request from Saluka on 1 November 2001 (*i.e.* after the present arbitration had been initiated) for the removal of the suspension Order, and the police's refusal to do so, the Public Prosecutor's Office in Prague ruled on 23 April 2002 that there was no legal basis for the suspension Order against the shares, but ordered that Saluka's IPB shares be held in the custody of the District Court of Prague. On appeal to the Supreme Public Prosecutor's Office on 16 May 2002 the Public Prosecutor's custodial order over Saluka's shares was quashed. The Supreme Public Prosecutor's Office, however, also held – on a point which was not part of Saluka's appeal, and on which Saluka had not been heard – that it was still justifiable to secure Saluka's shares in IPB by suspending trading in them. Since the Supreme Public Prosecutor's Office was the final appellate instance, Saluka lodged a petition with the Czech Constitutional Court on 18 July 2002 seeking an appropriate remedy.

157. On 30 January 2001, the Czech police carried out a search of Nomura's Prague Representative Office and seized documents belonging to Nomura. This police search was subsequently held by the Constitutional Court on 10 October 2001 (*i.e.* after the present arbitration had been initiated) to have violated Nomura's fundamental rights, and the Court ordered the return of the documents seized during the search.



158. On 19 March 2001, the OPC reopened the proceedings which led to its decision of 19 June 2000 (above, paragraph 142) approving the Agreement for the sale of IPB to CSOB and the associated State Guarantee Agreement. On 23 August 2001, *i.e.* after the present arbitration had been initiated, the OPC disapproved the payment to CSOB for the costs of the forced administration, but, in a further decision of 15 December 2003, the OPC approved that item and approved the Sale Agreement and State Guarantee.

159. On 18 July 2001 Saluka filed its Notice of Arbitration initiating the present arbitration against the Czech Republic. All subsequent events (to some of which attention has already been drawn) therefore post-date the commencement of this arbitration.

160. On 16 June 2002 the forced administration of IPB ended and Nomura resumed control over IPB. IPB subsequently filed several claims against the Czech Republic, CSOB and JP Morgan. On 4 December 2002 the Czech Republic and the NPF initiated the NPF arbitration against Saluka and Nomura, and later that month an arbitration tribunal ordered Nomura to transfer the IPB shares to CSOB.

161. On 16 December 2003 and in January 2004 the European Commission (“EC”) made decisions which had the effect of establishing that it would not review the compatibility of all State measures towards KB and CS with EC State aid rules.

162. At the end of January 2004 the Board of Directors of IPB (controlled by Nomura) and Mr Petr Beneš (former director of IPB) separately filed for IPB’s bankruptcy. On 5 February 2004 IPB was declared bankrupt.

163. On 16 February 2004 the CSC registered CSOB as the new owner of Saluka’s IPB shares.

### III. THE PARTIES’ ARGUMENTS AND SUBMISSIONS

164. On the basis of the facts and the law as it saw them, the Claimant considered that the Czech Republic had acted in a way which was discriminatory, unfair, inequitable and expropriatory, and was thus in breach of its obligations under the Treaty, in particular those arising under Articles 3 and 5.

165. In its Memorial, the Claimant requested the following relief:

- (a) a declaration that the Czech Republic has breached Article 3 of the Treaty by failing to accord Saluka’s investment fair and equitable treatment;
- (b) a declaration that the Czech Republic has breached Article 5 of the Treaty by depriving Saluka of its investment unlawfully and without just compensation equal to the genuine value of the investment;
- (c) an order that the Czech Republic pay Saluka compensation for the damages that it has suffered as a result of the breaches of the Treaty, such damages to be determined by the Tribunal based on further submissions;

- (d) interest on the compensation to be awarded to Saluka, in an amount to be determined by the Tribunal; and
- (e) an order that the Czech Republic pay the costs of these arbitration proceedings, including the costs of the Tribunal and the legal and other costs incurred by Saluka, on a full indemnity basis.

166. The Claimant's subsequent pleadings, both written and oral, did not vary those requests.

167. For its part, the Respondent, on the basis of the facts and the law as it saw them, denied that there had been any breach of its obligations under the Treaty and, in any event, challenged the entitlement of Saluka to invoke the arbitration provisions of the Treaty.

168. In its pleadings, the Respondent requested the following relief:

- (a) In its Notice to Dismiss, "that the Tribunal dismiss with prejudice the arbitration filed by Saluka and award the Czech Republic its attorneys' fees and costs";
- (b) In its Counter-Memorial,
  - (i) a declaration that Saluka breached the Agreement and engaged in other unlawful acts;
  - (ii) an order that Saluka pay the Czech Republic compensation for the damages suffered as a result of Saluka's unlawful acts presently estimated to be approximately CZK 100 billion to CZK 260 billion (approximately US\$3.22 billion to US\$8.38 billion);
  - (iii) interest on the compensation awarded to the Czech Republic, in an amount to be determined by the Tribunal; and
  - (iv) an order that Saluka pay the costs of these arbitration proceedings, including the costs of the Tribunal and the legal and other costs incurred by the Czech Republic, on a full indemnity basis;
- (c) In its Rejoinder (*i.e.* after the Tribunal's Decision on Jurisdiction over the Respondent's Counterclaims), "that the Tribunal render a final Award determining that the Czech Republic has not violated Articles 3 and 5 of the Treaty"; and
- (d) At the conclusion of its oral submissions, the Respondent asked that the Tribunal "render an award determining that there was no violation of either Article 3 or Article 5 of the Treaty" and, in its Post-Hearing Brief, "that the Tribunal issue a Final Award determining that the Treaty was not violated".

169. The Claimant in its Memorial stated that it was “appropriate and efficient to postpone precise issues of the quantification of Saluka’s loss to a separate phase of the proceedings when the Tribunal’s decision on liability is known”. In its Counter-Memorial, the Respondent stated that “[l]ike Saluka, the Czech Republic concludes that it is appropriate and efficient to postpone precise issues of the quantification of the Czech Republic’s loss to a separate phase of the proceedings”.

170. The parties developed their respective arguments fully in their written pleadings, which were submitted in the manner set out in Part I of this Award, the Introduction. They also refined their positions and put forward further arguments in support of their respective cases in the course of the oral hearings which were held in April 2005, as also set out in Part I of this Award.

171. The Tribunal considers that it will be more convenient if, rather than attempting to summarise the parties’ arguments as a whole, it instead summarises their contentions separately in the course of its consideration of each of the various particular issues which it is called upon to determine, and so far as they may be relevant to those issues.

#### IV. THE TRIBUNAL’S JURISDICTION

172. The Tribunal must first address the issue of its jurisdiction to hear and decide the dispute which Saluka has submitted to it.

##### A. The Parties’ Arguments

173. The Claimant’s Memorial was due to be filed on 15 August 2002. Two days earlier, on 13 August 2003, the Respondent filed a Notice to Dismiss, by which it requested that the Tribunal dismiss the Claimant’s claims.

174. By its Notice to Dismiss, the Respondent argued that (a) Nomura did not buy IPB shares in order to invest in IPB’s banking operations, but instead its true purpose was to facilitate its acquisition of Czech breweries in which IPB held a controlling shareholding; (b) Nomura did not disclose that true purpose to the Czech authorities at the time of its purchase of IPB shares; (c) Nomura had thus not acted in good faith and had violated the principle of non-abuse of rights, and was therefore not a *bona fide* investor; and (d) therefore Saluka, to whom Nomura had transferred its IPB shareholding, was precluded from having recourse to arbitration under the Treaty.

175. The filing of such a Notice had not been envisaged in the timetable fixed by the Tribunal, nor is it envisaged in the UNCITRAL Rules.

176. Article 21.3 of those Rules provides:

A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence or, with respect to a counter-claim, in the reply to the counter-claim.

177. Article 21.4 of the UNCITRAL Rules provides:

In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question. However, the arbitral tribunal may proceed with the arbitration and rule on such a plea in their final award.

178. At a Procedural Meeting in London on 10 September 2002 to consider the Respondent's request, the Tribunal ruled that, because the facts alleged in the Respondent's Notice to Dismiss were so closely related to the facts involved in the principal claim, the dismissal issue should be joined to the merits and ruled upon in the Tribunal's final award (above, paragraph 20, Part I.E. of the Decision on Jurisdiction over Counterclaims).

179. Nevertheless, the issue surfaced again in the context of the Respondent's Counterclaims. In the Notice of Counterclaim which the Respondent volunteered on 4 December 2002 the Respondent set out its proposed "counterclaim against Saluka" and stated that it would elaborate on such claims when it filed its Counter-Memorial. The Respondent stated in paragraph 380 of its Counter-Memorial that by its Counterclaim the Czech Republic sought relief on account of the manner in which Saluka (*sic*) handled its "purported investment". Although it thus appeared that the Counterclaim was intended to be directed against the Claimant, under each of the more specific heads of its Counterclaim, the Respondent's Counter-Memorial identified Nomura as the defendant (essentially Nomura Europe, which is a legal person constituted under the laws of England), whereas the Claimant in this arbitration is Saluka (which is a legal person constituted under the laws of The Netherlands).

180. The Claimant attached overriding weight to the fact that Nomura Europe on the one hand and Saluka on the other were separate legal persons constituted under the laws of different States, that only Saluka was the Claimant in this arbitration and within the jurisdiction of the Tribunal, that Nomura Europe could not be brought within the scope of the Czech-Netherlands Treaty, and that a counterclaim against Nomura Europe could not therefore be brought in these arbitration proceedings instituted by Saluka. The Respondent, however, maintained that, in the context of the circumstances which gave rise to this arbitration, the relationship between Nomura and Saluka was so close that they were in effect interchangeable as parties in these proceedings; indeed, in the Respondent's submission, such was the closeness of the relationship that the real party in interest was Nomura, and that Saluka was not a *bona fide* "investor" under the Treaty, for which reason the Respondent requested that the proceedings initiated by Saluka be dismissed.

181. The Tribunal did not, however, find it necessary to touch on those issues for the immediate purpose of reaching a decision on its jurisdiction to hear and determine the counterclaim advanced in this case by the Respondent. For that purpose, the Tribunal found it appropriate to proceed in the first place on the basis that the question of the relationship between Saluka and Nomura was assumed to be determined on the basis most favourable to the Respondent (see Decision on Jurisdiction over the Czech Republic's Counterclaim, paragraphs 41-44 and 81-82). Accordingly, the Tribunal initially proceeded on the assumption, but without deciding, that the relationship between Saluka and Nomura Europe was sufficiently close to enable the Tribunal's jurisdiction in proceedings instituted by Saluka to extend to claims against Nomura. The Tribunal then on that hypothetical basis addressed the several heads of the Counterclaim put forward by the Respondent, and concluded that the

disputes which had given rise to the Respondent's Counterclaim were not sufficiently closely connected with the subject-matter of the original claim put forward by Saluka to fall within the Tribunal's jurisdiction under Article 8 of the Treaty.

182. It followed from that conclusion that the Tribunal did not find it necessary in the context of its decision on its jurisdiction over counterclaims to reach any decision as to the nature of the relationship between Saluka and Nomura Europe and the consequences of that relationship, whatever it may be. Accordingly, the Tribunal's decision that it was without jurisdiction to hear and determine any of the heads of counterclaim put forward by the Respondent was without prejudice to the eventual consideration of that issue, involving in particular Saluka's standing as an "investor" under the Treaty. That issue remained to be considered at the merits phase of these proceedings, as originally decided by the Tribunal in its ruling of 10 September 2002.

183. In its Counter-Memorial and in subsequent pleadings, the Respondent elaborated its "dismissal" arguments, and added further arguments contesting the Tribunal's jurisdiction. In particular:

(a) The Respondent repeated its contention that Nomura had not made its investment in IPB in order to keep IPB viable but to facilitate the acquisition of two valuable Czech breweries through control of IPB's stake in them: Nomura's real objective was not to invest in IPB's banking operations but, by way of a Put Option scheme which in effect eliminated all downside risk from Nomura's purchase of the IPB shares, to acquire and then sell on IPB's shareholding in the brewery companies, which made Nomura's real objective something other than a *bona fide* investment in IPB. The investment had not been lawfully made (as was generally required for investment protection), but was part of a "dishonest scheme to secure enormous benefits". Czech law required Nomura to file a business plan for its investment in IPB, and a false filing was a breach of that legal requirement. Nomura's failure, in its filed business plan, to disclose its true objectives to the Czech authorities had led them to approve the purchase of IPB's shares, which they would not otherwise have done. Nomura had not acted in good faith and had violated the principle of non-abuse of rights, for which reason Saluka was precluded from relying on the international arbitral process provided by the Treaty.

(b) In any event, the Respondent contended that Saluka did not have any real and continuous *bona fide* social or economic factual links to The Netherlands, and should therefore be disqualified from being considered as an "investor".

(c) Moreover, the Respondent maintained that, in the context of the circumstances which gave rise to this arbitration, the relationship between Nomura and Saluka was so close that they were in effect interchangeable as parties in these proceedings and that the terms "Nomura" and "Saluka" could be used interchangeably, Saluka being nothing more than a shell used by Nomura for its own purposes. Indeed, in the Respondent's submission, such was the closeness of the relationship that the real party in interest was Nomura, and Nomura was not an eligible claimant under the Treaty.

(d) Saluka was not, so the Respondent contended, a *bona fide* “investor” as defined in the Treaty and was thus unable to have recourse to arbitration under it. The Respondent accordingly requested that the proceedings initiated by Saluka be dismissed.

184. In its subsequent pleadings (Rejoinder, oral argument, and Post-Hearing Brief), the Respondent contended principally that:

(a) Saluka had not made an investment in the Czech Republic since it had invested nothing, acting merely as a conduit for Nomura’s investment: Nomura retained the voting rights associated with the IPB shares, participated in the management of IPB, and conducted all the dealings with the Czech authorities. Saluka was a mere surrogate for Nomura, and a claim under an investment treaty could not be brought by an entity which was a surrogate for another entity which, like Nomura, was not covered by the Treaty. Saluka was an agent for Nomura, not a true investor.

(b) While a simplistic or literal view of Article 1 of the Treaty might suggest that Saluka was a qualified investor, the Treaty had to be interpreted in light of the realities of the situation, and they showed that Nomura and Saluka had not conducted themselves as true investors.

(c) “Piercing the corporate veil” was permissible as an equitable remedy where corporate structures had been utilised to perpetrate fraud or other malfeasance. Nomura had used corporate structures to realise profit and put the banking sector at risk, and to perpetrate fraud against the Czech Republic. The corporate veil should therefore be pierced, the real interest at stake should be recognised to be Nomura’s, and, as Nomura was not within the Treaty definition of an “investor”, the Tribunal was without jurisdiction.

(d) The Nomura Group had acted fraudulently and dishonestly throughout the events to which the case related. Nomura’s circular financing arrangements, the Czech beer deal, the Put Option and the establishment of the “Tritton Fund” (in the Cayman Islands) had all been conducted contrary to international *bonos mores*. This continuing failure to act in good faith and the abuse of process required that Saluka – which had never even been a *bona fide* holder of an investment which might have been injured – should be denied protection under the Treaty. Allegations of harm suffered by Nomura (rather than Saluka), and allegations based on the period before October 1998 when Saluka acquired its IPB shares, were outside the Tribunal’s jurisdiction.

(e) Moreover, the Claimant was acting in abuse of rights in instituting the arbitration since its purpose in doing so was to take advantage of the delay which would thereby be occasioned so that Nomura might gain advantage from the running of statutes of limitation in relation to civil or criminal proceedings which might be instituted by the Czech Republic in other fora.

185. In the Claimant’s Memorial, the Claimant simply relied on the fact that the Claimant was established under Dutch law for the express purpose of holding the IPB shares which Nomura had purchased, and that consequently it was an “investor” as defined in the Treaty and its shareholding was an “investment” as also so defined. The facts surrounding the purchase of the IPB shares showed that Saluka had fulfilled the requirement of Article 2 of

the Treaty that investments be lawfully made, and this was borne out by the approval given to the share purchase agreement by the Czech authorities. In its more specific written responses to the Respondent's more detailed exposition of its arguments on the question of the Tribunal's jurisdiction over counterclaims (*i.e.* in its Objections to Jurisdiction over the Czech Republic's Counterclaims and its Reply to the Czech Republic's Response to the Claimant's Objections to Jurisdiction over the Czech Republic's Counterclaims), the Claimant attached overriding weight to the fact that Nomura Europe on the one hand and Saluka on the other were separate legal persons constituted under the laws of different States, that only Saluka was the Claimant in this arbitration and within the jurisdiction of the Tribunal, and that Nomura Europe, as an English company, could not be brought within the scope of the Czech-Netherlands Treaty.

186. In its subsequent pleadings (Reply, oral argument, and Post-Hearing Brief), the Claimant repeated its view that Saluka was a Dutch legal entity and thus an "investor" and that its ownership of IPB shares was an "investment". The Claimant added further argument, in particular:

(a) Saluka's shareholding was not negated by allegedly not being "lawfully made" and therefore not *bona fide*; the only illegality which had been alleged concerned the Put Option, for which there was no basis and which in any event had already been held to be valid in an associated arbitration. In connection with obtaining the CNB's approval for the Share Purchase Agreement, Nomura had duly filed its business plan, which had only to relate to its intentions regarding the future conduct of IPB's banking operations.

(b) There was no need to consider whether or not Saluka had any factual links with The Netherlands, since the Treaty adopted the place-of-incorporation test and there was no basis for adding a "factual link" test.

(c) Saluka's investment in IPB was a real investment.

(d) Nomura did not mislead the Czech authorities as to the nature of its investment in IPB, having made clear its role as a portfolio investor all along.

(e) Nomura's acquisition of the brewery shares was a commercial and financial transaction which was not tainted by any impropriety.

(f) Nomura was a *bona fide* investor.

187. At the close of the oral hearings, the Tribunal asked the parties to address, in their post-hearing briefs, the following question:

[T]o what extent, if at all, (1) can the Tribunal consider and make findings about the conduct of Nomura? (2) is Nomura a necessary party to these proceedings in relation to that conduct?

188. The Claimant's response was that the Tribunal had jurisdiction to consider and make factual findings about the conduct of Nomura in so far as such findings might be relevant to

Saluka's positive case or the Czech Republic's defence, and that the possibility that the Tribunal had to make findings of fact with respect to Nomura's conduct did not require Nomura to be joined as a party to the proceedings.

189. The Respondent's answer to the Tribunal's question was that (1) the Tribunal might make findings of fact regarding Nomura's conduct without considering Nomura to be a "necessary party" to the proceedings, such an approach being typical in BIT arbitrations, and (2) although the Tribunal might make findings of fact regarding Nomura's conduct, Saluka could not recover any damages on the basis of Nomura's alleged loss – and since Saluka's alleged claims for damages were in fact Nomura's claims, Saluka's claims could be dismissed because Saluka is not seeking to recover for any losses that it had itself sustained.

190. In considering the various issues of jurisdiction and admissibility which have been raised, the Tribunal first notes that the Respondent's Notice to Dismiss in substance argues that the Tribunal should decline to entertain the proceedings initiated by the Claimant on the ground that the Claimant is not qualified to bring arbitration proceedings under the Treaty.

191. Accordingly, although the Notice to Dismiss is not worded as an objection to the Tribunal's jurisdiction, it may be assimilated to an objection that the Tribunal is without jurisdiction. As such, it was permissible (although perhaps procedurally unorthodox) for the Respondent to file its Notice making that objection. Doing so by way of the Notice to Dismiss filed on 13 August 2003 was within the time limit prescribed by Article 21.3 of the UNCITRAL Rules. So too was the further elaboration of the Respondent's arguments in its Counter-Memorial.

192. The Tribunal will now address the substantive arguments advanced by the Respondent by which it sought to show that the Tribunal was without jurisdiction to entertain the present proceedings.

#### B. Relevant Terms of the Treaty

193. The Tribunal's jurisdiction is governed by the terms of the Treaty. The immediately relevant terms of the Treaty are Article 8.1 and Article 1.

194. In relevant part, Article 8.1, to which Article 8.2 refers back, relates to "[a]ll disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter . . .".

195. In these proceedings, the Czech Republic is the relevant "Contracting Party" with which the Claimant claims a dispute exists.

196. In accordance with Article 8, the competence to make use of the arbitral process provided for in Article 8 of the Treaty is possessed by "investors" in respect of their "investments". Those terms are defined in Article 1 of the Treaty.

197. An investor of the "other" Contracting Party (in these proceedings, The Netherlands) must in the first place satisfy the definition of "investors" in Article 1(b)(ii) of the Treaty.



Under that definition, for the purposes of the present proceedings, that term comprises “legal persons constituted under the laws of [The Netherlands]”.

198. In the second place, the dispute between the Czech Republic and such an investor must be one “concerning an investment of [the investor]”. The term “investments” is defined in Article 1(a) as follows:

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.

### C. The Respondent’s Challenges to the Tribunal’s Jurisdiction

199. Although the Respondent did not always articulate the various grounds on which it challenged the Tribunal’s jurisdiction with the utmost clarity or consistency, and given its contention that Nomura and Saluka were interchangeable, the principal jurisdictional contentions put forward by the Respondent may be considered under the following headings:

- (a) the purchase of IPB shares was not an investment since Nomura/Saluka had invested nothing in IPB;
- (b) in so far as the purchase of IPB shares was an investment, it had not been lawfully made;
- (c) the real party in interest in the arbitration was not the Claimant, Saluka, but Nomura, which was not an eligible claimant under the Treaty;
- (d) the relationship between Nomura and Saluka was so close as to make them interchangeable;
- (e) Nomura/Saluka was not a *bona fide* investor in IPB;
- (f) Nomura/Saluka did not act in good faith in purchasing the IPB shares;

- (g) Nomura/Saluka acted in abuse of rights in the purchase of IPB shares;
- (h) Saluka had no real and continuous social and economic links with The Netherlands.

200. The Tribunal has concluded that the Claimant's shareholding of IPB shares is an "investment" within the meaning of the Treaty, that the Claimant is in respect of that investment an "investor" within the meaning of the Treaty, and that the Tribunal has jurisdiction to hear claims brought before it by the Claimant.

201. The Tribunal will now address each of the Respondent's contentions.

D. The Purchase of IPB Shares as an Investment and Compliance with Legal Requirements

202. Under a Share Purchase Agreement of 8 March 1998, Nomura Europe bought a controlling (but not majority) holding of shares in the Czech bank IPB. Most of Nomura Europe's shareholding in IPB was transferred to Saluka on 2 October 1998, with the balance being transferred on 24 February 2000. Saluka instituted these present proceedings by a Notice of Arbitration dated 18 July 2001, at a time when it was still the registered owner of the shares, alleging various Treaty breaches in respect of its holding of IPB shares.

203. The first question to be addressed is whether Saluka's holding of IPB shares is an "investment" for purposes of the Treaty. "Investments" are defined in the Treaty very widely. They comprise "every kind of asset invested directly or through an investor of a third State", certain of the more usual kinds of investments then being identified by way of illustration. These illustratively identified assets include in particular "shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom".

204. The Tribunal notes in passing that, although not in terms part of the definition of an "investment", it is necessarily implicit in Article 2 of the Treaty that an investment must have been made in accordance with the provisions of the host State's laws. In relevant part, Article 2 stipulates that "[e]ach Contracting Party . . . shall admit such investments in accordance with its provisions of law". Accordingly, and as both parties acknowledge, the obligation upon the host State to admit an investment by a foreign investor (*i.e.* in the present context, to allow the purchase of shares in a local company) only arises if the purchase is made in compliance with its laws.

205. There seems no room for doubt that a qualified investor's holding of shares in a Czech company such as IPB constitutes an investment within the scope of the definition.

206. The Respondent challenges that conclusion on a variety of grounds, notably on the basis that it was not an investment since Saluka had in reality invested nothing in IPB, and that, in so far as the purchase of IPB shares was an investment, it had not been lawfully made.

207. The argument that Saluka had invested nothing in IPB and for that reason the purchase of IPB shares could not be considered an "investment" seems to be based on two

considerations. The first is that Nomura, in making the original purchase of IPB's shares, and Saluka, in subsequently acquiring them, had no intention to make any true investment in the Czech Republic or in IPB's banking operations. The acquisition of IPB shares was never intended, so it is said, to be anything more than a short-term holding of shares with a view to the making of a large profit from the sale of major assets controlled by IPB, to be followed by the sale of the shares at an appropriate moment; Nomura and Saluka, so it is said, showed by their conduct throughout the events to which this case relates that they were not true investors.

208. The Tribunal first notes that the original purchase of IPB shares in March 1998 was not the act of Saluka but of Nomura Europe. Until 2 October 1998 only Nomura Europe held those IPB shares. It is consequently only the subsequent acquisition and holding of those shares by Saluka, from 2 October onwards, in respect of which the Respondent's arguments are relevant.

209. The Tribunal does not believe that it would be correct to interpret Article 1 as excluding from the definition of "investor" those who purchase shares as part of what might be termed bare profit-making or profit-taking transactions. Most purchases of shares are made with the hope that, in one way or another, the result will in due course be a degree of profit on the transaction. It is relevant in this context that, throughout the many discussions which took place between Nomura and the Czech authorities, Nomura insisted that it was only a portfolio investor in IPB and not a strategic investor. Even if it were possible to know an investor's true motivation in making its investment, nothing in Article 1 makes the investor's motivation part of the definition of an "investment".

210. The second consideration which is said by the Respondent to undermine any determination that the purchase of IPB's shares was an "investment" appears to be that Saluka itself invested nothing in IPB but was merely a conduit for the investment made by Nomura, which retained the voting rights associated with the IPB shares, participated in the management of IPB, and conducted all the dealings with the Czech authorities. Saluka was a mere surrogate for Nomura, being no more than an agent for Nomura and not itself a true investor.

211. To a considerable extent, this argument seeks to replace the definition of an "investment" in Article 2 of the Treaty with a definition which looks more to the economic processes involved in the making of investments. However, the Tribunal's jurisdiction is governed by Article 1 of the Treaty, and nothing in that Article has the effect of importing into the definition of "investment" the meaning which that term might bear as an economic process, in the sense of making a substantial contribution to the local economy or to the well-being of a company operating within it. Although the *chapeau* of Article 2 refers to "every kind of asset *invested*", the use of that term in that place does not require, in addition to the very broad terms in which "investments" are defined in the Article, the satisfaction of a requirement based on the meaning of "investing" as an economic process: the *chapeau* needs to contain a verb which is apt for the various specific kinds of investments which are listed, and since all of them are being defined as various kinds of investment it is in the context appropriate to use the verb "invested" without thereby adding further substantive conditions.

212. So far as concerns the lawfulness of the original purchase of IPB shares by Nomura Europe, the Respondent has argued that that shareholding cannot be regarded as a capital

investment through the purchase of IPB shares. These were that Nomura was not investing in IPB in order to support IPB's banking operations and keep IPB viable but to facilitate the acquisition of two valuable Czech breweries through control of IPB's stake in them: this was to be achieved by way of a Put Option scheme which in effect eliminated all downside risk from Nomura's purchase of the IPB shares, so enabling Nomura to acquire and then sell on IPB's shareholding in the brewery companies. This, so it was contended, made Nomura's real objective something other than a *bona fide* investment in IPB: the purchase of IPB's shares was part of a "dishonest scheme to secure enormous benefits". Czech law required a prospective purchaser of controlling shares in a bank to obtain the consent of the Czech authorities for that purchase, which meant that Nomura was required to file a business plan for its investment in IPB, and a false filing was a breach of that legal requirement. Nomura's failure, in its filed business plan, to disclose its true objectives to the Czech authorities had led them to approve the purchase of IPB's shares, which they would not otherwise have done.

213. In this context, the Respondent has invoked the requirements of Section 16(1)(a) and (e) of the Czech Banking Act. This provides (in the translation submitted by the Respondent):

Prior approval of the Czech National Bank shall be required

(a) for the establishment of an ownership interest by foreign a person in an existing bank,<sup>4</sup>

...

(e) acquisitions or transfers of registered capital amounting to more than 15% of a bank's registered capital, in the course of one or more transactions, by/to an individual or several persons acting in concert, unless due to inheritance.

While that provision of the Czech Banking Act establishes the need to obtain the CNB's approval, it says nothing about the investor's obligation to disclose its long-term plans and ultimate objectives.

214. The Respondent has in that respect invoked the provisions of the CNB's Official Communication 23/1995, Article III(2)(c) of which provides:

The investor shall submit the application to the CNB together with the following documents:

2. if the investor is a legal entity

...

(c) a business plan (in the event that the required volume of shares represents 10% and more of the registered capital of the bank).

While that provision requires the submission of a business plan, the Tribunal has seen nothing to suggest that it imposes a legal obligation upon an investor to disclose its future

long-term plans and objectives going far beyond the immediate purposes of its investment in the bank whose shares are being purchased. A “business plan” is inherently a label of considerable generality, and a Tribunal such as this must hesitate before reading into that label such a particular and far-reaching content.

215. The Respondent has not identified any other specific legal requirements relating to the filing obligation which have allegedly been violated. And although Mr Pavel Racocho (Executive Director of the Banking Supervision Department at the CNB) has testified that, had he been aware of the full story, he would not have approved Nomura’s share purchase, the Tribunal does not see in that statement anything to transform full disclosure of future long-term plans and objectives into a legal obligation for the investor.

216. So far as concerns any alleged illegality involved in the creation or operation of the Put Option, the Tribunal notes, and sees no reason to dissent from, the decision of the tribunal in the first arbitration under the Put Option agreement in *Torkmain Investments Ltd et al. v. Pembridge Investments BV et al.*,<sup>5</sup> in its second interim award, that the Put Option agreement was valid, as was the Put Option itself. Moreover, the Tribunal notes that, in the second such arbitration, it was accepted by CSOB (apparently acting on behalf of the Czech Republic) that those two matters were *res judicata* as a matter of Czech law.

217. The Tribunal is accordingly unable to conclude that the circumstances surrounding the original purchase of the shares by Nomura Europe have been shown to involve any breach of the law by Nomura Europe such as to warrant its purchase of IPB shares being considered an unlawful investment and so not entitled to protection under the Treaty. In this connection, the Tribunal notes that, throughout the events giving rise to this arbitration, the Czech authorities have never questioned either the legality of the original transaction by which Nomura acquired the IPB shares, or the legality of Saluka’s subsequent ownership of them: on the contrary, the Czech authorities took many steps explicitly acknowledging Saluka’s status as properly the owner of those shares after October 1998.

218. In any event, the Tribunal again observes that any illegality allegedly involved in Nomura Europe’s conduct at the time of its purchase of the IPB shares would be a failing by Nomura, not by the Claimant in these proceedings, Saluka. To be relevant to the present proceedings, Nomura’s failings (if any) at the time of purchasing the IPB shares in March 1998 need also to be in some way attributable to Saluka in relation to its acquisition and subsequent holding of the shares after October 1998.

219. So far as concerns the subsequent transactions by which those shares were transferred to Saluka, the Respondent appears to address this aspect of the matter by arguing that since, as it submitted, Nomura had not lawfully acquired any investment in IPB shares, therefore Saluka, which subsequently acquired the IPB shares from Nomura, was precluded from having recourse to arbitration under the Treaty, possibly (although this is not specified by the Respondent) either on the ground that the original purchase being unlawful, that illegality taints the subsequent holder’s title to the shares, or on the ground that since Nomura and Saluka are in effect interchangeable (as to which, see below), Nomura’s unlawful conduct is at the same time Saluka’s unlawful conduct.

220. Given the Tribunal's finding in paragraph 42 above, the Tribunal has no need to consider these arguments further.

221. The Tribunal accordingly concludes that there are no good reasons for declining to consider the Claimant's holding of IPB shares in issue in this case to be an "investment" within the meaning of the definition of that term in Article 1 of the Treaty.

E. Saluka's Qualification as an "Investor" Entitled to Initiate the Arbitration Procedures under the Treaty

222. The question which must next be considered is whether Saluka is a qualified "investor" for purposes of the Treaty.

223. There is no doubt that Saluka meets the only requirements expressly stipulated in Article 1 of the Treaty for qualification as an investor, namely that it be a "legal person", and be "constituted under the law of [The Netherlands]".

224. The Respondent, however, advances several arguments why Saluka should nevertheless not be considered an "investor" entitled to invoke the arbitration provisions of the Treaty in respect of Saluka's holding of IPB shares. These have been summarised in paragraph 199(c-h) above:

225. The six separate grounds there summarised amount, in substance, to three main arguments involving, first, the closeness of the relationship between Nomura and Saluka, second, the lack of good faith involved in the acquisition of IPB shares, and third, Saluka's lack of real links with The Netherlands.

1. The Corporate Relationship between Saluka and Nomura

226. As regards the first of these main lines of argument, the essential facts regarding the relationship between Saluka and Nomura have already been set out. In brief, "Nomura" or "the Nomura Group" is the convenient group name of a major Japanese merchant banking and financial services group of companies. It typically operates through subsidiaries set up in various countries. One element of the Nomura Group was Nomura Europe plc, a company constituted under the laws of England. (For convenience, where this company needs to be separately identified, it is referred to as "Nomura Europe".) Another part of the Nomura Group was Saluka, the Claimant in this arbitration. Saluka was constituted under the laws of The Netherlands for the sole and express purpose of holding the shares in IPB which Nomura Europe was at the time in the process of purchasing. Saluka was wholly controlled by Nomura Europe.

227. In those circumstances, the Respondent contended that, in the context of the circumstances which gave rise to this arbitration, the relationship between Nomura and Saluka was so close that they were in effect interchangeable as parties in these proceedings, Saluka being nothing more than a shell used by Nomura for its own purposes. Indeed, in the Respondent's submission, such was the closeness of the relationship that the real party in interest was Nomura (which was not eligible to present claims under the Treaty), and that

therefore Saluka was not a *bona fide* “investor” under the Treaty (a use of “*bona fide*” which, in this context, the Tribunal takes to mean something like “genuine” or “real”) and was therefore not entitled to have recourse to arbitration under it: Saluka was, in effect, a mere surrogate for Nomura, and a claim under an investment treaty could not be brought by an entity which was a surrogate for another entity which, like Nomura, was not covered by the Treaty. Although this involved looking behind the formal corporate structures of Nomura and Saluka, such “piercing the corporate veil” was permissible as an equitable remedy where corporate structures had been utilised to perpetrate fraud or other malfeasance. Nomura had used corporate structures to realise profit and put the banking sector at risk, and to perpetrate fraud against the Czech Republic. The corporate veil should therefore be pierced, the real interest at stake should be recognised to be Nomura’s, and as Nomura was not within the Treaty definition of an “investor”, the Tribunal was without jurisdiction.

228. The Tribunal accepts – and the parties have made no attempt to conceal, either from the Tribunal or, in the Claimant’s case, from the Czech authorities – the closeness of the relationship between Nomura and Saluka. In that respect, the companies concerned have simply acted in a manner which is commonplace in the world of commerce.

229. In dealing with the consequences of that way of acting, the Tribunal must always bear in mind the terms of the Treaty under which it operates. Those terms expressly give a legal person constituted under the laws of The Netherlands – such as, in this case, Saluka – the right to invoke the protection of the Treaty. To depart from that conclusion requires clear language in the Treaty, but there is none. The parties to the Treaty could have included in their agreed definition of “investor” some words which would have served, for example, to exclude wholly-owned subsidiaries of companies constituted under the laws of third States, but they did not do so. The parties having agreed that any legal person constituted under their laws is entitled to invoke the protection of the Treaty, and having so agreed without reference to any question of their relationship to some other third State corporation, it is beyond the powers of this Tribunal to import into the definition of “investor” some requirement relating to such a relationship having the effect of excluding from the Treaty’s protection a company which the language agreed by the parties included within it.

230. While it might in some circumstances be permissible for a tribunal to look behind the corporate structures of companies involved in proceedings before it, the Tribunal is of the view that the circumstances of the present case are not such as to allow it to act in that way. The Respondent acknowledges that this possibility presents itself as an equitable remedy where corporate structures had been utilised to perpetrate fraud or other malfeasance, but, in the present case, the Tribunal finds that the alleged fraud and malfeasance have been insufficiently made out to justify recourse to a remedy which, being equitable, is discretionary.

## 2. The Alleged Lack of Good Faith and Abuse of Rights

231. As regards the bundle of arguments which are said to involve in one way or another considerations of the alleged lack of good faith shown by Nomura/Saluka in the acquisition of the IPB shares, it seems that the Respondent relies on a variety of circumstances in support of its contention. Principal among these is that Nomura Europe did not, at the time of purchasing the IPB shares, disclose to the Czech authorities that its true purpose in doing so was not to invest in IPB’s banking operations, but rather, by way of the Put Option, to

facilitate its acquisition of Czech breweries in which IPB had a controlling interest, and that, by such non-disclosure, Nomura had not acted in good faith and had violated the principle of abuse of rights and was therefore not a *bona fide* investor. Expressed more generally (as set out above in paragraph 184), the Respondent maintained that the Nomura Group had acted fraudulently and dishonestly throughout the events to which the case related. Nomura's circular financing arrangements, the Czech beer deal, the Put Option and the establishment of the Tritton Fund had all been conduct contrary to international *bonos mores*. This continuing failure to act in good faith and the abuse of process required that Saluka – which had never even been a *bona fide* holder of an investment which might have been injured – should be denied protection under the Treaty.

232. The Tribunal does not consider that an investor – and particularly a portfolio investor – shows a lack of good faith in failing to disclose to the seller of shares, or to the host State's regulatory authorities, its ultimate objectives in entering into a share purchase transaction. The seller of shares, and the regulatory authorities, must be taken to be aware that a portfolio investor, particularly one forming part of a very large international financial group, will be making investments as part of a much wider corporate strategy than is involved in the purchase of shares in one particular company. In the Tribunal's view, it is both unreasonable and unrealistic to posit an obligation upon an investor to disclose its ultimate objectives in making a particular investment, whether through the purchase of shares or otherwise. Ultimate objectives will, in any event, often be highly speculative and not susceptible to precise articulation, and will be subject to change over time. An investor may choose to make its long-term plans known to a greater or (in the absence of a clearly legal requirement to the contrary) lesser degree, but that is quite different from establishing an obligation to that effect such as to make non-disclosure a head of "bad faith".

233. The Tribunal has already addressed the Respondent's further argument that Nomura's non-disclosure of its long-term intentions regarding its plans for the acquisition of Czech breweries and the construction of the Put Option involved a breach of the Czech law.

234. So far as specifically concerns the alleged abuse of rights by the Claimant, the right allegedly being abused could be either the right to acquire the shares in IPB, or the right to be regarded as an investor entitled to invoke the Treaty's arbitration provisions: the Respondent appears to assert that the circumstances are in either case sufficient to deprive the Claimant of its standing as an investor entitled to avail itself of those provisions. Those circumstances on which the Respondent relies appear to be Nomura's non-disclosure of its true long-term intentions with regard to its investment in IPB, and its alleged wish to use the delays which would be occasioned by recourse to arbitration so that Nomura might gain advantage from the running of statutes of limitation in relation to civil or criminal proceedings which might be instituted by the Czech Republic in other fora.

235. The Tribunal has already addressed the argument based on non-disclosure, and concluded that an investor – and particularly a portfolio investor – shows no lack of good faith in failing to disclose to the seller of shares, or to the host State's regulatory authorities, its ultimate objectives in entering into a share purchase transaction. Similarly, the Tribunal cannot see in such non-disclosure any circumstance which it could regard as an abuse of the right to acquire the shares or of the right to initiate the Treaty's arbitration procedures.



236. As regards the Respondent's allegation that the Claimant had in mind ulterior litigation motives in instituting the arbitration procedures provided by the Treaty, the Tribunal has to observe that, even if such an ulterior motive could be such as to involve an abuse of the right to invoke the arbitration procedures, that allegation is unsubstantiated and cannot be the basis for a decision by the Tribunal which would deprive it of jurisdiction to proceed with the arbitration which the Claimant has initiated.

237. In any event, the Tribunal again observes that the illegality, lack of good faith, or abuse of rights allegedly involved in Nomura Europe's conduct at the time of its purchase of the IPB shares would be a failing by Nomura, not by the Claimant in these proceedings, Saluka. To be relevant to the present proceedings, Nomura's failings (if any) at the time of purchasing the IPB shares in March 1998 need also to be in some way attributable to Saluka in relation to its acquisition and subsequent holding of the shares after October 1998.

238. The Respondent addresses this aspect of the matter by arguing that since, as it submitted, Nomura was not a *bona fide* or lawful investor, therefore Saluka, which subsequently acquired the IPB shares from Nomura, was precluded from having recourse to arbitration under the Treaty. Since the Tribunal is not persuaded that the original conduct of Nomura involved any illegality, lack of good faith, or abuse of rights, the Tribunal does not find it necessary to examine further the extent to which, had it made any findings of that kind, they might have affected Saluka's right to initiate arbitration proceedings under the Treaty.

### 3. Saluka's Lack of Factual Links with The Netherlands

239. The Respondent also argues that Saluka did not have *bona fide* (which term again seems to connote genuineness rather than any issue of bad faith), real and continuous links to The Netherlands, and for that reason did not satisfy the requirements which are necessary to qualify as an "investor" able to benefit from the provisions of the Treaty.

240. The Tribunal has some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure, and to practices of "treaty shopping" which can share many of the disadvantages of the widely criticised practice of "forum shopping."

241. However that may be, the predominant factor which must guide the Tribunal's exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal's jurisdiction. In the present context, that means the terms in which they have agreed upon who is an investor who may become a claimant entitled to invoke the Treaty's arbitration procedures. The parties had complete freedom of choice in this matter, and they chose to limit entitled "investors" to those satisfying the definition set out in Article 1 of the Treaty. The Tribunal cannot in effect impose upon the parties a definition of "investor" other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add.

242. The Tribunal is confirmed in the appropriateness of the view which it has taken by the consideration, in the particular circumstances of the present case, that it was always apparent to the Czech authorities that it was Nomura's intention to transfer the IPB shares it was purchasing to another company within the Nomura Group, and that that other company would be a special-purpose vehicle set up for the specific and sole purpose of holding those shares. The Share Purchase Agreement contained express provision to that effect. By applying the provisions of the Treaty in conformity with their express terms, no violence is done to the positions knowingly adopted by the parties at all relevant times.

#### F. The Tribunal's Conclusions as to Jurisdiction

243. Having thus considered the various challenges to its jurisdiction which the Respondent has advanced, the Tribunal concludes that the Claimant's shareholding of IPB shares is an "investment" within the meaning of the Treaty, and that the Claimant is in respect of that investment an "investor" within the meaning of the Treaty. Accordingly, the Tribunal is satisfied that it has jurisdiction to hear the claims brought before it by the Claimant under the arbitration procedure provided for in Article 8 of the Treaty.

244. In reaching that conclusion, however, the Tribunal wishes to emphasise that, in accordance with the Treaty, its jurisdiction is limited to claims brought by the Claimant, Saluka, in respect of damage suffered by itself in respect of the investment represented by its holding of IPB shares. It follows, therefore, that the Tribunal does not have jurisdiction in respect of any claims of Nomura, or any claims in respect of damage suffered by Nomura and not by Saluka, or any claims in respect of damage suffered in respect of the IPB shares before October 1998 when the bulk of those shares became vested in the Claimant. Although Nomura is not a party to these proceedings, the Tribunal nevertheless has jurisdiction to consider and make factual findings about the conduct of Nomura in so far as such findings might be relevant to the Tribunal's consideration of arguments advanced by the Claimant or the Respondent.

### V. SALUKA'S CLAIMS UNDER ARTICLE 5 OF THE TREATY

#### A. The Treaty

245. Article 5 of the Treaty 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.

B. The Parties' Principal Submissions

246. The Claimant asserts that Saluka has been deprived of the value of its shares in IPB by the Czech Republic's intervention which culminated in the forced administration of IPB.

247. The Claimant further maintains that, in this context, the only issue before the Tribunal is whether this deprivation was unlawful in accordance with the criteria of Article 5.

248. The Claimant concludes that the Czech Republic is liable under Article 5 if it can establish that one or more of the conditions set out in Article 5 has not been complied with, *i.e.* that:

- (a) the measures depriving Saluka of its investment were not taken in the public interest and under due process of law; or that
- (b) the measures were discriminatory; or that
- (c) the measures were not accompanied by payment of just compensation.

249. In support of its main contention, Saluka, in brief, maintains that the evidence before the Tribunal demonstrates the following:

- (a) The IPB proposal, rejected by the Czech Government, would have cost Czech taxpayers far less than the forced administration option. That option, says Saluka, was thus not in the public interest;
- (b) The Respondent's fact and expert witnesses were unable to point to a precise regulation with respect to a bank's liquidity requirements which had been breached by IPB. There was thus, argues Saluka, no due process;
- (c) The Forced Administrator never exercised truly independent judgment. Again, says Saluka, the forced administration measure was not taken under due process and was discriminatory;
- (d) The Czech Government granted State aid to IPB's competitors, thus infringing, says Saluka, the non-discrimination provision of Article 5;
- (e) The Czech Government resorted to its regulatory power unlawfully for the sole purpose of transferring IPB's business to CSOB. The measure, argues Saluka, was thus clearly discriminatory;
- (f) The Czech Government never paid any compensation to Saluka after having deprived Saluka of its investment.

250. The Czech Republic denies that it has violated Article 5 of the Treaty. In essence, it submits that the measures which it resorted to in order to address the IPB situation in the spring of 2000 and which culminated in the decision by the CNB to put IPB into forced administration were “permissible regulatory actions” which cannot be considered as expropriatory.

251. In support of its principal defense, the Czech Republic also avers that each of the measures cited by Saluka in its attempt to demonstrate that the Czech Republic’s actions were not genuine regulatory measures were indeed authorised by Czech law.

252. Subsidiarily, the Czech Republic argues that, since Saluka sold its IPB shares back to Nomura after June 2000 for the same amount as it purchased them, Saluka “has failed to establish a deprivation of sufficient magnitude to form the basis of an expropriation claim”.

### C. The Law

253. The Tribunal agrees with Saluka that the principal, if not the sole, issue which it must determine in the present chapter of its Award is whether the actions by the Czech Republic complained of by the Claimant are lawful or unlawful measures.

254. The Tribunal acknowledges that Article 5 of the Treaty in the present case is drafted very broadly and does not contain any exception for the exercise of regulatory power. However, in using the concept of deprivation, Article 5 imports into the Treaty the customary international law notion that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order. In interpreting a treaty, account has to be taken of “any relevant rules of international law applicable in the relations between the parties”<sup>6</sup> – a requirement which the International Court of Justice (“ICJ”) has held includes relevant rules of general customary international law.<sup>7</sup>

255. It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.

256. Nearly forty-five years ago, the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (“Harvard Draft Convention”),<sup>8</sup> which instrument is relied upon by the Czech Republic, recognised the following categories of non-compensable takings:

An uncompensated taking of an alien property or a deprivation of the use or enjoyment of property of an alien which results from the execution of tax laws; from a general change in the value of currency; from the action of the competent authorities of the State in the maintenance of public order, health or morality; or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful.

257. As Saluka correctly reminded the Tribunal, the above-quoted passage in the Harvard Draft Convention is subject to four important exceptions. An uncompensated taking of the sort referred to shall not be considered unlawful provided that:

- (a) it is not a clear and discriminatory violation of the law of the State concerned;
- (b) it is not the result of a violation of any provision of Articles 6 to 8 [of the draft Convention];
- (c) it is not an unreasonable departure from the principles of justice recognised by the principal legal systems of the world;
- (d) it is not an abuse of the powers specified in this paragraph for the purpose of depriving an alien of his property.

258. These exceptions do not, in any way, weaken the principle that certain takings or deprivations are non-compensable. They merely remind the legislator or, indeed, the adjudicator, that the so-called “police power exception” is not absolute.

259. The Tribunal further recalls that, in an accompanying note to the 1967 OECD Draft Convention on the Protection of Foreign Property,<sup>9</sup> it is provided that measures taken in the pursuit of a State’s “political, social or economic ends” do not constitute compensable expropriation.

260. Similarly, the United States Third Restatement of the Law of Foreign Relations in 1987<sup>10</sup> includes *bona fide* regulations and “other action of the kind that is commonly accepted as within the police power of State” in the list of permissible – that is, non-compensable – regulatory actions.

261. It is clear that the notion of deprivation, as that word is used in the context of Article 5 of the Treaty, is to be understood in the meaning it has acquired in customary international law.<sup>11</sup>

262. In the opinion of the Tribunal, the principle that a State does not commit an expropriation and is thus not liable to pay compensation to a dispossessed alien investor when it adopts general regulations that are “commonly accepted as within the police power of States” forms part of customary international law today. There is ample case law in support of this proposition. As the tribunal in *Methanex Corp. v. USA* said recently in its final award, “[i]t is a principle of customary international law that, where economic injury results from a *bona fide* regulation within the police powers of a State, compensation is not required”.<sup>12</sup>

263. That being said, international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered “permissible” and “commonly accepted” as falling within the police or regulatory power of States and, thus, non-compensable. In other words, it has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law.

264. It thus inevitably falls to the *adjudicator* to determine whether particular conduct by a state “crosses the line” that separates valid regulatory activity from expropriation. Faced with the question of *when, how and at what point an otherwise valid regulation becomes, in fact*

*and effect, an unlawful expropriation*, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.<sup>13</sup>

265. In the present case, the Tribunal finds that the Czech Republic has not “crossed that line” and did not breach Article 5 of the Treaty, since the measures at issue can be justified as permissible regulatory actions.

#### D. Analysis and Findings

266. Saluka’s shares in IPB were assets entitled to protection under the Treaty. Pursuant to Article 5 of the Treaty, the Czech Republic was prohibited from taking any measures depriving, directly or indirectly, Saluka of its investment in IPB unless one or more of the cumulative conditions set out in that Article were complied with. If the Tribunal finds that the Czech Republic has adopted such measures without having complied with one or more of these conditions, the conclusion will inevitably follow that the Respondent has breached Article 5 of the Treaty.

267. There can be no doubt, and the Tribunal so finds, that Saluka has been deprived of its investment in IPB as a result of the imposition of the forced administration of the bank by the CNB on 16 June 2000.

268. In Part III of the present Award, the Tribunal has reviewed in considerable detail the facts which led the CNB, on 16 June 2000, to “introduce forced administration” of IPB pursuant to Section 26(1)(d) of the Czech Banking Act.<sup>14</sup>

269. A translation of the CNB decision of 16 June 2000 has been produced as an exhibit before the Tribunal. It sets forth the many reasons which convinced the CNB, as the Czech banking regulator, to decide that the time had come to impose forced administration of IPB and appoint an administrator to exercise the forced administration. The decision also refers to the Czech legislation on which the CNB relied.

270. Rather than attempting to summarise the CNB’s decision, the Tribunal reproduces it here *in extenso*, in translation supplied by the Respondent:

#### Decision

On the basis of the establishment that INVESTIČNÍ A POŠTOVNÍ BANKA, akciová společnost, with its registered office in Praha 1, Senovážné nám. 32, IČO (Identification No.): 45 31 66 19 (the “Bank”) continually fails to maintain payment ability both in Czech currency and in foreign currencies and, accordingly, fails to comply with its obligation under Section 14 of Act No. 21/1992 Coll., the Banking Act, as amended (the “Banking Act”), the Czech National Bank has decided, pursuant to the provision of Section 26(1)(d), in accordance with the provisions of Section 30, Section 26(2), Section 26(6) and Section 26(3)(b) and with regard to the provisions of Section 27(1)(a) and (b) of the Banking Act, as follows:

- I. Forced administration shall be introduced in the Bank as of June 16, 2000.

- II. The administrator exercising the forced administration shall be Mr. Petr Staněk, birth number 670725/0847.

#### Reasoning

Under the provisions of Section 14, of the Banking Act, banks are obligated to continually maintain payment ability both in Czech currency and in foreign currencies. The Czech National Bank has evaluated, on the basis of the findings set forth below, the state of matters as of the date of issue of this Decision with the result that the Bank is in breach of said provision.

In its letter Ref. No. 277/520, dated March 2, 2000, the Czech National Bank requested data on liquidity condition and payment ability of the Bank to be provided by the Bank on a daily basis. In accordance with the Czech National Bank's requirement, the Bank provided, on a daily basis, tables showing the development of primary deposits (deposits from clients) in the preceding two weeks, the development of monitored items of financial market (the so-called liquidity cushion securing the Bank's payment ability) in the preceding two weeks and a summary of the development of primary deposits (deposits from clients) since February 20, 2000. On the basis of the documents provided, the Czech National Bank regularly monitored the development of the Bank's payment ability whose deterioration is shown by the data for the period from February 20, 2000, to June 11, 2000, and further from June 12, 2000 to June 14, 2000.

From the table "Development of primary deposits in the past two weeks in millions of CZK" provided by the Bank in its letter dated June 12, 2000, Ref. No. 1107/00/3-1, the Czech National Bank ascertained that in the period from February 20, 2000, to June 11, 2000, the amount of primary deposits (deposits from clients) decreased in the aggregate from CZK 237,966 million to CZK 204,155 million, i.e., by CZK 33,811 million. At the same time, the Czech National Bank ascertained from the table "Development of monitored items of the financial market in the past two weeks in millions of CZK" provided by the Bank in its letter dated March 6, 2000, Ref. No. 451/2000/3-1 and its letter dated June 12, 2000, Ref. No. 1107/00/3-1 that due to the decrease in the primary deposits (deposits from clients), the financial market balance (the so-called liquidity cushion) decreased from CZK 64,452 million to CZK 38,658 million in that same period.

From the table "Development of primary deposits in the past two weeks in millions of CZK" provided by the Bank in its letter dated June 15, 2000, Ref. No. 1143/00/3-1, the Czech National Bank ascertained that on June 12, 2000, the amount of primary deposits (deposits from clients) decreased in the aggregate from CZK 204,153 million to CZK 199,628 million, i.e., by CZK 4,525 million, on June 13, 2000, it decreased from CZK 199,628 million to CZK 193,664 million, i.e., by CZK 5,964 million, and on June 14, 2000, from CZK 193,664 million to CZK 187,173 million, i.e., by CZK 6,491 million. At the same time, the Czech National Bank ascertained from the table "Development of monitored items of the financial market in the past two weeks in millions of CZK" provided by the Bank in its letter dated June 15, 2000, Ref. No. 1143/00/3-1 that due to the decrease in the primary deposits (deposits from clients) in that period, the financial market balance (the so-called liquidity cushion) decreased on June 12, 2000, from CZK 39,385 million to CZK 34,926 million, i.e., by CZK 4,459 million, on June 13, 2000, it decreased from CZK 34,926 million to CZK 25,446 million, i.e., by CZK 9,480 million, and on June 14, 2000, from CZK 25,446 million to CZK 16,625 million, i.e., by CZK 8,821 million.

The Bank's Board of Directors addressed, in accordance with Section 26b of the Banking Act, a letter dated June 14, 2000, Ref. No. GŘ 202/2000 to the Czech National Bank stating that as a result of intensified cash and cash-free withdrawals in the last days, the Bank's liquidity condition had significantly deteriorated and a risk existed that if the current trend continued, the Bank could get into a situation where it would no longer be able to maintain the amount of the mandatory minimum reserves and consequently to comply with its obligations under debit clearing transactions, i.e., it would not be able to perform its clients' payment instructions.

The development in the deposits and liquidity cushion at the Bank constitutes a considerable risk from the point of view of a threat to its payment ability since, as established by the Czech National Bank, the current amount of the liquidity cushion that is constantly decreasing is not adequate for the current and constantly increasing requirements of the clients for deposit withdrawals. All factual findings made as of the date of issue of this Decision evidence that the current trend is continuing.

The Czech National Bank is entitled to introduce forced administration pursuant to Section 26(1)(d) of the Banking Act only after it has established deficiencies in a bank's operation. Under the provisions of Section 26(3)(b) of the Banking Act, "deficiencies in a bank's operation" means, among other things, a breach of the Banking Act. It has been unambiguously established on the basis of the aforementioned findings that the Bank has failed to comply with its obligation under Section 14 of the Banking Act. Accordingly it is in breach of that law, and a fundamental deficiency has been ascertained in its operation which deficiency continues.

Pursuant to the provisions of Section 30 of the Banking Act, the Czech National Bank is entitled to introduce forced administration in a bank if the deficiencies in such bank's operation endanger the stability of the banking system. According to the findings made by the Czech National Bank, this legal condition is fulfilled on the following grounds.

In 1999, the Bank ranked second within the interbank payment system of the Czech Republic in terms of the amount of payments processed – the Bank received and dispatched 2.3 million transactions totaling CZK 2,000 billion.

Second, according to the data stated in the statement "Bil 1-12. Monthly statement of assets and liabilities" as at April 30, 2000, the Bank's share in the amount of deposits from the public within the banking sector of the Czech Republic is 22% while its shares in the aggregate amount of assets within the banking sector of the Czech Republic amounts to 13.2% and the number of its clients is over 2.9 million.

In addition, the Bank is a major shareholder of two other banks operating in the Czech Republic, namely Českomoravská stavební spořitelna, akciová společnost, the leading building and loan association in the building loan market in the Czech Republic, and Českomoravská hypoteční banka, a.s., the leading bank in the mortgage-backed loan market in the Czech Republic. The severe financial condition of the Bank contests its position as the major shareholder or shareholder with the decisive controlling influence of these banks and is a threat to these banks' position.

On the basis of the above, the Czech National Bank holds as evidenced that the Bank directly endangers the stability of the banking system of the Czech Republic.

The Bank is a significant debtor of other banks, consequently its lower payment ability is liable to adversely affect the payment ability of the banks that are its



creditors. In addition, the Bank administers funds of many entities whose inability to pay caused by the Bank (the Bank's low liquidity) would result in serious consequences, whether direct or indirect, for the creditors of such entities including, without limitation, other banks constituting the banking system. Given the above, the Bank participates to a significant extent in the functioning of the entire banking system. The fact that, according to the notice given by its own statutory bodies, it may not be able to maintain its payment ability endangers the stability of the banking system in its entirety.

All the above facts with respect to the Bank's share in the interbank payment system, in the amount of deposits from the public within the banking sector, in the aggregate amount of assets within the banking sector, the number of its clients and its significant position as a shareholder evidence that the serious difficulties in the Bank's payment ability endanger the stability of the banking system in the Czech Republic to a considerable extent.

Pursuant to the provisions of Section 30 of the Banking Act, the Czech National Bank is entitled to introduce forced administration in a bank if such bank's shareholders have failed to take necessary measures to correct deficiencies. The effect of such measures may be measured only by the result, i.e., improvement in such bank's payment ability. According to the data ascertained with respect to the Bank's payment ability, it is evident that the situation of the Bank necessitates an immediate solution. The constant deterioration of the Bank's payment ability demonstrates that either the Bank's shareholders have failed to take appropriate measures securing the permanent payment ability of the Bank or such measures have been insufficient and ineffective as the Bank's payment ability is markedly deteriorating. The foregoing is implied both by the Czech National Bank's own findings and by the information contained in the letter from the Bank's Board of Directors, dated June 14, 2000, delivered to the Czech National Bank on June 15, 2000.

Based on the above, the Czech National Bank holds as evidenced that the conditions for the introduction of forced administration in the Bank, as set forth in the provisions of Section 26(1)(d) and Section 30 of the Banking Act with respect to the introduction of forced administration in a bank, are fulfilled.

Pursuant to the provisions of Section 2 of Act No. 6/1993 Coll., the Czech National Bank Act, as amended (the "Czech National Bank Act"), the responsibilities of the Czech National Bank include the management of monetary circulation and payments including banking clearance, maintaining the continuity and efficiency thereof, exercise of supervision over banking activities and maintaining the safe functioning and purposeful development of the banking system in the Czech Republic.

In addition, the Czech National Bank is responsible, under the provisions of Section 44(1)(a) of the Czech National Bank Act, for the exercise of supervision over banking activities and the safe functioning of the banking system. Given the critical financial condition of the Bank and with regard to the threat to the stability of the banking system constituted by the aforementioned deficiency in the Bank's operations as well as the failure of the Bank's shareholders to take necessary measures to correct such deficiencies, the Czech National Bank must avoid a situation where a panic among the Bank's depositors would result in a permanent destabilization of its operations and consequently in undermined confidence in the banking system in its entirety. By the introduction of forced administration, the Czech National Bank prevents further gradation of the Bank's critical situation.

Pursuant to the provisions of Section 26(2) of the Banking Act, the Czech National Bank is obligated to decide on the introduction of forced administration upon a bank's failure to correct deficiencies on the Czech National Bank's demand made pursuant to Section 26(1)(a) of the Banking Act. However, pursuant to Section 26(2) of the Banking Act, the Czech National Bank may introduce forced administration without a demand for correcting measures under Section 26(1)(a) of the Banking Act if the matter cannot withstand delay.

On the basis of the information ascertained by the Czech National Bank, it is incontestable that the Bank's payment ability is rapidly and significantly deteriorating and, consequently, the Czech National Bank considers the introduction of forced administration to be a matter that cannot withstand delay.

The Czech National Bank has requested, in accordance with the provisions of Section 30 of the Banking Act, the standpoint of the Ministry of Finance with respect to the introduction of forced administration. In its standpoint dated June 16, 2000, the Ministry of Finance consented to the introduction of forced administration.

Pursuant to the provisions of Section 28(1) of the Banking Act, the Banking Board has the obligation to appoint the administrator charged with the exercise of forced administration and determine the amount of his remuneration. However, pursuant to the provision of Section 27(1)(b) of the Banking Act, the decision on the introduction of forced administration must include, in addition to the grounds for the introduction of forced administration, also the name, surname and birth code of the administrator.

#### Advice on Appeal

An appeal may be lodged against this Decision pursuant to Section 61(1) of Act No. 71/1967 Coll., the Administrative Procedural Code (the Administrative Code), as amended, with the Czech National Bank, Na Příkopě 28, Praha 1, PSČ 115 03, within 15 days of the delivery hereof. In accordance with the provisions of Section 41(1) of the Banking Act, the Banking Board of the Czech National Bank decides on the appeal. An appeal lodged has no suspensive effect.

(Circular Seal)

(signature)

Ing. Pavel Racoča, MIA  
Senior Director

(signature)

Ing. Vladimír Krejča  
Director of the Banking Supervision Section

This Decision is addressed to:  
INVESTIČNÍ A POŠTOVNÍ BANKA, akciová společnost  
Senovazné nam. 32  
Praha 1

271. As will be seen, the CNB's decision is fully motivated. Having reviewed the totality of the evidence which the CNB invoked in support of its decision, the Tribunal is of the view that the CNB was justified, under Czech law, in imposing the forced administration of IPB and appointing an administrator to exercise the forced administration.

272. The Czech State, in the person of its banking regulator, the CNB, had the responsibility to take a decision on 16 June 2000. It enjoyed a margin of discretion in the

exercise of that responsibility. In reaching its decision, it took into consideration facts which, in the opinion of the Tribunal, it was very reasonable for it to consider. It then applied the pertinent Czech legislation to those facts – again, in a manner that the Tribunal considers reasonable.

273. In the absence of clear and compelling evidence that the CNB erred or acted otherwise improperly in reaching its decision, which evidence has not been presented to the Tribunal, the Tribunal must in the circumstances accept the justification given by the Czech banking regulator for its decision.

274. The Tribunal notes, additionally, that the decision of the CNB was confirmed by the CNB Appellant Board and subsequently upheld by the City Court in Prague on two occasions, firstly on an appeal lodged by three members of IPB’s Board of Directors and later on an appeal lodged by Saluka itself.

275. The CNB’s decision is, in the opinion of the Tribunal, a lawful and permissible regulatory action by the Czech Republic aimed at the general welfare of the State, and does not fall within the ambit of any of the exceptions to the permissibility of regulatory action which are recognised by customary international law. Accordingly, the CNB’s decision did not, fall within the notion of a “deprivation” referred to in Article 5 of the Treaty, and thus did not involve a breach of the Respondent’s obligations under that Article.

#### E. Conclusion

276. In summary, the Tribunal finds, based on the totality of the evidence which has been presented to it, that in imposing the forced administration of IPB on 16 June 2000 the Czech Republic adopted a measure which was valid and permissible as within its regulatory powers, notwithstanding that the measure had the effect of eviscerating Saluka’s investment in IPB.

277. Having so determined, it is not necessary for the Tribunal to address the Respondent’s subsidiary argument that, because Saluka sold its IPB shares back to Nomura after June 2000 for the same amount as it purchased those shares, the Claimant has failed to establish a deprivation of sufficient magnitude to form the basis of an expropriation claim.<sup>15</sup>

278. The Tribunal, in this Chapter of the present Award dealing with Saluka’s claim that the Czech Republic breached Article 5 of the Treaty, does not consider the Claimant’s allegations that the Czech Republic was an accessory to CSOB’s alleged plan to take over IPB, that the Forced Administrator did not exercise truly independent judgment or that the Czech Government discriminated against IPB by granting State aid to Saluka’s competitors. In the view of the Tribunal, these allegations, even if proven, would not rise to the level of a breach of Article 5. They will in any event be considered in the next Chapter of this Award that addresses the alleged breach by the Respondent of Article 3 of the Treaty.

## VI. SALUKA'S CLAIMS UNDER ARTICLE 3 OF THE TREATY

279. The way in which events unfolded with respect to Saluka's shareholding in IPB amounted, in the Claimant's view, to a breach by the Czech Republic of its obligation under Article 3 of the Treaty. The Respondent has denied that it breached Article 3 of the Treaty.

280. Article 3, paragraphs 1 and 2 of the Treaty provided that:

1. 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.
2. 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 States, whichever is more favourable to the investor concerned.

281. For reasons set out below, the Tribunal finds that the treatment accorded to Saluka's investment by the Czech Republic

- (a) was in some respects unfair and inequitable, and
- (b) impaired, by certain unreasonable and discriminatory measures, the enjoyment of such investment by Saluka,

and that the Czech Republic has therefore violated Article 3 of the Treaty.

### A. The Content of the Czech Republic's Obligations under Article 3 of the Treaty

282. Article 3.1 of the Treaty requires the signatory governments to treat investments of investors of the other Contracting Party according to the standards of "fairness" and "equity" and to avoid impairment of such investments by measures which are not in compliance with the standards of "reasonableness" and "non-discrimination". It is common ground that such general standards represent principles that cannot be reduced to precise statements of rules.

283. Even though Article 3.2 sets out, "more particularly", obligations to accord "full security and protection" as well as national and most-favoured-nation treatment, these formulations are merely indicative and are not exhaustive of the scope of the general standards laid down in Article 3.1. Furthermore, a violation of the national and most-favoured-nation treatment obligations is not at issue here, and "full security and protection" is not less general a formulation than the standards set out in Article 3.1.

284. This does not imply, however, that such standards as laid down in Article 3 of the Treaty would invite the Tribunal to decide the dispute in a way that resembles a decision *ex aequo et bono*. This Tribunal is bound by Article 6 of the Treaty to decide the dispute on the

basis of the law, including the provisions of the Treaty. Even though Article 3 obviously leaves room for judgment and appreciation by the Tribunal, it does not set out totally subjective standards which would allow the Tribunal to substitute, with regard to the Czech Republic's conduct to be assessed in the present case, its judgment on the choice of solutions for the Czech Republic's.<sup>16</sup> As the tribunal in *S.D. Myers* has said, the "fair and equitable treatment" standard does not create an "open-ended mandate to second-guess government decision-making".<sup>17</sup> The standards formulated in Article 3 of the Treaty, vague as they may be, are susceptible of specification through judicial practice and do in fact have sufficient legal content to allow the case to be decided on the basis of law. Over the last few years, a number of awards have dealt with such standards yielding a fair amount of practice that sheds light on their legal meaning.<sup>18</sup>

## B. Fair and Equitable Treatment

### 1. Meaning of the Standard

#### a) The Parties' Arguments

285. There is agreement between the parties that the determination of the legal meaning of the "fair and equitable treatment" standard is a matter of appreciation by the Tribunal in light of all relevant circumstances. As the tribunal in *Mondev* has stated, "[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case".<sup>19</sup> There is disagreement between the parties, however, about the limits of such appreciation. These limits are reflected in the threshold that is relevant for the determination of the unlawfulness of the Czech Republic's conduct in the present case.

286. The Claimant argues that the standard is a specific and autonomous Treaty standard. Since it is not in any way qualified, it should be interpreted broadly. The Claimant relies, *inter alia*, on *Pope & Talbot, Inc. v. The Government of Canada*, where the arbitral tribunal stated that guarantees similar to those contained in Article 3 of the Treaty do not limit an investor's recourse to protection only against conduct that is "egregiously unfair", but rather are meant to ensure "the kind of hospitable climate that would insulate them from political risks or incidents of unfair treatment".<sup>20</sup>

287. According to the Claimant, Article 3.1 does not refer to any high threshold of unreasonableness or flagrancy of the conduct constituting a breach and it must be interpreted broadly enough to translate into real and effective protection of the type that would encourage investors to participate in the economy of the host State.

288. The Claimant endorses, however, and commends as a useful guide, even in the present context, the threshold defined by the Tribunal in *Waste Management, Inc. v. United Mexican States*, which held that the fair and equitable treatment standard in Article 1105(1) of the North American Free Trade Agreement ("NAFTA")<sup>21</sup> is infringed if the conduct of the State

is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest

failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.<sup>22</sup>

289. The Respondent argues that the standard laid down in Article 3.1 conforms in effect to the “minimum standard” which forms part of customary international law. The Respondent relies, *inter alia*, on the *Genin* award where the tribunal interpreted the “fair and equitable treatment” standard indeed as “a minimum standard”. The *Genin* tribunal held that:

acts that would violate this minimum standard would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.<sup>23</sup>

290. For the determination of the relevant threshold, the Respondent also refers the Tribunal to the historical development of the customary minimum standard and, in particular, to the *Neer* case where it was held that the treatment of aliens, in order to constitute an international delinquency,

should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would recognize its insufficiency.<sup>24</sup>

The Respondent therefore argues that it is for the Tribunal to determine whether, under the circumstances,

the governmental action in question was willfully wrong, actually malicious, or so far beyond the pale that it cannot be defended among reasonable members of the international community.

291. Whatever the merits of this controversy between the parties may be, it appears that the difference between the Treaty standard laid down in Article 3.1 and the customary minimum standard, when applied to the specific facts of a case, may well be more apparent than real. To the extent that the case law reveals different formulations of the relevant thresholds, an in-depth analysis may well demonstrate that they could be explained by the contextual and factual differences of the cases to which the standards have been applied.

292. Also, it should be kept in mind that the customary minimum standard is in any case binding upon a State and provides a minimum guarantee to foreign investors, even where the State follows a policy that is in principle opposed to foreign investment; in that context, the minimum standard of “fair and equitable treatment” may in fact provide no more than “minimal” protection. Consequently, in order to violate that standard, States’ conduct may have to display a relatively higher degree of inappropriateness.

293. Bilateral investment treaties, however, are designed to promote foreign direct investment as between the Contracting Parties; in this context, investors’ protection by the “fair and equitable treatment” standard is meant to be a guarantee providing a positive incentive for foreign investors. Consequently, in order to violate the standard, it may be sufficient that States’ conduct displays a relatively lower degree of inappropriateness.

294. Whichever the difference between the customary and the treaty standards may be, this Tribunal has to limit itself to the interpretation of the “fair and equitable treatment” standard as embodied in Article 3.1 of the Treaty. That Article omits any express reference to the customary minimum standard. The interpretation of Article 3.1 does not therefore share the difficulties that may arise under treaties (such as the NAFTA) which expressly tie the “fair and equitable treatment” standard to the customary minimum standard.<sup>25</sup> Avoidance of these difficulties may even be regarded as the very purpose of the lack of a reference to an international standard in the Treaty.<sup>26</sup> This clearly points to the autonomous character of a “fair and equitable treatment” standard such as the one laid down in Article 3.1 of the Treaty.

295. Moreover, the Tribunal is not convinced that, as the Respondent suggests, Article 3.1 at least implicitly incorporates the customary minimum standard. The *Genin* case on which the Respondent relies does not support this suggestion. The *Genin* tribunal merely held that a BIT standard of “fair and equitable” treatment provides “a basic and general standard which is detached from the host States’ domestic law”.<sup>27</sup> This standard is characterised by the *Genin* tribunal as “an” international minimum standard, not as “the” international minimum standard. Far from equating the BIT’s standard with the customary minimum standard, the *Genin* tribunal merely emphasised that the “fair and equitable treatment” standard requires the Contracting States to accord to foreign investors treatment which does not fall below a certain minimum, this minimum being in any case detached from any lower minimum standard of treatment that may prevail in the domestic laws of the Contracting States. Also, the way the *Genin* tribunal defined the threshold for the finding of a violation of the “fair and equitable treatment” standard<sup>28</sup> does not incorporate the traditional *Neer* formula<sup>29</sup> which reflects the traditional, and not necessarily the contemporary, definition of the customary minimum standard, at least in certain non-investment fields.

b) The Tribunal’s Interpretation

296. In order to give specific content of the Czech Republic’s general obligation to accord “fair and equitable treatment” to Saluka’s investment in IPB shares, this Tribunal, being established under the Treaty, has to interpret Article 3 in accordance with the rules of interpretation laid down in the 1969 Vienna Convention on the Law of Treaties (the “Vienna Convention”).<sup>30</sup> These rules are binding upon the Contracting Parties to the Treaty,<sup>31</sup> and also represent customary international law. Article 31.1 of the Vienna Convention requires that a treaty is 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.

i) The Ordinary Meaning

297. The “ordinary meaning” of the “fair and equitable treatment” standard can only be defined by terms of almost equal vagueness. In *MTD*, the tribunal stated that:

In their ordinary meaning, the terms “fair” and “equitable” [...] mean “just”, “even-handed”, “unbiased”, “legitimate”.<sup>32</sup>

On the basis of such and similar definitions, one cannot say much more than the tribunal did in *S.D. Myers* by stating that an infringement of the standard requires

treatment in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.<sup>33</sup>

This is probably as far as one can get by looking at the “ordinary meaning” of the terms of Article 3.1 of the Treaty.

ii) The Context

298. The immediate “context” in which the “fair and equitable” language of Article 3.1 is used relates to the level of treatment to be accorded by each of the Contracting Parties to the investments of investors of the other Contracting Party. The broader “context” in which the terms of Article 3.1 must be seen includes the other provisions of the Treaty. In the preamble of the Treaty, the Contracting Parties

recognize[d] 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.

The preamble thus links the “fair and equitable treatment” standard directly to the stimulation of foreign investments and to the economic development of both Contracting Parties.

iii) The Object and Purpose of the Treaty

299. The “object and purpose” of the Treaty may be discerned from its title and preamble. These read:

Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic

The Government of the Kingdom of the Netherlands

And

The Government of the Czech and Slovak Federal Republic,

hereinafter referred to as the Contracting Parties,

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

Recognizing 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, 1st 1975 in Helsinki.

300. This is a more subtle and balanced statement of the Treaty's aims than is sometimes appreciated. The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations.

301. Seen in this light, the "fair and equitable treatment" standard prescribed in the Treaty should therefore be understood to be treatment which, if not proactively stimulating the inflow of foreign investment capital, does at least not deter foreign capital by providing disincentives to foreign investors. An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable.

302. The standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations<sup>34</sup> which is the dominant element of that standard. By virtue of the "fair and equitable treatment" standard included in Article 3.1 the Czech Republic must therefore be regarded as having assumed an obligation to treat foreign investors so as to avoid the frustration of investors' legitimate and reasonable expectations. As the tribunal in *Tecmed* stated, the obligation to provide "fair and equitable treatment" means:

to provide to international investments treatment that does not affect the *basic expectations* that were taken into account by the foreign investor to make the investment.<sup>35</sup>

Also, in *CME*, the tribunal concluded that the Czech authority

breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon which the foreign investor was induced to invest.<sup>36</sup>

The tribunal in *Waste Management* equally stated that:

In applying [the "fair and equitable treatment"] standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.<sup>37</sup>

303. The expectations of foreign investors certainly include the observation by the host State of such well-established fundamental standards as good faith, due process, and non-discrimination.<sup>38</sup> And the tribunal in *OEPC* went even as far as stating that

[t]he *stability* of the legal and business framework is thus an essential element of fair and equitable treatment.<sup>39</sup>

304. This Tribunal would observe, however, that while it subscribes to the general thrust of these and similar statements, it may be that, if their terms were to be taken too literally, they would impose upon host States' obligations which would be inappropriate and unrealistic. Moreover, the scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness *in light of the circumstances*.

305. No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. As the *S.D. Myers* tribunal has stated, the determination of a breach of the obligation of "fair and equitable treatment" by the host State

must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.<sup>40</sup>

306. The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.

307. A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment.

308. Finally, it transpires from arbitral practice that, according to the "fair and equitable treatment" standard, the host State must never disregard the principles of procedural propriety and due process<sup>41</sup> and must grant the investor freedom from coercion or harassment by its own regulatory authorities.

#### iv) Conclusion

309. The "fair and equitable treatment" standard in Article 3.1 of the Treaty is an autonomous Treaty standard and must be interpreted, in light of the object and purpose of the Treaty, so as to avoid conduct of the Czech Republic that clearly provides disincentives to foreign investors. The Czech Republic, without undermining its legitimate right to take measures for the protection of the public interest, has therefore assumed an obligation to treat a foreign investor's investment in a way that does not frustrate the investor's underlying

legitimate and reasonable expectations. A foreign investor whose interests are protected under the Treaty is entitled to expect that the Czech Republic will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (*i.e.* unrelated to some rational policy), or discriminatory (*i.e.* based on unjustifiable distinctions). In applying this standard, the Tribunal will have due regard to all relevant circumstances.

## 2. Application of the Standard

310. In applying Article 3 of the Treaty to the present case, the Claimant contends that the Czech Republic has violated the “fair and equitable treatment” standard in Article 3.1 of the Treaty in a number of ways. The Claimant principally contends that

(a) the Czech Republic gave a discriminatory response to the systemic bad debt problem in the Czech banking sector, especially by providing State financial assistance to the other Big Four banks to the exclusion of IPB, and thereby created an environment impossible for the survival of IPB;

(b) the Czech Republic failed to ensure a predictable and transparent framework for Saluka’s investment;

(c) the Czech Republic’s refusal to negotiate with IPB and its shareholders in good faith prior to the forced administration was unreasonable and discriminatory;

(d) the provision by the Czech Republic of massive financial assistance to IPB’s business, once the beneficiary of such assistance had become CSOB following the forced administration, was unfair and inequitable; and

(e) the Czech Republic’s failure to prevent the unjust enrichment of CSOB at the expense of the IPB shareholders, including Saluka, upon the transfer of IPB’s business to CSOB and the aforementioned State aid following the forced administration was equally unfair and inequitable.

311. The Tribunal will examine each of these claims separately.

### a) The Czech Republic’s Discriminatory Response to the Bad Debt Problem

312. The Claimant contends that, whereas the “systemic” bad debt problem which contributed to the serious difficulties of the Czech banking sector from 1998 to 2000 equally affected the Big Four banks (*i.e.* IPB, KB, CS and CSOB), the Czech Republic, in assisting these banks to overcome the problem, treated IPB differently in an unreasonable way which made it impossible for IPB to survive, especially by excluding IPB from the state assistance that was granted to its competitors, and which resulted in Saluka’s loss of its investment.

313. State conduct is discriminatory, if (i) similar cases are (ii) treated differently (iii) and without reasonable justification.

i) Comparable Position of the Big Four Banks regarding the Bad Debt Problem

314. According to the Claimant, the Big Four banks were in a comparable position in terms of their macroeconomic significance in the transitional period of the Czech Republic and their resulting share of the systemic bad debt problem.

315. By 1998 all of them had large non-performing loan portfolios and they were equally suffering from inadequacies of the legal regime for the enforcement of collateral rights. The impact of these bad debts was felt by all of the Big Four banks, although to different degrees. IPB, KB and CS suffered heavily, and only CSOB was relatively better off.

316. Another factor that the Big Four banks had in common was that they were all equally exposed to the increasingly rigorous banking supervision by the CNB and to the prudential standards that were drastically tightened by the CNB in order to bring them into line with the norms of the European Union. These measures resulted in major increases in loan loss provisions which caused losses that, in the longer term, none of these banks was able to absorb by drawing upon shareholder equity. Beyond a certain point the survival of all the banks was dependent upon some form of assistance from the Czech State.

317. The Claimant has put much emphasis on the “systemic” nature of the bad loan problem that affected the Big Four banks from 1998 to 2000. The Claimant has referred in this context to an International Monetary Fund (“IMF”) Report, defining a problem as “systemic” where the affected banks hold, in the aggregate, at least 20% of the total deposits of the banking system.<sup>42</sup>

318. The Respondent has denied that IPB’s position was comparable with the position of the other three of the Big Four banks. Much emphasis is put by the Respondent on the fact that IPB had already been privatised, whereas the State still held large blocks of shares in KB, CS and CSOB. Furthermore, the financial difficulties with which IPB was faced are said to have been caused by mismanagement and irresponsible lending practices. The Respondent has, *inter alia*, referred to a CNB inspection report of 25 February 2000 which had identified serious deficiencies regarding IPB’s internal organisation and operation.

319. The Tribunal is not convinced that the increasing financial difficulties with which IPB was faced and that finally resulted in its forced administration were predominantly due to bad banking management and organisational deficiencies. Even though the irregularities identified in the CNB inspection report of 25 February 2000 were serious and must have to some extent contributed to IPB’s problems, it can hardly be disputed that the bad debt problem still lay at the heart of IPB’s difficulties. In the autumn of 1999 it became abundantly clear that IPB needed more than a correction of the irregularities identified by the CNB. The CNB itself requested a significant increase in IPB’s equity capital. It is therefore not plausible that, had IPB solved the organisational problems identified by the CNB, it would no longer have suffered from its large non-performing loan portfolio and from the insufficiency of its regulatory capital.

320. The expert witnesses introduced by the Respondent have reported a number of differences between IPB and its competitors as far as liquidity, credit rating and business

strategies are concerned. The expert witnesses introduced by the Claimant have, however, questioned the validity of these findings and have arrived at the opposite conclusions. The Tribunal does not find that the evidence placed before it enables it to conclude that IPB differed sufficiently drastically from the other Big Four banks with regard to the risks involved in its lending policies so as to warrant a finding that the financial problems with which IPB was faced could not be attributed predominantly to the bad debt problem that plagued all the Big Four banks equally.

321. The Respondent also disagrees with the Claimant's characterisation of the bad debt problem as being "systemic". According to the Respondent, a "systemic" crisis is one affecting the entire commercial banking industry. The Claimant had not shown, however, that this had been the case. More than fifty of the other Czech commercial banks holding more than 30% of the country's banking assets had not at all been taken into consideration by the Claimant.

322. The Tribunal finds that, irrespective of whether the bad debt problem with which the Big Four banks were faced from 1998 to 2000 may properly be characterised as "systemic" or not, these banks were in a sufficiently comparable situation: All of them had large non-performing loan portfolios resulting in increased provisions and consequently in insufficient regulatory capital. None of them was able to absorb the losses by calling on shareholder equity. The survival of all of them was sooner or later seriously threatened unless the Czech State was willing to provide financial assistance. On the other hand, due to the macroeconomic significance of the Big Four banks, the Czech State apparently could not afford to let any one of these banks fail. And, as set out below, the Czech State did in fact sooner or later provide such assistance to all of them, including IPB after it had been acquired by CSOB. The Czech Government therefore has implicitly recognised that all the Big Four banks were in a comparable situation.

323. Consequently, as far as the Claimant is concerned, Nomura (and subsequently Saluka) was justified in expecting that the Czech Republic, should it consider and provide financial assistance to the Big Four banks, would do so in an even-handed and consistent manner so as to include rather than exclude IPB.

ii) Differential Treatment of IPB Regarding State Assistance

324. In 1997 and 1998 the Czech Government began to develop a strategy of dealing with the bad debt problem at the enterprise level. According to this strategy, the Government would directly finance the forgiveness of the indebted companies and provide guarantees for new loans (the so-called "Revitalisation Programme"). Consequently, the Government took a negative position towards financial assistance for the banking sector. This approach was clearly stated by the Czech Government at the time IPB was privatised (by way of the sale of the State's 36% shareholding to Nomura on 8 March 1998). The Czech Government was, however, careful not to give Nomura any assurance that this policy would never be changed by future Governments with regard to the privatisation of one or other of IPB's competitors.

325. Since the bad debt problem became worse, however, the Czech Government changed its policy and did in fact take a number of steps to assist the other of the Big Four banks to

overcome the financial difficulties with which they were faced. These measures were also deliberately taken in order to prepare IPB's competitors for privatisation. CSOB was privatised in 1999 (by way of a sale of the State's 65.69% shareholding to KBC of Belgium), CS was privatised in 2000 (by way of a sale of the State's 53.07% shareholding to Erste Bank of Austria), and KB was privatised in 2001 (by way of a sale of the State's 60% shareholding to Société Générale S.A.). All three banks had received considerable financial assistance from the Czech Republic before privatisation took place. Without such assistance, privatisation would clearly not have been possible.

326. IPB had also received some financial assistance before its privatisation. After Nomura had acquired its IPB shareholding, however, IPB was excluded as a beneficiary from the Revitalisation Programme as well as from the Czech Government's strategy to solve the bad debt problem of IPB's competitors by the provision of direct financial assistance to the banks. Only in the course of CSOB's acquisition of IPB's business during IPB's forced administration was considerable financial assistance from the Czech Government forthcoming. It follows that IPB has clearly been treated differently.

iii) Lack of a Reasonable Justification

327. The Respondent has argued that this differential treatment of IPB was justified for a number reasons.

328. Firstly, the Respondent argues that Nomura was not given any assurance that its competitors would be privatised in the same way as IPB, *i.e.* without previous support allowing them to get rid of the problems involved in the non-performing loan portfolios.

329. The Tribunal finds that the Claimant's reasonable expectations to be entitled to protection under the Treaty need not be based on an explicit assurance from the Czech Government. It is sufficient that Nomura (and subsequently Saluka), when making its investment, could reasonably expect that, should serious financial problems arise in the future for all of the Big Four banks equally and in case the Czech Government should consider and provide financial support to overcome these problems, it would do so in a consistent and even-handed way.

330. Secondly, the Respondent argues that Nomura (and subsequently Saluka) had no reason to expect that the Czech Government would be willing to alleviate IPB's future problems by providing State financial assistance, since Nomura, having gone through an extensive due diligence, had been aware of the risks involved in acquiring the shareholding in IPB. Nomura is even said to have known before it made its investment that the Czech Government planned to give aid to the other three of the Big Four banks during their privatisation. Nomura had therefore voluntarily assumed these risks and they were reflected in the share price paid by Nomura. Once these risks had materialised, Nomura (and subsequently Saluka) should not be allowed to ask for assistance.

331. On the basis of the available evidence, the Tribunal finds that the Czech Government changed its policy of non-assistance only after Nomura had acquired the shareholding in IPB on March 8, 1998. The earliest hint of such policy change was contained in a letter from the

head of the NPF, Mr Ceska, to the chairmen of the boards of directors of KB, CS and CSOB dated 21 April 1998 which contained the following statement:

We further confirm that, during the period prior to the full privatisation of the banks as aforesaid, we are ready to take such steps within our authority and power as shareholder of each of the banks [to ensure that the banks] comply with all regulatory requirements applicable to them, including capital adequacy and liquidity.

On 27 May 1998 the Government passed the following resolution:

The Government states that it is aware of its responsibility for the financial stability of the joint stock companies CSOB, KB and CS and that it is ready to secure such financial stability until the completion of the privatisation of those joint-stock companies.<sup>43</sup>

332. Furthermore, whatever the scope of Nomura's due diligence may have been, it could not possibly lead to a reliable forecast as to which policies future governments would adopt should an aggravation of the bad debt problem occur as it did after Nomura had made its investment. Therefore, the Claimant cannot be said to have assumed the risk of being treated differently when the Czech Government in fact decided to step in with financial assistance.

333. Thirdly, the Respondent argues that the Claimant was the dominant shareholder of IPB and should therefore itself have rescued IPB by providing the necessary additional capital. The Czech Republic therefore considers itself justified in expecting that the Claimant would have acted as a responsible strategic investor. Also, by providing the necessary financial support to IPB's competitors, the Czech Republic considers itself to have in fact done no more than act as a responsible shareholder. In doing so, the Czech Republic considers itself to have been justified in limiting its assistance to its own banks.

334. The Tribunal finds that Nomura cannot be said to have entered IPB as a strategic investor. Nomura has made it sufficiently clear from the beginning that it came as a portfolio investor acquiring a considerable block of shares with a view to selling it once IPB had improved and the value of its shares had appreciated. The Claimant as a private investor could not reasonably be expected to provide new capital unless this could be done on commercial terms. In this respect the Claimant was in a position similar to an investor acquiring a shareholding in IPB's still-to-be-privatised competitors: unless the bad debt problem was taken care of by financial assistance from the State, no new (or additional) private investment could reasonably be expected in any of the Big Four banks. The Czech Government implicitly recognised this when it provided considerable support to IPB's business upon the acquisition of IPB's business by CSOB.

335. Furthermore, it is less than plausible that, by granting State aid to one or other of the Big Four banks, the Czech Republic acted exclusively as a shareholder. Even though the Government may have expected to secure a better price for the shares when the other banks were privatised, this would not have been a commercially rational conduct. If that had been the motivation, the Czech Republic could just as well have saved the financial resources used for the provision of State aid and sold the shares at a lower price. Recovering the State aid by selling the shares at a higher price would have merely caused additional transaction costs. Anyway, even when acting in its role as a shareholder of IPB's competitors, the Czech

Republic could not at the same time disregard its role as the regulator of the banking sector who was responsible for somehow resolving the bad debt problem with which all the Big Four banks were faced. Consequently, by insisting on its role as shareholder in the other three banks the Czech Republic cannot reasonably justify the differential treatment of IPB. Also, once IPB's business was acquired by CSOB in the course of IPB's forced administration, the Czech Government abandoned its position and did in fact provide considerable financial assistance for IPB's business.

336. Fourthly, the Respondent argues that the financial assistance granted to IPB's competitors was closely linked to the Czech Government's privatisation strategy. The Czech State still held large blocks of shares in KB, CS and CSOB which could have been privatised either on an "as is" basis or after clearing of the non-performing loan portfolios. It is said to have been in the discretion of the Czech State to make this policy choice.

337. It is clearly not for this Tribunal to second-guess the Czech Government's privatisation policies. It was perfectly legitimate for the Government to sell its stakes in the remaining banks only after they had been relieved from the bad debt problem. This, however, did not at the same time relieve the Czech Government from complying with its obligation of non-discriminatory treatment of IPB. The Czech Republic, once it had decided to bind itself by the Treaty to accord "fair and equitable treatment" to investors of the other Contracting Party, was bound to implement its policies, including its privatisation strategies, in a way that did not lead to unjustified differential treatment unlawful under the Treaty.

338. Fifthly, the Respondent argues that, had IPB also received financial assistance, the benefits from clearing the non-performing loan portfolio would have accrued to IPB's private shareholders, whereas in case of the other three of the Big Four banks the benefits accrued to the Czech State itself which at the time was their dominant shareholder. This position is belied by the fact that at the time the Czech Republic granted financial assistance to CSOB after its acquisition of IPB's business, CSOB had already been privatised (by way of a sale of the State's 65.69% shareholding to KBC of Belgium). The policy on which the Respondent relies was therefore at least not consistently implemented and cannot therefore justify IPB's differential treatment.

339. Sixthly, the Respondent has asserted that IPB did not disclose its desire to receive State financial assistance until April 2000. Consequently, Saluka, and indeed IPB, could not now claim that it has been negatively affected by the Czech Republic's failure to provide such assistance.

340. It is undisputed, however, that at least during the autumn of 1999 it was clear that IPB needed an increase of capital to provide for its bad loans and that the CNB expressly requested a significant increase in IPB's equity capital. Also, in the context of the negotiations that took place during the spring of 2000 in order find a solution for IPB, the Czech Government made it known to Nomura on 14 March 2000 that the provision of State aid to IPB was conditional on Nomura injecting new capital into IPB. Nomura, on the other hand, made it known in the course of these negotiations that it was unwilling to provide such capital unless at the same time the Czech State provided adequate financial assistance to IPB. The parties were, however, unable to bridge this gap in their approaches.



341. The Tribunal therefore finds that the Czech Government was fully aware of IPB's need for State assistance at a time when it was still feasible to prevent IPB from failing.

342. Finally, the Respondent argues that IPB's financial problems that ultimately led to its failure and forced administration were due to IPB's own irresponsible business strategy, especially its lending policy. The Respondent therefore denies that the Claimant could legitimately expect a government bailout.

343. The Claimant denies that IPB differed in any significant way from the other Big Four banks, especially CS and KB: neither in terms of the size and the impact of its non-performing loan portfolio or in terms of its credit rating, nor in terms of its liquidity or in terms of the management of its loan portfolio could IPB be said to have been uniquely bad.

344. The Tribunal finds that the size of the non-performing loan portfolios and their impact on the balance sheet was in fact comparable for all the Big Four banks, with the exception, to some degree, of CSOB. Accordingly, the credit ratings of all these banks were equally downgraded in 1998 and the relative improvement of IPB's competitors in 2000 was due to the State aid they had received in the meantime.

345. As far as the Big Four banks' liquidity position until 1999 is concerned, the parties disagree on the criteria that are relevant for a comparison between IPB and its competitors. In principle, liquidity is defined as the sum of assets that can be easily turned into assets that may be used for the payment of debts in relation to total assets. In order to prove that IPB's liquidity position was worse than its competitors', the Respondent relies on the "liquid asset ratio" and the "cash asset ratio". The Claimant, in order to prove that IPB's liquidity position was even relatively better than its competitors', relies on the "quick asset ratio". The Tribunal finds, however, that "quick assets" are not much different from "liquid assets". Consequently, the parties' diverging calculations are less due to the criteria, but rather to their statistical foundations. Whatever the correct liquidity ratios of the Big Four banks from 1998 to early 2000 may have been, the Tribunal is not convinced that different liquidity ratios warranted different treatment with regard to the provision of State financial assistance in order to overcome the bad debt problem.

346. As far as the Respondent's contention relating to IPB's allegedly flawed business strategy and imprudent loan portfolio management is concerned, the Tribunal notes that IPB's competitors (especially CS and KB) proved not to be able to overcome the bad loan problem without financial assistance from the Czech State, even though they allegedly followed a less flawed business strategy and had a more prudent loan management.

347. The Tribunal therefore finds that the Respondent has not offered a reasonable justification for IPB's differential treatment. Consequently, the Czech Republic is found to have given a discriminatory response to the bad debt problem in the Czech banking sector, especially by providing state financial assistance to three of the Big Four banks to the exclusion of IPB, and thereby created an environment impossible for the survival of IPB.

b) Failure to Ensure a Predictable and Transparent Framework

348. The Czech Republic has failed to ensure a predictable and transparent framework for Saluka's investment, if it has frustrated Saluka's legitimate expectations regarding the treatment of IPB without reasonable justifications.

349. The Claimant argues that the Czech Republic has frustrated Saluka's expectations

(a) by contradictory and misleading declarations about its policy towards the banking sector in crisis and by justifying IPB's exclusion from the State aid granted to save the other banks on the grounds that it had already been fully privatised;

(b) by the unpredictable increase of the provisioning burden for non-performing loans; and

(c) by leaving the banks with no effective mechanisms to enforce loan security.

350. The Tribunal will assess the legitimacy and reasonableness of these expectations and, if they were legitimate and reasonable, whether they have been frustrated by the Czech Republic without reasonable justification.

i) Nomura's Expectation that IPB would not be Treated Differently

351. Firstly, Nomura's expectation that the Government would not address the bad loan problem by support to the banks was initially said to have been based on an express assurance to that effect given by the then Minister of Finance. The Claimant has also argued that this was consistent with the obligations undertaken by the Czech Government in their pre-accession agreement with the European Commission (the Europe Agreement) to adhere to European Union norms on State aid. The Claimant has admitted, however, that whatever assurance the Minister of Finance may have given, he could not bind future Governments. Especially, he could not give any assurance that the privatisation of the other banks would proceed in the same way as the privatisation of IPB, *i.e.* without any State financial assistance. Nomura therefore had no basis for expecting that there would be no future change in the Government's policy towards the banking sector's bad loan problem or in the Government's willingness to adhere during the pre-accession period to the rules on State aid in the Europe Agreement.

352. The Claimant insists, however, that Nomura was justified in expecting that, should the Czech Government change its policy and provide State financial assistance to the banks in order for them to overcome the "systemic" problem of bad loans, that solution would itself be "systemic" and thus non-discriminatory. The Claimant contends that the Czech Government has frustrated this expectation by excluding IPB from the financial assistance provided to IPB's competitors. This discriminatory treatment is said to have been unpredictable.

353. The Tribunal notes that this claim is in substance identical with the Claimant's previous claim according to which the Czech Republic has violated the "fair and equitable

treatment” standard by the discriminatory response of the Czech Republic to the bad debt problem in the Czech banking sector. It has therefore already been dealt with in the context of the Claimant’s first claim.

ii) The Unpredictable Increase of the Provisioning Burden for Non-Performing Loans

354. Secondly, the Claimant argues that Nomura’s legitimate expectations have been frustrated by the CNB’s introduction of more stringent prudential rules for the banks. The CNB should rather have taken a “gradualist” approach so that the banks had time to adjust.

355. The Respondent argues that Nomura was aware of some of the CNB’s regulatory amendments at the time the shareholding in IPB was acquired, and others were clearly foreseeable.

356. The Tribunal notes that the increased stringency of the CNB’s prudential rules contributed to the distress suffered by the Czech banking system by forcing the banks to increase provisioning. Consequently, it became even more difficult for the banks to meet the regulatory capital requirements than it had been before due to the bad loan problem.

357. However, the CNB’s policy of tightening the regulatory regime must be seen in the context of the Czech Republic’s preparation for accession to the European Union. It was the CNB’s declared intention to bring its regulatory regime into line with the norms in the European Union. In 1999 a “Twinning Programme” for banking supervision had been launched which was deliberately designed to adjust the Czech regulatory methodology and the practical implementation of banking supervision to European Union standards.<sup>44</sup>

358. It can hardly be disputed that these developments could have been anticipated in 1998. Nomura was, therefore, not justified to expect that the CNB would not introduce a more rigid system of prudential regulation and thereby change the framework for Nomura’s investment in IPB shares. However, Nomura was unable to anticipate the discriminatory way in which the Czech Government responded to the distress suffered by the Czech banking sector, *i.e.* the exclusion of IPB from any State assistance that was granted to the other three of the Big Four banks in order for them to overcome their inability to meet the regulatory capital requirements. This aspect of the Czech Government’s attitude towards the banking sector has, however, already been dealt with in the context of the Claimant’s first claim.

iii) Nomura’s Expectation regarding the Legal Framework for the Enforcement of Loan Security

359. It is undisputed between the parties that Czech Law failed to provide effective mechanisms to enforce loan security. The CNB expressly acknowledged that its tightening of the prudential regulations and the increase of the provisioning requirements were in fact a response to the shortcomings in the legislation to protect creditors in recovering receivables and exercising liens as well as to other institutional shortcomings that were preventing banks in practice from realising real estate pledged as collateral.

360. The Tribunal finds that the aforementioned legal shortcomings must have been known to Nomura when it made its investment. An expectation that such shortcomings would quickly be fixed by the Czech legislature would have been unfounded. Consequently, even though the lack of adequate protection of creditors' rights will most certainly have contributed to the aggravation of the bad debt problem, the Tribunal is unable to find that the Czech Republic has frustrated Nomura's legitimate and reasonable expectations and violated the "fair and equitable treatment" standard by its failure to improve the legal framework within a timescale of help to Nomura.

c) Refusal to Negotiate in Good Faith

361. The Claimant contends that, whereas Saluka and Nomura as well as IPB were actively engaged in seeking a solution to IPB's financial problems, the Czech Government refused to negotiate in good faith on the proposals made by IPB and its shareholders. The Czech Ministry of Finance and the CNB are said to have instead conspired and taken sides with CSOB, which was interested in acquiring IPB's business. While purporting to negotiate with IPB and its shareholders, the Czech Government is said to have acted as an accessory to CSOB's plan to take over IPB's business. According to this plan (the Paris Plan), IPB's business would be transferred to CSOB upon the pretence of forced administration. The Claimant argues that this conduct of the Czech Government was unreasonable and discriminatory.

362. The Respondent argues that the Claimant's proposition is unfounded. The Czech Government had neither engaged in a conspiracy nor taken sides with CSOB to the detriment of IPB and its shareholders. The Respondent denies that there was a premeditated plan (the Paris Plan) to oust IPB from control over its enterprise by transferring it to CSOB by way of IPB's forced administration. The CNB is rather said to have been compelled to impose forced administration because IPB was no longer meeting the regulatory requirements for its banking business. Also, IPB's banking business had to be transferred to CSOB since there was no other strategic investor capable of saving IPB's business and prepared to step in immediately. The Respondent therefore argues that the Czech Government's conduct was reasonable under the circumstances and that it did not in any way imply an unjustifiable discrimination against IPB and its shareholders.

363. The Tribunal's assessment starts from the proposition that the Czech Republic's conduct was unfair and inequitable if it unreasonably frustrated IPB's and its shareholders' good faith efforts to resolve the bank's crisis. A host State's government is not under an obligation to accept whatever proposal an investor makes in order to overcome a critical financial situation like that faced by IPB. Neither is a host State under an obligation to give preference to an investor's proposal over similar proposals from other parties. An investor is, however, entitled to expect that the host State takes seriously a proposal that has sufficient potential to solve the problem and deal with it in an objective, transparent, unbiased and even-handed way.

364. The Claimant has identified a number of elements of the factual record which are said to support the Claimant's proposition that the Czech Government used its power to unilaterally support CSOB in implementing its strategy to acquire the business of IPB to the detriment of IPB and Saluka. The factual details and especially the inferences and conclusions that may be derived therefrom are, however, highly disputed between the parties.

365. In light of the evidence before it, the Tribunal considers it helpful to contrast two intertwined but distinguishable developments during the first half of 2000: the unfolding of CSOB's acquisition of IPB, on the one hand, and the unfolding of the negotiations between IPB and Saluka/Nomura and the Czech Government, on the other.

i) The Developments during the First Half of 2000

(a) The Government's Role in CSOB's Acquisition of IPB

366. By January 2000 it became clear to CSOB that it could implement its strategic objective of expanding into the retail banking sector only by acquiring IPB. CSOB's interest in this acquisition was, if not "discussed" as the Claimant contends, then at least expressed at a meeting of the CEO and Chairman of the Board of CSOB, Mr Kavánek, with the Minister of Finance, Mr Mertlík, as early as 10 January 2000. It is not clear whether further meetings took place in January and February 2000.

367. In March 2000 CSOB retained Consilium Rothchilds and Boston Consulting Group to start preparing a deal structure for acquiring IPB.

368. On 26 April 2000 CSOB prepared a presentation to the Czech Government about its acquisition plans for IPB. This presentation entitled "Discussion Materials" provided an analysis of IPB's situation, CNB's objectives and the "main options" available to the Czech Government, including "do nothing", "self-help" of IPB, "broker a deal with a third party" and "full intervention". The two last options clearly referred to the entry of a strategic partner into IPB, on the one hand, and to forced administration (which was, however, characterised as being generally seen as the last resort) on the other. Since "self-help" was no longer considered a viable option in IPB's circumstances, "broker a deal" was seen as the next best option in persuading the CNB, whereas "full intervention" should remain a "credible potential stick" for IPB/Nomura to facilitate the process.

369. On 30 May 2000 the CEO and Chairman of the Board of CSOB, Mr Kavánek, presented several documents at a meeting held in Paris by the Czech Minister of Finance, Mr Mertlík, the Governor of the CNB, Mr Tošovský, and the President of CSOB's parent company KBC, Mr Remi Vermeiren, who on that day were attending a banking conference. The documents presented by Mr Kavánek, together referred to by the Claimant as "the Paris Plan", set out a "Preliminary approach to the Carthago-India business case"<sup>45</sup> (in which CSOB explained the potential synergies to be expected from a combination of CSOB and IPB), CSOB's "Readiness to act" (in terms of CSOB's readiness and capability to manage the integration of IPB into CSOB) and a "Summary Transaction Structure" (explaining the procedural steps to be taken for the integration of IPB into CSOB).

370. In the two appendices to the latter document, CSOB explained in more detail two alternative strategies for a takeover of IPB: firstly, the "transaction structure to be used in negotiated transaction with India"; secondly, the "transaction structure to be used in forced administration of India". The first "transaction structure" was characterised as not being without legal, political and implementation risk; but it was emphasised that it would "present a potential (and perhaps only [*sic*]) structure which, in light of the options available under

current Czech law, addresses the goal of a rapid transfer of the India business to Carthago”. The second “transaction structure” was characterised as being novel and as not being without legal, political and implementation risk either; it was also emphasised, however, that it would “present a potential (and perhaps only [*sic*]) structure which, in light of the options available under current Czech law, addresses the goals of minimal involvement of the Forced Administrator and of a rapid transfer of the India business to Carthago”.

371. In anticipation of the Paris meeting, the Chairman of the Board of CSOB, Mr Kavánek, had written a letter dated 26 May 2000 to the Minister of Finance expressing his expectation that the Paris meeting would “contribute to additional positive progress in the subject matter”. Nevertheless, the precise nature and content of the talks at the Paris meeting are a matter of dispute between the parties and remain unclear.

372. On 13 June 2000, after the second run on IPB had already set in, the Vicegovernor of the CNB, Mr Niedermayer, acting on behalf of an *ad hoc* working group whose mission was to determine a solution for IPB including a transfer of IPB’s business to a strategic investor, requested CSOB to submit by 9:00 a.m. the next day a “co-operative” proposal for a takeover of IPB.

373. On 14 June 2000 the CEO and Chairman of the Board of CSOB, Mr Kavánek, wrote a letter to the Vicegovernor of the CNB, Mr Niedermayer, setting out a detailed proposal for a takeover of IPB to be negotiated with Nomura. It was clearly stated that State participation in the risks and losses linked with the operation had to be anticipated. The letter stated at the same time, however, that Nomura had declared its lack of interest in the proposal. The Claimant has denied that Nomura had in fact been contacted to discuss the proposal.

374. Also on 14 June 2000 the Director of the State Aid Department of the OPC, Mr Rudolecký, was informed by his superior, Dr Buchta, of the State aid envisaged for IPB/CSOB in case of CSOB’s takeover of IPB’s business. It was anticipated that an exemption from the prohibition of State aid would be necessary.

375. On 15 June 2000 the Czech Government met to assess the situation of IPB. The Cabinet’s deliberations were based on “Materials for the Talks of the Czech Republic’s Government” prepared and submitted by the Minister of Finance, Mr Mertlík, and the Governor of the CNB, Mr Tošovský. The “Materials” took two alternative solutions into consideration: a cooperative solution involving IPB’s shareholders and a non-cooperative solution involving forced administration coupled with a quick sale to a strategic investor. In Appendix No. 3 to the “Materials” the strategic investor was clearly identified as being CSOB. Also, the “Materials” expressly stated that any solution “necessitates a support on the side of the state”.

376. The Claimant contends that only the non-cooperative solution was seriously presented to the Cabinet with CSOB being the only candidate taken into consideration as a strategic investor of IPB. The Respondent insists that the Cabinet was fully briefed on both alternative solutions, including the cooperative solution. In any event the Government, by Resolution No. 622 of 15 June 2000, consented to and recommended the imposition of forced administration upon IPB with the objective of a subsequent sale to CSOB as the strategic investor, the provision of a government guarantee for the assets of IPB in favour of CSOB

and the issuing of government guarantees in favour of the CNB in order to cover the losses resulting from the indemnity to be issued by the CNB in favour of CSOB for the debts assumed from IPB and the losses suffered from the takeover of IPB's business.

377. On 16 June 2000 the CNB decided to introduce forced administration of IPB and appointed Mr Staněk as administrator (*i.e.* a sort of trustee in bankruptcy). Mr Staněk was expressly instructed to “perform all required steps that would result in accelerated sale of the company to [CSOB], being its strategic partner”. He was also promised a “special bonus” for the implementation of this instruction.

378. On 19 June 2000 IPB's business was transferred to CSOB. The Ministry of Finance granted the guarantee envisaged in such Resolution No. 622 of the Government and the CNB signed its promise of compensation for any risk and loss that CSOB had requested. Also, on the same day, the OPC (to which the Government's guarantee and indemnity in favour of IPB/CSOB had been formally notified the day before) issued a decision exempting the State's financial assistance from the legal prohibition of State aid provided by the Public Assistance Act.

(b) The Government's Role in IPB's and Saluka's/Nomura's Attempts to Negotiate a Cooperative Solution

379. Nomura began searching for a strategic partner for IPB in October 1999. It was clear from the beginning that the involvement of the Czech Government would be needed, not only in terms of the various approvals required from the Czech regulatory authorities, but especially in terms of State financial assistance without which private investors would find an investment in IPB unattractive given the finding of the CNB that IPB was massively under-provisioned and had insufficient regulatory capital.

380. Discussions began between representatives of the CNB and the Ministry of Finance, on the one hand, and representatives of IPB and Saluka/Nomura on the other.

381. It appears that the CNB and the Ministry of Finance initially expected a Nomura-led solution, because they assumed that Nomura as IPB's largest shareholder (through Saluka) would try to preserve its investment in IPB and lead the effort to solve IPB's problems either by injecting additional capital into IPB or by identifying a strategic investor for IPB. It transpires from the evidence before the Tribunal that some representatives of the Government and the CNB regarded Saluka/Nomura itself as a *de facto* strategic investor whose responsibility it was to assist IPB in overcoming its difficulties.<sup>46</sup> Nomura has, however, always insisted on its role as a portfolio investor and has made its willingness to rescue IPB dependent upon State financial assistance which the Czech Republic was unwilling to provide in the circumstances.

382. It soon turned out that some foreign financial institutions began to show an interest in becoming a strategic partner of IPB, especially a consortium formed by Allianz and Hypo-Vereinsbank which was later replaced by the UniCredito.

383. In December 1999 Nomura proposed a merger of IPB and CS, since Allianz considered an offer for both IPB and CS. This proposal was rejected by the State, because a public tender for the State's shareholding in CS was already underway and negotiations with Erste Bank of Austria (to which CS was eventually sold) were in their final stages.

384. In February and March 2000 IPB and Nomura developed a proposal for a merger of IPB and KB. This proposal was also rejected by the Government, because it would have led to a combination of two banks both of which required consolidation and substantial assistance.

385. Also in February and March 2000 the Deputy Managing Director of Nomura, Mr Jackson, entered into negotiations with the Vicegovernor of the CNB, Mr Niedermayer, on the draft of a "Memorandum of Understanding on the restructuring of IPB by Nomura in cooperation with shareholders of IPB and with the Czech Republic" ("MOU"). The purpose of the cooperation was said "to combine private sector and public sector resources". Nomura expressly declared its willingness to invest in IPB "on commercial terms applicable to comparable investments by private sector investors", including Nomura's participation in an increase of IPB's capital. It was made equally clear, however, that the CNB and the Ministry of Finance were required to assure State measures of support for IPB, including the purchase of subordinated debt and potentially participating in the capital increase. The Memorandum was finally rejected by the Czech side on the ground that it did not specify any concrete steps that Nomura would take to address IPB's problem and that there was no assurance for the State that its financial input would be spent effectively or would not wind up in the hands of IPB's shareholders or management.

386. On 14 March the Prime Minister of the Czech Republic expressed the view that the provision of State aid to IPB was conditional on Nomura injecting new capital into IPB. Nomura for its part reiterated on 3 April 2000 its unwillingness to address IPB's capital adequacy problems without State support.

387. Sometime in mid-March 2000 the Minister of Finance and the CNB are said to have lost trust in Nomura, *i.e.* confidence that Nomura would be able to come up with a viable solution for IPB. The Minister of Finance refused to meet personally with representatives of Nomura any longer. Instead, he and the Governor of the CNB appointed deputies (Deputy Finance Minister, Mr Mládek, and Vicegovernor of the CNB, Mr Niedermayer) to deal with Saluka/IPB. They were merely provided with a "soft mandate" and could only have unofficial meetings off Ministry premises.

388. On 14 April 2000 IPB submitted to the CNB a draft proposal of "Measures for the Stabilisation of IPB". A revised draft of this proposal was submitted to the CNB in May 2000. It explored various possibilities of rescuing IPB from its untenable situation by "bridging measures" as well as by "stabilisation measures" which included again the idea of merging IPB and KB as well as the search for a strategic partner. In any case, all the solutions explored in the proposal required the State's financial assistance. The proposal envisaged, however, that "as for the principal solution related to the entry of a strategic partner, the requested government assistance should focus on that part of [the] loan and asset portfolio which was created before the IPB privatisation and is comparable with portfolios of KB and CS where the government assistance is being provided". The proposal was rejected as



unacceptable, because it did not give the State sufficient control over the restructuring process.

389. In April and May 2000 Nomura's attempt to find a strategic partner for IPB made some progress. The Allianz/UniCredito consortium's interest became more and more concrete. Finance Minister Mertlík met with representatives of the Allianz/UniCredito consortium who made proposals similar to those made by CSOB, *i.e.* they wished to purchase IPB's assets. On 22 May 2000 UniCredito began due diligence enquiries on IPB and on 26 May 2000 UniCredito in fact proposed to purchase IPB's assets at an opening bid for IPB of CZK 25-30 billion (twice its book value, subject to agreement on the book value) with a possibility of paying more. Allianz/UniCredito made it clear, however, that their willingness to acquire IPB's assets was dependent upon a guarantee and promise of indemnity from the Czech State. Also, Allianz/UniCredito wanted several months to conduct due diligence.

390. At the same time representatives of CSOB also had meetings with Nomura's representatives to discuss CSOB's potential entry into IPB as a strategic partner. CSOB made it clear to Nomura that if IPB wanted Government support, it needed CSOB. However, these discussions led nowhere, because CSOB wanted to take over IPB first and negotiate the terms of the acquisition later. This was (perhaps not surprisingly) unacceptable to Nomura.

391. On 2 May 2000 the Governor of the CNB, Mr Tošovský, expressed in a letter to the Minister of Finance, Mr Mertlík, some dissatisfaction with the negotiations between the Czech Government and Saluka/Nomura. He wrote:

As is well-known to you from a number of working meetings, the CNB, apart from the performance of its legal obligation of banking supervision, has also acted on the grounds of care in regard of the stability of the financial system and together with representatives of the Ministry of Finance and the National Property Fund it entered the talks with the main shareholder of the bank [*i.e.* Saluka/Nomura] and is contributing to the work of a working group whose establishment it initiated some time ago.

The aforesaid work brought about a widening of the awareness of the situation, clarified some opinions and priorities, but has not led as yet to a sufficiently expedite and clear course of action. The problem is not only the slow communication with the main shareholder [*i.e.* Saluka/Nomura], his unclear position at the bank and a certain unwillingness to discuss a specific course of action, but also certain "half-officiality" of communication between the state, the shareholder and the bank at a level other than supervisory.

However, Governor Tošovský also stated in the following terms the basic conditions for a satisfactory solution:

I believe the most necessary is to expedite and refine the works and prevent thereby the creation of still greater costs. For this reason allow me to acquaint you with the foundation and conclusions which I made together with my colleagues in regard to the situation:

- a) regardless of the specific results of the audit or supervision of the CNB at IPB it is possible to believe that without the substantial strengthening of the capital of the bank or a clean-up of assets, the bank will not be able to further exist,
- b) from this point of view it appears to be unlikely that the planned sale of the bank to a new strategic investor is realizable as a commercial transaction without the support of the state.

The letter concluded by setting out three options for action: the stabilisation of IPB by a private entity with the support of the State (the option favoured by the Governor, provided the State would retain a certain control over the whole process), the nationalisation of the bank (an option that was said to involve considerable risk), liquidation or bankruptcy (an option that was characterised as totally undesirable).

392. Shortly thereafter the CNB requested Nomura to approach the Minister of Finance and engage in formal dialogue about the future of IPB. However, letters addressed by Nomura to the Minister of Finance on 5, 8 and 9 May 2000, setting out its willingness to meet the CNB's request for an injection of fresh capital in IPB and to arrange for up to CZK 13.2 billion of new capital for a capital increase, remained without any response from the Minister.

393. Nomura continued its efforts to meet government officials in order to find a solution for IPB. Further letters dated 9, 18 and 24 May 2000 were sent to representatives of the Ministry of Finance and the CNB.

394. On 18 May 2000 Nomura was informed by the Deputy Finance Minister, Mr Mládek, that the Ministry of Finance intended to nationalise IPB and proposed that Nomura should sell Saluka's IPB shares at a symbolic price of 1 euro. Moreover, Mr Racoča for the CNB explained that, if neither IPB nor its shareholders resolved IPB's problems, the CNB would impose forced administration on IPB. Both propositions were not the ones that had been favoured by Governor Tošovský in his aforementioned letter of 2 May 2000 to the Minister of Finance.

395. On 24 May 2000 Nomura submitted to the Prime Minister a further proposal ("Securing future for IPB"). It involved a capital injection by Nomura of CZK 20 billion for a capital increase, a sale of 51% of IPB shares to the Allianz/UniCredito consortium and to CSOB/KBC, and a KoB guarantee of IPB's balance sheet. The same presentation was given to the Deputy Finance Minister, Mr Mládek, on 25 May 2000. On 29 May 2000 Mr Mládek rejected the proposal, the major concern being again that it involved direct aid to IPB without the State having any control over the use of the funds. More precisely, Mr Mládek declared the proposal regarding the guarantee of IPB's balance sheet by KoB to a new commercial bank unacceptable. Instead, Mr Mládek reiterated his proposal that Nomura should sell Saluka's IPB shares at a symbolic price of 1 euro.

396. Nomura subsequently wrote to Mr Mládek suggesting that the Ministry of Finance propose an amendment to Nomura's proposal that would make it acceptable to the Ministry. However, by 31 May 2000, the Ministry had refused to communicate officially with Nomura in order to consider any solution relating to IPB.

397. On 1 June 2000 the Government informed Nomura that State assistance would only be forthcoming if Nomura acquired a 51% stake in IPB (*i.e.* an additional 5%, since Saluka already held 46%).

398. On 2 June 2000 the Government repeated its 1 euro proposal. On 4 and 5 June, Nomura attempted to accommodate that proposal by presenting to the Deputy Finance Minister, Mr Mládek, and the Vicegovernor of the CNB, Mr Niedermayer, three alternative solutions to enable the entry of a strategic investor:

(1) Nomura would procure the transfer of 51% of the shares of IPB to the Government in return for acceptable financial assistance. The purchasing price should be 1 euro for 46.16% (*i.e.* the stake that Saluka already held in IPB) and market price for the remaining shares (which Saluka would have to acquire first). The IPB shares would then be sold for their purchase price to a commercial banking investor that was agreed in advance among the Government, CNB and Nomura. The commercial banking shareholder would recapitalise IPB and take management control on terms agreed in advance.

(2) Nomura would procure the recapitalisation of IPB with CZK 20 billion of new capital in return for acceptable financial assistance. The current and new shares of IPB would then be sold to a commercial banking shareholder who would become a controlling shareholder in IPB. The commercial shareholder would then recapitalise IPB and take management control.

(3) Nomura would procure the sale of 51% shareholder ownership of IPB to the CNB or the Government at fair market value defined as CZK 116 per share, representing the average purchase price of the seller.

None of these proposals was considered acceptable to the Government, mainly because they were seen to involve direct financial assistance by the State in favour of Nomura, or the State's assumption of all of IPB's losses and of the costs of IPB's restructuring.

399. Subsequently, by about 6 June 2000, Nomura was focussing on an asset sale as a solution.

400. On 7 June 2000 the Deputy Finance Minister, Mr Mládek, urged Nomura again to accept the 1 euro proposal, otherwise IPB would be "toast".

401. On Friday, 9 June 2000, the Czech news agency CTK reported the Deputy Finance Minister, Mr Zelinka, to have said that

[c]ompulsory administration makes sense, because talks with a potential investor are at an advanced stage and there is a danger that the bank will go bankrupt in the meantime.

Even though by law compulsory administration does not mean freezing the deposits, Zelinka does not see any other way of protecting the bank from being invaded by its customers.

402. During the run on IPB, which started the following Monday, 12 June 2000, Nomura, on behalf of Saluka, continued to search for a solution. On 14 June 2000 Nomura submitted a new proposal to the Ministry of Finance, the CNB and the Prime Minister (the “IPB Proposal”) that also received the approval of IPB’s Board of Directors and of IPB’s Supervisory Board. According to this proposal, IPB would transfer its banking business to KoB for CZK 1 for on-sale to a long-term commercial banking partner acceptable to the Government (*i.e.* Allianz/UniCredito or CSOB/KBC). The proposal also stated IPB’s readiness to execute the transaction before 16 June 2000.

403. Under this proposal KoB would have provided limited State assistance to accomplish the sale to a strategic partner. The sale proceeds would have been distributed to the Government as reimbursement for the costs of any financial assistance, and any excess would have been shared by IPB and the Government.

404. On 15 June 2000 Nomura’s representatives met with representatives of the CNB and of the Ministry of Finance, including the Deputy Finance Minister, Mr Mládek, to discuss the IPB Proposal. From the Czech side the IPB Proposal was seen to involve serious economic, legal and organisational risks. The Czech Republic’s main concern was the uncertain scope of the IPB assets that would not be covered by the proposed transfer to KoB but rather retained by IPB, especially the assets belonging to IPB’s Tritton Fund. Negotiations continued into the evening and, after their closure, continued by e-mail. The final e-mail concluded by saying that the Ministry of Finance team was “now leaving for home and will continue tomorrow morning”. This left Nomura’s representatives with the impression that the IPB Proposal had been substantially agreed and that the negotiations would continue the next day. That impression proved to be mistaken.

405. On the evening of 15 June 2000 the Government (*i.e.* the Cabinet Presidium) convened and considered IPB’s situation. The materials on which the Cabinet Presidium based its deliberations referred to both cooperative solutions and forced administration. However, the two cooperative solutions (the one relating to Saluka’s sale of its shareholding in IPB to the State and the other relating to IPB’s partial sale of its assets to KoB) were only briefly mentioned. The focus was on the CSOB proposal for forced administration followed by a quick sale to itself as a strategic investor. The Government preferred anyway the imposition of forced administration upon IPB with the objective of a subsequent sale of IPB’s business to CSOB on the terms mentioned before.

406. The Claimant argues that the IPB proposal would have been by far the better deal and the Government has therefore failed to choose the solution with the least cost for the State’s budget. The Respondent insists that after the run on IPB had started and IPB’s liquidity had deteriorated dramatically, forced administration was unavoidable and CSOB was the only bank that was prepared and able in terms of management capacity to step in immediately to rescue IPB’s banking business.

ii) The Tribunal’s Finding

407. In light of all the factual elements relating to the Czech Government’s role in CSOB’s successful acquisition of IPB’s business, and IPB’s as well as Saluka’s/Nomura’s unsuccessful attempts to find a cooperative solution, the Tribunal finds, for the reasons set

out below, that the Czech Republic's conduct towards IPB and Saluka/Nomura in respect of Saluka's investment in IPB shares was unfair and inequitable. In particular, the Ministry of Finance and the CNB unreasonably frustrated IPB's and its shareholders' good faith efforts to resolve the bank's crisis. The Czech Government failed to deal with IPB's as well as Saluka's/Nomura's proposals in an unbiased, even-handed, transparent and consistent way and it unreasonably refused to communicate with IPB and Saluka/Nomura in an adequate manner.

(a) The Lack of Even-Handedness

408. The Czech Government failed to deal with IPB and its shareholder Saluka/Nomura, on the one hand, and CSOB, on the other hand, in an unbiased and even-handed way.

409. It transpires from the evidence before the Tribunal that both CSOB as well as IPB and its shareholder Saluka/Nomura clearly needed the cooperation of the Czech Government in order to implement their plans to acquire IPB's business or find a strategic investor for IPB. The involvement of the Czech Government was indispensable in terms of the various approvals needed from the Czech regulatory authorities as well as in terms of State financial assistance without which neither CSOB nor any other private investor, including Saluka/Nomura, would find an injection of new capital, a strategic investment or a takeover of IPB's business attractive given IPB's financial distress. Moreover, the Allianz/UniCredito consortium had made this point sufficiently clear.

410. It is, however, equally clear that only CSOB met with the degree of responsiveness on the part of the Czech Government which was a prerequisite for a successful search for a strategic investment or a takeover of IPB's business. In particular, the Ministry of Finance and the CNB were always open to receive information about CSOB's plan to acquire IPB, to discuss CSOB's strategy and finally to contribute to its implementation both in terms of granting the necessary regulatory approvals and in terms of massive State financial assistance.

411. In principle, there is nothing wrong with a Government deciding in favour of an investor which is determined, ready and capable of maintaining the business of an important bank suffering serious financial problems such as IPB. It is also very doubtful whether a Government can be said to be under an international legal obligation always to choose the least cost alternative and not to waste taxpayers' money. A Government that is bound by the standard of fair and equitable treatment of foreign investors, however, cannot avoid paying due regard to the good faith efforts of a foreign investor holding a considerable block of shares in the bank to solve the bank's problems.

412. In the case before the Tribunal, the Czech Government was determined at a rather early stage to give preference to CSOB. Since mid-March 2000 – three months before IPB had to be put into forced administration – the Minister of Finance refused further meetings with representatives of Saluka/Nomura thereby indicating that he no longer considered proposals from Saluka/Nomura helpful in solving IPB's problems. The seriousness of any negotiations with IPB or Saluka/Nomura on alternative solutions was thereby undermined relatively early on when there was still time for alternative cooperative solutions. The failure to develop a workable cooperative solution in good time led to a situation where the forced

administration of IPB could be regarded as unavoidable and CSOB could appear as the only choice available for an immediate rescue of IPB's banking business whose failure was imminent.

413. An even-handed dealing with the situation would have required that the Government (*i.e.* the Cabinet Presidium) in its meeting on the evening of 15 June 2000 had paid the same attention to the two cooperative solutions proposed by Nomura (the one relating to Saluka's sale of its shareholding in IPB to the State and the other relating to IPB's partial sale of its assets to KoB) as was paid to the non-cooperative solution favoured in the meantime by CSOB. The Tribunal is sufficiently satisfied that in fact the contrary had happened: the cooperative solutions involving Nomura and IPB were not seriously considered because at this point they appeared to the Cabinet Presidium not satisfactory for whatever reasons, whereas it had already been decided that the forced administration and the subsequent transfer of IPB's business to CSOB was the Government's first choice. The Tribunal notes that, the day before the Cabinet meeting (*i.e.* on 14 June 2000), the Director of the State Aid Department of the OPC, Mr Rudolecký, had already been informed by his superior, Dr Buchta, of the financial assistance envisaged for IPB/CSOB in the event of CSOB's takeover of IPB's business, because the Government anticipated that an exemption from the prohibition of State aid would be necessary.

414. Furthermore, the Forced Administrator was not left with his usual discretion to find the most appropriate solution for IPB's future based on an objective and unbiased assessment of all relevant factors. Instead he was instructed by the Government to implement immediately the transfer of IPB's business to CSOB and he was even provided a financial incentive to follow exclusively the Government's instruction.

415. A crucial element in the Czech Republic's preferential treatment of CSOB was once again the Government's willingness to support CSOB's acquisition of IPB's business by granting massive State aid while at the same time refusing to provide similar support for the implementation of the proposals originating from IPB or its shareholder Saluka/Nomura.

416. The justifications offered by the Government for its uneven treatment of IPB and Saluka/Nomura, on the one hand, and CSOB, on the other hand, are unconvincing. The Government's position was largely based on the misconception that Saluka/Nomura was a *de facto* strategic investor in IPB and was therefore itself responsible for solving IPB's problem by injecting new capital. Nomura, however, had always made it clear that this was not so, that Nomura had entered IPB rather as a portfolio investor and that the Government was not justified in imposing upon Nomura a shareholder's responsibility that was unfounded. Furthermore, when CSOB planned its takeover of IPB's business, it did not consider entering IPB as a strategic investor either, but nevertheless successfully relied on the Government's willingness to provide financial assistance to overcome IPB's financial problem.

(b) The Lack of Consistency

417. The Czech Government's conduct was also characterised by inconsistencies which made it difficult or even impossible for IPB and Saluka/Nomura to accommodate their proposals to the Government's position.

418. IPB's and Saluka's/Nomura's requests for State assistance were always part of their various proposals. Yet, the Czech Government took varying, sometimes even contradictory positions. Basically, the Government's position was that it was Saluka's/Nomura's own responsibility to rescue IPB without any State aid. The MOU on which Nomura had negotiated with the Vicegovernor of the CNB, Mr Niedermayer, in February and March 2000 was, however, aborted on the grounds that there was no assurance for the State that its financial input would be spent effectively or would not wind up in the hands of IPB's shareholders or management. This reasoning implicitly acknowledged at least in principle that State aid was needed for the rescue of IPB, an acknowledgement that was later even expressly stated in the letter from the Governor of the CNB, Mr Tošovský, addressed to the Minister of Finance, Mr Mertlík, on 2 May 2000. On 14 March 2000 the Prime Minister expressed the view that the provision of State aid to IPB was conditional on Nomura injecting new capital: not only was this a suggestion that had in principle always been part of Saluka's/Nomura's own proposals, but it demonstrated that the provision of State aid for IPB was by no means excluded in principle. IPB's draft proposal of "Measures for the Stabilisation of IPB" submitted to the CNB on 14 April 2000 made an attempt to accommodate the request for State financial assistance to the Government's concern that the State would bail out IPB for losses caused after its privatisation by its own imprudent loan policy: the proposal limited the request for State aid to that part of the bad loan portfolio which was created before the privatisation. The proposal was nevertheless rejected. On 1 June 2000 the Government took another turn and informed Nomura that State assistance would be forthcoming, if Nomura acquired a 51% stake in IPB (*i.e.* an additional 5%, since Saluka already held 46%).

419. Moreover, the Czech Republic acted rather inconsistently in its overall communications with IPB and Saluka/Nomura. The MOU on which Nomura had negotiated with the Vicegovernor of the CNB in February and March 2000 was designed to lead to a mutually satisfactory solution still to be determined in detail. Before that could be achieved, however, the "Memorandum" was already aborted on the grounds that it did not specify any concrete steps that Nomura would take to address IPB's problem. Furthermore, since mid-March 2000, the Minister of Finance had refused to meet Saluka's/Nomura's representatives because he had lost confidence in Nomura's ability to develop a solution for IPB, but at the same time he kept the channel for communication formally open by appointing deputies to deal with Saluka/Nomura and IPB on the basis of a "soft mandate" off the Ministry's premises.

(c) The Lack of Transparency

420. The Czech Government's exchange of views with Saluka/Nomura and IPB on possible solutions for IPB also lacked sufficient transparency to allow Saluka/Nomura and IPB to understand exactly what the Government's preconditions for an acceptable solution were.

421. Saluka/Nomura and/or IPB made various proposals all of which the Czech Government simply rejected with varying reasons.

422. Some of the reasons, however, were not totally unfounded. Thus, Nomura's December 1999 proposal of a merger of IPB and CS as well as IPB's and Nomura's proposal for a merger of IPB and KB were rejected on acceptable grounds.

423. The MOU, however, which Nomura had negotiated with the Vicegovernor of the CNB in February and March 2000, was said to lack specific steps that Nomura would take to address IPB's problem, even though the specification of such steps was the very objective of the ongoing negotiations. The Government failed to respond in any constructive way. IPB's proposal of 14 April 2000 submitted to the CNB was refused because it allegedly did not give the State sufficient control over the restructuring process. The proposal submitted on 24 May 2000 to the Prime Minister was rejected on the grounds that it involved direct aid to IPB without the State having any control over the use of the funds.

424. Nomura's proposals of 4 and 5 June 2000, which were designed to lead to the entry of a strategic investor, attempted to accommodate the Government's proposal of 1 June 2000 as well as its 1 euro proposal. They were nevertheless rejected on the grounds that they involved direct financial assistance from the State in favour of Nomura or the State's assumption of all of IPB's losses and of the costs of IPB's restructuring, even though the Governor of the CNB, Mr Tošovský, had already stated in his letter of 2 June 2000 to the Minister of Finance, Mr Mertlík, that a sale of IPB to a new strategic investor was not realizable without the support of the State.

425. Nomura's last proposal of 14 June 2000 also sought to accommodate the 1 euro proposal by offering a partial sale of IPB's assets to KoB for 1 CZK (for on-sale to a strategic investor such as Allianz/UniCredito or CSOB/KBC). The next day representatives of the CNB and of the Ministry of Finance began even to negotiate this proposal with Nomura's representatives and led them to believe that negotiations would be continued the next day, the main point for further clarification being the specification of IPB's assets that would not be covered by the transfer to KoB. This proposal was aborted by the supervening imposition of forced administration upon IPB.

(d) The Refusal of Adequate Communication

426. In light of the serious difficulties IPB was in and the urgency of finding a solution that would rescue IPB, the Czech Government's refusal to actively engage in constructive and direct negotiations with IPB and its major shareholder Saluka/Nomura was unreasonable. There could not have been any doubt that any cooperative solution necessarily made Saluka's/Nomura's involvement indispensable.

427. From mid-March onwards – three months before forced administration was imposed upon IPB – the Minister of Finance, Mr Mertlík, simply gave up communicating directly with IPB's major shareholder Saluka/Nomura. He downgraded the Ministry's communication with Saluka/Nomura to the Deputy level while at the same time he continued communicating personally with the CEO and Chairman of the Board of Directors of CSOB, Mr Kavánek.

428. Even on the Deputy level, communication with Saluka's/Nomura's representatives was not allowed on the premises of the Ministry of Finance.

429. Letters addressed by Nomura to the Minister of Finance on 5, 8 and 9 May 2000, setting out Nomura's willingness to meet the CNB's request for an injection of fresh capital and to arrange for up to CZK 13.2 billion of new capital for a capital increase in IPB simply remained without any response from the Minister.



430. Nomura nevertheless continued its efforts to meet Government officials, although with only limited success. Instead of engaging in meaningful negotiations, Nomura was confronted with the possibility of IPB's nationalisation or forced administration and with the 1 euro proposal.

431. On 31 May 2000, one day after the Minister of Finance, Mr Mertlík, had met with the CEO and Chairman of the Board of Directors of CSOB, Mr Kavánek, in Paris, official communication with Saluka/Nomura was discontinued even on the Deputy level. Saluka's representative, Mr Dillard, had to meet informally with Deputy Minister of Finance, Mr Mládek, in a wine bar.

432. Official communication was resumed on 15 June 2000 in order to discuss Nomura's last proposal. The Tribunal is very doubtful whether these discussions between Nomura's representatives and representatives of the CNB and of the Ministry of Finance were seriously meant as a last-minute effort of the Czech Government to find a cooperative solution. The OPC had already been informed the day before of the imminent takeover of IPB's business by CSOB. Already on 9 June 2000 the Deputy Minister of Finance, Mr Zelinka, had indicated to the Czech news agency CTK that forced administration of IPB was unavoidable.

d) Provision of Financial Assistance to IPB after Acquisition by CSOB

433. The Claimant argues that the Czech Republic acted in violation of the "fair and equitable treatment" standard by illegally granting massive financial assistance to IPB's business, once the beneficiary of such assistance had become CSOB following the forced administration.

434. On 19 June 2000 the Ministry of Finance, following the Government's Resolution No. 622 of 15 June 2000, issued an unlimited and unconditional guarantee of all on- and off-balance sheet assets transferred to CSOB, and the CNB entered into an agreement with CSOB under which the CNB promised to indemnify CSOB for certain other potential risks in connection with the acquisition of IPB's business. The transaction implemented by the Forced Administrator therefore conveyed to CSOB a fully guaranteed bank without requiring any substantial payment for its franchise value.

435. The Claimant, relying on the expert evidence of Professor Piet Jan Slot, contends that the Government Guarantee and the CNB indemnity were State aids provided in contravention of the Czech Public Assistance Act and in breach of the Czech Republic's obligations under the Europe Agreement, concluded between the European Communities and the Czech Republic on 4 October 1993.<sup>47</sup> Article 64 of that Agreement provided:

- (1) The following are incompatible with the proper functioning of the Agreement, in so far as they may affect trade between the Community and the Czech Republic:

...

- (iii) any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.

436. The OPC's decision of 19 June 2000 exempted the Government's financial assistance for CSOB/IPB from the legal prohibition of State aid, on the grounds that it was "restructuring aid" and especially aid to remedy a "serious disturbance" in the Czech economy consistent with the Europe Agreement as interpreted by the EC Commission in its Guidelines on Rescue and Restructuring Aid. The validity of that decision is questioned by the Claimant, in particular, on the grounds that the assistance did not properly qualify as "restructuring aid" or aid to remedy a "serious disturbance", and that the OPC lacked independence and had also violated the procedural rules of the Public Assistance Act. Furthermore, the Government is said to have illegally implemented its aid for CSOB/IPB before the OPC's exemption decision came into effect.

437. The Claimant has also emphasised that the exemption decision was in any case conditional upon the Ministry of Finance subsequently submitting to the OPC (i) by 19 September 2000 a restructuring plan for IPB; (ii) by 19 September 2000 preliminary information concerning the amount of assistance provided under the Government Guarantee; and (iii) by 19 December 2000 final information concerning the assistance. The Ministry of Finance is said to have failed to comply with the last of these Conditions and to have thereby committed another breach of the Public Assistance Act which was not adequately penalised by the OPC.

438. The Claimant argues that the Czech Republic, by providing illegal State aid and by failing to implement procedural rules giving effect to violations of the prohibition of State aid, violated its international Treaty obligation under the Europe Agreement thereby establishing a *prima facie* violation of the "fair and equitable treatment" standard in Article 3.1 of the Treaty.

439. The Respondent, relying on the expert testimony of Professor Dr Jürgen Basedow, contested the subject matter jurisdiction of the Tribunal as far as the application of the substantive rules on State aid of the Europe Agreement are concerned. Since the Europe Agreement's substantive provisions are not "directly applicable" (self-executing), it is said to be not for this Tribunal to assess the legality of the Czech Government's financial assistance for CSOB/IPB under the Europe Agreement. The Tribunal is said to be only competent to assess the procedural legality of that assistance.

440. In any case, the OPC is said to have been justified in exempting the Government's financial assistance as "restructuring aid" and as a remedy for a "serious disturbance". Also, the State aid could have been exempted as indirect investment aid or operating aid in accordance with the EC Commission's Guidelines on national regional aid. The Claimant's criticism is therefore said to be unfounded.

441. The Tribunal finds, for the reasons set out below, that the Claimant's claim is without merit. The Czech Government's provision of State financial assistance to CSOB/IPB, *i.e.* upon the acquisition of IPB's business by CSOB subsequent to the imposition of forced administration upon IPB, did not amount to a breach of Article 3.1 of the Treaty.

442. The unlawfulness of a host State's measures under its own legislation or under another international agreement by which the host State may be bound, is neither necessary nor sufficient for a breach of Article 3.1 of the Treaty. The Treaty cannot be interpreted so as to penalise each and every breach by the Government of the rules or regulations to which it is subject and for which the investor may normally seek redress before the courts of the host State.

443. As the tribunal in *ADF Group Inc.* has stated with regard to the "fair and equitable treatment" standard contained in Article 1105(1) NAFTA:

something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements....<sup>48</sup>

Quite similarly, the *Loewen* tribunal stated in the same legal context that

whether the conduct [of the host State] amounted to a breach of municipal law as well as international law is not for us to determine. A NAFTA claim cannot be converted into an appeal against decisions of [the host State].<sup>49</sup>

444. The Czech Government's conduct of which the Claimant is complaining must therefore be assessed in light of the Treaty's own "fair and equitable treatment" standard. Consequently, the Tribunal does not find it necessary to determine the legality of the financial assistance given to CSOB/IPB under Czech national law or under the Europe Agreement. The only relevant question is whether the Czech Government's provision of financial assistance to CSOB/IPB constituted unfair and inequitable treatment of Saluka irrespective of whether it was in compliance with the Czech Public Assistance Act or the Europe Agreement.

445. The "fair and equitable treatment" standard cannot easily be assumed to include a general prohibition of State aid. Financial assistance is a tool used by States to implement their commercial policies. Even though it tends to distort competition and to undermine the level playing field for competitors, States cannot be said to be generally bound by international law to refrain from using this tool. According to States' treaty practice, prohibitions of State aid are explicitly stated and defined in international agreements such as the Europe Agreement. A similar prohibition cannot be read into general principles such as the "fair and equitable treatment" standard. Consequently, an investor cannot claim to be generally protected against the host State providing State aid to its competitors.

446. Having said this, the Tribunal also emphasises that the host State, in providing State aid, is clearly bound not to frustrate an investor's legitimate and reasonable expectation to be treated fairly and equitably. The host State is therefore obliged to provide financial assistance to firms or industries in a way that does not amount to an unfair or inequitable treatment of a foreign investor. In particular, the provision of State aid to specific firms or industries must not be discriminatory or unreasonably harmful for the foreign investor.

447. In the case before the Tribunal, the Czech Government's guarantees and indemnities in favour of CSOB/IPB were part of the overall transaction whereby IPB's banking business

was transferred to CSOB subsequent to the imposition of forced administration upon IPB. At the time the financial assistance was implemented, IPB had already lost its banking business to CSOB. It is therefore not conceivable that, due to the State aid provided for CSOB/IPB, IPB and its shareholders could have suffered harm in addition to the harm that had already been caused by the forced administration and the subsequent loss of the banking business. After the takeover of IPB's banking business by CSOB, IPB was no longer a competitor of CSOB whose competitive position could be undermined by the State aid provided by the Czech Government.

e) Unjust Enrichment of CSOB at the Expense of Saluka

448. The Claimant contends that the Czech Republic failed to prevent the unjust enrichment of CSOB at the expense of the IPB shareholders including Saluka upon the transfer of IPB's business to CSOB and the provision of the aforementioned State aid following the forced administration.

449. The concept of unjust enrichment is recognised as a general principle of international law.<sup>50</sup> It gives one party a right of restitution of anything of value that has been taken or received by the other party without a legal justification. As the Iran-United States Claims Tribunal has stated more specifically:

There must have been an enrichment of one party to the detriment of the other, and both must arise as a consequence of the same act or event. There must be no justification for the enrichment, and no contractual or other remedy available to the injured party whereby he might seek compensation from the party enriched.<sup>51</sup>

450. If it is assumed that the "fair and equitable treatment" standard also includes the general principle of unjust enrichment, an investor would therefore also be protected by this standard against unjust enrichment by the host State.

451. In the case before the Tribunal, the question would be whether the Czech State has, by means of the transfer of IPB's business to CSOB and the provision of the aforementioned State aid following the forced administration, taken or received anything of value at the expense of Saluka. For the reasons set out below, the Tribunal would answer this question in the negative.

452. Firstly, it was not the Respondent which received the banking business from IPB, but CSOB. Even though the Czech State was still a (minority) shareholder of CSOB, CSOB cannot be equated with the Czech State. It is a general principle of company law that a company is a legal entity separate from its shareholders. The corporate assets are owned by the company itself, not by the shareholders. The concept of piercing the company's veil would be totally inapposite in this context. Anything acquired by CSOB from IPB was therefore not acquired by the Respondent.

453. Secondly, it was IPB's and not the Claimant's banking business that was transferred to CSOB. IPB's assets were owned by IPB itself, not by its shareholders. Again, the concept of the separateness of the company from its shareholders prevents the Tribunal from equating IPB and Saluka. Consequently, CSOB did not receive anything at the expense of Saluka.

454. The Claimant has in fact acknowledged that the transfer of IPB's business to CSOB resulted in the enrichment, if any, of one private entity at the expense of another. The Claimant has also argued, however, that in order for the Czech Republic to become liable towards Saluka it is sufficient to establish that the Czech Republic actively participated in a conspiracy to enrich one private party at the expense of another by using regulatory powers to effect an illegal transfer of ownership in IPB's business.

455. The Tribunal finds that the Claimant's argument is legally not well founded. It stretches the principle of unjust enrichment beyond its proper scope. The notion of one party being an accessory to an unjustified transfer between two other parties is not part of the concept of unjust enrichment. Even though, according to the Claimant, it is well established in the general international law of State responsibility for wrongful acts, especially in case of unlawful expropriation, that the ultimate beneficiary of the wrongful act of the State need not be the State itself, the Tribunal has not been convinced that this holds true for the principle of unjust enrichment.

456. Since there was no enrichment of the Respondent to the detriment of the Claimant, the Tribunal does not consider it necessary to assess the legal justification of the transfer of IPB's business to CSOB at any length. Suffice it to say that the transfer was based on the Sale Agreement between the Forced Administrator of IPB, and CSOB. It cannot be for this Tribunal to question the validity of this agreement as long as it has not been invalidated by a competent court or tribunal. Questionable as the circumstances surrounding the Sale Agreement may be, it provides, within the context of the principle of unjust enrichment, a sufficient legal justification for the transfer of IPB's banking business to CSOB.

### C. Non-Impairment

457. The legal basis of the Claimant's claims is not limited to the "fair and equitable treatment" standard contained in Article 3.1 of the Treaty but includes the non-impairment obligation contained in the same provision. Article 3.1 of the Treaty provides that:

[W]ith reference to the investments of investors of the other Contracting Party, each Contracting Party . . . shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.

It is for the Tribunal therefore, to determine whether the Czech Republic has, by certain measures, violated this obligation.

#### 1. Meaning of the Standard

458. "Impairment" means, according to its ordinary meaning (Article 31 of the Vienna Convention on the Law of Treaties), any negative impact or effect caused by "measures" taken by the Czech Republic.

459. The term "measures" covers any action or omission of the Czech Republic. As the ICJ has stated in the *Fisheries Jurisdiction Case (Spain v. Canada)*

[I]n its ordinary sense the word is wide enough to cover any act, step or proceeding, and imposes no particular limit on their material content or on the aim pursued thereby.<sup>52</sup>

460. The standard of “reasonableness” has no different meaning in this context than in the context of the “fair and equitable treatment” standard with which it is associated; and the same is true with regard to the standard of “non-discrimination”. The standard of “reasonableness” therefore requires, in this context as well, a showing that the State’s conduct bears a reasonable relationship to some rational policy, whereas the standard of “non-discrimination” requires a rational justification of any differential treatment of a foreign investor.

461. Insofar as the standard of conduct is concerned, a violation of the non-impairment requirement does not therefore differ substantially from a violation of the “fair and equitable treatment” standard. The non-impairment requirement merely identifies more specific effects of any such violation, namely with regard to the operation, management, maintenance, use, enjoyment or disposal of the investment by the investor.

462. The term “investment” is defined in Article 1 of the Treaty so as to include, *inter alia*,  
  
shares, bonds and other kinds of interests in companies [...], as well as rights derived therefrom.

As the Tribunal has already stated earlier, Saluka’s shareholding in IPB clearly is an “investment” in this sense.

463. It will transpire from the application of the non-impairment standard to the facts of this case that among the various objects of a potential impairment listed in Article 3.1 of the Treaty only Saluka’s “enjoyment” of its investment appears to be relevant in the present context. “Enjoyment” means, *inter alia*,

[t]he exercise of a right [...] [which] includes the beneficial use, interest and purpose to which property may be put, and implies right to profits and income therefrom.<sup>53</sup>

## 2. Application of the Standard

464. Three different sets of facts need to be assessed in light of the non-impairment obligation:

(a) first, the facts that have given rise to the Tribunal’s findings of violations of the “fair and equitable treatment” standard contained in Article 3.1 of the Treaty;

(b) second, the facts on which the Claimant has based its deprivation claim under Article 5 of the Treaty;

(c) third, the facts relating to the second run on IPB which subsequently led to the forced administration of IPB.

The Tribunal will assess these three sets of facts separately.

a) The Facts Underlying the Violations of the “Fair and Equitable Treatment” Standard (Article 3.1 of the Treaty)

465. The Tribunal finds that the Czech Republic, by violating the “fair and equitable treatment” standard of Article 3.1 of the Treaty, at the same time violated its non-impairment obligation under the same provision.

466. The Czech Republic, by

(i) giving a discriminatory response to the bad debt problem in the Czech banking sector, especially by providing State financial assistance to three of the Big Four banks to the exclusion of IPB and thereby creating an environment impossible for the survival of IPB, and

(ii) by refusing to negotiate in good faith on the proposals made by IPB and its shareholders,

impaired the “enjoyment” of Saluka’s investment, *i.e.* the shareholding in IPB.

467. There can be no doubt that the Czech Republic’s discriminatory response to the bad debt problem in the Czech banking sector and its unfair and inequitable treatment of IPB regarding the provision of State aid as well as its refusal to negotiate in good faith on the proposals made by IPB and its shareholders for the rescue of IPB had a detrimental impact upon IPB and Saluka’s shareholding in IPB. The unlawful conduct of the Czech Government contributed to the aggravation of IPB’s financial distress and to its subsequent failure and thereby impaired Saluka’s beneficial use of and interest in its shareholding in IPB.

b) The Facts Underlying the Deprivation Claim (Article 5 of the Treaty)

468. The Claimant’s allegation that the Czech Republic has, by certain measures, unlawfully deprived Saluka of its investment in IPB also includes the allegation that the Czech Republic has, by the same measures, impaired the operation, management, maintenance, use, enjoyment or disposal of Saluka’s investment in IPB. A “deprivation” is most certainly at the same time an “impairment”.

469. In order for the Tribunal to find in favour of the Claimant, the “measures” assessed in light of Article 5 of the Treaty must be shown, in the context of Article 3.1 of the Treaty, to have been “unreasonable or discriminatory”.

470. As far as the Claimant’s allegation of an unlawful impairment of Saluka’s investment by the Czech Government’s imposition of forced administration upon IPB is concerned, the reasons which led the Tribunal, in the preceding Chapter of this Award, to find that the “deprivation” of Saluka’s investment caused by the forced administration was lawful and that the Czech Republic did not violate Article 5 of the Treaty also lead the Tribunal to find that the “impairment” of Saluka’s investment by the same measure was lawful as well and that the

Czech Republic did not violate Article 3.1 of the Treaty in this respect either. Since in the context of Article 5, the “deprivation” of Saluka’s investment by the imposition of forced administration upon IPB was justified on reasonable regulatory grounds, the same applies *a majore ad minus* to the “impairment” of Saluka’s investment in the context of Article 3.1. In other words: to the extent that the concepts of “deprivation” and “impairment” overlap, because a “deprivation” is just one variety of possible “impairments”, the regulatory power exception (or “police power exception”) explained in the previous Chapter of this Award applies to both.

c) The Czech Government’s Alleged Triggering of the Second Run on IPB

471. The Claimant contends that the second run on IPB, which began on 12 June 2000 and which led directly to the imposition of forced administration upon IPB, was triggered by the Czech Government’s leaks of information. The Respondent has denied any such leaks. The details are highly controversial.

472. The Tribunal finds, for the reasons set out below, that the Government did in fact unreasonably spread negative information on IPB to the public and that this contributed to the aggravation of IPB’s financial distress and to its subsequent failure.

473. According to the evidence before the Tribunal, the following appears to be undisputed: In May 2000 IPB submitted to the CNB its revised draft proposal of “Measures for the Stabilisation of IPB”. Shortly thereafter, the Czech newspaper *Mladá Fronta DNES* reported that:

According to a highly reliable source, the central bank received a document titled “Measures for stabilisation of IPB” where the managers of the bank, among others things, propose the transfer of bad debts to the State-owned Konsolidacni banka.

The source quoted in the newspaper was the CNB.

474. On 8 June 2000 Dow Jones Newswires reported that

a source in the central bank [has told] [there was] a “fifty-fifty” chance forced administration will occur [at IPB].

475. According to the Claimant, on 9 June 2000 the Czech news agency CTK reported the Deputy Finance Minister, Mr Zelinka, as having said that

[c]ompulsory administration makes sense, because talks with a potential investor are at an advanced stage and there is a danger that the bank will go bankrupt in the meantime.

Even though by law compulsory administration does not mean freezing the deposits, Zelinka does not see any other way of protecting the bank from being invaded by its customers.



476. On 10 June 2000 *Mladá Fronta DNES* wrote:

According to reliable sources at the central bank, IPB does not have adequate reserves to cover losses from bad loans ... in such a case, the current status of IPB may lead to the withdrawal of its banking licence.

An undisclosed source from the ministry [of Finance] ... said that the intent is to cut off the existing shareholders from any influence on the operations of the bank.

...

The State has two possibilities for nationalisation of the bank and continuation of operations. It either acquires the majority share from Nomura, or takes over control of the bank via imposing forced administration.

...

“Both variants are possible”, said a source from the ministry that is a party to the negotiations. After the taking over control of the bank and an expensive cleaning up of its portfolio, it is to be sold to a strategic partner. Among the interested parties are, for example, CSOB or Italian Unicredito.

However, Nomura for the present does not want to accept the proposal to assign the shares to the State at a symbolic price of 1.- CZK, since it doesn't want to participate in the stabilisation of the bank.

477. As will be recalled, on 12 June 2000 the second run on IPB began.

478. None of the aforementioned press reports was in any way misstating the situation. Almost all of them contained a clear indication that forced administration of IPB was imminent. All of the reported information was said to have been received from Government sources.

479. The Respondent, by contending that there had been numerous press articles about the bank, some reporting publicly available information in ways that could easily create public panic or cause depositors to begin to make withdrawals, implicitly admits that there have also been press articles reporting confidential information that was not publicly available. There is even reason to believe that certain information was deliberately leaked to the press by “sources” in the CNB and the Ministry of Finance.

480. The crucial question for the Tribunal to determine relates to causation: was the publication of the information referred to a *conditio sine qua non* for IPB's forced administration? The nature of the information was such that IPB's customers could become seriously concerned about the safety of their savings deposited with IPB and start to withdraw their deposits. On the other hand, it is inconceivable that the public was not already to some degree aware that IPB had problems with its bad loan portfolio. It was one thing, however, for the public to have known of IPB's distress in general terms; it was quite another for the public to have been informed that the failure of IPB was imminent and forced administration

unavoidable, as stated by the Deputy Finance Minister, Mr Zelinka, on 9 June 2000 (*i.e.* on the Friday before the Monday when the second bank run set in).

481. Furthermore, there is some indication that the Government “sources” deliberately engineered the circulation of negative information about IPB in order to precipitate IPB’s failure. Mr Zelinka’s statement of 9 June 2000 may well be interpreted in this sense. Once forced administration was publicly stated to be unavoidable, that statement became a self-fulfilling prophecy, because the bank run was certain to set in the following Monday. This conduct of the Government was unjustifiable and unreasonable and contributed in all probability to the unsustainability of IPB’s situation. The Respondent has provided no convincing evidence to the contrary.

#### D. Full Security and Protection

482. The Claimant has argued that the Czech Republic has also violated its obligation under Article 3.2 of the Treaty which “more particularly” provides that each Contracting Party shall accord to the investments of investors covered by the Treaty “full security and protection”.

##### 1. Meaning of the Standard

483. The “full protection and security” standard applies essentially when the foreign investment has been affected by civil strife and physical violence.<sup>54</sup> In the *AMT* arbitration, it was held that the host State “must show that it has taken all measures of precaution to protect the investments of [the investor] in its territory”.<sup>55</sup>

484. The standard does not imply strict liability of the host State however. The *Tecmed* tribunal held that “the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it”.<sup>56</sup> The host State is, however, obliged to exercise due diligence.<sup>57</sup> As the tribunal in *Wena*, quoting from *American Manufacturing and Trading*,<sup>58</sup> stated,

The obligation incumbent on the [host State] is an obligation of vigilance, in the sense that the [host State] shall take all measures necessary to ensure the full enjoyment of protection and security of its investments and should not be permitted to invoke its own legislation to detract from any such obligation.<sup>59</sup>

Accordingly, the standard obliges the host State to adopt all reasonable measures to protect assets and property from threats or attacks which may target particularly foreigners or certain groups of foreigners.<sup>60</sup> The practice of arbitral tribunals seems to indicate, however, that the “full security and protection” clause is not meant to cover just any kind of impairment of an investor’s investment, but to protect more specifically the physical integrity of an investment against interference by use of force. In light of the following findings, it appears not to be necessary for the Tribunal to precisely define the scope of the “full security and protection” clause in this case.

## 2. Application of the Standard

485. The Claimant contends that the Czech Republic has failed to accord Saluka's investment full protection and security by its oppressive use of public powers, post-forced administration, with a view to depriving Saluka of any residual economic benefit or use of its investment and by harassing its officers and employees. The measures complained of by the Claimant relate more specifically to

- (a) the suspension of trading of IPB shares;
- (b) the prohibition of transfers of Saluka's shares; and
- (c) the police searches of premises occupied by Nomura and its employees.

The Tribunal will assess these three groups of measures separately.

### a) The Suspension of Trading in IPB Shares

486. According to the Claimant, the CSC's preliminary injunction of 15 June 2000 imposing an immediate suspension of trading in IPB shares as well as the subsequent successive extensions thereof were unjustified. The Respondent argues that there was nothing improper with the suspension decisions.

487. Saluka has lodged appeals against the CSC's suspension decisions. The appeals were rejected, however, by the competent Presidium of the CSC.

488. On 1 January 2001, the Czech Securities Act was amended to the effect that shareholders no longer had standing to appeal a CSC's suspension of trading in the shares held by the shareholders. Consequently, after 1 January 2001 Saluka was excluded from challenging suspensions of trading in its IPB shares.

489. The Respondent argues that the amendment to the Czech Securities Act was of general application and was not specifically targeted against Saluka.

490. Even assuming that the suspension of trading of shares may be State conduct within the scope of the "full security and protection" clause, the Tribunal, without deciding that question, finds that this claim of the Claimant is without merit. On this account, the Czech Republic cannot be said to have failed to provide "full protection and security" to Saluka's investment. The reasoning behind the CSC's suspension decisions cannot be said to have been totally devoid of legitimate concerns relating to the securities market. The suspensions of trading in IPB shares were at least justifiable on regulatory grounds. Also, the elimination of shareholders' right of appeal does not *per se* transcend the limits of a legislator's discretion. Shareholder's rights vary greatly in different jurisdictions. The amendment of the Czech Securities Act cannot be said to be totally unreasonable and unjustifiable by some rational legal policy.

b) The Prohibition of Transfers of Saluka's Shares

491. The Claimant also argues that the Police Order issued at the request of CSOB by the Public Investigator's Office on 26 October 2000 as well as subsequent decisions of the police authorities, freezing specifically Saluka's shareholding in IPB, were unjustified.

492. Saluka, however, appealed, with some success, against the freezing orders. Even the Public Prosecutor's Office's order of 23 April 2002 which upheld the freezing order on different grounds was quashed, upon Saluka's appeal, by the Supreme Public Prosecutor's Office. The Claimant still feels aggrieved by a procedural denial of justice due to the fact that the latter office, which was the last instance for appeals, upheld the freezing of Saluka's shares in IPB on still different grounds on which Saluka had not been heard. No further appeal being possible, on 18 July 2002 Saluka lodged a petition with the Constitutional Court seeking an appropriate remedy.

493. Even assuming that the freezing of the IPB shares held by Saluka may be State conduct within the scope of the "full security and protection" clause, the Tribunal, without deciding that question, fails to see a procedural denial of justice that would violate the Czech Republic's Treaty obligations. The absence of further appeals against decisions of the last instance for appeals is not *per se* a denial of justice. The alleged denial of Saluka's right to be heard is the basis for the petition lodged with the Constitutional Court. Nothing therefore emerges from the facts before the Tribunal that would amount to a manifest lack of due process leading to a breach of international justice and to a failure of the Czech Republic to provide "full protection and security" to Saluka's investment.

c) The Police Searches

494. The Claimant furthermore complains of the search of Nomura's (not Saluka's) Prague Representative Office and the seizure of Nomura's documents. According to the Claimant, these police actions were illegal and violated Nomura's fundamental rights to the inviolability of privacy and home, to the protection against unauthorised interference with its privacy and unauthorised gathering of data, and to the protection of ownership rights.

495. Saluka (not Nomura), however, successfully lodged a petition with the Czech Constitutional Court which in a decision of 10 October 2001 held in favour of Saluka.

496. Consequently, having been granted the relief petitioned for, the Claimant can no longer be aggrieved. The Tribunal, without going into the relevance of the distinction between Nomura and Saluka in this context, therefore finds that, on this account also, the Czech Republic cannot be found to have violated its Treaty obligation to accord "full protection and security" to Saluka's investment.

E. Conclusion

497. In summary, the Tribunal finds, based on the totality of the evidence which has been presented to it, that the Respondent's treatment of Saluka's investment was in some respects

unfair and inequitable and violated the “fair and equitable treatment” obligation as well as the “non-impairment” obligation under Article 3.1 of the Treaty.

498. The Respondent has violated the “fair and equitable treatment” obligation by responding to the bad debt problem in the Czech banking sector in a way which accorded IPB differential treatment without a reasonable justification. The Big Four banks were in a comparable position regarding the bad debt problem. Nevertheless, the Czech Republic excluded IPB from the provisioning of financial assistance. Only in the course of CSOB’s acquisition of IPB’s business during IPB’s forced administration was considerable financial assistance from the Czech Government forthcoming. Nomura (and subsequently Saluka) was justified, however, in expecting that the Czech Republic would provide financial assistance in an even-handed and consistent manner so as to include rather than exclude IPB. That expectation was frustrated by the Respondent. The Tribunal finds that the Respondent has not offered a reasonable justification for IPB’s differential treatment.

499. The Czech Republic has furthermore violated its “fair and equitable treatment” obligation by unreasonably frustrating IPB’s and its shareholders’ good faith efforts to resolve the bank’s crisis. Saluka was entitled to expect that the Czech Republic took seriously the various proposals that may have had the potential of solving the bank’s problem and that these proposals were dealt with in an objective, transparent, unbiased and even-handed way. The fundamentally different approach of the Czech Government towards CSOB’s acquisition of IPB, on the one hand, and towards IPB’s and Saluka’s/Nomura’s attempts to negotiate a cooperative solution, on the other, frustrated Saluka’s legitimate expectations. The Czech Government’s conduct lacked even-handedness, consistency and transparency and the Czech Government has refused adequate communication with IPB and its major shareholder, Saluka/Nomura. This made it difficult and even impossible for IPB and Saluka/Nomura to identify the Czech Government’s position and to accommodate it. The Respondent has not offered a reasonable justification for its treatment of Saluka.

500. The Tribunal does not find, however, that the Respondent has violated its “fair and equitable treatment” obligation by a failure to ensure a predictable and transparent framework for Saluka’s investment. Neither was the increase of the provisioning burden for non-performing loans unpredictable for Saluka/Nomura, nor could Saluka/Nomura legitimately expect that the Czech Republic would fix the legal shortcomings regarding the protection of creditor’s rights and the enforcement of loan security within a timescale of help to Nomura.

501. Nor does the Tribunal find that the Respondent has violated its “fair and equitable treatment” obligation by providing financial assistance to CSOB after its acquisition of IPB. At the time the financial assistance was implemented, IPB had already lost its banking business to CSOB. Therefore, IPB and its shareholders could no longer have suffered harm in addition to the harm that had already been caused by the forced administration and the subsequent loss of the banking business. After the takeover of IPB’s banking business by CSOB, IPB was no longer a competitor of CSOB whose competitive position could be undermined by the State aid provided by the Czech Government.

502. The Tribunal also cannot find that the Respondent has violated its “fair and equitable treatment” obligation by a failure to prevent the unjust enrichment of CSOB at the expense of the IPB shareholders, including Saluka, upon the transfer of IPB’s business to CSOB and the provision of State aid following forced administration. For there to be an actionable, unjust

enrichment as between the parties, the Respondent must have received something at the expense of the Claimant. It was not the Respondent which received the banking business from IPB, but rather CSOB, nor was it the Claimant's banking business that was transferred to CSOB, but rather IPB's.

503. The Tribunal does find a violation by the Respondent of its "non-impairment" obligation under Article 3.1 of the Treaty. This violation is based firstly on the same grounds which have led the Tribunal to find a violation of the "fair and equitable treatment" standard. The unjustified differential treatment of IPB regarding the Czech Republic's response to the bad debt problem in the banking sector as well as the Czech Government's refusal to negotiate in good faith on the proposals made by IPB and its shareholders were measures that impaired the enjoyment of Saluka's investment, *i.e.* the shareholding in IPB.

504. The violation of the "non-impairment" obligation is based secondly on the Czech Government's unjustifiable and unreasonable conduct regarding the circulation of negative information about IPB during the week before the second run on IPB that led to its failure. This conduct contributed in all probability to the unsustainability of IPB's situation.

505. The Tribunal fails to find a breach by the Respondent of its "full security and protection" obligation under Article 3.2 of the Treaty. Neither the suspension of trading of IPB shares, which was justifiable by legitimate concerns relating to the securities market, nor the prohibition of transfers of Saluka's IPB shares or the police searches of Nomura's Prague Representative Office and the seizure of Nomura's documents, against which Saluka has lodged appeals or petitions to the competent authorities or courts, amount to a breach of that obligation.

## VII. OTHER MATTERS

506. The Claimant, in its Memorial, considered it appropriate and efficient to postpone precise issues of the loss it had suffered to a separate phase of the proceedings when the Tribunal's decision on liability would be known. The Respondent, in its Counter-Memorial, was of the same view in relation to losses which were the subject to its counterclaims. Accordingly, neither party pursued questions of *quantum* in any detail in their various pleadings on the merits of the dispute submitted to arbitration.

507. Now that the Tribunal's conclusions of the question of liability are known, and include its finding that there has been a breach by the Respondent of its obligations under Article 3 of the Treaty, it is necessary to address the question of the appropriate redress for that breach, including questions of *quantum* which arise in that context.

508. The Tribunal, pursuant to Article 32.1 of the UNCITRAL Rules, accordingly renders its present Award as only a partial Award. The Tribunal retains its jurisdiction in order to decide the outstanding question of redress, including questions of *quantum*, in a second phase of this arbitration.

509. The Tribunal, bearing in mind Article 23 of the UNCITRAL Rules, will communicate with the parties about appropriate periods of time for the filing by the parties of written statements on the question of redress, including questions of *quantum*.

510. The Tribunal, bearing in mind Article 38 of the UNCITRAL Rules, will address questions of costs within the framework of its eventual decision at the conclusion of the second phase of this arbitration.

## VIII. DECISIONS

511. For the foregoing reasons, the Tribunal unanimously renders the following decisions as its Partial Award in the present arbitration:

- a. The Tribunal has jurisdiction to hear and decide the dispute which the Claimant, Saluka Investments BV, has submitted to it;
- b. the Respondent, the Czech Republic, has not acted in breach of Article 5 of the Treaty;
- c. the Respondent has acted in breach of Article 3 of the Treaty;
- d. the question of the appropriate redress for that breach, including questions of *quantum*, will be addressed in a second phase of this arbitration, for which the Tribunal retains jurisdiction;
- e. the Tribunal will separately determine the timetable for the second phase of this arbitration; and
- f. the Tribunal reserves questions of costs until final consideration can be given to the costs of this arbitration as a whole.

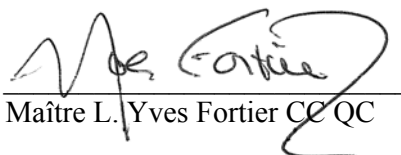
---

Place of arbitration: Geneva, Switzerland

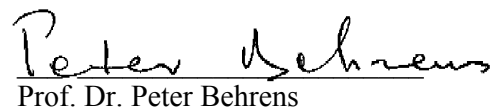
Dated: 17 March 2006



\_\_\_\_\_  
Sir Arthur Watts KCMG QC  
Chairman



\_\_\_\_\_  
Maître L. Yves Fortier CC QC



\_\_\_\_\_  
Prof. Dr. Peter Behrens

- 
- <sup>1</sup> CNB Report, *The Banking Sector During the Economic Transformation* 7 (1997).
- <sup>2</sup> Decision of the Council and Commission of 19 December concerning the conclusion of a Europe Agreement establishing an association between the European Communities and their Member States, of the one part, and the Czech Republic, of the other, OJ (L 360/1), 31 December 1994 [hereinafter Europe Agreement].
- <sup>3</sup> Treaty Establishing the European Community, OJ (C 325), 24 December 2002.
- <sup>4</sup> *Sic.* Presumably, “by a foreign person” was intended.
- <sup>5</sup> Claimant’s Reply, para. 30.
- <sup>6</sup> Article 31(3)(c) of the 1969 Vienna Convention on the Law of Treaties, 1155 UNTS 331.
- <sup>7</sup> See Case Concerning Oil Platforms (Islamic Republic of Iran v. USA), Judgment, 6 November 2003, ICJ Reports (2003), paras 23 and 41. See also *AAPL v. Sri Lanka*, 106 ILR 440, para. 41 (1990).
- <sup>8</sup> L.B. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AJIL 515 (1961).
- <sup>9</sup> OECD Draft Convention on the Protection of Foreign Property (12 October 1967), 71 ILM 117.
- <sup>10</sup> Restatement (Third) of Foreign Relations Law § 712 cmt. g (1987).
- <sup>11</sup> The tribunal in *ADF Group Inc. v. United States of America* agreed with the position taken by a tribunal in another case (*Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2) “that any general requirement to accord ‘fair and equitable treatment’ ... must be disciplined by being based upon State practice and judicial or arbitral caselaw or other sources of customary or general international law”. Although the foregoing case deals with “fair and equitable” treatment, the principle quoted applies in the same way to “deprivation”. See *ADF Group Inc. v. USA*, ICSID Case No. ARB(AF)/00/1, Award, 9 January 2003, para. 184.
- <sup>12</sup> *MethanexCorp. v. USA*, Final Award, 3 August 2005, 44 ILM 1343, para. 410 (2005). See also *Too v. Greater Modesto Insurance Associates*, 23 Iran U.S. Cl. Trib. Rep. 378, para. 26 (1989); *S.D. Myers, Inc. v. Canada*, 40 ILM 1408, para. 281 (2001); *Lauder (USA) v. Czech Republic*, Final Award, 3 September 2002, para. 198 (available at [www.investmentclaims.com](http://www.investmentclaims.com)); *Technicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, 29 May 2003, para. 119.
- <sup>13</sup> See *Too v. Greater Modesto*, 23 Iran U.S. Cl. Trib. Rep. 378; *Robert Azinian and others v. United Mexican States*, ICSID Case No. ARB(AF)97/2, Award, 1 November 1999; and *S.D. Myers Inc.*, 40 ILM 1408.
- <sup>14</sup> The Presidium of the Cabinet of the Czech Republic had consented to the imposition of forced administration by Resolution on 15 June 2000.
- <sup>15</sup> In any event, the Respondent will have the opportunity to raise this argument, if it wishes, in the quantum phase of this arbitration.
- <sup>16</sup> See *NAFTA Arbitration Pope & Talbot Inc. v. The Government of Canada*, Award on the Merits of Phase 2, 10 April 2001, para. 155 (available at [www.naftaclaims.com](http://www.naftaclaims.com)).
- <sup>17</sup> *S.D. Myers, Inc.*, 40 ILM 1408, para. 261.
- <sup>18</sup> Guidance may also be derived from some comprehensive surveys that have recently taken stock of States’ treaty practice, arbitral jurisprudence, relevant literature and documents prepared by international organisations. See, e.g., OECD, *Fair and Equitable Treatment Standard in International Investment Law*, Working Papers on International Investment, No. 2004/3 (2004) [hereinafter OECD Working Papers]; R. Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, *The International Lawyer* 87-106 (Spring 2005); C. Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, *Journal of World Investment & Trade* 357-386 (June 2005).
- <sup>19</sup> *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, 11 October 2002, para. 118; see also *Waste Management, Inc. v. United Mexican States*, 30 April 2004 (available at [www.naftaclaims.com](http://www.naftaclaims.com)) and *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, 25 May 2004.
- <sup>20</sup> *Pope & Talbot*, 10 April 2001; other arbitral awards referred to by the Claimant in support of its submission include *Lauder v. Czech Republic*, 3 September 2002, para. 292, and *CME Czech Republic BV (The Netherlands) v. Czech Republic*, Partial Award, 13 September 2001, para. 611 (available at [www.investmentclaims.com](http://www.investmentclaims.com)), both of which were also based on Article 3 of the Treaty.



- 
- <sup>21</sup> North American Free Trade Agreement, 8-17 December 1992, 32 ILM 605 (entered into force 1 January 1994).
- <sup>22</sup> *Waste Management*, 30 April 2004, para. 98.
- <sup>23</sup> See Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia, ICSID Case No. ARB/99/2, 25 June 2001, para. 367.
- <sup>24</sup> USA (L.F. Neer) v. United Mexican States, 21 AJIL 555, at 556 (1927).
- <sup>25</sup> Article 1105(1) of NAFTA, *supra* note 21, provides that:
- Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.
- <sup>26</sup> See G. Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection, Recueil des Cours*, Tome 269, at 341 (1997); R. Dolzer & M. Stevens, *Bilateral Investment Treaties* 60 (ICSID 1995); see also United Nations Conference on Trade and Development (UNCTAD), *Fair and Equitable Treatment*, Series on Issues in International Investment Agreements 40 (1999).
- <sup>27</sup> *Genin*, ICSID Case No. ARB/99/2.
- <sup>28</sup> *Genin*, ICSID Case No. ARB/99/2, para. 289.
- <sup>29</sup> *Genin*, ICSID Case No. ARB/99/2, para. 290; see also *Mondev*, ICSID Case No. ARB(AF)/99/2, para. 116.
- <sup>30</sup> Vienna Convention on the Law of Treaties, May 23, 1969, 1155 UNTS 331.
- <sup>31</sup> The Treaty entered into force on 1 October 1992 for both The Netherlands and the Czech and Slovak Federal Republic.
- <sup>32</sup> See *MTD Equity*, ICSID Case No. ARB/01/7, para. 113, where the Tribunal referred to The Concise Oxford Dictionary of Current English (5<sup>th</sup> ed.).
- <sup>33</sup> *S.D. Myers, Inc.*, 40 ILM 1408, para. 263.
- <sup>34</sup> For a comprehensive account of recent arbitral practice see Schreuer, *supra* note 18, at 374-380; see also Dolzer, *supra* note 18, at p. 103.
- <sup>35</sup> *Tecmed*, ICSID Case No. ARB(AF)/00/2, para. 154 (emphasis added).
- <sup>36</sup> *CME v. Czech Republic*, 13 September 2001, para. 155 (emphasis added).
- <sup>37</sup> *Waste Management*, 30 April 2004, para. 98 (emphasis added).
- <sup>38</sup> See the comprehensive account of arbitral practice in OECD Working Papers, *supra* note 18, at 25-39; see also Schreuer, *supra* note 18, at 373-385.
- <sup>39</sup> Occidental Exploration and Production Company (OEPC) v. Ecuador, 1 July 2004, para. 183 (emphasis added).
- <sup>40</sup> *S.D. Myers, Inc.*, 40 ILM 1408, para. 263.
- <sup>41</sup> For a comprehensive account of arbitral practice see Schreuer, *supra* note 18, at 380-383.
- <sup>42</sup> IMF, *Lessons from Systemic Bank Restructuring: A Survey of 24 Countries* (Washington 1997).
- <sup>43</sup> Resolution of the Czech Government No. 369, 27 May 1998.
- <sup>44</sup> See Czech National Bank, *Report on Banking Supervision in the Czech Republic* 24-28 (December 1999).
- <sup>45</sup> In the documents, the following code names were used for CSOB and IPB: “Carthago” for CSOB; “India” for IPB.
- <sup>46</sup> Witness Statement of Mr Daniel Jackson, at para. 72: “Mr Niedermayer [Vicegovernor of the CNB] warned that there was little appreciation within the Government or the CNB about the limitations of shareholder liability, and this misapprehension underlay the expectation that Nomura must cover any losses at IPB”.
- <sup>47</sup> Europe Agreement, *supra* note 2.
- <sup>48</sup> *ADF Group*, ICSID Case No. ARB(AF)/00/1, para. 42.

- 
- <sup>49</sup> The Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID Case No. ARB(AF)/98/3, 19 June 2003, para. 134.
- <sup>50</sup> See the Award in the Lena Goldfields, Ltd., Arbitration, 3 September 1930, 36 Cornell Law Quarterly 42, paras. 23-24 (1950); A. Nussbaum, *The Arbitration Between the Lena Goldfields, Ltd., and the Soviet Government*, 36 Cornell Law Quarterly 31, at 41 (1950); C. Schreuer, *Unjustified Enrichment in International Law*, 22 American Journal of Comparative Law 281 (1974).
- <sup>51</sup> *Benjamin Isaiah v. Bank Mellat*, 2 Iran U.S. Cl. Trib. Rep., 30 March 1983, 232, at 236-237.
- <sup>52</sup> Fisheries Jurisdiction Case (Spain v. Canada), Judgment on Jurisdiction of the Court, 4 December 1998, ICJ Reports (1998), at para. 66.
- <sup>53</sup> Black's Law Dictionary (6<sup>th</sup> ed. 1990).
- <sup>54</sup> See American Manufacturing & Trading, Inc. (AMT) (USA) v. Republic of Zaire, ICSID Case No. ARB/93/1, 21 February 1997 (lack of protection against loss of investment caused by widespread looting); *Tecmed*, ICSID Case No. ARB(AF)/00/2, paras. 175-177 (alleged lack of the host State's protection against interference with the investor's investment by adverse social demonstrations).
- <sup>55</sup> *AMT*, ICSID Case No. ARB/93/1, para. 6.05; see also *Wena Hotels Ltd. (UK) v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, 8 December 2000 (lack of protection against loss of investment by forced and illegal seizure of investor's hotels).
- <sup>56</sup> *Tecmed*, ICSID Case No. ARB(AF)/00/2, para. 177.
- <sup>57</sup> Dolzer & Stevens, *supra* note 26, at 61.
- <sup>58</sup> *AMT*, ICSID Case No. ARB/93/1, para. 28.
- <sup>59</sup> *Wena*, ICSID Case No. ARB/98/4, para. 84.
- <sup>60</sup> See OECD Working Papers, *supra* note 18, at 26-28 ("obligation of vigilance and protection").

**CLA-017**

**International Centre for Settlement of Investment Disputes**

**TECNICAS MEDIOAMBIENTALES TECMED S.A.**

**v.**

**THE UNITED MEXICAN STATES**

**CASE No. ARB (AF)/00/2**

**AWARD**

**President: Dr. Horacio A. GRIGERA NAON**

**Co-arbitrators: Prof. José Carlos FERNANDEZ ROZAS  
Mr. Carlos BERNAL VERA**

**Secretary to the Tribunal: Ms. Gabriela ALVAREZ AVILA**

**Date of dispatch to the parties: May 29, 2003**

## TABLE OF CONTENTS

	Para.
A. <b><u>Introduction</u></b> .....	1-3
B. <b><u>Procedural History</u></b> .....	4-34
C. <b><u>Summary of Facts and Allegations</u></b> .....	35-51
D. <b><u>Preliminary Matters</u></b> .....	52-92
I.    Jurisdiction of the Arbitral Tribunal.....	53-71
II.   Timely submission by Claimant of its claims against Respondent.....	72-74
III.  Scope of the Purchase Transaction.....	75-92
E. <b><u>The Merits of the Dispute</u></b> .....	93-201
I.    Expropriation.....	95-151
II.   Fair and Equitable Treatment.....	152-174
III.  Full Protection and Security and other Guarantees under the Agreement.....	175-181
F. <b><u>Compensation. Restitution in Kind</u></b> .....	182-200
G. <b><u>Decision</u></b> .....	201

## THE TRIBUNAL

Constituted as indicated above,

Having conducted its deliberations,

Issues the following award:

### **A. Introduction**

1. The Claimant, Técnicas Medioambientales, TECMED S.A., is a commercial company organized under Spanish law, domiciled in Madrid, Spain. It is represented in this arbitration proceeding by:

Mr. Juan Carlos Calvo Corbella  
Técnicas Medioambientales TECMED S.A.  
Albasanz 16 – 1a planta  
28037 Madrid, Spain

Ms. Mercedes Fernández  
Mr. Juan Ignacio Tena García  
Jones, Day, Reavis & Pogue abogados  
Velázquez 51 – 4a planta  
28001 Madrid, Spain

2. The Respondent is the Government of the United Mexican States, represented in this arbitration proceeding by:

Mr. Hugo Perezcano Díaz  
Consultor Jurídico  
Dirección General de Consultoría Jurídica  
de Negociaciones Comerciales  
Subsecretaría de Negociaciones Comerciales Internacionales  
Secretaría de Economía  
Alfonso Reyes No. 30, piso 17  
Colonia Condesa  
Mexico, D.F., C.P. 06179, Mexico

3. This Award decides on the merits of the dispute between the parties in accordance with Article 53 of the Arbitration Additional Facility Rules (Arbitration Rules) of the International Centre for Settlement of Investment Disputes.

## **B. Procedural History**

4. On July 28, 2000, the Claimant filed with the Secretariat of the International Centre for Settlement of Investment Disputes (“ICSID”) an application for approval of access to the Additional Facility and a request for arbitration against the Respondent in accordance with the Additional Facility Rules for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes (hereinafter referred to as the “Rules”) and under the provisions of the Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States (hereinafter referred to as the “Agreement”). The Agreement entered into force for both countries on December 18, 1996. The Claimant is the parent company in Spain of TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. de C.V. (“Tecmed”), a company incorporated under Mexican law, and holds over 99% of the shares of such company. Additionally, Tecmed holds over 99% of the shares of CYTRAR, S.A. DE C.V. (“Cytrar”), a company incorporated under Mexican law through which the investment giving rise to the disputes leading to these arbitration proceedings was made.

5. On August 28, 2000, the Acting Secretary-General of ICSID, pursuant to Article 4 of the Rules, notified the Claimant that access to the Additional Facility Rules had been approved with respect to this case and that the notice of institution of arbitration proceedings had been registered; he then sent the certificate of registration to the parties and forwarded copies of the notice of institution of arbitration proceedings to the Respondent.

6. On October 2, 2000, the Claimant notified the Centre of the appointment of Professor José Carlos Fernández Rosas as arbitrator and of its consent for the Parties to appoint as arbitrator a person of the same nationality of the Party making the proposal.

7. On November 7, 2000, the Respondent notified the Centre of the appointment of Mr. Guillermo Aguilar Alvarez as arbitrator and nominated Mr. Albert Jan van den Berg as President of the Arbitral Tribunal.

8. On November 29, 2000, the Claimant objected to the nomination of Mr. van den Berg and proposed instead that the Parties request their designated arbitrators to appoint the President of the Arbitral Tribunal, which was accepted by the Respondent.

9. On January 30, 2001, the ICSID Secretariat informed that Mr. Fernández Rosas and Mr. Aguilar Alvarez had appointed Dr. Horacio A. Grigera Naón as President of the Arbitral Tribunal. On February 2, 2001, the Claimant confirmed its agreement to this appointment and, in its communication dated February 22, 2001, the Respondent notified the Centre of its agreement to the President’s appointment.

10. On March 13, 2001, the Centre’s Acting Secretary-General informed the parties that, as from that date, the Arbitral Tribunal was deemed to have been constituted and the proceedings to have begun.

11. The first session of the Arbitral Tribunal with the parties was held in Paris, France on May 7, 2001. During the course of the session, procedural rules applicable to these

proceedings were established and the schedule for the submission of memorials by the Parties was fixed, among other things.

12. On September 4, 2001, the Claimant filed its memorial.

13. On November 16, 2001, the Respondent made certain observations regarding opinions alleged to have been given by Mr. Aguilar Alvarez in another arbitration proceeding which, in the Respondent's view, also involved legal matters to be debated in this arbitration proceeding.

14. On November 16, 2001, Lic. Aguilar Alvarez submitted his resignation as arbitrator in these proceedings, upon which, in a letter of the same date, the ICSID Secretariat served notice of the suspension of the proceedings until the vacancy created by Mr. Aguilar Alvarez's resignation was filled.

15. On November 20, 2001, the Arbitral Tribunal accepted the resignation of Mr. Aguilar Alvarez.

16. On December 14, 2001, the Respondent served notice of the appointment of Mr. Carlos Bernal Vereá in replacement of Mr. Guillermo Aguilar Alvarez.

17. On December 17, 2001, the ICSID Secretariat informed that Mr. Carlos Bernal Vereá had accepted his appointment by the Respondent to serve as arbitrator in these proceedings and as from such date deemed the Arbitral Tribunal to have been reconstituted and the arbitration proceedings to have resumed.

18. On January 22, 2002, the Arbitral Tribunal issued a procedural order deciding certain procedural matters raised by the Parties and extended the deadline for the submission of the Respondent's counter-memorial until February 4, 2002.

19. Following a new request by the Respondent in its written communication of January 31, 2002, on February 1, 2002, the Arbitral Tribunal extended the deadline for the submission of the Respondent's counter-memorial until February 11, 2002.

20. The Respondent's counter-memorial was received on February 11, 2002. On February 19, 2002, the Respondent enclosed a list of the facts alleged in the memorial that were recognized by the Respondent in its counter-memorial and those that were not.

21. On March 7, 2002, the Arbitral Tribunal issued Procedural Order No. 1, fixing the week of May 20, 2002 for the Evidentiary Hearing to be held in Washington, D.C., USA, dispensing with the submission of a reply and rejoinder by the Parties, establishing guidelines for holding the hearing and setting June 28, 2002 as the deadline for the Parties to submit their closing statements after the hearing.

22. Following new requests and exchanges between the Parties in the notes of the Respondent and Claimant dated March 13 and 21, 2002, respectively, the Arbitral Tribunal issued its Procedural Order No. 2, which—in addition to specifying certain additional



matters in relation to the hearing scheduled for the week of May 20 – provided that, at the end of the hearing on May 24, 2003, the Parties could address the Arbitral Tribunal orally, and extended the deadline for the submission of closing statements until July 15, 2002.

23. On April 29, 2002, the Secretariat of ICSID notified the Parties of the agenda issued by the Arbitral Tribunal for the conduct of the hearing.

24. The hearing was held in Washington, D.C., at the seat of ICSID. It began in the morning of May 20, 2002, and ended on May 24, 2002, after the Parties addressed the Arbitral Tribunal orally.

25. A stenographic transcript of the hearing was made, which lists the following persons as having been present at the hearing:

**Members of the Arbitral Tribunal**

1. Dr. Horacio A. Grigera Naón, President
2. Prof. José Carlos Fernández Rozas
3. Mr. Carlos Bernal Vereá

**Secretary of the Arbitral Tribunal**

4. Ms. Gabriela Alvarez Avila

**Técnicas Medioambientales TECMED S.A.**

5. Mr. Juan Carlos Calvo Corbella
6. Ms. Mercedes Fernández
7. Mr. José Daniel Fernández

**The United Mexican States**

8. Mr. Hugo Perezcano Díaz
9. Mr. Luis Alberto González García
10. Ms. Alejandra Treviño Solís
11. Mr. Sergio Ampudia
12. Mr. Carlos García
13. Mr. Rolando García

14. Cameron Mowatt, Esq.
15. Stephen Becker, Esq.
16. Sanjay Mullick, Esq.
17. Ms. Jacqueline Paniagua
18. Lars Christianson, Engineer
- 19 Ms. Ruth Benkley
20. Francisco Maytorena Fontes, Engineer
21. Christopher Thomas, Esq.

26. The hearing was held in accordance with the agenda fixed by the Arbitral Tribunal and within the time limit set for the Parties in Procedural Order No. 2 for the examination of witnesses and experts.

27. The following witnesses and experts were heard at the hearing after the opening statements made by the Claimant and the Respondent, respectively.

Offered by the Claimant

José Luis Calderón Bartheneuf

Javier Polanco Gómez Lavin

Enrique Diez Canedo Ruiz

José María Zapatero Vaquero

Jesús M. Pérez de Vega

Luis R. Vera Morales

José Visoso Lomelín

Offered by the Respondent

Alfonso Camacho Gómez

Cristina Cortinas de Nava

Jorge Sánchez Gómez

Lars Christianson

28. During the course of the hearing, the Arbitral Tribunal decided to agree to the inclusion of documents introduced by either the Respondent or the Claimant during the hearing. It further decided —after dismissing the Respondent’s objections in this regard— to agree to the inclusion of certain documents submitted in support of the statement made by Mr. Jesús M. Pérez de Vega as an expert proposed by the Claimant; nevertheless, it gave the Respondent an opportunity to examine such documents and exercise its right to question the expert once the inclusion of such documents had been decided. However, the Respondent declined to exercise such right.

29. At the end of the hearing, the Arbitral Tribunal heard the oral presentations made by the Parties, each of which was allowed 90 minutes.

30. On August 1, 2002, the Claimant and the Respondent submitted their respective closing statements.

31. In a note dated July 31, 2002, the Respondent had explained the reasons why it was annexing to its closing statement a “Declaration of Lars Christianson, Engineer”, accompanied by exhibits.

32. In a note dated August 2, 2002, the Claimant objected to the inclusion of such declaration and exhibits.

33. In its procedural order of August 12, 2002, the Arbitral Tribunal decided to agree to the inclusion of such statement and exhibits, not as part of the evidence offered and produced, but as part of the Respondent’s closing statement.

34. By note dated April 9, 2003, the Secretariat of ICSID notified the Parties that the Arbitral Tribunal had declared the proceedings closed in accordance with Article 45 of the Rules.

### **C. Summary of Facts and Allegations presented by the Parties**

35. The Claimant's claims are related to an investment in land, buildings and other assets in connection with a public auction called by Promotora Inmobiliaria del Ayuntamiento de Hermosillo (hereinafter referred to as "Promotora"), a decentralized municipal agency of the Municipality of Hermosillo, located in the State of Sonora, Mexico. The purpose of the auction was the sale of real property, buildings and facilities and other assets relating to "Cytrar", a controlled landfill of hazardous industrial waste. Tecmed was the awardee, pursuant to a decision adopted by the Management Board of Promotora on February 16, 1996. Later on, the holder of Tecmed's rights and obligations under the tender came to be Cytrar, a company organized by Tecmed for such purpose and to run the landfill operations.

36. The landfill was built in 1988 on land purchased by the Government of the State of Sonora, in the locality of Las Víboras, within the jurisdiction of the Municipality of Hermosillo, State of Sonora. The landfill had a renewable license to operate for a five-year term as from December 7, 1988, issued by the Ministry of Urban Development and Ecology (SEDUE) of the Federal Government of Mexico to Parques Industriales de Sonora, a decentralized agency of the Government of the State of Sonora. During this period, the landfill operator was not this agency but another entity, Parque Industrial de Hermosillo, another public agency of the State of Sonora. Ownership of the landfill was then transferred to a decentralized agency of the Municipality of Hermosillo, Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.; in this new phase, it had a new authorization to operate for an indefinite period of time. Such authorization had been granted on May 4, 1994, by the Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico (hereinafter referred to as INE), an agency of the Federal Government of the United Mexican States within the Ministry of the Environment, Natural Resources and Fisheries (SEMARNAP), which cancelled the previous authorization, granted on December 7, 1988. INE—both within the framework of SEDUE as well as of its successor SEMARNAP—is in charge of Mexico's national policy on ecology and environmental protection, and is also the regulatory body on environmental issues.

37. Upon the liquidation and dissolution of the above-mentioned decentralized agency, ordered by the Governor of the State of Sonora on July 6, 1995, in mid-1995, the assets of the landfill became the property of the Government of the State of Sonora. Subsequently, on November 27, 1995, through a donation agreement entered into between that Government and the Municipality of Hermosillo, the property was transferred to Promotora.

38. In a letter dated April 16, 1996, confirmed by letters of June 5, August 26 and September 5, 1996, Tecmed made a request to INE for the operating license of the landfill—then in the name of Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.—to be issued in the name of Cytrar. The Municipality of Hermosillo supported this request in its note to INE dated March 28, 1996, requesting INE to provide all possible assistance in connection with the name change procedure in the operating license in favor of Tecmed or of the company organized by it. In an official letter of September 24, 1996, INE notified

Cytrar, in connection with the application to change the name of the entity from Promotora to Cytrar, that Cytrar had been registered with INE. The official letter was then returned by Cytrar to INE as requested by INE after having been issued, and replaced by another one of the same date to which the authorization relating to the landfill was attached, dated November 11, 1996, stating the new name of the entity. Such authorization could be extended every year at the applicant's request 30 days prior to expiration. It was so extended for an additional year, until November 19, 1998.

39. The arbitration claim seeks damages, including compensation for damage to reputation, and interests in connection with damage alleged to have accrued as of November 25, 1998, on which date INE rejected the application for renewal of the authorization to operate the landfill, expiring on November 19, 1998, pursuant to an INE resolution on the same date, whereby INE further requested Cytrar to submit a program for the closure of the landfill. Subsidiarily, the Claimant has requested restitution in kind through the granting of permits to the Claimant enabling it to operate the Las Víboras landfill until the end of its useful life, in addition to compensation for damages.

40. The Claimant further argues that the successive permits granted by INE to Cytrar in connection with the operation of the landfill constitute a violation of the conditions on which the Claimant made its investment because (i) such permits, both as regards their duration as well as the conditions to which they were subject, were different from the permit given for operation of the landfill at the time the investment was made; and (ii) the price paid by Cytrar included the acquisition of intangible assets which involved the transfer to Cytrar of existing permits to operate the landfill and under which such landfill was being operated at the time of making the investment, and not the ones ultimately granted to it. The Claimant argues that such a violation of conditions also involves a violation of, among other provisions, Articles 2 and 3(1) of the Agreement and a violation of Mexican law. However, the Claimant states that it is not seeking in these arbitration proceedings a pronouncement or declaration regarding the lawfulness or unlawfulness, legality or illegality of acts or omissions attributable to the Respondent in connection with permits or authorizations relating to the operation of the Las Víboras landfill prior to the INE resolution of November 19, 1998, which terminated Cytrar's authorization to operate the landfill, considered in isolation, although it highlights the significance of such acts or omissions as preparatory acts for subsequent conduct attributable to the Respondent which, according to the Claimant, is in violation of the Agreement or facilitated such conduct.

41. The Claimant argues that the refusal to renew the landfill's operating permit, contained in the INE resolution of November 25, 1998, constitutes an expropriation of its investment, without any compensation or justification thereof, and further constitutes a violation of Articles 3(1), 3(2), 4(1), 4(5), 5(1), 5(2) and 5(3) of the Agreement, as well as a violation of Mexican law. According to the Claimant, such refusal would frustrate its justified expectation of the continuity and duration of the investment made and would impair recovery of the invested amounts and the expected rate of return.

42. The Claimant alleges that the conditions of the tender and the invitation to tender, the award or sale of the landfill or of the assets relating thereto and the investment made by the Claimant were substantially modified after the investment was made for reasons

attributable to acts or omissions of Mexican municipal, state and federal authorities. The Claimant claims that such modifications, with detrimental effects for its investment and which allegedly led to the denial by the Federal Government of an extension to operate the landfill, are, to a large extent, due to political circumstances essentially associated to the change of administration in the Municipality of Hermosillo, in which the landfill is physically situated, rather than to legal considerations. Specifically, the Claimant attributes such changes to the result of the election held in Mexico in July 1997, one of the consequences of which was the taking of office of a new Mayor of the Municipality of Hermosillo and similar changes in other municipal governments in the State of Sonora. According to the Claimant's allegations, the new authorities of Hermosillo encouraged a movement of citizens against the landfill, which sought the withdrawal or non-renewal of the landfill's operating permit and its closedown, and which also led to confrontation with the community, even leading to blocking access to the landfill. The authorities of the State of Sonora, where the Municipality of Hermosillo is located, are alleged to have expressly supported the position adopted by the Municipality.

43. The Claimant argues that the Federal Government yielded to the combined pressure of the municipal authorities of Hermosillo and of the State of Sonora along with the community movement opposed to the landfill, which, according to the Claimant, led to the INE Resolution of November 25, 1998, referred to above. This Resolution denied Cytrar authorization to operate the landfill and ordered its closedown. The Claimant argues that INE's refusal to extend the authorization to operate the landfill is an arbitrary act which violates the Agreement, international law and Mexican law. It further denies any misconduct or violation on its part of the terms under which the landfill permit was granted and which could justify a refusal to extend the authorization. The Claimant alleges that certain breaches of the conditions of the permit that expired on November 19, 1998, which was subsequently not extended by INE, did not warrant such an extreme decision. The Claimant points out that such breaches had been the subject matter of an investigation conducted by the Federal Environmental Protection Attorney's Office ("PROFEPA"), which, like INE, is an agency within the purview of SEMARNAP, but with powers, among other things, to monitor compliance with federal environmental rules and to impose sanctions, which may include a revocation of the operating license. It also stresses that PROFEPA had not found violations of such an extent that they might endanger the environment or the health of the population or which justified more stringent sanctions than the fines eventually imposed on Cytrar by PROFEPA as a result of its investigations.

44. The Claimant stresses the commitment of Cytrar, with the support of Tecmed, as from July 3, 1998, to relocate the hazardous waste landfill operation to another site on the basis of agreements reached with federal, state and municipal authorities as of such date, and denies the allegation that the fact that such relocation had not yet taken place at the time the extension of Cytrar's permit was refused could be validly argued among the grounds referred to by INE in its resolution of November 1998 denying the extension. The Claimant points out that Cytrar, with the support of Tecmed, subsequently added to its commitment to relocate the landfill another commitment to pay the costs and economic consequences involved in such relocation, and further denies that the delay or failure to relocate was attributable to it. The Claimant insists that the only condition to which Cytrar subjected its relocation commitment was that, pending such relocation, operation by Cytrar of the Las

Viboras landfill and the relevant operating permit should continue, and that such condition is a part of the relocation agreement entered into with the federal, state and municipal authorities of the Respondent. At any rate, the Respondent argues that Cytrar unsuccessfully applied to INE for a limited extension of its permit to operate the Las Viboras landfill (five months as from November 19, 1998), in order to come to an agreement, within such term, on the identification of the site to which the landfill operation would be relocated and to carry out the relocation.

45. According to the Claimant, the expropriation act and other violations of the Agreement which it deems to have suffered, have caused the Claimant to sustain a complete loss of the profits and income from the economic and commercial operation of the Las Viboras landfill as an on going business. Therefore the damage sustained includes the impossibility of recovering the cost incurred in the acquisition of assets for the landfill, its adaptation and preparation and, more generally, the investments relating to or required for this kind of industrial activity, including, but not limited to, constructions relating to the landfill; lost profits and business opportunities; the impossibility of performing contracts entered into with entities producing industrial waste, thus leading to termination of such contracts and to possible claims relating thereto; and the injury caused to the Claimant and to its subsidiaries in Mexico due to the adverse effect on its image in that country, with the consequent negative impact on the Claimant's capacity to expand and develop its activities in Mexico.

46. The Respondent, after pointing out that it does not consider that the powers of INE to deny the landfill's operating permit are regulated but discretionary, denies that such denial was a result of an arbitrary exercise of such discretionary powers. The Respondent claims that denial of the permit is a control measure in a highly regulated sector and which is very closely linked to public interests. Accordingly, the Respondent holds that such denial seeks to discourage certain types of conduct, but is not intended to penalize. The Respondent stresses that the matters debated in these arbitration proceedings are to be solved in a manner consistent with the provisions of the Agreement and of international law.

47. The Respondent denies that the subject matter of the tender and subsequent award to Tecmed was a landfill, understood as a group or pool of tangible and intangible assets including licenses or permits to operate a controlled landfill of hazardous waste. The Respondent argues that the assets tendered and sold by Promotora solely include certain facilities, land, infrastructure and equipment, but no permits, authorizations or licenses. With regard to the documents signed by Promotora, Tecmed and Cytrar in connection with the public auction of the assets relating to the landfill, the Respondent further argues that (i) the obligation or responsibility to obtain permits, licenses or authorizations to operate the landfill was vested in Cytrar; (ii) Promotora did not attempt to obtain or provide such permits, licenses and authorizations for the benefit of or in the name of Cytrar, of the Claimant or of Tecmed, nor did it guarantee that they would be obtained; (iii) Promotora's only commitment in this regard was to ensure that Cytrar could operate the landfill under the existing permits, authorizations or licenses, which remained vested in Confinamiento Parque Industrial de Hermosillo O.P.D. until Cytrar obtained its own permits, authorizations or licenses; (iv) it was always clear to Cytrar that it would require its own licenses, authorizations or permits in order to operate the landfill; and (v) neither Cytrar nor

Tecmed contacted the competent federal authorities for information regarding the possibility of transferring existing authorizations or permits. The Respondent denies the claim that the amount of \$ 24,047,988.26 (Mexican Pesos) was paid as price for the permits or authorizations to operate the landfill, or that Promotora's related invoice reflects the reality of the tender and of the subsequent sales transaction.

48. The Respondent challenges the Arbitral Tribunal's jurisdiction to decide in connection with conduct attributable or attributed to the Respondent which occurred before the entry into force of the Agreement, or that any interpretation thereof—particularly Article 2(2), which extends the application of the Agreement to investments made prior to its entry into force— could lead to a different conclusion. Likewise, based on Title II.5 of the Appendix to the Agreement, the Respondent rejects the Arbitral Tribunal's jurisdiction over acts or omissions attributed or attributable to the Respondent which were or could have been known to the Claimant, together with the resulting damages, prior to a fixed 3-year period, calculated as from the commencement date of this arbitration pursuant to the Agreement. The Respondent further denies that the conduct allegedly in violation of the Agreement attributed to the Respondent caused any damage to the Claimant, so the Claimant's claims would not fulfill the requirements of Title II.4 of the Appendix to the Agreement.

49. The Respondent claims that the granting and conditions of the license of November 11, 1996, were within the statutory powers of INE, and that such conditions were similar to the ones governing other permits granted by INE at the time. The Respondent stresses the negative attitude of the community towards the landfill due to its location and to the negative and highly critical view taken by the community with regard to the way Cytrar performed its task of transporting and confining the hazardous toxic waste originating in the former lead recycling and recovery plant of Alco Pacífico de México, S.A. de C.V. (hereinafter referred to as "Alco Pacífico"), located in Tijuana, Baja California, which would highlight the importance of demanding strict compliance with the new operating permit granted by INE to Cytrar on November 19, 1997.

50. The Respondent alleges that the municipal, state and federal authorities, as well as the security forces and courts of law addressed by Cytrar, acted diligently and in a manner consistent with the Respondent's obligations under the Agreement to offer protection to Cytrar, to its personnel and to the Claimant's investment relating to the landfill, in view of the different forms of social pressure exercised by groups or individuals opposed to the landfill, as well as to finding solutions to the problems resulting from such social pressure. The Respondent further denies that any acts or omissions on the part of such groups or individuals or any liability arising out of such acts or omissions are attributable to the Respondent under the Agreement or under international law. The Respondent underscores the distinct duties performed by PROFEPA and INE, and points out that only INE is competent to decide whether or not to renew an expired permit, based on an assessment of different elements and circumstances exclusively pertaining to INE. The Respondent therefore argues that it is irrelevant that PROFEPA did not revoke Cytrar's permit relating to the Landfill or that it did not close it down due to considerations taken into account by INE in order to decide not to extend the authorization, or that PROFEPA did not find that such matters were significant enough to justify more serious sanctions other than a fine.



However, the Respondent highlights the growing number of violations committed by PROFEPA in Cytrar's operation of the landfill.

51. The Respondent ultimately concludes that there is no conduct on the part of municipal, state or federal authorities of the United Mexican States in connection with Cytrar, Tecmed, the Claimant, the landfill or the Claimant's investments which constitutes a violation of the Agreement pursuant to its provisions or to the provisions of Mexican or international law. It specifically denies that refusing to give a new permit to Cytrar to operate the landfill is in the nature of an expropriation or that there has been a violation of Article 5 of the Agreement. The Respondent also denies that the Claimant suffered discrimination or that it was denied national treatment in violation of Article 4 of the Agreement. The Respondent denies having violated Article 2(1) of the Agreement regarding promotion or admission of investments or having committed any violation of Article 3 of the Agreement. Finally, the Respondent challenges the calculation basis for the compensation sought by the Claimant, which it considers absolutely inappropriate and inordinate.

#### **D. Preliminary Matters**

52. The Arbitral Tribunal will first examine the issues which, due to their nature or connection with its jurisdiction to decide this case or due to their close connection with other matters relating to the decisions that the Tribunal must make on the merits of the disputes between the Parties, need to be decided previously. Such matters are (i) the Respondent's challenges to the Arbitral Tribunal's jurisdiction; (ii) the Respondent's challenges to the timely submission by the Claimant of some of its claims; and (iii) the price and scope of the acquisition by Cytrar and Tecmed of assets relating to the Las Viboras landfill.

#### **I. Jurisdiction of the Arbitral Tribunal**

53. The Claimant argues,<sup>1</sup> based on Article 2(2) of the Agreement, that the Agreement applies retroactively to the Respondent's conduct prior to the effective date of the Agreement. Such provision stipulates that the Agreement "...shall also apply to investments made prior to its entry into force by the investors of a Contracting Party". According to the Claimant, under this provision, the Agreement covers all conduct or events relating to the investment giving rise to the disputes of this arbitration which took place before December 18, 1996, the entry into force of the Agreement pursuant to Article 12 thereof. Article 12 provides that the Agreement will enter into force on the date of mutual notification between the Contracting Parties of compliance with constitutional requirements for the entry into force of international agreements. Title X of the Appendix to the Agreement shows that this took place on December 18, 1996. The Claimant also alleges, based on Article 18 of the United Nations Vienna Convention of 1969 on the Law of Treaties (hereinafter referred to as the "Vienna Convention"),<sup>2</sup> that the Respondent was

---

<sup>1</sup> Memorial, p. 84, note 109.

<sup>2</sup> United Nations Conference on the Law of Treaties, First and Second Sessions, Official Records-Documents of the Conference, A/CONF.39/11/Add.2, or 1155 U.N.T.S. 331.

bound, even before entry into force of the Agreement, to “...refrain from acts which would defeat the object matter and purpose...” of the Agreement.<sup>3</sup>

54. The Respondent, in turn,<sup>4</sup> contends that this Arbitral Tribunal has no jurisdiction *ratione temporis* to consider the application of the Agreement to the Respondent’s conduct prior to December 18, 1996. The Respondent alleges that any other interpretation would be inconsistent with the principle of non-retroactive application of treaties embodied in Article 28 of the Vienna Convention and with a basic rule of international law. In other words, the Respondent does not recognize the Arbitral Tribunal’s jurisdiction to decide in connection with matters or conduct taking place prior to such date.<sup>5</sup>

55. The Arbitral Tribunal does not deem it appropriate to establish the meaning, in abstract or general terms, of “retroactive application” of a legal provision, an expression that does not appear to meet generally accepted criteria.<sup>6</sup> Therefore, in this regard, in addition to following the claims of the Parties as indicated below, the Tribunal will follow the text of the Agreement itself and the rules governing the interpretation of treaties.<sup>7</sup>

56. Based on the standards that have just been defined, consideration of whether the Agreement is to be applied retroactively must first be determined in light of the claims of the Parties. The mandate of an arbitration tribunal is subject to limitations, among them those arising out of disputed issues specifically referred to it by the Parties in their claims. An arbitral tribunal cannot decide more or less than is necessary to settle the disputes referred to it. There is no doubt that the Parties have opposing views as to whether the Agreement applies retroactively or not, and they have extensively argued this point<sup>8</sup> —all the more reason to examine this matter in light of the express requests and arguments of the Parties.

57. The Respondent’s conduct prior to December 18, 1996, complained about by the Claimant, essentially consisted of (a) failure to transfer to Cytrar the permit already existing for the operation of the landfill or failure to grant to Cytrar a permit equal or equivalent to such permit, particularly as regards its indefinite duration;<sup>9</sup> and (b) INE’s alleged

---

<sup>3</sup> In 109, p. 85 of its memorial, the Claimant misquotes Article 28 of the Vienna Convention, when in fact the correct reference, based on the text and content of such note, should have been to Article 18 of the Convention.

<sup>4</sup> Counter-memorial, pp. 116-120; 414 *et seq.*

<sup>5</sup> The text and case quoted on page 117, 418 of the counter-memorial and note 327, clearly evidence that the Respondent challenges the jurisdiction of the Arbitral Tribunal to the extent stated above.

<sup>6</sup> See Decision on Jurisdiction in *Tradex Hellas S.A. v. Republic of Albania*, December 24, 1996, ICSID case No. Arb/94/2, [http://www.worldbank.org/icsid/cases/tradex\\_decision.pdf](http://www.worldbank.org/icsid/cases/tradex_decision.pdf), p. 186, “there does not seem to be a common terminology as to what is “retroactive” application, and also the solutions found in substantive and procedural national and international law in this regard seem to make it very difficult, if at all possible, to agree on a common denominator as to where “retroactive” application is permissible and where not”.

<sup>7</sup> Award in *Mondev International Ltd. v. United States of America*, October 11, 2002, ICSID case No. ARB(AF)/99/2, p. 14, 43: [www.nafta.law.org](http://www.nafta.law.org).

<sup>8</sup> Counter-memorial, pp. 116-120, 414 *et seq.* Claimant’s closing statement, pp. 93-97. Respondent’s closing statement, pp. 4-6; 13 *et seq.*

<sup>9</sup> These events took place as follows: the first one on September 24, 1996 (note from INE to Cytrar informing that “it had been duly registered”), document A42, and the second one some time later, upon INE replacing the note by a new one on even date and with a substantially identical text, except that the new note evidences

ambiguous conduct, in that it first included Cytrar in an INE register in terms that could be deemed to be a transfer to Cytrar of the existing unlimited permit, subsequently revoking it by replacing it with another one, limited in its initial duration (a year) and the subsequent renewal of which was subject to approval by INE.<sup>10</sup>

58. In its memorial, the Claimant states as follows with regard to the conduct of INE with respect to the exchange or replacement of operating permits for the landfill:

However, this fact, although serious when we know what happened subsequently, did not cause immediate prejudice to the claimant which, after all, was still entitled to operate the Landfill acquired.<sup>11</sup>

Nevertheless, the Claimant highlights the following in this regard:

...the unwarranted change in the conditions of operation and as a result of a new and different permit being issued, unrelated to the plans and guarantees existing as of the time of the investment, is truly a discriminatory measure without any legal foundation, expressly prohibited by Article III of the ARPPI (Agreement on the Reciprocal Promotion and Protection of Investments).<sup>12</sup>

And a little later:

It should not be understood that the conversion of an authorization for an unlimited period of time into a temporary one legitimized or enabled the subsequent resolution contrary to renewal. That resolution of INE, challenged in this arbitration, is illegal and unlawful just like a revocation of the license on the same grounds. It is, however, beyond doubt that the precariousness (due to the short duration) and provisional nature of an authorization for such a limited time are greater than in the case of an authorization for an unlimited period of time.<sup>13</sup>

In connection with the same point, the Claimant explains the following:

However, CYTRAR, S.A. de C.V. and TECMED had an authorization covering the operation of the landfill and were not in a position to make complaints that could “displease” the competent officials. Still, in spite of undeniable differences between an authorization for an unlimited duration and a temporary one, the one granted in 1996 was a legitimate and sufficient title, operation of the landfill continued uninterruptedly and relations between the personnel of the companies and the representatives of the Administration were cordial and fluid. Everyone’s intent was that the landfill should operate and be managed appropriately and that it should last. At the time, at least for the Claimant, it was unthinkable that it would be unlawfully deprived of its lawfully obtained authorization only two years later.<sup>14</sup>

---

the granting of a new permit and notifies it to Cytrar (this permit, for a year and renewable, was dated November 11, 1996) as an annex, documents A43 and A44, Memorial, pp. 40-45; 107-109. Claimant’s closing statement, pp. 30-38.

<sup>10</sup> Claimant’s closing statement, pp. 110-115.

<sup>11</sup> Memorial, p. 42.

<sup>12</sup> Memorial, p. 108.

<sup>13</sup> Memorial, p. 109.

<sup>14</sup> Memorial, pp. 44-45. This was later reaffirmed by the Claimant when referring to the authorization granted by INE for the operation of the landfill by Cytrar, of November 19, 1997: “At any rate, we shall reiterate what has already been stated regarding the sufficiency of both authorizations to make operation of the landfill lawful and the practical considerations that caused CYTRAR S.A. de C.V. and TECMED to refrain from expressly protesting such changes in the conditions. The landfill continued to be operational; its duration potential, which depended on its useful life, had not been altered; and the competent authorities had expressed

Referring to INE's refusal to renew the authorization granted on November 19, 1997, the Claimant states that:

This is precisely the violation challenged in this arbitration —an Official Letter of the National Ecology Institute which deprived Cytrar, S.A. de C.V. of the asset that was the basis of its exclusive activity. A definitive and fundamental act accompanied by a number of proximate, previous and subsequent acts which completed the multiple violation of the ARPPI and which are claimed against in this arbitration.<sup>15</sup>

The Claimant further states:

However, the necessary accuracy with which the facts have been dealt in this memorial shows how the respondent's breach did not materialize in a single act, but was gradually prepared, implemented and strengthened until it was finally consummated in the act of refusing renewal.

It was certainly the refusal that caused damage and definitively prevented this company from obtaining a legitimate return on its investment. The preceding acts, particularly the ones leading to adverse modifications of the terms of the authorization, are in the nature of acts prior to that decisive breach which caused the damage for which compensation is requested. But the truth is that, although there is a difference between the operation of a landfill under a temporary authorization and under a license for an unlimited duration, in both cases there exists a title to undertake and lawfully continue operations, and the day-to-day activities are not curtailed by such time limitations.<sup>16</sup>

In connection with the refusal to renew the authorization of November 19, 1997, the Claimant further points out the following:

Therein lies the respondent's essential breach, which has caused the damage for which compensation is requested in this arbitration.<sup>17</sup>

Referring to the fair and equitable treatment under international law guaranteed by Article 4(1) of the Agreement, the Claimant claims that it encompasses the duty to act transparently and respecting the legitimate trust generated in the investor. In this regard, the Claimant states the following:

In sum, the legitimate trust generated in TECMED inducing it to make the investment was violated and seriously trampled upon. First, as a result of the change in the landfill's operating conditions and, subsequently and definitively, through the measure that led to its immediate standstill.

If Mexican law were to protect and permit the conversion of unlimited permits into annual ones, which we deny, the least that could be said is that such legislation is completely lacking in transparency, since none of its provisions specifies that licenses are limited in duration.<sup>18</sup>

The Claimant also argues that the replacement of the existing unlimited duration license, which in the past was given to state investors (municipal investors or investors from the

---

no reservations with regard to the landfill or operation thereof, nor had they expressed any intention that might affect the extent or duration of such operation": Memorial, pp. 47-48.

<sup>15</sup> Memorial, p. 53.

<sup>16</sup> Memorial, p. 103-104.

<sup>17</sup> Memorial, p. 112.

<sup>18</sup> Memorial, p. 122.

State of Sonora) by a limited duration license when it was granted to Cytrar constituted a violation of the fair and equitable treatment guarantee set forth in Article 4(5) of the Agreement.<sup>19</sup>

Finally, the Claimant summarizes its claims as follows:

A declaration is sought from the Arbitral Tribunal regarding the breach committed by the United Mexican States as a result of the actions and decisions stated in this memorial, both as regards the breach itself and in connection with acts in preparation of such breach...<sup>20</sup>

After listing the main breaches of the Agreement alleged by the Claimant against the Respondent, which include “the substantial change in the conditions governing the operation of the landfill...” as a result of the replacement of the authorization existing at the time of making the investment and “...particularly due to the conversion of an unlimited duration permit into an annual or annually renewable one”,<sup>21</sup> the Claimant summarizes its claims as follows:

Such acts prepare and constitute an express, serious and blatant breach of the duty to protect foreign investments, declared in Article II of the ARPPI and of the duty to offer fair and equitable treatment to foreign investors, pursuant to Article IV of the Agreement; non-renewal is a measure having equivalent effects to the type of expropriation provided for in Article V of the ARPPI, carried out for political reasons and interests contrary to the public interest and without appropriate compensation.<sup>22</sup>

59. In its closing statement, the Claimant gives additional details of its requests and claims. Regarding the replacement of the unlimited duration license to operate the Landfill by a one-year license, and in view of the Respondent’s statement that the Claimant’s claims also seek to hold the Respondent liable for such replacement, the Claimant states as follows:

This is absolutely false. Suffice it to look at the request for relief in the claim, which contains the Claimant’s claims, to understand that the only declaration of breach sought from the Arbitral Tribunal relates to the refusal to renew the license for the operation of the CYTRAR Landfill.

Certainly, the Claimant has provided an account, and informed the Tribunal, of other facts occurring prior to November 25, 1998, because they are relevant and clearly illustrate the attitude and conduct of the Mexican authorities, but the Claimant has not requested a declaration of breach or liability in respect of only one of them.<sup>23</sup>

The Claimant then adds:

In sum, we hold that the act in connection with which an award is requested in this arbitration is the refusal to renew the permit with respect to the Landfill of Cytrar, aside from the fact that the Tribunal needs to know and assess the meaning of previous acts and measures of the Mexican authorities.

---

<sup>19</sup> Memorial, p. 127.

<sup>20</sup> Memorial, p. 139.

<sup>21</sup> Memorial, p. 139.

<sup>22</sup> Memorial, pp. 139-140.

<sup>23</sup> Claimant’s closing statement, p. 93.

This claim is fully and expressly supported by the provisions on retroactivity contained in the ARPPI between Spain and Mexico, and does not need to rely on any other conventions.<sup>24</sup>

The Claimant further states that:

We stress that the only violation of the ARPPI requested to be penalized by the Tribunal is the decision not to renew the license, which caused the damage sustained by TECMED [...] However, this does not prevent, but rather determines, that the Arbitral Tribunal should examine and assess the preceding and even subsequent acts of the Mexican authorities.<sup>25</sup>

60. The Arbitral Tribunal sees a certain fluctuation in the Claimant's position as to whether the Respondent's conduct prior to December 18, 1996, can be taken into account in order to determine whether the Respondent has violated the Agreement. In any case, the Arbitral Tribunal concludes that the Claimant does not include in its claims submitted to this Tribunal acts or omissions of the Respondent prior to such date which, considered *in isolation*, could be deemed to be in violation of the Agreement prior to such date.

61. A more difficult issue is whether such acts or omissions, combined with acts or conduct of the Respondent after December 18, 1996, constitute a violation of the Agreement after that date.

62. The Claimant's considerations, particularly detailed in its memorial and transcribed in paragraph 58 above, show that the Claimant, in order to determine whether there has been a violation of the Agreement, holds that the investment and the Respondent's conduct are to be considered as a process and not as an unrelated sequence of isolated events. This position of the Claimant would have two consequences. The first one is that the Respondent, prior to December 18, 1996, and through the conduct of different agencies or entities in the state structure, gradually but increasingly appears to have weakened the rights and legal position of the Claimant as an investor. Such conduct would appear to have continued after the entry into force of the Agreement, and would have resulted in the refusal to extend the authorization on November 25, 1998, which would have caused the concrete damage suffered by the Claimant as a result of such conduct. The common thread weaving together each act or omission into a single conduct attributable to the Respondent is not a subjective element or intent, but a converging action towards the same result, i.e. depriving the investor of its investment, thereby violating the Agreement. The second consequence is that, before getting to know the final result of such conduct, this conduct could not be fully recognized as a violation or detriment for the purpose of a claim under the Agreement,<sup>26</sup> all the more so if, at the time a substantial part of such conduct occurred, the provisions of the Agreement could not be relied upon before an international arbitration tribunal because the Agreement was not yet in force.

---

<sup>24</sup> Claimant's closing statement, p. 97.

<sup>25</sup> Claimant's closing statement, p. 98.

<sup>26</sup> Whether it be conduct that continues in time, or a complex act whose constituting elements are in a time period with different durations, it is only by observation as a whole or as a unit that it is possible to see to what extent a violation of a treaty or of international law rises or to what extent damage is caused: J. Crawford, *The International Law Commission's Articles on State Responsibility* (Cambridge University Press, 2002), pp. 136-137; 143.

63. Clearly, the basic principle in international law is that unless there is a different interpretation of the treaty or unless otherwise established in its provisions, such provisions are not binding in connection with an act or event which took place or a situation that ceased to exist before the date of its entry into force.<sup>27</sup> The burden of proving the existence of any exception to the principle of non-retroactive application established therein naturally lies with the party making the claim.

64. Although the Agreement applies to investments existing as of the date of its entry into force—which suggests as a logical conclusion that the situations surrounding investments existing at the time do not escape its provisions—the way the provisions on which the Claimant relies are drafted suggests that application thereof is forward-looking. Thus, for example,<sup>28</sup> Article 3(1) of the Agreement:

Each Contracting Party *shall offer* full protection and security...[...] and *shall not hinder*<sup>29</sup> [...] the management, maintenance, development, use, enjoyment, expansion, sale or, as the case may be, the liquidation of such investments.

The same can be said about Article 3(2) of the Agreement:

Each Contracting Party, within the framework of its own legislation, *shall grant*<sup>30</sup> any authorizations needed in connection with the investments...

Or about Article 4(1) and (2) with regard to fair and equitable treatment:

Each Contracting Party *shall guarantee*<sup>31</sup> fair and equitable treatment in its territory pursuant to international law for investments made by investors from another Contracting Party [...]. Such treatment *shall not be* less favorable than that afforded in similar circumstances by each Contracting Party to investments made in its territory by investors from a third party state.

The same is found in Article 4(5) in connection with national treatment:

...each Contracting party *shall offer*<sup>32</sup> to investors from the other Contracting Party treatment no less favorable than that afforded to its own investors.

Or in Article 5(1) in connection with nationalization or expropriation:

Nationalization, expropriation or any other measure of similar effects [...] *which may be adopted*<sup>33</sup> by the authorities of a Contracting Party against investments in its territory made by investors from the other Contracting Party...

---

<sup>27</sup> Vienna Convention, Article 28. Award in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), 68, p. 22, [www.naftalaw.org](http://www.naftalaw.org). I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2<sup>nd</sup> Edition (Manchester University Press, 1984), p. 85.

<sup>28</sup> Italics in the quotations transcribed in paragraph 64 inserted by the Arbitral Tribunal.

<sup>29</sup> Emphasis added by the Arbitral Tribunal.

<sup>30</sup> Emphasis added by the Arbitral Tribunal.

<sup>31</sup> Emphasis added by the Arbitral Tribunal.

<sup>32</sup> Emphasis added by the Arbitral Tribunal.

<sup>33</sup> Emphasis added by the Arbitral Tribunal.

65. The continuous use of the future tense, which connotes the undertaking of an obligation linked to a time period, rules out any interpretation to the effect that the provisions of the Agreement, even in relation to investments existing as of the time of its entry into force, apply retroactively.<sup>34</sup>

66. However, it should not necessarily follow from this that events or conduct prior to the entry into force of the Agreement are not relevant for the purpose of determining whether the Respondent violated the Agreement through conduct which took place or reached its consummation point *after* its entry into force. For this purpose, it will still be necessary to identify conduct —acts or omissions— of the Respondent after the entry into force of the Agreement constituting a violation thereof.

...events or conduct prior to the entry into force of an obligation for the respondent State may be relevant in determining whether the State has subsequently committed a breach of the obligation. But it must still be possible to point to conduct of the State after that date which is itself a breach.<sup>35</sup>

In broader terms, Article 28 of the Vienna Convention reads as follows on this matter:

If, however, an act or fact or situation which took place or arose prior to the entry into force of a treaty continues to occur or exist after the treaty has come into force, it will be caught by the provisions of the treaty.(United Nations Conference on The Law of Treaties, First and Second Sessions, Official Records (Documents of the Conference, Draft Articles on the Law of Treaties with Commentaries, as adopted by the International Law Commission at its Eighteenth Session), pag. 32, (3) (United Nations publication, Sales No.:E.70V.5, A/CONF.39/11/Add.2))

67. In view of the above precedents and of the Claimant's specific requests, the Arbitral Tribunal will not consider any possible violations of the Agreement prior to its entry into force on December 18, 1996, as a result of isolated acts or omissions that took place previously or of conduct by the Respondent considered in whole as an isolated unit and that went by before such date. In order to reach such conclusion, a relevant fact is that Cytrar, Tecmed and the Claimant did not choose to make any claim in connection with conduct occurring prior to December 18, 1996, not even through a note addressed to the relevant Mexican authorities stating their objections to the measures or resolutions adopted,<sup>36</sup> although they were not under any violence or pressure at the time preventing them from doing so.

---

<sup>34</sup> Decision on Jurisdiction in *Tradex Hellas S.A. v. Republic of Albania*, December 24, 1996, ICSID case No.Arb/94/2, p. 191, [http://www.worldbank.org/icsid/cases/tradex\\_decision.pdf](http://www.worldbank.org/icsid/cases/tradex_decision.pdf).

<sup>35</sup> Award in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), 70, p. 23, [www.naftalaw.org](http://www.naftalaw.org).

<sup>36</sup> For instance, the Claimant chose not to make any claim in connection with the replacement of its operating permits in order not to damage its relationship with the Mexican authorities: see transcript of the Claimant's statements in paragraph 58. As pointed out by the arbitral tribunal in the case *Kuwait and the American Independent Oil Company (Aminoil)*, 21 I.L.M. p. 976 et seq. (1982), 44, p. 1008: "In truth, the Company made a choice; disagreeable as certain demands might be, it considered that it was better to accede to them because it was still possible to live with them. The whole conduct of the Company shows that the pressure it was under was not of a kind to inhibit its freedom of choice. The absence of protest during the years following [...], confirms the non-existence, or else the abandonment, of this ground of complaint." See also I. Brownlie, *Principles of International Law* (5<sup>th</sup> Ed., Oxford University Press, 1998), p. 642-644.



68. On the other hand, conduct, acts or omissions of the Respondent which, though they happened before the entry into force, may be considered a constituting part, concurrent factor or aggravating or mitigating element of conduct or acts or omissions of the Respondent which took place after such date do fall within the scope of this Arbitral Tribunal's jurisdiction. This is so, provided such conduct or acts, upon consummation or completion of their consummation after the entry into force of the Agreement constitute a breach of the Agreement, and particularly if the conduct, acts or omissions prior to December 18, 1996, could not reasonably have been fully assessed by the Claimant in their significance and effects when they took place, either because as the Agreement was not in force they could not be considered within the framework of a possible claim under its provisions or because it was not possible to assess them within the general context of conduct attributable to the Respondent in connection with the investment, the key point of which led to violations of the Agreement following its entry into force.

69. The Arbitral Tribunal is aware that the Claimant, relying on the decision in the case *Emilio Agustín Maffezini v. Kingdom of Spain*,<sup>37</sup> refers in its closing statement to the most favored nation treatment provided for in Article 8(1) of the Agreement in order to enable retroactive application in view of the more favorable treatment in connection with that matter which would be afforded to an Austrian investor under the bilateral treaty on investment protection between the United Mexican States and Austria of June 29, 1998. The Arbitral Tribunal will not examine the provisions of such Treaty in detail in light of such principle, because it deems that matters relating to the application over time of the Agreement, which involve more the time dimension of application of its substantive provisions rather than matters of procedure or jurisdiction, due to their significance and importance, go to the core of matters that must be deemed to be specifically negotiated by the Contracting Parties. These are determining factors for their acceptance of the Agreement, as they are directly linked to the identification of the substantive protection regime applicable to the foreign investor and, particularly, to the general (national or international) legal context within which such regime operates, as well as to the access of the foreign investor to the substantive provisions of such regime. Their application cannot therefore be impaired by the principle contained in the most favored nation clause.<sup>38</sup>

70. In assessing the Respondent's conduct, for the purpose of and with the scope provided for in paragraph 68 above, the Arbitral Tribunal shall take into account the principle of good faith, both as the general expression of a principle of international law embodied in Article 26 of the Vienna Convention and in its particular manifestation embodied in Article 18 of such Convention<sup>39</sup> with respect to the Respondent's conduct between June 23, 1995

---

<sup>37</sup> ICSID Case No. ARB/97/7, decision on jurisdiction of January 25, 1999, <http://www.worldbank.org/icsid/cases/awards.htm>.

<sup>38</sup> *Ibid.*, *Maffezini case*, Decision on jurisdiction, p. 25-26, 62-63.

<sup>39</sup> Regarding the importance of the principle of good faith within the framework of the law of treaties, including the period between signing and ratification, see R. Kolb, *La bonne foi en droit international public*, Presses Universitaires de France, 179-207 (2000). Article 18 of the Vienna Convention arises out of a general rule of international law based on good faith, which it expresses; it is therefore independent, and does not constitute an exception to the principle of non-retroactive application of treaties: I. Sinclair, *The Vienna Convention on the Law of Treaties*, p. 99, Manchester University Press (2<sup>nd</sup> Edition, 1984).

—the date on which the Agreement was signed by the Contracting Parties— and the date of its entry into force mentioned above,<sup>40</sup> in that such Article provides that:

A State shall refrain from acts that defeat<sup>41</sup> the object and purpose of a treaty when:

a) it has signed the treaty or has exchanged instruments constituting the treaty subject to ratification, acceptance or approval, until it shall have made its intention clear not to become a party to the treaty...

71. Writings of publicists point out that Article 18 of the Vienna Convention does not only refer to the intentional acts of States but also to conduct which falls within its provisions,<sup>42</sup> which need not be intentional or manifestly damaging or fraudulent to go against the principle of good faith, but merely negligent or in disregard of the provisions of a treaty or of its underlying principles, or contradictory or unreasonable in light of such provisions or principles. It should be noted that the principle inspiring such article has been applied in order to settle, through international arbitration, disputes between States and individuals which, in order to be decided, required a pronouncement on obligations of the former vis-à-vis the latter based on the law of treaties. The Mixed Greek-Turkish Arbitral Tribunal, in the case *A.A. Megalidis v. Turkey*,<sup>43</sup> stated:

qu'il est de principe que déjà avec la signature d'un Traité et avant sa mise en vigueur, il existe pour les parties contractantes une obligation de ne rien faire qui puisse nuire au Traité en diminuant la portée de ses clauses.

Qu'il est intéressant de faire observer que ce principe –lequel en somme n'est qu'une manifestation de la bonne foi qui est la base de toute loi et de toute convention- a reçu un certain nombre d'applications...<sup>44</sup>

## II. Timely submission by the Claimant of its Claims against the Respondent

72. In Chapter III of its counter-memorial, in a general section entitled “C. Objections regarding Jurisdiction”, the Respondent introduces defenses based on the Claimant’s claims allegedly not satisfying the requirements of Title II(4) and Title II(5) of the Appendix to the Agreement, for which reason this Arbitral Tribunal would be prevented from dealing with such claims.

Title II(4) of the Appendix to the Agreement provides the following:

An investor from a Contracting Party may, either on its own behalf or representing a company owned by it or under its direct or indirect control, refer to arbitration a claim on the grounds that the other Contracting Party

---

<sup>40</sup> See comment at the International Law Commission (United Nations Conference on the Law of Treaties, Official Records, Documents of the Conference, United Nations Publication A/CONF.39/11/Add.2), p. 22.

<sup>41</sup> It should be noted that the English version of this provision uses the expression “*defeat the object*”, which is not strictly equivalent to the notion of “frustrate” in English or “frustrar” in Spanish.

<sup>42</sup> A. Remiro Brotons, *Derecho Internacional Público*. 2 Derecho de los Tratados (Tecnos, Madrid, 1987), p. 246.

<sup>43</sup> Annual Digest of Public International Law Cases (1927-1928) [A. Mc Nair & H. Lauterpacht Editors], Vol. 4 (1931), 272, p. 395.

<sup>44</sup> Lord McNair, *The Law of Treaties* (Clarendon Press, Oxford, 1961), p. 202.

has violated an obligation under this Agreement, as long as the investor or its investment have suffered a loss or damage by reason or as a consequence of the breach.

Title II(5) of the Appendix to the Agreement provides the following:

The investor may not submit a claim under this Agreement if more than three years have elapsed since the date on which the investor had or should have had notice of the alleged violation, as well as of the loss or damage sustained.

73. In the opinion of the Arbitral Tribunal, the defenses filed by the Respondent, relying on Title II(4) and (5) of the Appendix to the Agreement, do not relate to the jurisdiction of the Arbitral Tribunal but rather to (non)compliance with certain requirements of the Agreement governing the admissibility of the foreign investor's claims. The Arbitral Tribunal notes that to the extent such defenses have been filed with respect to claims referring to conduct or acts or omissions of the Respondent which are excluded from the Arbitral Tribunal's jurisdiction or from the substantive scope of application of the Agreement pursuant to the decision contained in paragraphs 67 and 68 of this award, any determination as to whether such claims fulfill the requirements of Title II(4) and (5) of the Appendix to the Agreement would be superfluous.

74. When it comes to the Claimant's claims falling within the scope of this arbitration and of the provisions of the Agreement, the Arbitral Tribunal will decide if the admissibility requirements set forth in Title II(4) and (5) of the Appendix to the Agreement have been complied with or not with respect to the acts on which such claims are based, together with the remaining considerations or matters to be taken into account by the Arbitral Tribunal in deciding on the merits of the allegations of the Parties in this award. If the acts under review are deemed by the Arbitral Tribunal to be a part of more general, and not merely isolated conduct, the Arbitral Tribunal reserves the power to consider that the time when it will assess whether such acts have caused losses or damage for the purposes of Title II(4) of the Appendix to the Agreement, or whether they were deemed by the Claimant to be a breach of the Agreement or damaging within the three-year term provided for in Title II(5), will not be earlier than the point of consummation of the conduct encompassing and giving an overarching sense to such acts. In any case, and within the general framework of considerations already made when deciding whether the provisions of the Agreement are to be applied retroactively or not, the Arbitral Tribunal is of the view that Title II(4) and (5) of the Appendix to the Agreement contains requirements relating to the substantive admissibility of claims by the foreign investor, i.e. its access to the substantive protection regime contemplated under the Agreement. Consequently, such requirements are necessarily a part of the essential core of negotiations of the Contracting Parties; it should therefore be presumed that they would not have entered into the Agreement in the absence of such provisions. Such provisions, in the opinion of the Arbitral Tribunal, therefore fall outside the scope of the most favored nation clause contained in Article 8(1) of the Agreement.

### III. The Scope of the Purchase Transaction

75. The Claimant alleges, mainly on the basis of documents signed with Promotora in the process of award and transfer of the assets under which it operated the landfill of hazardous waste physically located in Las Víboras, Municipality of Hermosillo, State of Sonora, that what the Claimant acquired through that process was actually a pool of personal and real property and intangibles, the latter consisting of permits issued by municipal and federal authorities of the Respondent which enabled and empowered the Claimant to operate the Las Víboras site as a hazardous waste landfill. According to the Claimant, out of the total price of \$34,047,988.26 (Mexican Pesos) paid to Promotora for the acquisition of the assets relating to the landfill, the most substantial part, \$24,047,988.26 (Mexican Pesos), was paid by the Claimant in kind —by closing down an existing landfill for urban waste and constructing and advising in respect of the operation of a new landfill for the same purpose— in exchange for the permits and authorizations to operate the Las Víboras site as a landfill for hazardous waste.<sup>45</sup> Both the landfill that was closed down as well as the new one currently in operation are located in land owned by the Municipality of Hermosillo, under the jurisdiction of that Municipality and this location is other than the site for landfill of hazardous waste at Las Víboras, acquired by the Claimant as a result of the public bidding.<sup>46</sup>

76. The Respondent, on the other hand, argues that Promotora only tendered and sold to the Claimant a pool of personal and real property “relating to the Industrial Park” of the city of Hermosillo, which did not include permits or licenses to operate the landfill.<sup>47</sup> According to the Respondent, the public bidding and award of assets relating to the landfill at the Las Víboras site to Tecmed and Cytrar also included acquisition by another company of the Tecmed group of a concession for a landfill —a municipal dump also situated in the Municipality of Hermosillo—, for which Cytrar allegedly paid the above-mentioned amount of \$ 24,047,988.26 (Mexican Pesos). The Respondent specifically argues the following:

Tecmed (Mexico) acquired two things in the tender of February 1996. A pool of personal and real property relating to the landfill of hazardous waste, which consisted of a piece of land, existing constructions and machinery and equipment clearly described in the supporting documents of the transaction. It paid 10 million pesos in cash for them, as reflected in the financial statements submitted in these proceedings.

Secondly, it acquired the concession of a landfill, the municipal dump, for which it offered 24 million pesos, a concession which it still holds and continues to operate. What Dr. Calvo Corbella said a moment ago is true, not in respect of Cytrar but in respect of the company [sic], as confirmed by engineer Polanco, who attended the Tecmed (Mexico) tender. This was also confirmed by engineer Diez-Canedo, in reply to a question I expressly made when I asked him if, in addition to the amount of ten million pesos, he had offered a non-monetary contribution consisting of the construction and comprising the general facilities and the first phase of operations. Engineer Díaz Canedo answered that that was true.<sup>48</sup>

---

<sup>45</sup> Memorial, pp. 20-40. Claimant’s closing statement, pp. 10-30.

<sup>46</sup> Declaration of Javier Polanco Gómez Lavin, Hearing of May 20-24, 2002; transcription of May 20, 2002, pp. 31 overleaf/33.

<sup>47</sup> Counter-memorial, pp. 24-31; N° 90 *et seq.*

<sup>48</sup> Oral statement by the Claimant at the Hearing of May 20, 2002, transcript of May 24, 2002, pp. 27-28.

In sum, the Respondent not only holds that that amount, or contribution in kind valued at such amount, was not paid or made in exchange for intangible assets (the permits, authorizations or licenses to which Claimant refers), but also that it was not even a part of the price paid for assets relating to the landfill in Las Víboras. According to the Respondent, such amount or contribution was paid or made in exchange for the concession to operate the urban waste landfill of Hermosillo.

77. Based on the allegations of the Parties and of the facts presented before this Arbitral Tribunal, it is to be concluded that the award, the public bidding and sales transaction of assets relating to the Las Víboras landfill and the rights and obligations for each of the parties to such transaction and resulting therefrom were embodied in different instruments requiring joint consideration in order to determine the scope of the operation and its effects.

78. The award by Promotora of assets relating to the Las Víboras landfill to Tecmed as a result of the tender of such assets by Promotora was followed by the signing of a “promise to sell” contract dated February 20, 1996, entered into between Promotora and Tecmed, the fourth clause of which provides that at the time of executing the notarial deed of conveyance, the assets conveyed would include copies of permits, licenses and authorizations relating to the assets specified in the agreement.<sup>49</sup> In item or representation No. III of such instrument, it is stated that the Board of Directors of Promotora unanimously approved the following proposal:

Price offer for the purchase of Cytrar, alternative number two, consisting of 10 million pesos plus a non-monetary contribution to the Municipality of Hermosillo in the form of a project for the construction of and advice in connection with the operation of the new landfill in accordance with the attached project which comprises the general facilities and their first phase of operation, including the closedown of the current landfill, services valued at \$ 24,155,185.00 (Mexican Pesos). Total offer: \$34,155,185 (Mexican Pesos).

The second clause of the document stipulates that part of the price - \$ 10,000,000 (Mexican Pesos)- would be paid in cash, part upon signing the promise to sell and part upon signing the notarized deed of conveyance of the tendered real property, with the balance, amounting to \$24,155,185.00 (Mexican Pesos), to be paid in kind, by providing the service of closing down the existing landfill and constructing and providing advice in connection with the operation of a new one as mentioned above and referred to in item or representation number III of the “promise to sell” contract. As regards payment in kind of that part of the price, the second clause of the promise to sell expressly states as follows:

The difference relates to the cost of constructing a new landfill and closing down the existing one, in accordance with the approved proposal, which would be at the time of completing the construction of the new landfill to the satisfaction of Promotora Inmobiliaria of the Municipality of Hermosillo based on the construction project submitted by the buyer, upon which time the reservation of ownership would end; in the case of sale of the personal property located in the “landfill”, it will be billed by seller to buyer upon formalization of the final transaction, such formalities being the responsibility of Promotora Inmobiliaria of the Municipality of Hermosillo.

In turn, the fifth clause of the “promise to sell” contract provides the following:

---

<sup>49</sup> Document A23.

The parties specify that as from now the use to be given to the hazardous waste landfill shall be precisely that, failing which the property will revert back to the seller, in which case the buyer shall automatically forfeit any advances or payments made, unless the buyer “Tecmed, Técnicas Medioambientales de México S.A. de C.V.” fails to obtain the government permits and licenses required for lawful operation, in which case it may change the mode of operation by using the existing original license for operation of the landfill by “Tecmed, Técnicas Medioambientales de México S.A. de C.V.”.

79. In addition to the above, on the same date, Promotora, Tecmed and Cytrar entered into an agreement “to determine the method and terms of payment of the consideration arising out of the ‘promise to sell’ contract with reservation of ownership, dated February 20, 1996”.<sup>50</sup> Under such agreement, the total price to be paid by Cytrar amounted to \$ 24,047,988.26 (Mexican Pesos), broken down as follows: \$6,277,409.50 (Mexican Pesos) for land and constructions; \$237,034.00 (Mexican Pesos) for machinery and equipment; \$24,047,988.26 (Mexican Pesos) for intangibles. The agreement sets forth that Promotora shall issue an invoice covering the intangibles and that Cytrar shall issue invoices for the part of the price payable through the construction of the new landfill and closedown of the Hermosillo municipal dump, such invoices to be issued upon completion of the works. Clauses three and four of the agreement specifically provide the following:

Third: Promotora Inmobiliaria of the Municipality of Hermosillo OPD further undertakes to issue an invoice for the intangibles upon full compliance by Cytrar S.A. de C.V. of the obligation set forth in clause two of the above-mentioned agreement of February 20, 1996. The invoice value will be \$24,047,988.26 (Mexican Pesos) plus \$ 3,607,198.24 (Mexican Pesos) VAT, totaling \$ 27,655,186.50 (Mexican Pesos).

Fourth: Cytrar S.A. de C.V. agrees to the terms of the preceding clauses and in turn undertakes to issue invoices for the part it will pay with the construction and delivery of the new landfill of the Municipality of Hermosillo and the closedown of the current municipal dump. Such invoices will be issued upon formal delivery of the works.

80. Finally, pursuant to the award conditions, through a notarial deed of March 27, 1996,<sup>51</sup> Cytrar acquired from Promotora the real property, constructions and personal property relating to the landfill. Item or representation number 1 of the deed specifies that the seller (Promotora). “..tendered various assets held by it, in particular the ‘hazardous waste landfill situated at the Las Víboras’ site in the Hermosillo Industrial Park.” In item or representation II of such deed, reference is made to the meeting of the Board of Directors of Promotora, which unanimously approved the proposal submitted by Tecmed on the following terms:

“Price Offer for Acquisition of Cytrar”, alternative number two, consisting of \$10,000,000 (ten million pesos), plus a non-monetary contribution to the Municipality of Hermosillo, approval recorded in minutes, stating that it was unanimous, and including the closedown of the current landfill, the project and the construction of the first phase of the new landfill, pursuant to the resolutions approving performance, issued by the Board of Directors...”

The requirements for approval by the Board of Directors of Promotora include, as point c) of item or representation II the following:

---

<sup>50</sup> Document A24.

<sup>51</sup> Document A25.

Identifying the responsibility of each party and the timing for obtaining operating licenses.

The second clause of the deed states a cash amount of \$ 10,000,000 (Mexican Pesos) as the price, which is broken down into different amounts paid for the constructions already existing, personal property and land. Such clause also provides that:

... regardless of the price fixed, the PURCHASER undertakes to perform non-monetary obligations consisting of the project and construction of the first phase of the new landfill and closedown of the existing one, to the satisfaction of “Promotora Inmobiliaria of the Municipality of Hermosillo”, in accordance with the approved proposal.

The fourth clause of the deed provides that the reservation of ownership subject to which the sale is made will be lifted

...upon completion of the construction works for the new landfill and the closing down of the existing one, to the entire satisfaction of “Promotora Inmobiliaria of the Municipality of Hermosillo”, in accordance with the approved proposal.

Clause 5a) of the deed provides that the transferee (Cytrar) must undertake to perform its obligations under the public bidding in full, including the following obligations:

Specification that the acquired assets will be used solely as a landfill for hazardous waste, failing which they shall revert back to Promotora Inmobiliaria of the Municipality of Hermosillo, and any payments made will be forfeited, if the buyer “Cytrar” S.A. de C.V. should fail to obtain the government permits and licenses required for lawful operation; in such case, the mode of operation may be changed by using the existing original license for operation of the landfill by “Cytrar” S.A. de C.V.

Clause 5d) also provides that:

The steps required to be taken in order to obtain the government permits and licenses necessary for operation of the hazardous waste landfill shall be the sole responsibility of the transferee, Promotora Inmobiliaria of the Municipality of Hermosillo hereby being released from any liability with regard to the official authorizations required to be requested from the Municipality of Hermosillo. Promotora Inmobiliaria will lend its support to secure approval.

81. In a rectifying notarial deed of December 16, 1996,<sup>52</sup> Promotora and Cytrar corrected the amount of the part of the price relating to the acquisition of the real property as described in the original deed of conveyance of March 27, 1996, which was thus rectified and fixed at \$ 6,132,530 (Mexican Pesos), but the prices for the other items were not rectified. The deed also specified that real property and intangibles would be invoiced separately as follows:

As specified in the agreement signed between the parties on March 20, 1996, which fixes the terms and conditions under which the transaction will be settled, an involuntary error led to a mistaken and insufficient breakdown of values and calculation of Value Added Tax, AS THE TECHNICAL DESCRIPTION<sup>53</sup> of such assets WAS NOT TAKEN INTO ACCOUNT, i.e. the necessary topographic survey and description of

---

<sup>52</sup> Document A26.

<sup>53</sup> Emphasis in the original.

constructions and intangibles, since it was agreed that personal property and intangibles would be invoiced separately.

82. In a service contract of March 28, 1996,<sup>54</sup> between Promotora and Cytrar, in consideration of Cytrar's provision of "environmental advice services to the Municipality of Hermosillo" (clause 6), Promotora undertook, among other things (clause 2 d), to:

Keep in force any federal, state and municipal licenses and other permits required for operation of the landfill.

83. After the contribution in kind provided for as part of the purchase price of the assets relating to the landfill having been made, and apparently pursuant to the procedure set forth in the second clause of the "promise to buy" contract of February 20, 1996, the third and fourth clauses of the agreement regarding the method and terms of payment on the same date and the rectifying notarially-recorded deed of December 16, 1996, Promotora issued on July 24, 1997, Invoice No. 304 to Cytrar<sup>55</sup> for the amount of \$24,047,988.26 (Mexican Pesos) plus the applicable value added tax (VAT). The invoice comprises:

An authorization granted by the National Ecology Institute for the operation of a controlled landfill, through the collection, transport, treatment, temporary storage, and disposal of hazardous waste; the authorization also includes an authorization for soil use on the part of the Municipality of Hermosillo.

84. The different provisions laid down above and included in several documents signed by Promotora and Tecmed or Cytrar to record their mutual rights and obligations in connection with the sale and operation of the Las Víboras landfill show that performance of the works and services that were the responsibility of Cytrar relating to the landfill of urban waste, valued at \$ 24,047,988.26 (Mexican Pesos), was a payment in kind that was part of the consideration to be furnished by Cytrar for the award and sale to it of different assets for Cytrar to operate the hazardous waste landfill at Las Víboras; in other words, it was part of the price for which the assets of the Las Víboras landfill were awarded and sold to Tecmed and ultimately to Cytrar. So much so that the reservation of ownership to which such sale was subject would only terminate when such consideration had been furnished in full.<sup>56</sup> The audited financial statements of Cytrar as of December 31, 1997 enclosed with the expert witness report of American Appraisal<sup>57</sup> offered by the Claimant, particularly note 6, leads to the same conclusion; no evidence to the contrary has been provided based on the accounting books of Promotora or on statements of its management that took part in the sale of assets relating to the hazardous waste landfill of Las Víboras, nor evidence of any judicial challenges, for fiscal or any other reasons, with respect to the part of the sales price paid in kind, or the value or amount thereof, or the public tender offer proposed by Tecmed on the basis of such price, or its division into a cash component and a component in kind, nor denying that such payment in kind is all part of the price payable for assets relating to the Las Víboras landfill. The expert witness proposed by the Respondent does not state otherwise in his reports, when he says that "The urban waste landfill was an operation arising out of the payment in kind to be made by Tecmed for the acquisition of Cytrar".<sup>58</sup>

---

<sup>54</sup> Document A33.

<sup>55</sup> Document A31

<sup>56</sup> Deed of purchase and sale of March 27, 1996, fourth clause (Document A25).

<sup>57</sup> Document A117.

<sup>58</sup> Report by Fausto García y Asociados, p. 26.



85. It is the view of the Arbitral Tribunal that the minutes of the board meeting of Promotora of March 15, 1996,<sup>59</sup> which reflect Promotora's decision to approve the offer made by Tecmed, clearly establish, in accordance with alternative 2 of the Tecmed acquisition offer,<sup>60</sup> that the contribution in kind, valued at \$ 24,155,185.00 (Mexican Pesos), which was to take place through the performance of different works and services relating to the municipal dump of Hermosillo for urban waste, was part of the price paid for the assets of the Las Víboras landfill, concerned with hazardous waste, as can be read on the second page of the minutes:

In item two, RODOLFO SALAZAR PLATT (an engineer) reads out the resolution adopted at the preceding meeting which reads (verbatim): After these reviews, the Board declares the following proposal to be unanimously approved: "Price offer for the acquisition of CYTRAR, alternative 2 (two), consisting of \$10,000,000.00 (TEN MILLION MEXICAN PESOS) and a non-monetary contribution to the Municipality of Hermosillo in the form of a construction project and provision of advice to the operation of the new landfill in accordance with the enclosed project, which comprises the general installations and the first phase of operation. It includes the closing of the current landfill, work valued at \$24,155,185.00 (Mexican Pesos) [...] Total value of offer is \$34,155,185.00 (Mexican Pesos) [...], the opinion of the full Board being that it is the most convenient offer from the economic and technical point of view and that it is beneficial for all the community of Hermosillo.

86. There is no doubt that payment of the sales price was to be made by the purchaser of the tendered assets,<sup>61</sup> regardless of the individual or corporation holding or being the beneficiary of the concession for the operation of the Hermosillo urban waste landfill, and that such obligation was vested in Cytrar.<sup>62</sup> The approval of the tender by Promotora's management board already contemplated the acquisition by Cytrar of the Las Víboras landfill assets awarded to Tecmed, and further that Cytrar should become "...a joint and several obligee with respect to the rights and obligations acquired by the successful awardee...",<sup>63</sup> without excluding from such obligations the ones relating to the furnishing of the consideration in kind, referred to above. The declaration of Mr. Javier Polanco Gómez Lavín—which has not been challenged or refuted in this regard by any other evidence produced in this arbitration— confirms the above.<sup>64</sup>

87. Having been concluded that the consideration in kind to be furnished by the purchaser of the assets relating to the hazardous waste landfill of Las Víboras in connection with the urban waste landfill of the Municipality of Hermosillo is part of the purchase price of such assets, it remains to be determined to what extent all or part of such consideration is allocable to the acquisition of the intangible assets referred to by the Claimant.

88. A rational and logical interpretation of the documentation presented by the Parties shows that what Promotora, on the one hand, and Tecmed and Cytrar, on the other, had in

---

<sup>59</sup> Document A21.

<sup>60</sup> Document A17

<sup>61</sup> Page 5, notarial deed of conveyance, document A25.

<sup>62</sup> Second clause of the "promise-to-buy" contract (document A23); third clause of the Agreement (document A24).

<sup>63</sup> Document A21, p. 4

<sup>64</sup> Declaration of Javier Polanco Gómez Lavín, transcript of the Hearing for the Production of Evidence of May 20-24, 2002, section on May 20, 2002, pp. 31-33.

mind when entering into the agreement (from the standpoint of the latter, also when contemplating an investment in Mexico and in the Las Víboras landfill), was not simply the transfer of certain personal and real property but also to create the means for Cytrar to be able to operate the Las Víboras site as a hazardous waste landfill —i.e. to accomplish a public use purpose fully consistent with the activity that this landfill had been serving since its beginning in 1988— and to continue the same activity. Such were necessarily the legitimate expectations of Cytrar and of the Claimant, not only because the site and facilities being acquired as well as the commitments in terms of use and operation undertaken upon doing so, were to serve the normal purpose of operations of Tecmed and Cytrar, but also because the documentation of the tender whereby Tecmed was awarded the landfill assets, and the subsequent documentation signed with Promotora, highlighted that this was the only possible use for the assets being acquired, to such an extent that they would revert to Promotora if Cytrar failed to use them for the exclusive public use purpose for which such assets had been earmarked long before. This was, certainly, the expectation of Promotora and of the Municipality of Hermosillo, which controlled it, as they were both certainly interested in ensuring that the assets of the Las Víboras landfill continued being allocated to the hazardous waste landfill in view of their having been set aside for the protection of the environment and public health, as evidenced by the conditions of the tender of the assets of the landfill<sup>65</sup> and the terms and conditions of the documents whereby the sale was executed.<sup>66</sup> For example, paragraph eleven of the tender specifications required (and this requirement was fulfilled) that the notarial deed of conveyance include a clause whereby the purchaser agreed to include as an advisor, appointed by the Municipality of Hermosillo, with a voice but no vote, on an “indefinite and irrevocable” basis, in addition to ensuring that the landfill would be operated in accordance with the highest national and international standards. The Respondent points out<sup>67</sup> that this clause evidences

the interest and powers of the Municipality, as a government agency formed by representatives elected by the people, by and for the purpose of supervising the proper operation of the landfill in accordance with the highest applicable national and international standards.

The appointment of the advisor was thus directly linked to the Municipality’s interest in ensuring that the assets purchased should be treated as a unit for landfill of hazardous waste pursuant to the legal provisions, which was obviously not possible without the permits authorizing the operation.

89. Promotora could not, in good faith, impose such a drastic requirement or such a harsh sanction on Cytrar as the reversion to Promotora of the assets relating to the Las Víboras landfill if Cytrar was not authorized to use them in accordance with the agreed use, without assuming that access to the permits and licenses for the operation of the Las Víboras landfill in a manner consistent with their historical use was a fundamental part of the operation and of the expectations of Cytrar, Tecmed and, ultimately, the Claimant, and without assuming certain commitments to vest Cytrar with minimum rights that would prevent an outcome as adverse to such expectations and interests as the reversion of assets

---

<sup>65</sup> Document A16, paragraph 6.

<sup>66</sup> Document A25, notarial deed of March 27, 1996, fifth clause.

<sup>67</sup> Counter-memorial, pp. 24-25, 95.

and at the same time the loss of amounts paid in cash or consideration furnished until then as payment of the price. Neither could INE ignore that the real property and tangible personal property relating to the Las Víboras landfill—and the investment relating to the Las Víboras landfill— would be devoid of economic value if Cytrar did not obtain the permits, licenses or authorizations required for operation. The note of the Municipality of Hermosillo addressed to INE on March 28, 1996,<sup>68</sup> whereby the Municipality “most respectfully” requests the Institute

to provide to TECMED Técnicas Medioambientales de México, S.A. de C.V., or to the company organized by it to operate the landfill, all necessary assistance to comply with the formalities for changing the name appearing in the operating license, which is currently Confinamiento Controlado Parque Industrial de Hermosillo<sup>69</sup>

not only confirms the above, but also evidences that no doubts were being cast as to the fact that the change of the license holder’s name was considered to be the lawful, normal and logical procedure in order to ensure that Cytrar could operate the Las Víboras site in accordance with the purpose mandated to it under the tender, sale and transfer documents.

90. However, Promotora did not guarantee to Cytrar or to Tecmed that Cytrar would obtain from INE the outcome certainly desired by Cytrar and apparently –at least at that time- by Promotora and by the Municipality of Hermosillo, i.e. that Cytrar would secure an authorization to operate a hazardous waste landfill at Las Víboras, or, if granted, that such authorization would conform to certain expected requirements such as its duration. Promotora did not guarantee to Cytrar either that the transfer to the latter’s name of the license given to Confinamiento Controlado Parque Industrial de Hermosillo O.P.D. would definitely take place. This does not, however, mean that Promotora was not willing to maintain the existing permits and licenses and their potential use by Cytrar in the event that that authorization or transfer did not materialize, as evidenced in clause 5 (a) of the contract of sale of March 27, 1996, between Promotora and Cytrar, mentioned above. Nor does it mean that Cytrar, through the transaction entered into with Promotora, only acquired real property and tangible personal property considered as such in isolation, i.e. unrelated to their historical and structural use and to the functional and economic dimension intimately associated to such use. As stated by Tecmed in its offer when it made it conditional to obtaining the authorizations for the use of such assets as a hazardous waste landfill,<sup>70</sup> neither Tecmed nor Cytrar would have acquired the assets without access to the authorizations and permits that would enable them to use them for a hazardous waste landfill. Accordingly, pursuant to clause five of the promise to sell contract signed with Tecmed on February 20, 1996, and clause 5 a) of the notarially recorded deed executed by Promotora, Tecmed and Cytrar on March 27, 1996 (transcribed above), Promotora consented to the potential use, in the case of the first document, by Tecmed, and in the second case, by Cytrar, of the existing licenses, authorizations or permits (mainly the authorization granted by INE on May 4, 1994, to Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.) in the event of the failure of – as applicable – Cytrar or Tecmed to obtain the permits, licenses or authorizations required for the operation of the

---

<sup>68</sup> Document A41.

<sup>69</sup> Emphasis in the original.

<sup>70</sup> Document A17.

landfill. Under clause 2 d) of the service contract of March 28, 1996, Promotora also undertook to keep current the existing licenses and authorizations, including the federal ones, for the operation of the Las Víboras landfill until Cytrar could do so on its own. These provisions show beyond any doubt that access by Cytrar to the licenses, authorizations or permits enabling it to operate the landfill was a central part of the tender and acquisition of assets relating to the Las Víboras landfill and of the expectations of Tecmed and Cytrar when the decision was made to invest in the landfill.

91. The documentation produced evidences that such licenses, authorizations and permits, and the right to use them for the operation of the Las Víboras landfill were vested in Promotora as a result of the winding-up of Confinamiento Controlado.<sup>71</sup> Accordingly, and also in view of the precedent of such landfill having already been operated by an entity other than that authorized,<sup>72</sup> it is also inferred that Promotora could allow the operation of the Las Víboras landfill by third parties under such authorizations, licenses or permits (to the extent such third parties adapted their operation to the framework allowed thereunder), as well as the transfer to third parties of the real property and tangible personal property of the Las Víboras landfill. This is a logical conclusion not only from a functional point of view, because the personal and real property of such landfill cannot be put to use for the benefit of the public or to the advantage of the community in accordance with or pursuant to the function on the basis and in furtherance of which they are technically structured and organized as an autonomous unit, without the required authorizations, licenses or permits, but also from an economic or business point of view, as the value of the real property and tangible personal property of the landfill—which, in practical terms, have been invalidated for any use other than the landfill of hazardous waste—depends on the existence or subsistence of such authorizations, licenses and permits. Consequently, from the perspective of Promotora, the price of those assets is, at the time of sale, enhanced by the possibility of use under such authorizations or permits. It should therefore be concluded that the consideration in kind valued at \$ 24,155,185.00 (Mexican Pesos) was paid as a lump sum in consideration of, on the one hand, Promotora's undertakings relating to the maintenance of the licenses, permits and authorizations and of their being made available to Cytrar for the operation, as a hazardous waste landfill, of the Las Víboras site and other assets allocated to it in the event of Cytrar not obtaining new authorizations or licenses,<sup>73</sup> or the transfer to Cytrar of existing ones; and on the other hand, in recognition of the higher value of the real property and tangible personal property acquired in anticipation of the expectation to use them under such authorizations, permits and licenses and, consequently, as part of the purchase price of such personal and real property, as such value was not just

---

<sup>71</sup> Administrative record of the winding-up of Confinamiento Controlado Parque Industrial de Hermosillo O.P.D. of August 31, 1995, Point IV, Annex No. 15 (Document A13); donation contract between the Government of the State of Sonora and Promotora, evidencing transfer to Promotora of the personal property listed in the record, which in Point IV, Annex 15, includes a list of permits for operation of the Las Víboras landfill, including the authorization granted by INE on May 4, 1994 (Document A14, introductory paragraphs III and IV; third clause).

<sup>72</sup> See paragraph 36 of this award.

<sup>73</sup> Regardless of the way in which this commitment on the part of Promotora should be complied with, even if compliance was as suggested by the Respondent: Cytrar being hired by Promotora—the latter, as holder of the authorizations, licenses and permits for the operation of the Las Víboras landfill- for Cytrar to operate it under them (“Admissions and Denials”, pleading filed by the Respondent, p. 25).

their inherent value but also the value resulting from the possibility of being functionally applied to the storage and management of hazardous waste within the framework of a legally authorized landfill operation. From this perspective, payment of a higher price is justified by the expectation of Tecmed and Cytrar —highlighted by the expert witness appointed by the Respondent— at the time of the tender and sale of the assets relating to the Las Viboras landfill and of their acquisition by such companies, to use it “with an “unlimited duration” license”.<sup>74</sup> It has also been established that the part in kind of the purchase price for the landfill was fully paid by its purchaser, Cytrar.

92. Upon replacement of the first official letter of INE dated September 24, 1996, by a subsequent new letter of the same date, but accompanied by an INE authorization, different not only in terms of its duration and in other respects, but which also revoked the existing authorization that had been issued to Confinamiento Controlado Parque Industrial de Hermosillo OPD under which the landfill had operated since May 4, 1994, an important change in the existing situation took place, because Promotora could no longer make such authorization available to Cytrar, nor would Cytrar probably be able to hold Promotora responsible because presumably, under both the “promise-to-buy” contract of February 20, 1996 and the notarial deed of March 27, 1996, Cytrar could only demand the performance of Promotora’s obligation to make the 1994 license available if Cytrar had failed to obtain a license “required for the lawful operation of the landfill”. Although of limited duration, the license of November 11, 1996, obtained by Cytrar from INE enabled the legal operation of the landfill and therefore did not give Cytrar rights against Promotora under the deed. In any event, this Arbitral Tribunal is not called to decide on these issues.

#### **E. The Merits of the Dispute**

93. The Claimant alleges that the Respondent’s conduct violates the following provisions of the Agreement:

- 1) Article 2(1) on the promotion and admission of investments;
- 2) Article 3 on protection of investments;
- 3) Article 4(1) on fair and equitable treatment;
- 4) Article 4(2) on the most favorable treatment;
- 5) Article 4(5) on national treatment; and
- 6) Article 5 on nationalization and expropriation.

94. The Arbitral Tribunal deems it appropriate to consider and resolve upon the issues referred to above in the following order:

---

<sup>74</sup> Report of Fausto García y Asociados, p. 48.

- 1) The obligation to refrain from expropriating or nationalizing in violation of the Agreement;
- 2) The obligation to assure fair and equitable treatment in accordance with international law; and
- 3) The obligation to grant full security and protection to investments under international law, and the other violations to the Agreement alleged by the Claimant.

#### I. Expropriation

95. The Claimant alleges that, when the INE did not renew the permit to operate the Las Viboras Landfill (the «Landfill») through its resolution dated November 25, 1998 (hereinafter the «Resolution»), it expropriated the Claimant's investment and that such expropriation has caused damage to the Claimant. The Claimant relates the expropriation—which according to the Claimant is the exclusive cause of the damage—to the prior actions of a number of organizations and entities at the federal, state and municipal levels, and also states that those actions are attributable to the Respondent and that they are adverse to the Claimant's rights under the Agreement and to the protection awarded to its investment thereunder. The Claimant further alleges that those actions objectively facilitated or prepared the subsequent expropriatory action carried out by INE.

96. The Claimant alleges that the Agreement protects foreign investors and their investments from direct and indirect expropriation; i.e. not only expropriation aimed at real or tangible personal property whereby the owner thereof is deprived of interests over such property, but also actions consisting of measures tantamount to an expropriation with respect to such property and also to intangible property. The Claimant states that, as the resolution deprived Cytrar of its rights to use and enjoy the real and personal property forming the Landfill in accordance with its sole intended purpose, the Resolution put an end to the operation of the Landfill as an on going business exclusively engaged in the landfill of hazardous waste, an activity that is only feasible under a permit, the renewal of which was denied. Therefore, Cytrar alleges that it was deprived of the benefits and economic use of its investment. The Claimant highlights that without such permit the personal and real property had no individual or aggregate market value and that the existence of the Landfill as an on going business, as well as its value as such, were completely destroyed due to such Resolution which, in addition, ordered the closing of the Landfill.<sup>75</sup>

97. The Respondent alleges that INE had the discretionary powers required to grant and deny permits, and that such issues, except in special cases, are exclusively governed by domestic and not international law. On the other hand, the Respondent states that there was no progressive taking of the rights related to the permit to operate the Las Viboras landfill by means of a legislative change that could have destroyed the *status quo*, and that the Resolution was neither arbitrary nor discriminatory. It also states that the Resolution was a regulatory measure issued in compliance with the State's police power within the highly regulated and extremely sensitive framework of environmental protection and public

---

<sup>75</sup> Memorial, p. 53.

health. In those circumstances, the Respondent alleges that the Resolution is a legitimate action of the State that does not amount to an expropriation under international law.<sup>76</sup>

98. The Claimant affirms that the Resolution is arbitrary because the reasons invoked therein to deny the renewal of the permit that had been granted on November 19, 1997 (the «Permit»), under which the Claimant had operated the Landfill over the last year, are not proportional to the decision not to renew the Permit.

99. The Resolution<sup>77</sup> refuses renewal of the Permit on the following grounds: (i) the Landfill was only authorized to receive waste from agrochemicals or pesticides or containers and materials contaminated with such elements; (ii) PROFEPA's delegates in Sonora had informed, in the official communication dated November 11, 1998,<sup>78</sup> that the waste confined far exceeded the landfill limits established for one of the Landfill's active cells, cell No. 2; (iii) the Landfill temporarily stored hazardous waste destined for a place outside the Landfill, acting as a «transfer center», an activity for which the Landfill did not have the required authorization; Cytrar was requested on October 16, 1997 to file reports in connection with this activity, but to date the relevant authorization had not been issued; and (iv) liquid and biological-infectious waste was received at the Landfill, an activity that was prohibited and that amounted to a breach of the obligation to notify in advance any change or modification in the scope of the Permit, and to unauthorized storage at the Landfill of liquid and biological-infectious waste. The Resolution also textually provides as follows:

Furthermore, CYTRAR S.A. de C.V. agreed with the different levels of the Federal, State and Municipal Government and communicated to the public the relocation of the landfill.

100. The Claimant challenges those statements because, among other things, the excess of the authorized landfill levels of cell no. 2 was the subject matter of an investigation and an audit by PROFEPA, as a result of which a fine was imposed on Cytrar by means of an official communication dated December 16, 1999.<sup>79</sup> That fine was a minor penalty, substantially smaller than the maximum fine established by law. The Claimant also highlights that the official communication issued by PROFEPA to impose the fine stated that the infringement did not have a «significant effect on public health or generate an ecological imbalance».<sup>80</sup> The Claimant also stated that in another similar official communication issued by PROFEPA,<sup>81</sup> in which a fine was imposed on Cytrar for a number of infringements—including acting as a temporary storage of hazardous waste to be sent to other companies and operating as a transfer center, circumstances that were invoked by INE in the Resolution that denied the renewal of the Permit—<sup>82</sup>, PROFEPA expressly stated that

---

<sup>76</sup> Counter-memorial, pp.160-162, 550 *et seq.* Respondent's closing statement, pp. 24-25, 56 *et seq.*

<sup>77</sup> Document A59.

<sup>78</sup> Document A62.

<sup>79</sup> Official communication No. PFPA-DS-UJ-2625/99 issued by Profepa, December 16, 1999; document A61.

<sup>80</sup> PROFEPA's official communication already cited, document A61, p. 16.

<sup>81</sup> Official communication No. PFPA-DS-UJ-1105/99 dated May 25, 1999. Document A63.

<sup>82</sup> PROFEPA's official communication already cited, page 55, paragraph (ah). Document A63.

... the infringements committed by the company involved are not sufficient to immediately cancel, suspend or revoke the permit for carrying out hazardous material and/or waste management activities, nor do they have an impact on public health or generate an ecological imbalance.<sup>83</sup>

101. The Claimant also states that, through the notes dated June 25<sup>84</sup> and July 15<sup>85</sup> 1998, Cytrar had already requested from INE the permit to expand cell No. 2 of the Landfill and build another cell. INE replied to this request on October 23, 1998,<sup>86</sup> stating, among other things, that the expansion request would be resolved together with the decision on renewal of the Permit. The Claimant claims that this decision adversely affected it because INE partly used the same reasons for which it already knew that the authorization to expand cell No. 2 would be denied (the same reasons used by PROFEPA to impose a fine on Cytrar by means of an official communication dated December 16, 1999, mentioned above), but deferred its decision to be able to use those reasons as the grounds for the Resolution under which INE refused to renew the Permit.<sup>87</sup>

102. The Claimant also states that in the letter dated September 5, 1996,<sup>88</sup> upon requesting «the change of name», Tecmed had reported to INE, among other things, that the processes carried out at the Landfill included the collection of waste in a specialized means of transportation, the preparation, packaging and labelling of waste for its subsequent transportation and the «temporary storage of waste (oil and solvents)» and that INE made no objection or reservation. Tecmed also reported that the operation of the transfer center and temporary storage of biological-infectious waste at the Landfill was not carried out by Cytrar, but by an affiliate, Técnicas Medioambientales Winco S.A. de CV,<sup>89</sup> which was authorized to engage in those activities at that site under a permit granted by INE for that purpose,<sup>90</sup> circumstances that could not be ignored by INE upon issuing the Resolution.

103. The Respondent highlights that Cytrar had not met the requirements to allow INE to evaluate an authorization to expand cell No. 2, since Cytrar had not submitted the related plans. The Respondent also states that as Cytrar had not submitted these plans and, regardless of such a breach, had commenced the cell's expansion activities, Cytrar had not complied with one of the Permit's conditions. The Respondent states that on October 23, 1998, INE requested additional information from Cytrar to decide on the expansion of cell No. 2 and on the construction of cell No. 3, and requested that Cytrar present the engineering project and the related drawings.<sup>91</sup> The Claimant complied with such requirement on November 4, 1998.<sup>92</sup>

104. The Respondent also refers to a number of circumstances related to the Landfill and its operation. The Claimant also refers to such circumstances, and substantial evidence has

---

<sup>83</sup> PROFEPA's official communication already cited, paragraph A, page 50. Document A63.

<sup>84</sup> Document A49

<sup>85</sup> Document A50

<sup>86</sup> Official Communication No. D00.800/005262, document A51.

<sup>87</sup> Memorial, pp.58-59.

<sup>88</sup> Document A39.

<sup>89</sup> Claimant's closing statement, p. 65 *et seq.*

<sup>90</sup> Memorial, p. 62.

<sup>91</sup> Counter-memorial, p. 78, 282; document D142.

<sup>92</sup> Counter-memorial, p. 79, 287; document D146.



been produced in that regard. Such circumstances underlie the Resolution or had a significant effect thereon, although not all such circumstances have been mentioned in the text of the Resolution.

105. According to the Respondent, those circumstances are:<sup>93</sup>

- 1) the site of the Landfill did not comply with applicable Mexican regulations in terms of its location and characteristics;
- 2) in 1998, Cytrar had committed a number of irregularities while operating the Landfill, mainly related to the transportation of waste from Alco Pacífico, and such irregularities triggered strong community pressure against the Landfill;
- 3) Mexican authorities, mainly from the Municipality of Hermosillo, expressed their doubts as to the Landfill's operations;
- 4) there was the risk that community pressure might increase if operation of the Landfill continued; and
- 5) Since 1997 Cytrar had reportedly been aware that community pressure suggested that the operation of the Landfill was not feasible due to its location, and that is why it agreed to relocate it at its own cost.

106. The opposing community groups claimed that the Landfill was only 8 km from the urban center of Hermosillo, and that such proximity breached the regulations that required a distance of at least 25 km from any settlement of more than 10,000 residents. Legally, however, such circumstance could not be invoked against Cytrar because the Landfill had been located and authorized to operate at such site before the adoption of such regulations, which are not retroactive. Reportedly, in deciding to refuse to renew the Permit, INE took into account the fact that the location of the site did not comply with the regulations as well as the resulting community pressure.<sup>94</sup>

107. The Parties agree that community opposition to the Landfill was due not to the manner in which Cytrar operated it, but to the transportation to the Landfill of contaminated and abandoned soil from the Alco Pacífico plant located in the state of Baja California, Mexico. Owing to a series of events that are not relevant at this point, Cytrar was in charge of the collection, transportation and landfill of Alco Pacífico's hazardous waste and contaminated soil pursuant to an agreement dated November 19, 1996, executed between PROFEPA, Los Angeles County, USA, Fomento de Ingeniería S.A. de C.V. (Fomín) and Cytrar.<sup>95</sup> Fomín was entrusted with the supervision of the transportation and discharge services that Cytrar had to provide under such agreement, in compliance with the contract and the applicable legal provisions, and had to report its findings to PROFEPA. The shipments of toxic materials and soil destined for the Landfill began under an initial transport permit

---

<sup>93</sup> Counter-memorial, pp. 88-89, 315.

<sup>94</sup> Memorial, pp. 72-74; Counter-memorial, p. 89, 315-316.

<sup>95</sup> Document D64

issued by INE<sup>96</sup> in early 1997.<sup>97</sup> In view of the claims of the community, PROFEPA conducted inspections of the trucks in October 1997, which essentially determined that there were open hazardous material packaging bags. PROFEPA therefore adopted urgent measures for Cytrar to rectify the situation, which were complied with by Cytrar. There were similar situations in November 1997, and, at the time, in addition to adopting urgent measures affecting Cytrar, PROFEPA applied a fine to Cytrar.<sup>98</sup> In April 1998, PROFEPA found some irregularities in the discharge of Alco Pacífico's waste and levied a fine on Cytrar, stating that «there are circumstances that pose or may pose a risk to the environment or to health». A similar situation was found in May 1998 in connection with the transportation and discharge of waste from the company Siderúrgica de California, which also gave rise to the issuance of urgent measures by PROFEPA, which were also complied with by Cytrar.<sup>99</sup>

108. The community's opposition to the Landfill, in its public manifestations, was widespread and aggressive, as evidenced by several events at different times. In November 1997, the association *Alianza Cívica de Hermosillo* (Hermosillo's Alliance for Civic Affairs) publicly denounced Cytrar's "actions and omissions" particularly in connection with waste transportation from Alco Pacífico, and requested that Cytrar's permit to operate the Landfill be cancelled and the extension thereof be denied.<sup>100</sup> Also in November<sup>101</sup> "...around 200 people organized a demonstration, marching to the landfill and closing it down symbolically... ", and then, a meeting was held with federal, state, and municipal public officials including the President of INE, the Deputy Director of the PROFEPA Environmental Audit Bureau, the Minister of SEMARNAP and representatives of the community organizations. In December 1997, the association *Academia Sonorense de Derechos Humanos* (Sonora Human Rights Academy) filed a criminal complaint against Cytrar for the commission of acts that could be defined as "environmental crimes".<sup>102</sup> In January 1998, the same association " ...filed a challenge... " against the Municipality of Hermosillo for the permit granted by that Municipality in 1994 to operate the Landfill.<sup>103</sup> In late January 1998 "...members of the community and of the different community organizations ...." organized a blockade of the Landfill which lasted until March 7, 1998, when the police intervened under orders of the Attorney's General Office. After the police intervention, the community organizations that questioned such measures organized a sit-in at Hermosillo's Town Hall<sup>104</sup> that lasted 192 days. By late March 1998, the same opposition groups issued a communication condemning the actions of the authorities that had put an end to the blockade of the Landfill.<sup>105</sup> In April 1998, a group of demonstrators attempted to block access to the Landfill but the police thwarted this action.<sup>106</sup> In

---

<sup>96</sup> Official Communication D00-800/000269 dated January 23, 1997; document D65.

<sup>97</sup> Counter-memorial, pp. 43-44, 161 *et. seq.*; particularly 166.

<sup>98</sup> Counter-memorial, pp. 48-52, 180 *et. seq.*

<sup>99</sup> Counter-memorial, pp. 67-70, 240 *et. seq.*

<sup>100</sup> Counter-memorial, pp. 51-52, 191 *et. seq.*

<sup>101</sup> Article published in Hermosillo newspaper *El Imparcial* on November 23, 1997. Document D88.

<sup>102</sup> Counter-memorial, p. 55, 203

<sup>103</sup> Counter-memorial, p. 56, 207

<sup>104</sup> Counter-memorial, pp. 57-59, 210 *et. seq.*

<sup>105</sup> Counter-memorial, p. 63, 232

<sup>106</sup> Counter-memorial, p. 66, 237

September 1998, a certain *Asociación de Organismos No Gubernamentales en Lucha contra el CYTRAR* (Association of NGOs Against CYTRAR) filed a claim before the State Commission of Human Rights against the authorities of the State of Sonora and the Municipality of Hermosillo for having intervened to put an end to the 192-day sit-in organized at the Town Hall<sup>107</sup>. In October 1998, a “family demonstration for the defense of health and dignity” and against “the landfill and the authorities’ position in that regard” was organized and a public communication contrary to the Landfill was issued.<sup>108</sup> According to the news media, about 400 people participated in the demonstration.<sup>109</sup> In November 1998, community organizations submitted a petition to the local office of SEMARNAP so that expressions of such associations and individual citizens be considered upon evaluating the renewal of the Permit. During that period —as evidenced by the “Press Dossier (I)” included in the documents offered by the Claimant—<sup>110</sup> these developments were covered by the local press and Hermosillo’s radio and television.

109. The authorities of the Municipality of Hermosillo were the direct target of “community pressure”. The Municipality was one of INE’s interlocutors at the time of consideration of the Permit’s renewal. In view of the pressure that questioned the Municipality’s grant of the permit to use the land where the Landfill was operated, the Municipality rendered an opinion on March 31, 1998, which explained that at the time of granting such permit the current legal provisions were not applicable and that those provisions came into force subsequently, establishing a minimum distance between landfills and urban centers which the Landfill did not comply with. However, the Municipality expressed its agreement with the community about the need to relocate Cytrar’s hazardous waste landfill operation to a different site and its support to conduct an audit of operations to determine whether the Landfill’s operation entailed any risks. That same day, the Health Commission of the Municipality rendered an opinion confirming that, although Cytrar’s operation at the Las Víboras site met the legal requirements for functioning and there were no “legal, ethical or logical arguments” to seek the closing of the Landfill, all necessary efforts should be made to relocate Cytrar’s operations. After this, several other decisions to the same effect were issued by the Municipality, additionally highlighting that only the federal Mexican authorities were competent in “...events relating to toxic waste”.<sup>111</sup> INE also consulted with the Municipality on November 18, 1998 about Cytrar’s requests to, among other things, expand cell No. 2 and build another one. The Municipality did not agree to the construction of a third cell, but accepted expansion subject to:<sup>112</sup>

....a detailed and legal relocation commitment agreed upon between the three levels of Government and the company

---

<sup>107</sup> Counter-memorial, pp. 74-75, 265 *et. seq.*

<sup>108</sup> Counter-memorial, p. 79, 285

<sup>109</sup> Article published in Hermosillo newspaper *El Imparcial* on October 26, 1998. Press dossier (I), annex A70.

<sup>110</sup> Under annex A70

<sup>111</sup> Counter-memorial, pp. 63-65, 233 *et. seq.*

<sup>112</sup> Counter-memorial, pp. 86-97, 311 *et. seq.*; note of the Mayor of the Municipality of Hermosillo to INE’s President dated November 18, 1998, document D157.

and provided that:

...a commission with representatives from each party be formed; and that, prior to that, an audit of operations be conducted and the final close down of the landfill be carried out; and that it would have to be made clear that that would be the last authorization for the current site.

The consultation with the Municipality and with the authorities of the State of Sonora and its results have been summarized as follows in the declaration of Dra. Cristina Cortinas de Nava,<sup>113</sup> who was at the time INE's General Director for Hazardous Materials, Waste and Activities and issued the Resolution, during the Hearing held from May 20 to May 24, 2002:

.... the gentleman is right to point out that I consulted with the municipal authority and with the state authority before making my decision about the company's application for an authorization to expand its capacity while relocation was pending[...]. Let me inform you that the reply that I obtained from the authorities was "let them fill in the cell, that's all right. But don't let them build anything else because we have waited too long for their relocation to allow them to have more space at the site they are at".

110. The relocation of Cytrar's operations as a response to community pressure was therefore also one of the factors taken into account by INE, and mentioned incidentally in the Resolution, upon deciding whether to renew the Permit. By late 1997, owing to the community pressure against the Landfill, Cytrar and the Municipality of Hermosillo started negotiations about the relocation, which, indeed, entailed the final close down of the hazardous waste landfill operation at the Las Víboras site, and that was undoubtedly the aim pursued by the community groups and the authorities of the Municipality. The relocation and the final close down of the Landfill, as it has been seen, were also the express claims of the Municipality of Hermosillo, apparently in response to the complaints about the Landfill and Cytrar's operation described above. The Claimant underscores that, as from the commencement of the negotiations, it did not object to the relocation but accepted it on the condition that a new site be identified before closing the operation at Las Víboras, and that the continuity of the operation at the new site and premises be guaranteed with the necessary permits.<sup>114</sup> On March 16, 1998, in a notice published by the local press, Cytrar ratified, among other things, its agreement to relocate its operation.<sup>115</sup> On July 3, 1998, at a meeting called by the Governor of the State of Sonora and attended by the Minister of SEMARNAP, Ms. Julia Carabias Lillo and the authorities of the Municipality of Hermosillo, Cytrar was informed of a joint declaration issued by the federal, state and municipal authorities stating that although the inspections conducted did not provide "...evidence of any risk to health and the ecosystems..." arising out of the Landfill, the relocation was necessary to "secure environmental safety in view of the rapid urban growth of Hermosillo, provide a response to the concerns that had been expressed and guarantee, in the long term, the environmental infrastructure to handle and dispose of industrial waste".<sup>116</sup>

The declaration also states that:

---

<sup>113</sup> Hearing held from May 20 to May 24, 2002, transcript of the session of May 21, 2002, p. 82 overleaf.

<sup>114</sup> Memorial, pp. 77-78

<sup>115</sup> Counter-memorial, p. 61, 228; document D111

<sup>116</sup> Document A92; Memorial, pp. 78-79

...As a consequence, the present landfill operated by CYTRAR shall cease to operate as soon as the new premises are ready to start operations...

111. Later, IMADES (Sonora's Environmental and Sustainable Development Institute), a government entity, focused on the search for a new site in the State of Sonora on the basis of a broader and more ambitious landfill proposal as to the scope, activities and functions related to the landfill of hazardous waste, or CIMARI (integral center for the management of industrial waste).<sup>117</sup> By October 1998, IMADES had "... shortlisted three possible areas...". After visiting the sites, together with Cytrar, INE considered that, with the approval of Cytrar, "carrying out the applicable studies" in a site located in the Municipality of Benjamín Hill<sup>118</sup> would be feasible.

112. When INE considered the renewal of the Permit, the relocation had not taken place and, reportedly, the final relocation site had not been identified, i.e. a site which had tested positive to all feasibility studies for the purpose for which it would be used, and a site qualified to be authorized as hazardous waste landfill. On November 9, 1998, a few days before issuance of the Resolution, Cytrar sent a note to the Governor of the State of Sonora—following the procedure stated by INE through the official communication of October 23, 1998, sent by Dr. Cristina Cortinas Nava—<sup>119</sup> ratifying its relocation commitment, stating also that it would relocate to any site indicated to it. In this note Cytrar also expressed that it would assume all costs related to the acquisition of the land, constructions and transfer of the landfill's waste to the new site, all the above without resigning to its position that the Permit should remain in full force and effect until the relocation had effectively taken place.<sup>120</sup> Similar commitments were reaffirmed by Tecmed in the notes dated November 12, 1998, to Julia Carabias Lillo, head of SEMARNAP,<sup>121</sup> and November 17, 1998, to Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities.<sup>122</sup> This last note was also sent by Cytrar to Sonora's governor and to the mayor of the Municipality of Hermosillo by means of communications where Cytrar highlighted its relocation commitment included in point 7 of the original note.<sup>123</sup> After issuance of the Resolution that denied the renewal of the Permit, there were a number of discussions and actions, which involved Tecmed, intended to carry out the relocation. These discussions and actions extended to January 2000 but have currently ceased.<sup>124</sup>

113. The Agreement does not define the term "expropriation", nor does it establish the measures, actions or behaviors that would be equivalent to an expropriation or that would

---

<sup>117</sup> Counter-memorial, p. 67, 239.

<sup>118</sup> Counter-memorial, p. 75, 270

<sup>119</sup> Document A51. This official communication makes reference to the relocation agreement and makes a proposal to Cytrar so that it "...contact the authorities of the State and Municipal Government to define the steps to be followed as to the landfill relocation."

<sup>120</sup> Document A89. Counter-memorial, pp. 84-85, 303 *et seq.* Memorial, pp. 80-81.

<sup>121</sup> Document A 90.

<sup>122</sup> Document A55.

<sup>123</sup> Document A 54.

<sup>124</sup> Counter-memorial, p. 96, 337.

have similar characteristics. Although formally an expropriation means a forcible taking by the Government of tangible or intangible property owned by private persons by means of administrative or legislative action to that effect, the term also covers a number of situations defined as *de facto* expropriation, where such actions or laws transfer assets to third parties different from the expropriating State or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government.<sup>125</sup>

114. Generally, it is understood that the term “...equivalent to expropriation...” or “tantamount to expropriation” included in the Agreement and in other international treaties related to the protection of foreign investors refers to the so-called “indirect expropriation” or “creeping expropriation”, as well as to the above-mentioned *de facto* expropriation.<sup>126</sup> Although these forms of expropriation do not have a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect. This type of expropriation does not necessarily take place gradually or stealthily — the term “creeping” refers only to a type of indirect expropriation—and may be carried out through a single action, through a series of actions in a short period of time or through simultaneous actions. Therefore, a difference should be made between creeping expropriation and *de facto* expropriation,<sup>127</sup> although they are usually included within the broader concept of “indirect expropriation” and although both expropriation methods may take place by means of a broad number of actions that have to be examined on a case-by-case basis to conclude if one of such expropriation methods has taken place.<sup>128</sup>

115. To establish whether the Resolution is a measure equivalent to an expropriation under the terms of section 5(1) of the Agreement, it must be first determined if the Claimant, due to the Resolution, was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto —such as the income or benefits related to the Landfill or to its exploitation— had ceased to exist. In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss.<sup>129</sup> This determination is important because it is one of the main elements to distinguish, from the point of view of an international tribunal, between a regulatory measure, which is an ordinary expression of the exercise of the state’s police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives

---

<sup>125</sup> Award dated August 30, 2000, in ICSID case No. ARB(AF)/97/1 *Metalclad v. United Mexican States*, 16 Mealey’s International Arbitration Report (2000), pp. A-1 *et seq.*; p. A-13 (p. 33 of the award, 103): «Thus, expropriation [...] includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be expected economic benefit of property even if not necessarily to the obvious benefit of the host State. »

<sup>126</sup> G. Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 269 *Recueil des cours*, Académie de droit international de La Haye, 255, 385-386 (1997).

<sup>127</sup> *Ibid.* p. 383.

<sup>128</sup> R. Dolzer & M. Stevens, *Bilateral Investment Treaties*, pp. 99-100 (1995).

<sup>129</sup> Partial award in the case *Pope Talbot Inc v. Government of Canada*, 102-104, pp. 36-38, [www.naftalaw.org](http://www.naftalaw.org); and II Restatement of the Law (Third) Restatement of the Foreign Relations Law of the United States, § 712, pp. 200-201; notes 6-7, pp. 211-212 (1987).

those assets and rights of any real substance. Upon determining the degree to which the investor is deprived of its goods or rights, whether such deprivation should be compensated and whether it amounts or not to a *de facto* expropriation is also determined. Thus, the effects of the actions or behavior under analysis are not irrelevant to determine whether the action or behavior is an expropriation. Section 5(1) of the Agreement confirms the above, as it covers expropriations, nationalizations or

...any other measure with similar characteristics or *effects*...<sup>130</sup>

The following has been stated in that respect:

In determining whether a taking constitutes an «indirect expropriation», it is particularly important to examine the effect that such taking may have had on the investor's rights. Where the effect is similar to what might have occurred under an outright expropriation, the investor could in all likelihood be covered under most BIT provisions.<sup>131</sup>

116. In addition to the provisions of the Agreement, the Arbitral Tribunal has to resolve any dispute submitted to it by applying international law provisions (Title VI.1 of the Appendix to the Agreement), for which purpose the Arbitral Tribunal understands that disputes are to be resolved by resorting to the sources described in Article 38 of the Statute of the International Court of Justice<sup>132</sup> considered, also in the case of customary international law, not as frozen in time, but in their evolution.<sup>133</sup> Therefore, it is understood that the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that "...any form of exploitation thereof..." has disappeared; i.e. the economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed.<sup>134</sup> Under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary. The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects.<sup>135</sup> To determine whether such an expropriation has taken place, the Arbitral Tribunal should not

---

<sup>130</sup> Emphasis added by the Arbitral Tribunal.

<sup>131</sup> R. Dolzer & M. Stevens, *Bilateral Investment Treaties*, p. 100 (1995).

<sup>132</sup> I. Brownlie, *Principles of International Law* (5<sup>th</sup> Edition, 1998) p.3: «These provisions [...] represent the previous practice of arbitral tribunals, and Article 38 is generally regarded as a complete statement of the sources of international law ».

<sup>133</sup> *Mondev International Ltd v. United States of America* award, October 11, 2002, ICSID case No. ARB(AF)/99/2, p. 40, 116

<sup>134</sup> European Court of Human Rights, *In the case of Matos e Silva, Lda., and Others v. Portugal*, judgment of September 16, 1996, 85, p. 18, <http://hudoc.echr.coe.int>

<sup>135</sup> See Iran-USA Claims Tribunal, *Tippetts, Abbet,McCarthy, Stratton v.TAMS/Affa Consulting Engineers of Iran et al.*, decision of June 29, 1984; 6 Iran-United States Rep., p. 219 *et seq.*; p. 225 (1984-II); of the same Tribunal, *Phelps Dodge Corp. et al.v.Iran*, 10 Iran-U.S.Cl. Trib. Rep. p. 121 *et seq.*; esp. 22, p.130 (1986-I).

.... restrict itself to evaluating whether a formal dispossession or expropriation took place, but should look beyond mere appearances and establish the real situation behind the situation that was denounced.<sup>136</sup>

117. The Resolution meets the characteristics mentioned above: undoubtedly it has provided for the non-renewal of the Permit and the closing of the Landfill permanently and irrevocably, not only due to the imperative, affirmative and irrevocable terms under which the INE's decision included in the Resolution is formulated, which constitutes an action — and not a mere omission— attributable to the Respondent, with negative effects on the Claimant's investment and its rights to obtain the benefits arising therefrom, but also because after the non-renewal of the Permit, the Mexican regulations issued by INE become fully applicable. Such regulations prevent the use of the site where the Landfill is located to confine hazardous waste due to the proximity to the urban center of Hermosillo. Since it has been proved in this case that one of the essential causes for which the renewal of the Permit was denied was its proximity and the community pressure related thereto, there is no doubt that in the future the Landfill may not be used for the activity for which it has been used in the past and that Cytrar's economic and commercial operations in the Landfill after such denial have been fully and irrevocably destroyed, just as the benefits and profits expected or projected by the Claimant as a result of the operation of the Landfill. Moreover, the Landfill could not be used for a different purpose since hazardous waste has accumulated and been confined there for ten years. Undoubtedly, this reason would rule out any possible sale of the premises in the real estate market. Finally, the destruction of the economic value of the site should be assessed from the investor's point of view at the time it made such an investment. In consideration of the activities carried out, of its corporate purpose and of the terms and conditions under which assets related to the Landfill were acquired from Promotora, the Claimant, through Tecmed and Cytrar, invested in such assets only to engage in hazardous waste landfill activities and to profit from such activities. When the Resolution put an end to such operations and activities at the Las Viboras site, the economic or commercial value directly or indirectly associated with those operations and activities and with the assets earmarked for such operations and activities was irremediably destroyed. The above conclusions are not jeopardized by the fact that the Resolution has not prevented Cytrar from continuing operating the Landfill until completion of the authorized installed capacity existing as of the Resolution's date. Such limited, temporary and partial continuation of operation of the Landfill does not modify the definitive and detrimental effects of the Resolution with respect to the long-term investment made in the Landfill. As far as the effects of such Resolution are concerned, the decision can be treated as an expropriation under Article 5(1) of the Agreement.

118. However, the Arbitral Tribunal deems it appropriate to examine, in light of Article 5(1) of the Agreement, whether the Resolution, due to its characteristics and considering not only its effects, is an expropriatory decision.

119. The principle that the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable. Another undisputed issue is that within the framework or from the viewpoint of the

---

<sup>136</sup> Interamerican Court of Human Rights, *Ivcher Bronstein Case (Baruch Ivcher Bronstein vs. Peru)*, judgment of February 6, 2001, 124, p. 56; [www.corteidh.or.cr](http://www.corteidh.or.cr).



domestic laws of the State, it is only in accordance with domestic laws and before the courts of the State that the determination of whether the exercise of such power is legitimate may take place. And such determination includes that of the limits which, if infringed, would give rise to the obligation to compensate an owner for the violation of its property rights.

120. However, the perspective of this Arbitral Tribunal is different. Its function is to examine whether the Resolution violates the Agreement in light of its provisions and of international law. The Arbitral Tribunal will not review the grounds or motives of the Resolution in order to determine whether it could be or was legally issued. However, it must consider such matters to determine if the Agreement was violated. That the actions of the Respondent are legitimate or lawful or in compliance with the law from the standpoint of the Respondent's domestic laws does not mean that they conform to the Agreement or to international law.<sup>137</sup>

An Act of State must be characterized as internationally wrongful if it constitutes a breach of an international obligation, even if the act does not contravene the State's internal law – even if under that law, the State was actually bound to act that way.<sup>138</sup>

121. After reading Article 5(1) of the Agreement and interpreting its terms according to the ordinary meaning to be given to them (Article 31(1) of the Vienna Convention), we find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever. It has been stated that:

Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.<sup>139</sup>

122. After establishing that regulatory actions and measures will not be initially excluded from the definition of expropriatory acts, in addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.<sup>140</sup> Although the analysis starts at the due deference owing to

---

<sup>137</sup> International Court of Justice, *Elettronica Sicula s.p.a.(ELSI)(United States v. Italy)* case, judgment dated July 20, 1989, ICJ Reports, 1989, 73. ICSID Case No.ARB(AF)/99/1, *Marvin Feldman v. Mexico*, award of December 16, 2002, p.26, 78, [www.naftalaw.org](http://www.naftalaw.org).

<sup>138</sup> J. Crawford, *The International Law Commission's Articles on State Responsibility*, p. 84 (Cambridge University Press, 2002).

<sup>139</sup> Award: *Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica*, ICSID case No. ARB/96/1, 15 ICSID Review-Foreign Investment Law Journal, 72, p.192 (2000).

<sup>140</sup> European Court of Human Rights, *In the case of Matos e Silva, Lda., and Others v. Portugal*, judgment of September 16, 1996, 92, p. 19, <http://hudoc.echr.coe.int>.

the State when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values, such situation does not prevent the Arbitral Tribunal, without thereby questioning such due deference, from examining the actions of the State in light of Article 5(1) of the Agreement to determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation. There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.<sup>141</sup> To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not.<sup>142</sup> On the basis of a number of legal and practical factors, it should be also considered that the foreign investor has a reduced or nil participation in the taking of the decisions that affect it, partly because the investors are not entitled to exercise political rights reserved to the nationals of the State, such as voting for the authorities that will issue the decisions that affect such investors.

The European Court of Human Rights has defined such circumstances as follows:

Not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim « in the public interest », but there must also be a reasonable relationship of proportionality between the means employed and the aim sought to be realised...[...]. The requisite balance will not be found if the person concerned has had to bear “an individual and excessive burden” [...] The Court considers that a measure must be both appropriate for achieving its aim and not disproportionate thereto.<sup>143</sup>

...non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals.<sup>144</sup>

The Arbitral Tribunal understands that such statements of the Strasbourg Court apply to the actions of the State in its capacity as administrator, not only to its capacity as law-making body.

123. During its operation of the Landfill, Cytrar breached a number of the conditions under which the Permit was issued, which have been referred to above. Such breaches were verified by PROFEPA. In the opinion of the Arbitral Tribunal, these are the breaches to the Permit that triggered the issuance of the Resolution, since those are the breaches on which the Resolution is based and to which it refers. This is the conclusion to be reached under

---

<sup>141</sup> European Court of Human Rights, *In the case of Mellacher and Others v. Austria*, judgment of December 19, 1989, 48, p.24; In the case of *Pressos Compania Naviera and Others v. Belgium*, judgment of November 20, 1995, 38, p. 19, <http://hudoc.echr.coe.int>

<sup>142</sup> It has been stated that: “...on the whole [...] notwithstanding compliance with the public interest requirement, the failure to pay fair compensation would render the deprivation of property inconsistent with the condition of proportionality”, Y. Dinstein, *Deprivation of Property of Foreigners under International Law*, 2 *Liber Amicorum Judge Shigeru Oda*, p. 849 *et seq.*; esp. p. 868 (2002).

<sup>143</sup> European Court of Human Rights, *In the case of James and Others*, judgment of February 21, 1986, 50, pp.19-20, <http://hudoc.echr.coe.int>

<sup>144</sup> *ibid.*, 63, pp. 24.

Mexican law, according to which administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies.<sup>145</sup> The Resolution has not referred to the events related to the transportation and discharge of the hazardous waste of Alco Pacífico, as they took place under the terms of the permits and authorizations granted by the Mexican authorities, including INE, other than the Permit, and the violations committed by Cytrar in the performance of such activities have not been proved or penalized as infringements to the Permit. Therefore, without prejudice to the possibility of taking into account later on the effects of such events on the political and social considerations taken into account by INE upon issuing the Resolution—such considerations are generally referred to in the Resolution and in INE’s correspondence addressed to Cytrar immediately before such Resolution—the Arbitral Tribunal considers that such infringements, that did not trigger the revocation or termination of the permits under which such transportation and discharge took place and that are not defined in the Permit’s conditions, are not determinants of the Resolution. On the other hand, PROFEPA and SEMARNAP also stated that the violations in the transportation and discharge of the hazardous waste of Alco Pacífico should not be taken into account to determine if the Landfill’s permit should be revoked upon answering a claim to that effect filed by a social group adverse to the Landfill.<sup>146</sup>

124. This Arbitral Tribunal considers that the violations to the Permit mentioned in the Resolution, to the extent they have been verified by PROFEPA or INE under the applicable Mexican law, are issues that the Tribunal does not need to review. However, the Arbitral Tribunal points out that such Resolution does not suggest that the violations compromise public health, impair ecological balance or protection of the environment, or that they may be the reason for a genuine social crisis. Additionally, when PROFEPA verified the existence of such violations in 1999, it applied the pertinent sanctions in the proportion it deemed appropriate to the importance of the violation. The sanction applied was in the form of a fine imposed after evaluating whether a greater or more serious sanction would have been applicable, such as the revocation of the Permit, and underscoring the fact that such violations did not compromise the condition of the environment, the ecological balance or the health of the population. With that, PROFEPA confirmed its statements in the note dated February 11, 1998, sent to Cytrar:<sup>147</sup>

The inspections conducted by this Office to the landfill referred to several times, have not shown [sic in the Spanish original] any indication that risks for the population’s health or the environment might exist.

On various occasions, the Municipality of Hermosillo<sup>148</sup> and the Minister of SEMARNAP, Ms. Julia Carabías Lillo,<sup>149</sup> have insisted that Cytrar’s Landfill operation complies with the

---

<sup>145</sup> Declaration of expert witness Alfonso Camacho Gómez, Hearing held from May 20 to May 24, 2002, transcript of May 22, 2002, pp. 36-36 overleaf.

<sup>146</sup> Note signed by PROFEPA and SEMARNAP of December 18, 1997, 44, p. 21; document D93.

<sup>147</sup> Document D101, p. 2.

<sup>148</sup> Communication issued by the Municipality of Hermosillo dated March 26, 1998, document D114; Declaration 300398 issued by the Commission of Public Health of the Municipality of Hermosillo dated April 1998, document D116, Communication Forms of the Municipality of Hermosillo, document D117.

<sup>149</sup> Stenographic transcript of the declaration given by Julia Carabías Lillo in her appearance before the House of Representatives of the Federal Congress on September 10, 1999; pp. 10-11; document A69.

Mexican legal provisions on environmental protection and public health preservation or meets the requirements necessary not to impair the environment or public health. More specifically, in a document dated September 3, 1998,<sup>150</sup> SEMARNAP—which comprises both INE and PROFEPA as autonomous divisions—, on the basis of the statements made by PROFEPA, stated as follows:

...CYTRAR's handles hazardous waste in strict compliance with the law, that the last stage of the landfill has the maximum safety conditions required, which provide the necessary grounds to authorize the relevant operations.

125. In addition to the reference made to the infractions to conditions for the Permit and a brief statement about Cytrar's commitment to relocate, the Resolution does not specify any reasons of public interest, public use or public emergency that may justify it. According to the Respondent's allegations, such reasons would basically be the following:

1. The protection of the environment and public health, and
2. The need to provide a response to the community pressure resulting from the location of the Landfill and Cytrar's violations during the operation, which some groups interpreted as harmful to the environment or the public health and the social unease in Hermosillo originated in these circumstances.

126. One of the factors that undoubtedly underlies such reasons is the location of the Landfill with respect to Hermosillo's urban center. As the Respondent's counsel stated in its oral allegation:

I have stated several times and insisted that the problem was not a problem with a company or with an investor, but with a specific site.<sup>151</sup>

Such declaration does not differ from the statements made by Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities in this regard:

I insist once again that, for us, the position was: let's come to a close with this site; it is the reason for the conflict. People keep coming to the place to see how it's being operated; they won't even let it operate with all that community pressure. Let's start from scratch in some other place, in the right manner and with all the mechanisms that we think might ensure that this operation could be acceptable for society.<sup>152</sup>

127. Actually, according to the evidence submitted in this arbitration proceeding, it is irrefutable that there were factors other than compliance or non-compliance by Cytrar with the Permit's conditions or the Mexican environmental protection laws and that such factors had a decisive effect in the decision to deny the Permit's renewal. These factors included

---

<sup>150</sup> Document A92.

<sup>151</sup> Oral allegation by the Respondent's counsel. Hearing held from May 20 to May 24, 2002. Transcript of the session of May 24, 2002, p. 37 overleaf.

<sup>152</sup> Hearing held from May 20 to May 24, 2002. Transcript of the session of May 21, 2002, p. 78.

“political circumstances”. As stated by Dr. Cristina Cortinas Nava in the official communication sent to Cytrar on October 23, 1998,<sup>153</sup>

It is publicly known that your company has assumed a relocation commitment as to the landfill you operate and that, as you have stated in point seven of the brief dated July, 15, 1998, there are political issues that have to be taken into account to render a resolution as to the renewal of the operation permit and an increase in the landfill capacity. Therefore, we suggest that you contact the authorities of the State and of the Municipality to define the steps to be followed to relocate the landfill.

In its note dated July 15, 1998, addressed to INE, Cytrar requests that INE issue its decision on Cytrar’s application for an increase in the landfill capacity according to the alternatives that Cytrar had presented to INE while

...the actions to be taken are defined on the basis of the political events affecting Cytrar (relocation)...<sup>154</sup>

128. Therefore the Arbitral Tribunal has to evaluate, pursuant to Article 5(1) of the Agreement and from the perspective of international law, the extent to which such political circumstances—that in the opinion of the Arbitral Tribunal, on the basis of the evidence submitted, do not seem to go beyond the circumstances arising from community pressure—are the basis of the Resolution, in order to assess whether the Resolution is proportional to such circumstances and to other circumstances, and to the neutralization of the economic and commercial value of the Claimant’s investment caused by the Resolution.

129. These socio-political circumstances are the reason why INE has considered the renewal of the Permit as an “exceptional case”. As a consequence, INE, instead of deciding by itself—as it was empowered by law—as to the Permit’s renewal on the basis of considerations exclusively related to INE’s specific function linked to the protection of the environment, ecological balance and public health, it consulted with the mayor of the Municipality of Hermosillo and the Governor of the State of Sonora as to Cytrar’s requests related to the expansion of cell N° 2 and the construction of cell N° 3 in the Landfill.<sup>155</sup> The only conclusion possible is that such consultation or inquiries were driven by INE’s socio-political concerns, since it is not in dispute that INE and PROFEPA were the only entities legally authorized and technically competent to have a role in issues in which public health and the protection of the environment in connection with the Landfill were involved. None of the parties to which INE makes the inquiry expresses concerns as to the danger that the Landfill may pose to public health, ecological balance or the environment. To the contrary, their concerns are to ensure the relocation of the Landfill to a different site far away from Hermosillo, the immediate closing of the Landfill and, after depleting its authorized and installed capacity, the prohibition to grant new permits to confine hazardous waste at the Las Víboras site;<sup>156</sup> i.e. to put an end to the political problems—defined as “community

---

<sup>153</sup> Document A51.

<sup>154</sup> Document A50.

<sup>155</sup> Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 70 overleaf /71.

<sup>156</sup> Note of November 18, 1998, of the Mayor of the Municipality of Hermosillo to INE’s President, document D157.

pressure”— caused by the Landfill to the federal, state and municipal authorities, by permanently closing the Landfill.

130. The INE’s General Director of Hazardous Materials, Waste and Activities, Dr. Cristina Cortinas Nava, sustains the political or social factor “...was one of the factors involved but not the main factor...”,<sup>157</sup> and to the question of whether the influence on the Resolution of the unauthorized expansion of cell no. 2 was “strong, small, insignificant, decisive”, the answer was “I would say it was important”.<sup>158</sup> However, in fact, the absence of any statement in the Resolution and in the opinions rendered by the municipal and state officers consulted by INE prior to issuing the Resolution about these or the other infringements committed by Cytrar and mentioned in the Resolution being infringements seriously or imminently affecting public health, ecological balance or the environment, together with the confirmation by PROFEPA that such infringements did not pose such dangers, reveal that the Resolution was mainly driven by socio-political factors. Even the significance awarded by INE to the technical infringements committed during the operation of the Landfill, on which the Resolution is based, and therefore the relative relevance awarded by INE to such factors upon issuing the Resolution, were actually strongly influenced by the community pressure and the political consequences faced by INE since municipal and state authorities and opposing community associations interpreted the expansion of the Landfill and any other action intended to expand the Landfill capacity as a signal that such facility would not be relocated and that the Las Víboras site, close to Hermosillo’s urban center, would continue to be a hazardous waste landfill site in violation of existing rules and regulations.<sup>159</sup> Indeed, Dr. Cristina Cortinas Nava considered that continuation by Cytrar of the expansion of cell no. 2 did not create current or future hazards for the protection of the environment or public health; she considered that such expansion increased INE’s difficulties to manage community pressure and the related political consequences adverse to the Landfill:

..... as I had issued no written resolution authorizing the expansion of the cell, the fact that [Cytrar] commenced to expand the cell was a concern to me and I took it as evidence that the company was doing things before obtaining the permit it had applied for [...] I took that into account as one of the elements, but I insist: the circumstance that the company had not helped me create trust among local authorities as it expanded the cells without any authorization, whether issued by me or local authorities, was included among such elements...<sup>160</sup>

131. This item has been confirmed by the importance attributed to the relocation of Cytrar’s operations to a site different from the Landfill. Such importance was actually motivated by the community’s opposition to the Landfill’s existing site and was not related to the fact that Cytrar’s operations in the site or the site’s appropriateness<sup>161</sup> or the way in which the Landfill was operated —as the municipal and state authorities and PROFEPA themselves

---

<sup>157</sup> Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 71, overleaf.

<sup>158</sup> *Ibid.*, p. 80.

<sup>159</sup> *Ibid.*, p.82 overleaf.

<sup>160</sup> *Ibid.*, p.82 overleaf.

<sup>161</sup> *Ibid.*, p.90 overleaf. “Because our interest was to recover the infrastructure that had already been created, and, as I have always held and still believe today, those premises were necessary for this State, they were located at the right site and, with an environmentally safe handling of hazardous waste; it was a good option”.

admitted— entailed a risk for the environment or for the public health. The Landfill's still unresolved relocation, which, according to Dr. Cristina Cortinas Nava, was one of the motivations for the Resolution in that denying the renewal of the Permit —thus preventing Cytrar from operating the Landfill— was a strategy to put pressure on Cytrar to relocate, was then one of the factors that were closely related to the social and political tense circumstances surrounding the Landfill and its operation. INE thought it would placate such tensions by denying the renewal of the Permit instead of keeping the preservation of public health, ecological balance or the environment in mind.<sup>162</sup>

132. To sum up, the reasons that prevailed in INE's decision to deny the renewal of the Permit were reasons related to the social or political circumstances and the pressure exerted on municipal and state authorities and even on INE itself created by such circumstances. It will be necessary, then, for the purpose of establishing whether the Respondent breached Article 5(1) of the Agreement, to evaluate such reasons as a whole to determine whether the Resolution is proportional to the deprivation of rights sustained by Cytrar and with the negative economic impact on the Claimant arising from such deprivation.

133. There is no doubt as to the existence of community or political pressure —as both Parties have acknowledged and as made public by the local mass media and shown by the evidence submitted in these arbitral proceedings— against the Landfill. However, a substantial portion of the community opposition is based on objective situations that are beyond Cytrar or Tecmed's control or even beyond the Claimant's control. On the other hand, the Arbitral Tribunal should consider whether community pressure and its consequences, which presumably gave rise to the government action qualified as expropriatory by the Claimant, were so great as to lead to a serious emergency situation, social crisis or public unrest, in addition to the economic impact of such a government action, which in this case deprived the foreign investor of its investment with no compensation whatsoever. These factors must be weighed when trying to assess the proportionality of the action adopted with respect to the purpose pursued by such measure.

134. As highlighted before, the events related to the transportation and discharge of hazardous waste from Alco Pacifico belong to an operation safeguarded by legal instruments, licenses and permits that are different from the ones governing the Landfill. Therefore, any infringement or sanction imposed in connection with operations covered by such instruments, licenses and permits may not be regarded as infringements committed or sanctions imposed under the Permit or the legal provisions applicable to the activities specifically contemplated by such Permit. For that very same reason, any violation to such transport operation could not be part of the Resolution's grounds as the Resolution is based exclusively on violations to the legal provisions applicable to the activities covered by the Permit. However —as both Parties have admitted— the negative attitude that some social groups had with respect to the Landfill was taken as a result of the events related to the waste transportation from Alco Pacifico. Consequently, upon an overall examination of the impact of socio-political factors on the Resolution, such adverse attitude should be considered together with the real weight it had.

---

<sup>162</sup> Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 72 overleaf-73, 75 overleaf-76.

135. Actually, the negative reactions to the transportation of waste from Alco Pacífico to Hermosillo became apparent even before PROFEPA verified that Cytrar had committed certain violations when carrying out this operation. In the Respondent's words:

The landfill of Alco Pacífico's waste in Sonora generated reactions almost immediately. On January 14, 1997, a local newspaper published an article stating that Cytrar would confine imported hazardous waste that had been abandoned in Alco Pacífico's premises [...]. On March 7, 1997, another article was published about the landfill of Alco Pacífico's hazardous waste in Sonora. On March 9, 1997, Manuel Llano Ortega, an engineer and a resident of Hermosillo, requested that the State Governor provide a response to the community's concerns about the landfill of Alco Pacífico's waste [...]. On May 2, 1997, Sonora's Human Rights Academy filed a complaint against SEMARNAP, PROFEPA, the State Legislature and the State Governor. It held that the authorities had violated the State's sovereignty by authorizing the deposit of toxic waste from Baja California without the relevant permit by the competent local authorities. On May 15, 1997, the same association filed a complaint before the National Commission of Human Rights.<sup>163</sup>

136. Thus, community opposition to Cytrar's activities of transportation and discharge of Alco Pacífico's waste must be analyzed in light of the initial opposition shown by some citizens or associations to the decision of PROFEPA—which hired the transportation to Hermosillo of such waste with Cytrar—and INE—which granted the relevant permits for Cytrar to undertake such transportation activities—<sup>164</sup> as to whether such waste could be confined in Hermosillo. Undoubtedly, the Mexican authorities opted to choose or accept Hermosillo, Sonora, as the appropriate site for the landfill of Alco Pacífico's waste and they were responsible for that decision. The criticism by groups from Sonora on Cytrar's management of Alco Pacífico's waste transportation cannot be separated from such groups' repudiation of the authorities' decision to transport the waste from Alco Pacífico to Hermosillo, Sonora, to have it confined there, and at the same time such criticism was the evident expression of such repudiation. And it is not possible to state that it was Cytrar's management of such transportation activities, and not the previous decision of the authorities to have Alco Pacífico's waste confined in Hermosillo, the determinant of community opposition.

137. The truth is that PROFEPA did not choose the early termination of the agreement entered into with Cytrar because of community opposition; and under no circumstance did INE cancel or otherwise remove Cytrar's permit for the transportation or discharge of Alco Pacífico's waste. The infringements or irregularities found by PROFEPA in connection with these operations triggered the imposition of fines on Cytrar or brought about orders to amend its manner of operation, but apparently they did not originate any recommendation or action by PROFEPA for the cancellation of the permit or the termination of the agreement under which Cytrar operated. Neither Cytrar's shortcomings as to Alco Pacífico's waste transportation nor the community opposition that such transportation brought about seem to have originated emergency situations, genuine social crisis or public unrest or urgency, which, due to their severity, could have led the competent authorities to terminate the contractual relationship governing the transport operation or to revoke or

---

<sup>163</sup> Counter-memorial, pp. 44-45; 164 *et. seq.*

<sup>164</sup> INE's permit of January 23, 1997 for the transportation and discharge of waste from Alco Pacífico. Clause 11 (p. 3), (document D65) of this permit also allowed for the termination of the permit in the event of justified complaints or risk to the environment or to human life.



deny the renewal of the licenses or permits under which such transport operation was carried out. Upon the termination of Alco Pacífico's waste transportation agreement with Cytrar, PROFEPA did not make note of any breach or obligation under such agreement. Although in one of the provisions of the minutes evidencing the cessation of Cytrar's services under the agreement PROFEPA reserved its right to subsequently hold Cytrar liable "... for any hidden defects or non-performance and non-fulfillment of its obligations...",<sup>165</sup> no evidence has been brought forth to indicate that PROFEPA has enforced that right against Cytrar. There is no evidence that during the effective term of the agreement any actions against Cytrar were filed by the other parties to the contract for breach, whether seeking to terminate the contract on sufficient grounds as authorized by its clause 6,<sup>166</sup> to interrupt payments owed under the contract or to seek any other type of redress or compensation for breach of contract. There is no evidence either that Fomín, the company that under clause 5-D (p. 5) of such agreement was responsible for the supervision of Cytrar's services provided under the agreement, made any reservations, negative remarks or warnings about Cytrar's performance of its contractual obligations during the effective term of the agreement.

138. Therefore, if the level of opposition generated by the transportation and discharge by Cytrar of Alco Pacífico's waste did not trigger any decisive action by the competent federal authorities, including PROFEPA —such as revocation of the relevant permits or authorizations, the commencement of legal actions or the early termination of the agreement— to put an end to such activities and if such opposition is not of the essence in the Resolution, it is not appropriate to attribute any considerable significance to it upon taking into account and weighing factors to determine if the Resolution *per se* amounts to a violation of the Agreement.

139. Those events —not related to the transportation and discharge of Alco Pacífico's waste by Cytrar— which constitute material evidence of the opposition put up by community entities and associations to the Landfill or its operation by Cytrar, do not give rise, in the opinion of the Arbitral Tribunal, to a serious urgent situation, crisis, need or social emergency that, weighed against the deprivation or neutralization of the economic or commercial value of the Claimant's investment, permits reaching the conclusion that the Resolution did not amount to an expropriation under the Agreement and international law.

140. First of all, such opposition was mainly based —as recognized by the Respondent itself— on the site's proximity to Hermosillo's urban center and on the circumstance, not attributable to Cytrar, that the site's location violated the applicable Mexican regulations —i.e. NOM-055-ECOL-1993 issued by INE—,<sup>167</sup> a circumstance that was certainly known by Promotora upon selling the Landfill's assets to Cytrar and also by INE upon granting the different permits to operate the Landfill. As expressed by the Respondent, the Landfill's proximity to Hermosillo's urban center, and not concrete evidence that the Landfill's operation is harmful for the environment or public health, is the issue that concentrates the opposition of the groups that are against the Landfill. Therefore, since such groups could not obtain the Permit's revocation due to the lack of such evidence —as explained to them

---

<sup>165</sup> Document A76: Minutes executed by PROFEPA, Cytrar and Fomín on July 6, 1999. Provision 11.

<sup>166</sup> Agreement dated November 19, 1996, p. 6, document D64.

<sup>167</sup> Counter-memorial, 33, p. 9

by INE and the municipal authorities—their ultimate goal was to close down the Landfill and make Cytrar relocate its operations. SEMARNAP, INE, and the authorities of the Municipality and of the State of Sonora finally agreed with these objectives.

141. Tecmed and Cytrar were certainly aware of the existence of those regulations, but it is clear that those regulations did not apply to the Landfill, since when the Landfill was designed and built and specific technical procedures governing the Landfill's operation were established, such regulations were not effective and their application could not be retroactive, as confirmed by a note from PROFEPA to Cytrar.<sup>168</sup> Therefore, at the time the investment was made, Cytrar and Tecmed had no reason to doubt the lawfulness of the Landfill's location, regardless of the social and political pressure that appeared subsequently. These companies were not negligent upon analyzing the legal issues related to the Landfill's location.

142. As a result of the community pressure it ran into, Cytrar also agreed that the relocation—actively sought by the municipal and state authorities and by SEMARNAP—should take place. However, Cytrar conditioned the relocation, as was obviously to be expected from any operator of an on going business, to being able to transfer its activities to a new site. The minimum requirements for the relocation were the identification of the site, the completion of the studies to prove the site's adequacy for the landfill of hazardous waste, the acquisition of the site and the granting of the relevant authorizations and permits required to operate a hazardous waste landfill prior to closing down the Las Víboras site. As time went by, due to the growing pressure arising from the above-mentioned events and from the Mexican federal, state and municipal authorities, Cytrar or Tecmed agreed to assume a substantial portion of the cost of the acquisition and start-up of the new site as a hazardous waste landfill and of the cost of transferring the waste confined at the Las Víboras site to the new landfill site. The Mexican authorities were to find the site and issue the relevant permits, and they focused the search on the state of Sonora. An institution from Sonora, IMADES (Sonora's Environmental and Sustainable Development Institute) was in charge to look for the site. The evidence submitted has not proved that Cytrar breached, or had the intention to breach, any of its relocation commitments. In addition, there is no proof, and no evidence has been submitted, that the federal or state authorities or IMADES sent any notice to Cytrar or Tecmed demanding compliance with their relocation commitment to a concrete site identified by such authorities with or without the consent of Cytrar. Evidence is only available as to a number of sites identified by the state and federal authorities in the Municipality of Benjamín Hill which, in principle, were fit for the relocation of the Landfill, subject to the related studies. Cytrar agreed that the sites identified in such place were fit for the Landfill<sup>169</sup>. However, for reasons that, based on the evidence available, cannot be attributed to Cytrar, the relocation did not take place at such time or subsequently within that Municipality. Reportedly, such reasons were the community pressures that Mexican authorities did not deem advisable to contradict.<sup>170</sup>

---

<sup>168</sup> Note dated February 11, 1998. document D101.

<sup>169</sup> Counter-memorial, 270, p. 75.

<sup>170</sup> Opposition to the Landfill's relocation to Benjamín Hill, reportedly coming from the same groups that also opposed to the Las Víboras Landfill, continued even after the Resolution was issued, as shown by the journalistic evidence submitted: readers' opinions and articles published in Hermosillo newspaper *El Imparcial*, dated March 30, April 23, and May 4, 1999; letter from an environmental activist, Francisco

143. The evidence submitted does not lead to concluding that Cytrar's petitions to expand cell N° 2 of the Landfill were actually a surreptitious way to postpone the relocation in order to continue operating the Landfill for the longest time possible, rather than a way to pursue an alternative solution to operating needs until the relocation was effective. In Cytrar's note to INE dated July 15, 1998,<sup>171</sup> in which Cytrar states the need to increase the Landfill's volume capacity by expanding cell N° 2, Cytrar expressly relates such increase to the time required to continue operating the Landfill for a year, which was necessary for the relocation. That was precisely the minimum term estimated for that purpose by the Municipality of Hermosillo. INE never denied that that was the appropriate term to relocate nor did it state that the proposed additional landfill capacity was excessive compared to the Landfill's proposed additional term for operation by Cytrar until relocation or that it may have had the purpose of prolonging the Landfill's exploitation for a period longer than necessary –or indefinitely– to achieve such relocation. If the construction of cell N° 3 — the authorization of which was also requested by Cytrar to INE “only in the event relocation was not completed after expanded cell N° 2 was full”<sup>172</sup>— meant giving Cytrar landfill capacity at the Las Víboras site for a term longer than necessary to relocate, it would have been enough for INE to refuse to grant such authorization in order to dissuade Cytrar from delaying the relocation and it would not have been necessary for that purpose to dismiss the application for renewal of the Permit. INE, by itself or in association with IMADES, the Government of Sonora or the Municipality of Hermosillo, did not respond to the proposal included in the note dated July 15, 1998, with any other counter-offer. Until a few days before the Resolution, both Cytrar and Tecmed reaffirmed, through communications dated November 9, 12 and 17, 1998, their commitment to relocate the Landfill to any of the areas identified by the Mexican authorities and to bear the most significant costs associated with the relocation, including any costs related to the

---

Pavlovich, published in *El Imparcial* on April 16, 1999, (Press Dossier (I) exhibit A70). The same happened in connection with other places or sites located in Sonora according to the press information submitted by IMADES: note published in *El Imparcial* on March 25, 1999, about the towns of Carbó and Guaymas; notes published in *El Imparcial* on March 4 and April 15, 1999, about the town of Carbó, article published in *El Imparcial* on November 6, 1998 about the Agua Blanca site located in Benjamín Hill) (Press Dossier (I) exhibit A70). The approval by the Municipality of Benjamín Hill and the Mayor of this Municipality to commence the studies related to the identification of the site and the preliminary contract of sale of «El Pinito», a plot located in this Municipality, occurred in April 1999, i.e. quite a long time after the date of the Resolution. Such actions continue to be preparatory acts that have apparently not been implemented through concrete decisions or relocation proposals made by the authorities: Counter-memorial, 337, p. 96. On the other hand, according to the article published in *El Imparcial* on May 4, 1999, mentioned above, as well as to the article published in such newspaper on April 15, 1999, related to the construction of a landfill in “El Pinito”, despite the resolutions of the authorities of Benjamín Hill, the community opposition to the relocation of the Landfill to that town continues and the issue does not seem to be definitively resolved. It is striking that as of February 22, 2000, almost a year later, the identification studies to determine whether that site would be definitely chosen by the authorities as a place fit for the relocation of the Landfill (letter of the Government of Sonora to Dra. Cristina Cortinas de Nava dated February 22, 2000, document D165) are still pending. In April 1999, IMADES had referred to another site located in Benjamín Hill, called “El Tilico”. IMADES had reportedly obtained the permit of the authorities of such Municipality to construct the landfill (article published in *El Imparcial* on April 16, 1999, Press Dossier (I), exhibit A70). However, it seems that the authorities never carried this out.

<sup>171</sup> Document A50, 7.

<sup>172</sup> Cytrar's note to INE dated November 16, 1998, 5, p. 2, document A54.

construction of the new premises in the new site and the payment of part of the purchase price of the land.<sup>173</sup> INE and the Mexican authorities involved in the relocation arrangements did not indicate, in view of this statement and before the Resolution was issued, any site for such commitment, nor did they challenge Cytrar's technical, economic or operational capacity to fulfill its relocation commitment and operate in the new site under conditions that would guarantee the protection of the environment and the preservation of public health. The fact that such capacities were not controversial is confirmed by the fact that Cytrar and Tecmed continued negotiating to relocate the Landfill even after the Permit's renewal had been denied, at least during January 2000.<sup>174</sup>

144. Finally, the Respondent has not presented any evidence that community opposition to the Landfill—however intense, aggressive and sustained—was in any way massive or went any further than the positions assumed by some individuals or the members of some groups that were opposed to the Landfill. Even after having gained substantial momentum, community opposition, although it had been sustained by its advocates through an insistent, active and continuous public campaign in the mass media, could gather on two occasions a crowd of only two hundred people the first time and of four hundred people, the second time out of a community with a population of almost one million inhabitants, "... which makes it the city with the highest population in the state of Sonora".<sup>175</sup> Additionally, the "blockage" of the Landfill was carried out by small groups of no more than forty people.<sup>176</sup> The absence of any evidence that the operation of the Landfill was a real or potential threat to the environment or to the public health, coupled with the absence of massive opposition, limits "community pressure" to a series of events, which, although they amount to significant pressure on the Mexican authorities, do not constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.

145. The fact that the real problem was the site of the Landfill and not the manner in which the Landfill was operated by Cytrar is confirmed by the fact that the Mexican federal, state and municipal authorities, including INE, did not hesitate to entrust Cytrar with the construction and operation of a new hazardous waste landfill located outside Hermosillo, with characteristics, activities and a scope apparently wider and more ambitious than the operation in Las Víboras. If these authorities had considered that Cytrar was not a suitable company to operate the Landfill in a prudent and responsible manner, and under technical conditions that ensured the protection of the environment, ecological balance and the health of the population, these authorities could not have agreed to—or even proposed—Cytrar's relocation, in good faith and without committing a breach of their obligations. That would entail the possible and almost certain risk that Cytrar's unscrupulous and careless

---

<sup>173</sup> Counter-memorial, pp. 85, 304. Cytrar's note to the President of INE, dated November 9, 1998, document D94; Tecmed's notes dated November 12, 1998 sent to the Governor of Sonora, document D149 and to the Minister of SEMARNAP, Ms. Julia Carabías Lillo, document D150; Tecmed's note dated November 17, 1998 sent to the Director of INE, Ms. Cristina Cortinas Nava, document D154.

<sup>174</sup> Counter-memorial, p. 96, 337.

<sup>175</sup> Counter-memorial, p. 15, 54.

<sup>176</sup> Hearing held from May 20 to May 24, 2002. Transcript of the session of May 20, 2002. Declaration of Javier Polanco Lavín, pp 33 overleaf, 35, 42-43; transcript of the session of May 21, 2002, declaration of José María Zapatero Vaquero, p. 57 overleaf.

action, allegedly lacking meticulousness in public relations management or in the relationship with the people, would lead to new expressions of condemnation in addition to the predictable damage to the environment and public health. This confirms that it was political pressure mainly revolving around the physical location of the site rather than a condemnation of major consequences expressed by the community or a situation originating a serious social emergency due to Cytrar's behavior that motivated the refusal to renew the Permit.

146. The situation described above is not comparable to the situation that led to the case *Elettronica Sicula S.p.A.(Elsi)*, invoked by the Respondent.<sup>177</sup> First, the decision of the Mayor of Palermo, which brought about the US claim against Italy filed before the International Court of Justice<sup>178</sup> upon ordering that the foreign investor's plant be requisitioned, is expressly based on —and the preambular clauses thereof refer to— a serious emergency and social crisis related to the closing of the plant located in Palermo, Italy (the closing down of an important job source —the second one in significance of the district— with the consequent dismissal of around one thousand workers and negative consequences on the same number of families and the Palermo community in general, which added to the suffering caused by the earthquakes that had occurred in the area a few months before).<sup>179</sup> This emergency was also recognized by the Palermo courts in terms of significant public hardship related to the plant's closing and of the unexpected urgent need to adopt measures to alleviate the crisis.<sup>180</sup> Second, the closing and mass firing of workers were directly attributable to the decision of the controlling shareholders of the company that owned the plant —i.e. the foreign investors— not to make new capital contributions or to execute the necessary bonds as security to obtain financial resources that would allow the company to stay in business.<sup>181</sup>

147. In this case, there are no similar or comparable circumstances of emergency, no serious social situation, nor any urgency related to such situations, in addition to the fact that the Mexican courts have not identified any crisis. The actions undertaken by the authorities to face these socio-political difficulties, where these difficulties do not have serious emergency or public hardship connotations, or wide-ranging and serious consequences, may not be considered from the standpoint of the Agreement or international law to be sufficient justification to deprive the foreign investor of its investment with no compensation, particularly if it has not been proved that Cytrar or Tecmed's behavior has been the determinant of the political pressure or the demonstrations that led to such deprivation, which underlie the Resolution and conclusively conditioned it. On the contrary, the commitment by such companies to relocate the Las Víboras operation to a different site, although immediately motivated in the deeply reasonable —though non-altruistic— concern of being able to continue with the commercial exploitation they were engaged in makes it clear that, objectively, such commitment was intended to make a positive contribution to mitigate the socio-political pressure and to continue providing

---

<sup>177</sup> E.g., see p. 127, 452, Counter-memorial.

<sup>178</sup> Case *Elettronica Sicula S.p.A (ELSI) (United States of America v. Italy)*, July 20, 1989, ICJ Reports, 1989.

<sup>179</sup> *Ibid.* 30, pp. 21-22

<sup>180</sup> *Ibid.* 75, pp. 40-41

<sup>181</sup> *Ibid.* 17, p. 14

Mexico with hazardous waste landfill services from a new site. It should be underscored that, as argued in these arbitration proceedings, Mexico urgently needs these services due to a serious lack thereof.

148. Another factor should be added: Cytrar's operation of the Landfill never compromised the ecological balance, the protection of the environment or the health of the people, and all the infringements committed were either remediable or remediated or subject to minor penalties. The Resolution not only terminates the Permit, but also resolves to permanently close down the site at Las Víboras, and such circumstance irrefutably confirms that the problem concerned the location of the Landfill rather than Cytrar's operation of it. This is so, as such closing means that the Landfill may not be operated by Cytrar or by anyone else, even if it complied with INE's requirements as to the expansion of cell N° 2, the prohibition to act as a transfer center or the requirements as to the type of waste to be confined or the temporary storage of such hazardous waste or any other action on which the Resolution was based. Such an extreme measure, the effects of which will have a permanent impact on the future, in view of the fact that the violations did not give rise to irreparable deficiencies in the operation of the Landfill, shows that INE concluded that the Permit granted to Cytrar should not be renewed and also that from then on nobody should be authorized to operate a hazardous waste landfill at the Las Víboras site, even if it was an operator whose behavior was so flawless that it could not give rise even to minor faults. Such conclusion was consistent with the requests of the Municipality of Hermosillo and the authorities of the state of Sonora with whom INE consulted.

149. While the Resolution is based on some of these violations to deny the renewal of the Permit, apparently through a literal and strict interpretation of the conditions under which the Permit was granted,<sup>182</sup> it would be excessively formalistic, in light of the above considerations, the Agreement and international law, to understand that the Resolution is proportional to such violations when such infringements do not pose a present or imminent risk to the ecological balance or to people's health, and the Resolution, without providing for the payment of compensation as required by Article 5 of the Agreement, leads to the neutralization of the investment's economic and business value and the Claimant's return on investment and profitability expectations upon making the investment. The Arbitral Tribunal does not agree with the Respondent's position denying that upon making its investment, the Claimant had legitimate reasons to believe that the operation of the Landfill would extend over the long term.<sup>183</sup> The political and social circumstances referred to above, which conclusively conditioned the issuance of the Resolution, were shown with all their magnitude after a substantial part of the investment had been made and could not have reasonably been foreseen by the Claimant with the scope, effects and consequences that those circumstances had. There is no doubt that, even if Cytrar did not have an indefinite permit but a permit renewable every year, the Claimant's expectation was that of a long-term investment relying on the recovery of its investment and the estimated return through the operation of the Landfill during its entire useful life.

---

<sup>182</sup> Counter-memorial, 314 *et. seq.*, pp. 87-93; 489, p.143

<sup>183</sup> Closing statement of the Respondent's counsel, 124-126, pp. 65-66

150. Such circumstances are also included in the bid offer submitted by Tecmed under the bidding auction of the assets related to the Landfill, where it states that the investment will be applied for the benefit of the “...industries of the state of Sonora in the short, medium and long terms, and that to that effect no policies that might deplete the full capacity of the Landfill in the short term will be adopted...”, and that “...Cytrar will increase its role as a regional plant, self-limiting its annual volume of waste acceptance from extra-regional sources to the level required to maintain a minimum profitability level ...”.<sup>184</sup> In view of the above, it is clear the Cytrar would not have an operation level to reach a break-even point and obtain the expected rate of return in a short time. INE could not be unaware of this and of the need to act in line with such expectations to avoid rendering unfeasible any private investment of the scale required to confine hazardous waste in the United Mexican States under acceptable technical operating conditions. Both the authorization to operate as a landfill, dated May 1994, and the subsequent permits granted by INE, including the Permit, were based on the Environmental Impact Declaration of 1994, which projected a useful life of ten years for the Landfill.<sup>185</sup> This shows that even before the Claimant made its investment, it was widely known that the investor expected its investments in the Landfill to last for a long term and that it took this into account to estimate the time and business required to recover such investment and obtain the expected return upon making its tender offer for the acquisition of the assets related to the Landfill. To evaluate if the actions attributable to the Respondent—as well as the Resolution—violate the Agreement, such expectations should be considered legitimate and should be evaluated in light of the Agreement and of international law.

151. Based on the above; and furthermore considering that INE’s actions (an entity of the United Mexican States “...in charge of designing Mexican ecological and environmental policy and of concentrating the issuance of all environmental regulations and standards”)<sup>186</sup> are attributable to the Respondent under international law<sup>187</sup> and have caused damage to the Claimant, and the fact that the claim related to the violation of Article 5(1) of the Agreement attributable to the Respondent is admissible under Title II(5) of its Appendix because the date of the damage and the date on which the Claimant should have become aware of the alleged violation of Article 5(1) of the Agreement is the date of the expropriatory act—i.e. the Resolution—subsequent to the entry into force of the Agreement but always within three years before the date the request for arbitration was filed,<sup>188</sup> the Arbitral Tribunal finds and resolves that the Resolution and its effects amount to an expropriation in violation of Article 5 of the Agreement and international law.

---

<sup>184</sup> Tecmed’s tender offer, Sections 1.1.1; 1.1.2, document A17.

<sup>185</sup> Document D21, 51, p. 33. Counter-memorial, 43, p. 13.

<sup>186</sup> Counter-memorial, p. 2, 11.

<sup>187</sup> J. Crawford, *The International Law Commission’s Articles on State Responsibility*, 94-99 (Cambridge University Press, 2002).

<sup>188</sup> According to the certificate of registration issued on August 28, 2002, by the ICSID Interim Secretary-General, the Claimant’s notice to commence this arbitration was received by the ICSID Secretariat on August 7, 2000. The three-year term established in Title II(5) of the Appendix to the Agreement, within which the Claimant became aware or should have become aware of the alleged violations of the Agreement on which its claims are based and of the related damage, is the period commencing on August 7 1997, and ending on August 7, 2000.

## II. Fair and Equitable Treatment

152. According to Article 4(1) of the Agreement:

Each Contracting Party will guarantee in its territory fair and equitable treatment, according to International Law, for the investments made by investors of the other Contracting Party.

153. The Arbitral Tribunal finds that the commitment of fair and equitable treatment included in Article 4(1) of the Agreement is an expression and part of the *bona fide* principle recognized in international law,<sup>189</sup> although bad faith from the State is not required for its violation:

To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.<sup>190</sup>

154. The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle. Therefore, compliance by the host State with such pattern of conduct is closely related to the above-mentioned principle, to the actual chances of enforcing such principle, and to excluding the possibility that state action be characterized as arbitrary; i.e. as presenting insufficiencies that would

---

<sup>189</sup> I. Brownlie, *Principles of Public International Law*, Oxford, 5<sup>th</sup>. Edition (1989), p. 19. It is understood that the fair and equitable treatment principle included in international agreements for the protection of foreign investments expresses "...the international law requirements of due process, economic rights, obligations of good faith and natural justice": arbitration case *S.D. Myers, Inc.v. Government of Canada*, partial award of November 13, 2000; 134, p. 29 ; [www.naftalaw.org](http://www.naftalaw.org).

<sup>190</sup> ICSID Arbitration no. ARB(AF)/99/2, *Mondev International Ltd v United States of America*, p.40, 116, October 11, 2002, [www.naftalaw.org](http://www.naftalaw.org).



be recognized “...by any reasonable and impartial man,”<sup>191</sup> or, although not in violation of specific regulations, as being contrary to the law because:

...(it) shocks, or at least surprises, a sense of juridical propriety.<sup>192</sup>

155. The Arbitral Tribunal understands that the scope of the undertaking of fair and equitable treatment under Article 4(1) of the Agreement described above is that resulting from an autonomous interpretation, taking into account the text of Article 4(1) of the Agreement according to its ordinary meaning (Article 31(1) of the Vienna Convention), or from international law and the good faith principle, on the basis of which the scope of the obligation assumed under the Agreement and the actions related to compliance therewith are to be assessed.

156. If the above were not its intended scope, Article 4(1) of the Agreement would be deprived of any semantic content or practical utility of its own, which would surely be against the intention of the Contracting Parties upon executing and ratifying the Agreement since, by including this provision in the Agreement, the parties intended to strengthen and increase the security and trust of foreign investors that invest in the member States, thus maximizing the use of the economic resources of each Contracting Party by facilitating the economic contributions of their economic operators. This is the goal of such undertaking in light of the Agreement’s preambular paragraphs which express the will and intention of the member States to “...intensify economic cooperation for the benefit of both countries...” and the resolve of the member States, within such framework, “...to create favorable conditions for investments made by each of the Contracting Parties in the territory of the other ...”.

157. Upon making its investment, the fair expectations of the Claimant were that the Mexican laws applicable to such investment, as well as the supervision, control, prevention and punitive powers granted to the authorities in charge of managing such system, would be used for the purpose of assuring compliance with environmental protection, human health and ecological balance goals underlying such laws.

158. The evidence submitted reveals that when the authorities of the Municipality of Hermosillo, in the state of Sonora, of SEMARNAP and INE, perceived that the political problems mentioned above, closely related to the community opposition already described, made it necessary to relocate Cytrar’s activities in the Landfill to a place outside Hermosillo, Cytrar, with Tecmed’s support, agreed that its publicly known relocation proposal would become a commitment of Cytrar and of the Mexican federal, state and municipal authorities. Such evidence also shows that although Cytrar accepted or agreed to such relocation, it made it conditional upon having a new site to carry out its technical and business activities and that it expressed this condition before the Mexican authorities on several occasions. In its note dated June 25, 1998, to the President of INE, Cytrar defines the distribution of duties and obligations related to the relocation as follows:

---

<sup>191</sup> *Neer v. México* case, (1926) R.I.A.A. iv. 60.

<sup>192</sup> International Court of Justice Case: *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, 128, p. 65, July 20, 1989, ICJ, General List No. 76.

....[Cytrar] will accept its relocation and, to that end, the municipal and state authorities will be in charge of finding, acquiring and delivering a new site, and they will also be in charge of carrying out any and all pertinent studies and of granting the related permits and licenses.<sup>193</sup>

159. There is no proof that INE or the state and municipal authorities challenged the distribution of the relocation obligations. Such allocation was only changed to the extent that Cytrar offered to assume a significant portion of the financial cost of the relocation. At no time, from the time the authorities communicated to the public the relocation of the Landfill to the date of the Resolution, did such authorities or IMADES express any disagreement as to conditioning the operation of the Landfill by Cytrar to the relocation of such operations to a different place, nor did they deny that the relocation was the result of an agreement with Cytrar on the basis of conditions agreed upon between Cytrar and such authorities. Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities recognized this as follows:

.....I recognize that the company stated that the relocation would take place after finding a new site. Therefore, the company expected to continue operating the Landfill at its current site until then. [...] I recognize that, and if you ask me why, then, at the time I made the decision that implied an interruption of the continuity sought by the company, why did I do it? [...] my answer is that it was because the circumstances in November were such that I am sure that if I had renewed the permit I would not have been able to guarantee to the company the continuity of its operations there. Because there were many objections to the continuity of the company's operations there.<sup>194</sup>

160. Cytrar may have understood in good faith that its operations at Las Víboras under the Permit would continue for a reasonable time until effective relocation. Although it is true that the relocation agreement has not been memorialized in an instrument signed by all the parties involved, the evidence submitted leads to the conclusion that there was such an agreement, as evidenced by the joint declaration of SEMARNAP, the Government of the state of Sonora and the Honorable Municipality of Hermosillo to that effect. Section 4 of such declaration states that "...the current landfill operated by CYTRAR shall be closed as soon as the new facilities are ready to operate".<sup>195</sup> On the other hand, the Resolution<sup>196</sup> itself stated that:

Furthermore, CYTRAR S.A. de C.V. agreed with the different levels of the federal, state and municipal government that the landfill would be relocated and made this agreement public.

There is no doubt that the agreement commenced to be performed, as evidenced by the joint visits of Cytrar and IMADES to sites that were possible locations for the relocated landfill. There is no evidence stating or suggesting that the parties to such agreement agreed that external factors stemming from community pressure—which the Mexican authorities were fully aware of upon reaching the agreement— would cause the closing of Cytrar's business

---

<sup>193</sup> Document A49. The relocation commitment project between the Mexican authorities and Cytrar referred to by the Respondent in the Counter-memorial, n. 324-329, pp. 93-94, which reportedly gives rise to a change in the allocation of obligations described above, has never been executed and was still subject to comments as of January 13, 1999. Therefore, such commitment cannot be taken into account to measure the allocation of the relocation obligations assumed by the parties in the stage prior to the issuance of the Resolution.

<sup>194</sup> Hearing held from May 20 to May 24, 2002; transcript of the session of May 21, 2002, pp. 77-77 overleaf.

<sup>195</sup> Document A88.

<sup>196</sup> Document A59.

at the Landfill without complying with the prior relocation of this business to another place. The incidental statements as to the Landfill's relocation in the correspondence exchanged between INE and Cytrar or Tecmed, and that constitute the immediate precedents of the Resolution, cannot be considered to be a clear and unequivocal expression of the will of the Mexican authorities to change their position as to the extension of the Permit so long as Cytrar's business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to Cytrar from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of Cytrar's operations at the Landfill to another place, a rejection that should not have been expressed only by INE, but also by the other authorities responsible for deciding on the Landfill's relocation; i.e. the Municipality of Hermosillo, the Government of Sonora and SEMARNAP. The conclusion is that Cytrar may have reasonably trusted, on the basis of existing agreements and of the good faith principle, that the Permit would continue in full force and effect until the effective relocation date.

161. As stated above, on July 15, 1998, in a letter sent to the General Director of Hazardous Materials, Waste and Activities of INE, Dr. Cristina Cortinas Nava, Cytrar presented a number of proposals related to the expansion of cell N° 2 and the construction of cell N° 3 to address the company's commitments while the process to relocate its operations to a different site was carried out.<sup>197</sup> In spite of the urgency of the case and of the letter that Cytrar had sent to INE's President on June 25, 1998, reporting the need to increase the Landfill's capacity for those very reasons,<sup>198</sup> and reiterating Cytrar's commitment to relocate subject to the conditions expressed therein, INE took about three months to issue its reply to Cytrar. In its response, included in an official communication sent to Cytrar on October 23, 1998,<sup>199</sup> i.e. scarcely more than one month before the expiration of the Permit's term and when Cytrar had already requested the Permit's renewal in a letter sent to INE on October 19, 1998,<sup>200</sup> INE did not express the existence of any irregularity committed by Cytrar in the Landfill's operation or of any default by Cytrar of the conditions under which the Permit was granted that, in the opinion of INE, might jeopardize the Permit's renewal or its limited extension for a reasonable time so as to permit the relocation as proposed by Cytrar. INE could not have been unaware at the time of the existence of irregularities or infringements related to the expansion of cell N° 2. The expansions seemed to be the biggest concern of the sectors that opposed the Landfill, as their interpretation was that the expansions, which had been communicated by PROFEPA to INE by means of an official communication received by INE on September 14, 1998,<sup>201</sup> were *sine die* the cause for the delay in closing the Landfill. As INE only stated that it would evaluate the request for the expansion of cell N° 2 and construction of cell N° 3 upon considering renewal of the Permit, without warning Cytrar of any breach or irregularity in the expansion of the Landfill's capacity that, in the opinion of INE, jeopardized the renewal of the Permit, INE significantly affected Cytrar's ability to cure such defaults or irregularities in due time and prevent the denial of the Permit's renewal upon its expiration. Although INE, in its official

---

<sup>197</sup> Letter sent to Dr. Cristina Cortinas Nava, document A50.

<sup>198</sup> Letter sent to Enrique Provencio, document A49.

<sup>199</sup> Official communication no. DOO-800/005262 of October 23, 1998, document A51.

<sup>200</sup> Cytrar's letter to Dr. Cristina Cortinas Nava, document A52.

<sup>201</sup> Document D133.

communication addressed to Cytrar on November 13, 1998,<sup>202</sup> in reply to the note sent by Cytrar on October 19, 1998, whereby it requested the renewal of the Permit, refers to these and other infringements, only six days before expiration of the Permit, it seems evident that, at that time, any meaningful effort to cure such infringement and prevent a denial of the permit's renewal was not feasible.

162. INE did not report, in clear and express terms, to Cytrar or Tecmed, before issuing the Resolution, its position as to the effect of these infringements on the renewal of the Permit. As a consequence, it prevented Cytrar from being able to express its position as to such issue and to agree with INE about the measures required to cure the defaults that INE considered significant when it denied the renewal without allowing a reasonable time to relocate Cytrar to another site. Providing an opportunity to Cytrar was reasonable and equitable, since at all times the parties considered that Cytrar would relocate the Landfill to another place, and such relocation and the necessity for the Landfill to continue operating at Las Víboras until the effective relocation, was the purpose of the recent correspondence exchanged between the parties. There was no disagreement that relocation could not be immediate and that it would require continued efforts, probably for many months, even for more than a year. There are clear inconsistencies or contradictions in the attitude of INE, which, on the one hand, did not challenge the technical capacity and operating qualifications of Cytrar upon entrusting it with the operation of a hazardous waste landfill that would be relocated to another site and that would operate under the more ambitious conditions—and surely with more responsibilities for the operator— of a Comprehensive Center for the Management of Industrial Waste, or CIMARI, and that, on the other hand, did not warn Cytrar about the curable defaults in its operations at Las Víboras sufficiently in advance so as to avoid the denial of the Permit's renewal. As shown, such defaults have not endangered public health, ecological balance or the environment. It should be noted that, although the official communication sent by INE to Cytrar on November 13, 1998, refers to an alleged violation by Cytrar of the specific condition 1.12 of the Permit, under which “...the presentation of repeated and justified complaints against the company or the occurrence of events due to problems in the Landfill's operation that may endanger public health...” (without going any deeper into this subject or expressly mentioning such events) are sufficient events to «cancel» the Permit (not to *deny its renewal*), such condition was not invoked among the grounds of the Resolution. After analyzing such inconsistencies, it may be concluded that the contradictions and lack of transparency in INE's attitudes vis-à-vis Cytrar, and the absence of clear signs from INE, did not permit Cytrar to adopt a behavior to prevent the non-renewal of the Permit, or that might at least guarantee the continuity of the permit for the period required to relocate the Landfill to a new site.

163. If INE's position was that relocation was to take place within a given period—which, as stated above, according to the Mexican authorities, should be about twelve months—<sup>203</sup> after the expiration of which the Permit would not be renewed, it would be reasonable to expect such situation to be reported to or agreed upon by Cytrar. Certainly, it is surprising that INE did not unequivocally and clearly specify the deadlines, terms and conditions that would apply to the relocation, as requested by the authorities of the Municipality of

---

<sup>202</sup> Document A53.

<sup>203</sup> Communication of the Mayor of the Municipality of Hermosillo, document D113.

Hermosillo a day before the Permit's expiration,<sup>204</sup> even when Cytrar and Tecmed had agreed to relocate Cytrar's business to any site selected by the Mexican authorities and regardless of the note sent by Tecmed to INE on November 17, 1998, in which Tecmed clearly requests the execution of an agreement with INE and the Mexican federal, state and municipal authorities containing a certain and specific relocation schedule.<sup>205</sup> There are also express inconsistencies between, on the one hand, the absence of such specifications and a notice to Cytrar warning it to agree to or abide by such conditions and, on the other hand, the use of the denial to renew the Permit as a factor to pressure Cytrar to relocate, as declared by INE's General Director of Hazardous Materials, Waste and Activities, who authored the Resolution:

.....for them [the local authorities] if I continued renewing the Permit, that would [sic] extend ... For as long as the company could continue receiving waste, it would not assume a full commitment to perform the studies required to relocate the site ...<sup>206</sup>

This statement reveals the two goals pursued by INE upon issuing the Resolution. On the one hand it denies the renewal of Cytrar's Permit without any compensation whatsoever for the loss of the financial and commercial value of the investment. On the other hand, this denial is described as a means to pressure Cytrar and force it to assume a similar operation in another site, bearing the costs and risks of a new business, mainly because by adopting such course of action, INE expected to overcome the social and political difficulties directly related to the Landfill's relocation. Under such circumstances, such pressure involves forms of coercion that may be considered inconsistent with the fair and equitable treatment to be given to international investments under Article 4(1) of the Agreement and objectionable from the perspective of international law.<sup>207</sup>

164. If, on the other hand, INE's position was —as has actually been established— to close the Landfill inevitably, with or without relocation, INE should have expressed such position clearly. Regardless of the hypothesis contemplated, the decisive factor —for which Cytrar was not responsible— was the Landfill's location at the Las Víboras site and its proximity to Hermosillo's urban center, which was in violation of Mexican regulations and a source of community opposition and political unrest, but which was not —as confirmed by Mexican authorities— against the legitimacy of the Landfill's operation under Mexican law. If the inevitable consequence of this situation, evaluated by the Mexican authorities, was the refusal to renew the Permit and the closing of the site, such determination, from the Agreement's standpoint, should have been accompanied, as has already been decided, by the payment of the appropriate compensation. The lack of transparency in INE's behavior and intention throughout the process that led to the Resolution, which does not reflect in full the reasons that led to the non-renewal of the Permit, cover up the final and real

---

<sup>204</sup> Communication sent to INE's President by the Mayor of the Municipality of Hermosillo on November 18, 1998, in which the Mayor requests "the execution of a landfill relocation agreement between the Federation, the State, the Municipality and the company. A detailed, signed, legal agreement containing a schedule and fixed dates." Document D157.

<sup>205</sup> Document A 91.

<sup>206</sup> Hearing held from May 20 to May 24, 2002; transcript of the session held on May 21, 2002, p. 72.

<sup>207</sup> D.F.Vagts, *Coercion and Foreign Investment Rearrangements*, 72. *The American Journal of International Law*, pp. 17 *et seq.*, specially p. 28 (1978) : "...the threat of cancellation of the right to do business might well be considered coercion."

consequence of such actions and of the Resolution: the definitive closing of the activities at the Las Víboras landfill without any compensation whatsoever, whether Cytrar agreed or not, in spite of the expectations created, and without considering ways enabling it to neutralize or mitigate the negative economic effect of such closing by continuing with its economic and business activities at a different place. Within the general context of the circumstances mentioned above, the ambiguity of INE's actions was even greater when it resorted to the non-renewal of the Permit to overcome obstacles not related to the preservation of health and the environment although, according to the evidence submitted, the protection of public health and the environment is where INE's preventive function should be focused. To the question about the factors or parameters that INE should take into account to decide on the renewal of authorizations such as the Permit, witness Dr. Cristina Cortina Navas answered:

Provisions can have two different purposes: to evaluate environmental performance and to assess the management of companies. Thus, you will distinguish, among the conditions established, such conditions that allowed for the evaluation of the former and the conditions that allowed for the assessment of the latter. As regards management, there were a series of instruments, reports, records and issues that the company had to take care of. In turn, performance involved providing sufficient security that there would not be escapes, leaks or accidents during hazardous waste management, including transportation and storage. Any of these issues could be verified, and, in fact, before issuing any resolution we tried to gather all the elements necessary to be able to pass judgment on whether or not such purposes had been fulfilled.<sup>208</sup>

The refusal to renew the Permit in this case was actually used to permanently close down a site whose operation had become a nuisance due to political reasons relating to the community's opposition expressed in a variety of forms, regardless of the company in charge of the operation and regardless of whether or not it was being properly operated.

165. The Arbitral Tribunal considers that INE's behavior described above with respect to Cytrar, which had a material adverse effect on Cytrar's ability to get to know clearly the real circumstances on which the maintenance or validity of the Permit depended —it must be recalled that Cytrar could not operate without this Permit— is not an unprecedented action. INE's denial to renew the Permit belongs to the wider framework of the general conduct taken by INE towards Cytrar, Tecmed and, ultimately, the Claimant's investment.

166. The Arbitral Tribunal finds that INE's behavior, as analyzed in paragraphs 153-164 above and because of the "deficiencies" explained therein, conflicts with what a reasonable and unbiased observer would consider fair and equitable, and that this amounts to a violation of Article 4(1) of the Agreement. The Arbitral Tribunal also finds that such a behavior can be related, in terms of its prejudicial consequences, to the consequences of the Resolution; and that only after the Resolution was issued could the Claimant fully realize the breach of the Agreement incurred by such behavior and the resulting damage. Consequently, the Claimant's claims in connection with such behavior satisfy the requirements for admissibility contemplated in Title II(4) and (5) of the Appendix to the Agreement.

---

<sup>208</sup> *Ibidem*, pp. 68-68 overleaf

167. Notwithstanding the above, the Arbitral Tribunal considers it equally appropriate to place this behavior within the context of INE's prior conduct on the basis of the abundant arguments and evidence presented by the Parties in connection with such prior conduct and in view of the undeniable fact that the legal relationship between INE and Cytrar or Tecmed associated with the Landfill is one and only one, starting with the initial procedures in connection with the authorization to operate the Landfill and finishing with the Resolution—the immediate cause for the damage sustained by the Claimant. This conduct should also be analyzed in light of the fact that throughout a relationship of such nature, necessarily prolonged in time, the Claimant was entitled to expect that the government's actions would be free from any ambiguity that might affect the early assessment made by the foreign investor of its real legal situation or the situation affecting its investment and the actions the investor should take to act accordingly.

168. As a result of the judicial sale of the Landfill's assets, Tecmed and the Municipality of Hermosillo request from INE the "change of name" or the facilitation of such change, which, according to the administrative practice up to date, at least in connection with the Landfill, entailed the replacement of the holder of the permits necessary for the operation of the landfill at Las Víboras by such holder's successors. There is no evidence that INE has responded to such communications stating that Cytrar had actually to request a new permit, which may differ from the existing one, instead of requesting the replacement of the old holder with a new one; and no convincing evidence has been offered to support the Respondent's allegations as to the fact that, from the beginning, INE's officers instructed Cytrar to obtain a new "operating license" because, for example, as stated by the Respondent, the nature of the operation undertaken by Cytrar and the consequent expansion of the Landfill's installed capacity would so require it.<sup>209</sup> Among others, in the note dated June 5, 1996, sent to INE by Tecmed together with the MRP Form, containing information that INE should evaluate in connection with the individual or entity that was to be in charge of a hazardous waste landfill operation, Tecmed specifically requested from INE "...the change of the name appearing in the permit granted by INE to the new company for such purpose, CYTRAR S.A. de C.V.". Attached as Annex "A" to such presentation and Form, are the Establishment License granted on December 7, 1988, and the permit to operate the already existing Controlled Landfill, dated May 4, 1994, together with its expansion of August 25, 1994.<sup>210</sup>

169. Thus, there was no possible margin for error with respect to the request made by Tecmed and Cytrar with the support of the Municipality of Hermosillo in connection with the existing licenses or permits by virtue of which the Landfill had operated and was still operating. Considering such very clear requests, there is no evidence that INE had warned Cytrar that such requests could only be interpreted as petitions to be included in INE's listing of companies that would qualify for the operation of CIMARIS or Comprehensive Centers for Industrial Waste Management—to which the witness Jorge Sánchez Gómez, the INE's General Director of Hazardous Materials, Waste and Activities at that time<sup>211</sup> had made reference—or evidence of practices, resolutions or administrative regulations or legal

---

<sup>209</sup> Counter-memorial, 127, pp. 34-35

<sup>210</sup> Document D46

<sup>211</sup> Hearing held from May 20 to May 24, 2002. Transcript of the session of May 23, 2002, p. 57.

provisions leading to such sole and exclusive interpretation. On September 24, 1996, INE sent Cytrar an official communication signed by Jorge Sánchez Gómez, whereby Cytrar was informed that “In view of the request filed by the company Promotora e Inmobiliaria del Municipio de Hermosillo, OPD to change its name to Cytrar S.A. de C.V.,” and considering that according to the recommendations of INE’s “...Legal Affairs Department ...” Cytrar had furnished “...the documents required by this General Office and had fulfilled all legal requirements that, in such Department’s understanding, are essential *for carrying out the necessary procedure*,”<sup>212</sup> Cytrar “... for all legal and administrative purposes...” had been “duly registered in this General Office under my charge”.<sup>213</sup> It is not surprising that from this communication, Cytrar interpreted that INE had changed the corporate name appearing on the permits to operate the Landfill, as requested by Cytrar, Tecmed and the Municipality of Hermosillo.

170. Subsequently, it is no wonder to see Cytrar surprised when after Cytrar had been operating the Landfill under the existing permit dated May 4, 1994, in its capacity as new company authorized under the permit pursuant to INE’s official communication dated September 24, 1996, as Cytrar was entitled to believe in good faith, INE demanded Cytrar to return such communication to be replaced by another, with the same date and an almost identical text, except for an annex whereby Cytrar was granted a permit to operate the Las Víboras landfill, dated November 11, 1996.<sup>214</sup> Such permit, in addition to terminating the prior permit dated May 4, 1994, in which Cytrar had requested the change of name, differed from the last one in some material respects. The most outstanding difference, which would only be appreciated upon refusal to renew the Permit in 1998, was that the permit of May 1994 had an indefinite duration and the permit of November 1996 had a term of one year that could be extended. As highlighted by the witness Jorge Sánchez Gómez, the purpose behind the annual renewal of permits was to facilitate INE’s actions to put an end to the operations carried out by companies that, in INE’s understanding, did not adjust their actions to the applicable legal provisions; the INE could refuse the extension or refuse to renew such permits at the end of each year. According to the witness, this allowed INE to dispense with the more cumbersome procedure —of uncertain success— of obtaining the revocation of the permit by PROFEPA, which required that a case be opened and that the party subject to sanctions be given the opportunity to express its argumentations and defenses:

...apparently, there is an alternative: that the agency that had to enforce the law; in this case, PROFEPA, carried out the execution. However, it was very difficult to have a company’s registration withdrawn if there were no elements that would clearly allow verification of a breach. Revocation of permits is a very complicated procedure.....<sup>215</sup>

To emphasize INE’s discretionary powers as to the continuation of Cytrar’s operation of the Landfill and in accordance with INE’s policy of facilitating the possibility of putting an end to such operation without having to start the proceeding to withdraw the permit, when

---

<sup>212</sup> Emphasis added by the Arbitral Tribunal

<sup>213</sup> Document A42

<sup>214</sup> Documents A43 and A44

<sup>215</sup> Hearing held from May 20 to May 24, 2002. Declaration of Jorge Sánchez Gómez, transcript for the session of May 23, 2002, p. 53 overleaf.



the Permit was granted —on November 19, 1997— it was determined that this Permit, instead of being “subject to extension” (as the previous permit stated), was subject to “renewal” upon request of the interested party. That is to say, it required a new permit at the end of each year, instead of extending its validity at the end of such period. In the words of the witness Jorge Sánchez Gómez:

...the notion of renewal is much easier to handle for the purpose of refusing a permit to a company that is not complying with the requirements.<sup>216</sup>

171. If the indefinite-duration permit dated May 4, 1994 had been transferred to Cytrar as requested to INE by Cytrar, Tecmed and the Municipality of Hermosillo, INE would not have been able to put an end to Cytrar’s operation of the Landfill by means of the Resolution and the only remedy available for that purpose would have been the revocation of the Permit by PROFEPA. But such revocation would probably have not been successful on the basis of the infringements of the Permit used to justify the Resolution, which were not even considered by PROFEPA as deserving any sanction other than a fine. To sum up, INE unilaterally transformed a previous administrative act, which, as such, was presumed to be legitimate, had immediate effects and could only be interpreted in good faith as having accepted Cytrar’s petition to be the transferee of the existing permits for the operation of the Landfill. The objective consequence of such transformation was to grant Cytrar a permit to operate the Landfill, which reduced Cytrar’s entitlement to question actions that deprived it of the Permit or that had such effect. Subsequently, INE —also unilaterally— classified the petition as a request to be registered in a listing that Cytrar was not aware of, and regarding which, in any case, Cytrar had shown no interest. The same objective consequence is to be attributed to the transformation as from November 19, 1997, of Cytrar’s permit to operate the Landfill, from a permit that was subject to extension to a permit that was subject to renewal.

172. The contradiction and uncertainty inherent in INE’s actions as to Cytrar and Tecmed is evidenced, then, both in the initial stage of the processing of the necessary permits to operate the Landfill and when INE decided to put an end to such operation by means of the Resolution. Such actions belong to one and the same course of conduct characterized by its ambiguity and uncertainty which are prejudicial to the investor in terms of its advance assessment of the legal situation surrounding its investment and the planning of its business activity and its adjustment to preserve its rights. Such ambiguity and uncertainty are also present in the last stage of the relationship, analyzed under paragraphs 153-164 above, which led to the Resolution, and added their harmful effects to the damage resulting from the denial to grant the Permit. Although INE’s initial behavior was before the effective date of the Agreement and the Arbitral Tribunal will not pass judgment on whether at that stage such conduct, considered in isolation, amounted to a breach of the provisions thereof before its entry into force, it cannot be ignored, in light of the good faith principle (Articles 18 and 26 of the Vienna Convention), that the conduct of the Respondent between the date of execution of the Agreement (in view of the Respondent’s determination to ratify it subsequently) and the effective date thereof, is incompatible with the imperative rules deriving from Article 4(1) of the Agreement as to fair and equitable treatment. This is

---

<sup>216</sup> Transcript of the session of May 23, 2002, p. 59 overleaf.

particularly so since, according to Article 2(2) of the Agreement, it is applicable to investments made before its entry into force, a circumstance to be certainly considered when analyzing the conduct attributable to the Respondent that took place before that time but after the Respondent having executed the Agreement. INE's contradictory and ambiguous conduct at the beginning of the relationship between INE, Cytrar and Tecmed before the entry into force of the Agreement has the same deficiencies as those encountered in such conduct during the last stage of the relationship, immediately preceding the Resolution. Thus, INE's conduct during such time is added to the prejudicial effects of its conduct during the last stage, which breached Article 4(1) of the Agreement.

173. Briefly, INE's described behavior frustrated Cytrar's fair expectations upon which Cytrar's actions were based and upon the basis of which the Claimant's investment was made, or negatively affected the generation of clear guidelines that would allow the Claimant or Cytrar to direct its actions or behavior to prevent the non-renewal of the Permit, or weakened its position to enforce rights or explore ways to maintain the Permit. During the term immediately preceding the Resolution, INE did not enter into any form of dialogue through which Cytrar or Tecmed would become aware of INE's position with regard to the possible non-renewal of the Permit and the deficiencies attributed to Cytrar's behavior—including those attributed in the process of relocation of operations—which would be the grounds for such a drastic measure and, thus, Cytrar or Tecmed did not have the opportunity, prior to the Resolution, to inform of, in turn, their position or provide an explanation with respect to such deficiencies, or the way to solve such deficiencies to avoid the denial of renewal and, ultimately, the deprivation of the Claimant's investment. Despite Cytrar's good faith expectation that the Permit's total or partial renewal would be granted to maintain Cytrar's operation of the Landfill effective until the relocation to a new site had been completed, INE did not consider Cytrar's proposals in that regard and not only did it deny the renewal of the Permit although the relocation had not yet taken place, but it also did so in the understanding that this would lead Cytrar to relocate.

174. Such behavior on the part of INE, which is attributable to the Respondent, results in losses and damage<sup>217</sup> for the investor and the investment pursuant to Title II(4) of the Appendix to the Agreement coinciding both as to essence and time with those derived from the Resolution, whether such behavior is considered generically or only as to the stages mentioned and analyzed by the Arbitral Tribunal in paragraphs 153-164 above. The Respondent's behavior in such stages amounts, in itself, to a violation of the duty to accord fair and equitable treatment to the Claimant's investment as set forth in Article 4(1) of the Agreement and such behavior constitutes sufficient basis for the Claimant's claims founded on such violation to be admissible, given the time at which the damage occurred and the time when the damage and the violation of the Agreement were necessarily perceived by the Claimant (on the date of issuance of the Resolution), pursuant to Title II(4) and (5) of the Appendix to the Agreement.

### III. Full Protection and Security and Other Guarantees under the Agreement

---

<sup>217</sup> "Damage" is not limited to the economic loss or detriment and shall be interpreted in a broad sense (J. Crawford, *The International Law Commission's Articles on State Responsibility*, 29-31 (Cambridge University Press, 2002).

175. The Claimant alleges that Mexican municipal and state authorities encouraged the community's adverse movements against the Landfill and its operation by Tecmed or Cytrar, as well as the transport by Cytrar of Alco Pacifico's waste. Further, the Claimant alleges that Mexican authorities, including the police and the judicial authorities, did not act as quickly, efficiently and thoroughly as they should have to avoid, prevent or put an end to the adverse social demonstrations expressed through disturbances in the operation of the Landfill or access thereto, or the personal security or freedom to move about of the members of Cytrar's staff related to the Landfill. It is the opinion of the Claimant that such behavior of the Mexican authorities, attributable to the Respondent, amounts to a violation of Article 3(1) of the Agreement, which provides that:

Each Contracting Party shall accord full protection and security to the investments made by the other Contracting Party's investors, in accordance with International Law and shall not, through legally groundless actions or discriminatory measures, hinder the management, maintenance, development, usage, enjoyment, expansion, sale, or, where applicable, disposition of such investments.

176. The Arbitral Tribunal considers that the Claimant has not furnished evidence to prove that the Mexican authorities, regardless of their level, have encouraged, fostered, or contributed their support to the people or groups that conducted the community and political movements against the Landfill, or that such authorities have participated in such movement. Also, there is not sufficient evidence to attribute the activity or behavior of such people or groups to the Respondent pursuant to international law.

177. The Arbitral Tribunal agrees with the Respondent, and with the case law quoted by it, in that the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it. At any rate, the Arbitral Tribunal holds that there is not sufficient evidence supporting the allegation that the Mexican authorities, whether municipal, state, or federal, have not reacted reasonably, in accordance with the parameters inherent in a democratic state, to the direct action movements conducted by those who were against the Landfill. This conclusion is also applicable to the judicial system, in relation to the efforts made to take action against the community's opposing demonstrations or to the attempt to reverse administrative measures which were deemed inconsistent with the legal rules applicable to the Landfill, such as the withdrawal by the Hermosillo's Municipal authorities of the license to use the Landfill's site.

178. Promotora's behavior, or INE's behavior attributable to the Respondent, regarding the sale of the assets related to the Landfill, the commitments undertaken in connection with such sale or the grant of the Permit to operate of November 11, 1996, and preceding events, all took place prior to the entry into force of the Agreement. With respect to Promotora, such behavior has not been considered by the Arbitral Tribunal due to the reasons described in paragraph 92 of this award, and will not be analyzed, even if it were hypothetically attributable to the Respondent, to determine whether there has been a violation of Article 3(1) of the Agreement or not.

179. With regard to INE's behavior prior to the entry into force of the Agreement, described above, and the subsequent stages following such date, the Arbitral Tribunal does

not consider, even at the time of its consummation and turning point —the refusal to renew the Permit— that such behavior has no legal grounds under Mexican law or that such behavior is discriminatory, as required by Article 3(1) of the Agreement in order to constitute a violation. The Arbitral Tribunal has not found that INE’s denial to renew the Permit violated any Mexican laws or was issued beyond the Mexican legal framework. As provided below, the Arbitral Tribunal has not verified, either, the existence of discriminatory treatment detrimental to the Claimant in violation of the national and foreign treatment guarantees also set forth in the Agreement. Therefore, the Arbitral Tribunal considers that neither the Resolution nor the Respondent’s behavior leading to such Resolution amount to a violation of Article 3(1) of the Agreement.

180. According to Article 4(2) of the Agreement, each Contracting Party guarantees the foreign investor a treatment that should not be less favorable... “than that accorded under similar circumstances [...] to investments made in its territory by investors from a third State”. Pursuant to Article 4(5) of the Agreement, each Contracting Party, “In accordance with the restrictions and methods provided by the local laws [...] shall accord to the investments made by the other Contracting Party’s investors a treatment that should not be less favorable than the treatment afforded to its own investors...”. The Arbitral Tribunal observes, however, in its post-hearing brief, when referring to the alleged breach of the Agreement, that the Claimant omits any statement regarding the violation of the guarantees of non-discriminatory treatment (national or accorded to investors from a third State) provided in Articles 4(2) and (5) of the Agreement, which are not even mentioned, though the Claimant does sustain its allegations relative to the breach attributable to the Respondent of Articles 3 and 5 of the Agreement as alleged by the Claimant in the request for arbitration.<sup>218</sup>

181. In any case, the Arbitral Tribunal does not consider that the behavior attributable to the Respondent, to the extent such behavior commenced prior to the entry into force of the Agreement and was accomplished after such date, or occurred following the entry into force, such as, for instance in the latter case, the issuance of the Resolution, amounts to violations to the guarantee of national or foreign treatment set forth by the provisions of the Agreement referred to above. The Claimant has failed to furnish convincing or sufficient evidence to prove, at least *prima facie*, that the Claimant’s investment received, under similar circumstances, less favorable treatment than that afforded to nationals of the State receiving the investment or of a third State, or that said investment was subject to discriminatory treatment upon the basis of considerations relative to nationality or origin of the investment or the investor. The Arbitral Tribunal further considers that the alleged discriminatory treatment attributed by the Claimant to the Respondent on the grounds of the unlimited duration of operation permits or licenses granted to Residuos Industriales Multiquim S.A. de C.V. (RIMSA), which would be owned by a foreign investor,<sup>219</sup> or to prior operators or owners of the landfill, all of which were government entities of the state of Sonora,<sup>220</sup> occurred and were entirely isolated events taking place prior to the

---

<sup>218</sup> Claimant’s post-hearing brief, pp. 104-126.

<sup>219</sup> Memorial, p. 124.

<sup>220</sup> Memorial, p. 26

Agreement's entry into force, and will not be considered by this Arbitral Tribunal as stated in paragraph 67 of this arbitration award.

182. With regard to other forms of discrimination apparently originated in the allegedly different treatment accorded by INE to RIMSA's and Claimant's investments, the Arbitral Tribunal holds that the Respondent has furnished satisfactory evidence —not rebutted by the Claimant on this point— of the fact that the circumstances under which RIMSA's investment was made and concerning such investment materially differed from the investment in the Landfill. Thus, it is not possible to establish standards which allow a comparison of the treatment accorded to the investment in RIMSA's landfill and the investment in the Landfill. Further, it is the opinion of this Arbitral Tribunal that the Respondent has not breached Article 2(1) of the Agreement with respect to the promotion and admission of foreign investments, and that no evidence of such violation has been submitted; it being also relevant to point out that the Claimant itself has stated that if such violation existed, it should be the subject matter of a direct claim between the Contracting Parties<sup>221</sup> of the Agreement. The Arbitral Tribunal also holds that the denial of the Permit's renewal does not amount to a violation of Article 3(2) of the Agreement, pursuant to which each Contracting Party "within the local legal framework" shall grant the necessary permits with regard to the investments from the other Party, as the Arbitral Tribunal considers that there is no evidence proving the fact that INE's denial of the Permit is contrary to Mexican laws.

#### **F. Compensation. Restitution in kind.**

183. The Claimant's claim for compensation or restitution in kind is based upon the provisions of Title VII(1) of the Appendix to the Agreement, which contemplates those two options. The Claimant requests restitution in kind —which the Claimant considers "absolutely impossible"— only secondarily, as the Claimant primarily seeks monetary damages.<sup>222</sup> The Arbitral Tribunal considers that monetary damages paid to the Claimant as compensation for the loss of the investment constitutes an adequate satisfaction of the Claimant's claim under the Agreement. Therefore, and taking into account that the Claimant primarily seeks monetary damages, the Arbitral Tribunal will not consider the admissibility or inadmissibility of the restitution in kind in this case.

184. The Claimant calculates the amount to be paid as monetary damages under the discounted cash flow calculation method by which the Claimant intends to determine the Landfill's market value. Upon the basis of the report issued by the expert witness appointed by the Claimant, the amount to be paid as damages as of the date of the expropriation —November 25, 1998—totals US\$ 52,000,000, plus interest. The Claimant further claims compensation for the damage allegedly caused to the Claimant's reputation, with arbitration costs to be borne by the Respondent.

185. The Respondent objects to the application of a discounted cash flow analysis, as the Respondent considers such calculation method to be highly speculative given the short term

---

<sup>221</sup> Memorial, p. 93.

<sup>222</sup> Memorial, pp. 142 – 144.

during which the Landfill operated as an on going business (about two years and a half), thus preventing the application of sufficient historical data to prepare the reliable estimates required by such calculation methodology. The Respondent has proposed the calculation of damages based on the investment made, upon which the investment's market value would be determined. In any case, the Respondent's expert witness challenges the discounted cash flow calculation methodology—as applied by the Claimant's expert witness—with regard to various aspects, including the price, costs, and market condition estimates, the failure to compute certain costs, such as remediation and maintenance of closed cells, and the discount rate applied by the Claimant's expert witness. Also, the Respondent's expert witness offers its own analysis under the discounted cash flow methodology, which in an “optimistic” version as such expert witness puts it, would be calculated in the amount of US\$ 2,100,000 for the investment, and according to a “conservative” version such amount would total US\$ 1,800,000.

186. The Arbitral Tribunal has noted both the remarkable disparity between the estimates of the two expert witnesses upheld throughout the examination directed by the parties and the Arbitral Tribunal at the hearing held on May, 20-24, 2002, and also the considerable difference in the amount paid under the tender offer for the assets related to the Landfill—US\$ 4,028,788—<sup>223</sup> and the relief sought by the Claimant, amounting to US\$ 52,000,000, likely to be inconsistent with the legitimate and genuine estimates on return on the Claimant's investment at the time of making the investment. The non-relevance of the brief history of operation of the Landfill by Cytrar—a little more than two years—and the difficulties in obtaining objective data allowing for application of the discounted cash flow method on the basis of estimates for a protracted future, not less than 15 years, together with the fact that such future cash flow also depends upon investments to be made—building of seven additional cells—in the long term, lead the Arbitral Tribunal to disregard such methodology to determine the relief to be awarded to the Claimant.<sup>224</sup>

187. In Article 5.2, the Agreement provides that, in the event of expropriation, or any other similar measure or with similar effects:

Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the time when the expropriation took place, was decided, announced or made known to the public (...) valuation criteria shall be determined pursuant to the laws in force applicable in the territory of the Contracting Party receiving the investment.

Also, Article 10 of the Mexican Federal Law on Expropriation provides that the applicable compensation shall indemnify for the commercial value of the expropriated property, which in the case of real property shall not be less than the tax value. There has been no evidence or allegations as to the interpretation of this rule in light of Mexican laws.

---

<sup>223</sup> Report by Fausto García y Asociados, p. 22

<sup>224</sup> Award of ICSID case No. ARB (AF)/97/1 *Metalclad Corporation v. United Mexican States*, 16 Mealey's International Arbitration Report, p. A-1 *et. seq.*; pp. A-14/A-15, 119-122 (2000). Award in case *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, 10 Iran-U.S. Claims Tribunal Reps., p. 121 *et. seq.*; 30, pp. 132-133 (1986-1); award of ICSID case No. ARB/98/4, *Wena Hotels v. Arab Republic of Egypt*, 41 I.L.M. 896 (2002), 122-125, pp. 918-919, award of December 8, 2000.

188. The Arbitral Tribunal considers that compensation to be awarded pursuant to such parameters—that is, the market value of the Landfill— shall be the total compensation for all the violations to the Agreement proved in this award, which, in relation to the Claimant, have the damaging effect of depriving the Claimant of its investment.

189. It is not in dispute that the assets forming the Landfill are owned by the “Tecmed Group”, which belongs to the Actividades, Construcciones y Servicios group and thus has the Claimant as its parent corporation, into which, under Spanish accounting standards, the accounts of Tecmed and Cytrar are consolidated.<sup>225</sup> According to Articles 1(1)(b) and (2)(e) of the Agreement, the Claimant—the foreign investor—is the owner of the foreign investment in Mexico through the Claimant’s subsidiaries. The Respondent has recognized that:

The TECMED group, through the Mexican company TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. de C.V., presently has the following environmental facilities in Mexico (in addition to the landfill, CYTRAR and its administrative offices).....<sup>226</sup>

It is also undisputed, at least after Cytrar obtained the permit from INE to operate the Las Viboras Landfill, that the related assets indirectly held by the Claimant constitute a hazardous waste landfill,<sup>227</sup> i.e. an integrated unit comprising tangible and intangible assets, including the Permit and other permits or licenses to operate as a hazardous waste landfill. Such unit must be valued by this Arbitral Tribunal upon rendering its award. Therefore, the Arbitral Tribunal concludes that the deprivation of the financial and business use of the Landfill’s operation arising from the Respondent’s actions and in violation of the Agreement has caused damage to the Claimant and its investment in the Landfill. Therefore, the Claimant is entitled to receive compensation in accordance with the provisions of the Agreement and on the basis of the market value of the assets the Claimant has been deprived of.

190. The Arbitral Tribunal also considers that, although the Arbitral Tribunal may consider general equitable principles when setting the compensation owed to the Claimant, without thereby assuming the role of an arbitrator *ex aequo et bono*,<sup>228</sup> the burden to prove the investment’s market value alleged by the Claimant is on the Claimant. Such burden is transferred to the Respondent if the Claimant submits evidence that *prima facie* supports its allegation, and any difficulty in determining the compensation does not prevent the assessment of such compensation where the existence of damage is certain.<sup>229</sup>

---

<sup>225</sup> “2000 Annual Report of Actividades de Construcción y Servicios”, document A7, Annex 8.1 “Consolidated Information”, pp. 131-132 ; 133.

<sup>226</sup> Respondent’s brief “Admissions and denials”, p. 4.

<sup>227</sup> Respondent’s brief “Admissions and denials”, p. 32.

<sup>228</sup> Award in the case *Kuwait and the American Independent Oil Company (Aminoil)*, 21 I.L.M., p. 976 *et seq.* (1982), 77-78 p.1016 ; specially No.78 : “It is well known that any estimate in purely monetary terms of amounts intended to express the value of an asset, of an undertaking, of a contract, or of services rendered, must take equitable principles into account”. To the same effect, award in the case *Himpurna California Energy Ltd. (Bermuda) v. PT (Persero) Perusahaan Listrik Negara (Indonesia)*, 14 Mealey’s International Arbitration Report, A-1 *et seq.* 441, p. 129 [A-44] (1999).

<sup>229</sup> ICSID case ARB/84/3, *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, 8 ICSID Law Review-Foreign Investment Law Journal, p. 389, 215 (1993).

191. The Parties have not raised any dispute as to the fact that this market value is defined as the fair value of the transaction on an arms' length basis, where both parties to the transaction have knowledge of the applicable circumstances.<sup>230</sup> The Respondent acknowledges that the price obtained in a public tender "...is an efficient manner to determine the price of the assets sold..."<sup>231</sup> The Claimant has not challenged this allegation. The Arbitral Tribunal finds that upon the 1996 sale the Landfill's market value was US\$ 4,028,788, and will take that figure as the starting point for a subsequent analysis. The Arbitral Tribunal also finds, on the basis of the evidence submitted, that the existence of a market supported by a sufficient number of similar transactions that may be used as a guide to determine the Landfill's market value as of November 25, 1998, has not been established.

192. In the task of establishing the market value as of such date —the moment when the expropriatory act occurred—, the Arbitral Tribunal will also take into account other factors in accordance with the practice of international arbitral tribunals in similar cases.

193. For such purposes and on the basis of Article 5(2) of the Agreement, although the Arbitral Tribunal will consider the existence of community pressure against the location of the Landfill at its current place and that such pressures and the location would have jeopardized the operations of the Landfill in the long run, the Arbitral Tribunal will not necessarily take into account the actions or determinations of the Mexican authorities that, echoing the community sentiment, in turn exerted pressure on Cytrar for it to relocate or that are part of the Respondent's actions considered to be in violation of the Agreement in this award or that contributed to the damage resulting from such violations,<sup>232</sup> and that may have an adverse effect on valuation of the compensation. Upon weighing such community pressure, the Arbitral Tribunal cannot ignore the relocation commitment assumed by Cytrar, supported by Tecmed, the performance of which would have mitigated or eliminated such pressure, and whose non-performance is not attributable to Cytrar or Tecmed, nor the responsibilities of the Municipality of Hermosillo and of INE, as the case may be, that were involved in the sale of the site to Cytrar or that authorized Cytrar to operate the site under the premise that its location was legitimate despite the fact that it did not comply with Mexican laws. Such legitimacy was terminated by the Resolution which, in practice, ignored such legitimacy in order to address social and political factors against such location.

194. The Arbitral Tribunal will also take into account the additional investments made as from the Landfill's acquisition until the date of the Resolution and will consider that Cytrar has contributed management and client development elements that caused, among other things, a 39% increase in the Landfill's operation by 1997, excluding the activities related

---

<sup>230</sup> American Appraisal report, p.2.

<sup>231</sup> Respondent's closing statement, 167, p. 76. Declaration of expert witness Christianson, hearing held from May 20 to May 24, 2002; transcript for the session of May 22, p. 50. Expert witness report of Fausto García y Asociados, p. 23.

<sup>232</sup> *Philips Petroleum Co. Iran v Iran*, 21 Iran-U.S. Claims Tribunal Reports, p. 79 *et seq.*, specially 135, p. 133 (1989-1).



to Alco Pacífico,<sup>233</sup> and that also produced net income in the second year of operations, i.e. during a stage of entry into and consolidation in the market at the beginning of its operations. It cannot be denied that the investment in the Landfill was productive and added value to the former Landfill's operations as well as goodwill, nor can it be denied that the Claimant was deprived of its investment's profits, and value added and goodwill, or that the Claimant's losses also include lost profits. As acknowledged by the Respondent itself, this operation almost did not exist for a long time before Cytrar's acquisition of the Landfill and, in the short periods in which it did exist, such activities were reduced in scope from a financial and business standpoint.<sup>234</sup> It is logical to understand that, as activities increased due to Cytrar's operations, this increase must have required additional investments. Although upon assessing the Landfill's market value two of the nine cells of the Landfill were full, thus reducing the original landfill capacity from nine to seven cells, it must also be taken into account that the increased productivity of the Landfill was evidenced after Cytrar took over the Landfill's operation. Such increased productivity is necessarily based on Cytrar's managerial and organizational skills and on gaining new clients, to the extent that the Respondent is willing to acknowledge at least net income for one additional year for an amount of US\$ 314,545.<sup>235</sup> On the basis of these considerations, it is legitimate to conclude that the Landfill's market value as of November 25, 1998, could not be lower than the acquisition price paid by Cytrar.

195. On the basis of its own valuation, taking into account the Landfill's market value of US\$ 4,028,788 upon its acquisition and adding the investments made thereafter according to Cytrar's financial statements for 1996, 1997 and 1998, and the profits for two years of operation following the Resolution date, the Arbitral Tribunal finds that such market value as of November 25, 1998, was US\$ 5,553,017.12.<sup>236</sup> Although the Claimant's expert witness assessed the value of such additional investments at US\$ 1,951,473,<sup>237</sup> no documentary evidence has been filed to support such amount, and such evidence has not been alleged by the Claimant in its closing statement. The Respondent challenges such amount in its closing statement on the basis of accounting data by comparing the fiscal years mentioned above, and estimates such amount to be US\$ 439,000.<sup>238</sup> This amount has been accepted by the Arbitral Tribunal. Regarding the profits for the two additional years of operation, the Arbitral Tribunal has calculated such profits at the amount of US\$ 1,085,229.12. For this, the Arbitral Tribunal has considered that an informed buyer of the Landfill would have assumed that it had to be relocated due to the community pressure and that such relocation might take about two years. In such calculation, the Arbitral Tribunal has further considered that the projections clearly stated that Cytrar was increasing its

---

<sup>233</sup> Report of Fausto García y Asociados, p. 26.

<sup>234</sup> Respondent's brief "Admissions and Denials", p. 12.

<sup>235</sup> Counter-memorial, 598, p. 171.

<sup>236</sup> The Arbitral Tribunal finds that the Claimant has made its compensation claim in US dollars (memorial, p. 146), and that such claim has not been challenged by the Respondent, who also uses such currency in its allegations to denominate the amounts to which it resorts to challenge the Claimant's claims. The expert witnesses for both parties also translate into such currency the figures they use for their analyses. Therefore, the Arbitral Tribunal makes its determination in US dollars.

<sup>237</sup> Hearing held from May 20 to May 24, 2003; transcript for the session of May 23, pp. 7 overleaf / 8.

<sup>238</sup> Respondent's closing statement added by expert witness Lars Christianson, taken into account by the Arbitral Tribunal as a part of such closing statement according to the Arbitral Tribunal's decision of August 12, 2002, p. 8.

revenues, the value of its clientele and goodwill as an on going business related to the Landfill exploitation, and the other considerations included in this Chapter F, particularly the circumstances explained in paragraphs 189-190 and 193-194, which, in the opinion of the Arbitral Tribunal, cannot be ignored upon establishing the economic compensation owed to the Claimant for the loss of the market value of its investment. The Arbitral Tribunal finds that it is not appropriate to deduct from such amount, which also reflects the principle that compensation of such loss must amount to an integral compensation for the damage suffered, including lost profits,<sup>239</sup> the cost of closing down the Landfill due to a decision attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement.

196. The Claimant requests that any compensation awarded to it accrue compound interest at a rate of 6%.<sup>240</sup> The Arbitral Tribunal has not found any specific allegation by the Respondent regarding this point. The application of compound interest has been accepted in a number of awards, and it has been stated that:

...compound (as opposed to simple) interest is at present deemed appropriate as the standard of international law in [...] expropriation cases.<sup>241</sup>

In connection with this case, in the opinion of the Arbitral Tribunal, application of compound interest is justified as part of the integral compensation owed to the Claimant as a result of the loss of its investment.

197. Therefore, the amount of US\$ 5,533,017.12 will accrue interest at an annual rate of 6%, compounded annually, commencing on November 25, 1998, until the effective and full payment by the Respondent of all amounts payable by the Respondent to the Claimant under this award.<sup>242</sup>

198. The Arbitral Tribunal finds no reason to award compensation for moral damage, as requested by the Claimant,<sup>243</sup> due to the absence of evidence proving that the actions attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement have also affected the Claimant's reputation and therefore caused the loss of business opportunities for the Claimant. In addition, the Arbitral Tribunal has not found that the adverse press coverage for Tecmed or Cytrar of the events regarding the Landfill,

---

<sup>239</sup> P.C.I.J., *Chorzów Factory* case, (1938) P.C.I.J., Ser. A, 17, p. 29, 47.

<sup>240</sup> Memorial, p. 146.

<sup>241</sup> Award in ICSID case ARB/99/6 *Middle East Cement Shipping and Handling Co.S.A v Arab Republic of Egypt*, April 12, 2002, 174 , p. 42, <http://www.worldbank.org/icsid/cases/awards.htm>. See also: award of December 8, 2000, in ICSID case ARB/98/4, *Wena Hotels Ltd. v Arab Republic of Egypt*, 41 I.L.M. 896 (2002), specially 128-129, p. 919; award in ICSID case No. ARB/96/1 *Compañía del Desarrollo de Santa Elena S.A. v Republic of Costa Rica*, 15 ICSID Law Review-Foreign Investment Law Journal, p. 167; specially 96-106, p. 200-202 (2000); award in ICSID case no. ARB(AF)/97/1 *Metalclad Corporation v United Mexican States*, 16 Mealey's International Arbitration Report, A-1; specially 128, pp. 41-42 (A-16) (2000).

<sup>242</sup> Award in ICSID case No. ARB/84 /3 *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, 8 Foreign Investment Law Journal-ICSID Law Review, p 328, specially 234-235, p. 393 (1993).

<sup>243</sup> Memorial, pp. 141-142.

was fostered by the Respondent or that it was the result of actions attributable to the Respondent.

199. Promptly after effective payment to the Claimant of all sums payable to it by the Respondent under this award, the Claimant shall take all the necessary steps to transfer, or cause to be transferred, to the Respondent, or to a nominee designated by the Respondent, the assets forming the Landfill.

200. Taking into account that the Claimant has been successful only with respect to some of its claims and that the challenges or defenses filed by the Respondent were also admitted partially, each Party will bear its own costs, expenses and legal counsel fees. The costs incurred by the Arbitral Tribunal and ICSID will be shared equally between the Claimant and the Respondent.

### **G. Decision**

201. Therefore, the Arbitral Tribunal finds as follows:

1. The Respondent has breached its obligations under the Agreement set forth in Articles 4(1) and 5(1).
2. The Respondent will pay the Claimant the amount of US\$ 5,533,017.12, plus a compound interest on such amount at an annual rate of 6%, commencing on November 25, 1998, until the effective and full payment by the Respondent of all amounts payable by the Respondent to the Claimant under this award.
3. Promptly after effective and full payment to the Claimant of all sums payable to it by the Respondent under this award, the Claimant shall take all the necessary steps to transfer, or cause to be transferred, to the Respondent, or to a nominee designated by the Respondent, the assets forming the Landfill.
4. Each Party will bear its own costs, expenses and legal counsel fees. The costs incurred by the Arbitral Tribunal and ICSID will be shared equally between the Claimant and the Respondent.
5. Any claim or petition filed in this arbitration and not admitted herein will be considered rejected.

Rendered in Washington, D.C.

Mr. Carlos Bernal Verea  
Arbitrator  
Date and place of  
execution:

Prof. José Carlos Fernández-  
Rozas  
Arbitrator  
Date and place of execution:

Dr. Horacio A. Grigera Naón  
Chairman of the Arbitral  
Tribunal  
Date and place of execution

**CLA-018**

UNCITRAL Arbitration Proceedings  
CME Czech Republic B.V. (The Netherlands)

vs.

The Czech Republic

**PARTIAL AWARD**

We hereby certify this  
to be a true copy of the  
original.

Signed Clifford Chance  
Clifford Chance  
Limited Liability Partnership  
200 Aldersgate Street  
London  
EC1A 4JJ

issued in Stockholm, Sweden, on September 13, 2001 in the UNCITRAL  
Arbitration Proceedings

between

CLAIMANT: CME Czech Republic B.V., Hoogoorddreef 9, 1101 BA Am-  
sterdam Zuid-Oost, The Netherlands (hereinafter referred  
to as "CME") represented by:

Mr. John S. Kiernan and Mr. Michael M. Ostrove, De-  
bevoise & Plimpton, 875 Third Avenue, New York, New  
York 10022, U.S.A.

and

RESPONDENT: The Czech Republic

represented by the Minister of Finance of the Czech Re-  
public Mr. Jiří Rusnoki, Ministry of Finance, Letenzka 15,  
11810 Prague 1, The Czech Republic represented by:  
Mr. Jeremy Carver and Mr. Audley Sheppard, Clifford  
Chance, 200 Aldersgate Street, London EC1A 4JJ and  
Mr. Vladimír Petrus and Mr. Miroslav Dubovský, Clifford  
Chance Pünder, Charles Bridge Center, Křižovnické  
nám. 2, 110 00 Prague 1, Czech Republic

BEFORE: Dr. Wolfgang Kühn, Düsseldorf, Chairman,  
Judge Stephen M. Schwebel, Washington D.C., Arbitrator,  
JUDr. Jaroslav Hándl, Prague, Arbitrator

TABLE OF CONTENTS

A.	Background of the Dispute	
	(1) The Parties	1
	(2) The UNCITRAL Arbitration Proceedings	2
	(3) The Netherlands / Czech Republic Bilateral Investment Treaty	3
	(4) CME's "investments" under the Treaty	4
	(5) CME's shareholding	5
	(6) The Broadcasting Licence	8
	(7) The Formation of ČNTS	11
	(8) The ČNTS Memorandum of Association	12
	(9) ČNTS' Broadcasting Services	13
	(10) TV NOVA's success	14
	(11) The Change of Media Law	15
	(12) The Amendment of the Memorandum of Association	16
	(13) The 1999 Events	17
	(14) The Prague Civil Court proceedings	19
	(15) CME's Allegations	20
	(16) Investment Dispute and Breach of Treaty	23
B.	Relief Sought	25
	(1) Relief Sought by CME Czech Republic B.V.	26
	(2) Relief Sought by the Czech Republic	29
C.	Procedure	
	(1) Initiation and Conduct of Proceedings	30
	(2) The Procedural Hearing	40
	(3) The Parties' Request for Production of Documents	52
	(4) The Parties' Request for Interim Remedies or Similar Orders	55
	(5) The Tribunal's Decision on Interim Remedies and Similar Orders	64
	(6) Further Conduct of Proceedings	65
	(7) The Submission of Witness Statements	70
	(8) Declarations in Support of the Statement of Claim	
	(9) Statements in Support of the Statement of Defence	
	(10) Documents and Authorities	71
	(11) The Stockholm Hearing	72
D.	Position of the Claimant	74
	I. The Claimant's Investment in the Czech Republic	75
	II. The Role of ČNTS	86
	III. The Memorandum of Association	93
	IV. The Formation of TV NOVA	103
	V. The Media Council's Reversal of Position	107
	VI. The Council Compels ČNTS to Alter the MOA	114
	VII. The Destruction of Claimant's Investment	119
	VIII. The Media Council's Failure to Fulfil its Obligation to Protect Claimant's Investment	133
	IX. The Czech Republic's Additional Continuing Violations of the Treaty	137
	X. Other Legal Actions by CME or ČNTS Apart from this Arbitration	140
E.	Claimant's Argument	
	I. CME's Entitlement to Assert a Claim under the Treaty	145
	II. The Czech Republic's Obligations under the Treaty	148
	1. The Obligation Not to Deprive Investors of Their Investments	149
	2. The Obligation of Fair and Equitable Treatment	155

3.	The Obligation Not to Engage in Unreasonable and Discriminatory Treatment	158
4.	The Obligation of Full Security and Protection	159
5.	The Obligation of Treatment in Accordance with Standards of International Law	162
III.	The Czech Republic Has Violated Its Treaty Obligations	
1.	The Czech Republic Is Responsible for the Media Council's Conduct	163
2.	The Media Council's Conduct has Violated the Czech Republic's Treaty Obligations	166
IV.	The Czech Republic Is Required to Remedy Its Breaches of the Treaty	171
F.	Position of the Respondent	
I.	Introduction	172
II.	The Treaty	181
III.	The Media Law	182
IV.	The Media Council	189
V.	The Grant of the Licence to CET 21	191
VI.	The Formation of ČNTS	214
VII.	The Unlawful Implementation of the Licence	225
VIII.	Administrative Proceedings Against ČNTS	237
IX.	CME Takes Secret Control of CET 21	241
X.	Change of Memorandum of Association of ČNTS and Service Agreement	243
XI.	The Media Council did not reverse its Position	253
XII.	The Media Council did not Compel ČNTS to Alter the MOA	257
XIII.	March 15, 1999 Letter	261
XIV.	The Dispute Between CET 21 and ČNTS	265
XV.	The alleged Destruction of Claimant's Investment	270
XVI.	The Media Council did not Fail to Protect Claimant's Investment	277
XVII.	The Czech Republic's Alleged Additional Continuing Violations of the Treaty	281
G.	The Respondent's Argument	
I.	The Interpretation of the Treaty and Burden of Proof	284
II.	The Governing Law	286
III.	The Tribunal Lacks Jurisdiction	288
1.	CME has Failed to Establish that It has an Asset Invested in the Czech Republic	291
2.	CME's Claim is Not an Investment Dispute under the Treaty	294
3.	CME May Not Currently Pursue the Same Remedies in Different Fora	302
IV.	CME Czech Republic B.V. has no claim in substance	311
V.	The Czech Republic's Obligations under the Treaty	312
1.	The Obligation Not to Deprive Investors of Their Investments	317
2.	The Obligation of Fair and Equitable Treatment	335
3.	The Obligation Not to Engage in Unreasonable and Discriminatory Treatment	342
4.	The Obligation of Full Security and Protection	351
5.	The Obligation of Treatment in Accordance with Standards of International Law	359
VI.	The Czech Republic has not Violated its Treaty Obligations	
1.	The Czech Republic is Responsible for the Media Council's Conduct	362
2.	The Council's Conduct did not Violate the Czech Republic's Treaty Obligations	363
VII.	CME Failed to Plead Any Loss	372
VIII.	Respondent's Conclusion	374



H.	The Analysis of the Tribunal	
I.	Jurisdiction	
	(1) The Claimant's Investment	375
	(2) The Claimant's 1997 Share Acquisition	378
	(3) The Claimant's Predecessor's 1994 Share Acquisition	382
	(4) The 1994 Share Assignment not notified	385
	(5) The Claimant's Predecessor's 1996 Share Acquisitions	391
	(6) CME's Predecessor's Original 1993/1994 Contributions qualify as Investment under the Treaty	393
	(7) The Investment Dispute under the Treaty	401
	(8) Parallel Proceedings	409
	(9) No abuse of Treaty Proceedings	412
	(10) Outcome of Civil Court Proceedings have no Effect on Jurisdiction	413
	(11) Respondent's Defence that no Loss Occurred	416
	(12) Claimant itself made no Investment	418
II.	The Substance of the Claimant's Case	
	1. Admissibility / Timewise Limitation	
	(1) Parallel Treaty Proceedings	419
	(2) No restriction of the Claimant's case timewise	420
	(3) Admissibility of the Claimant's case in respect to the 1994 Share Acquisition	425
	2. The Merits of the Claimant's Case under the Treaty	427
	(1) CME's and CME's predecessor's investments in the Czech Republic	428
	(2) The Media Council in 1996 coerced CME to abandon the legal security for its investment in the Czech Republic	460
	(3) The Media Council supports the destruction of CME's investment	539
	(4) CNTS' dismantling as exclusive service provider supported by Council's actions and inactions	559
	(5) Causation of damage by Council's actions and omissions	575
	(6) The Respondent breached the Treaty	586
	(i) The obligation not to deprive the Claimant of its investment (Treaty Article 5)	591
	(ii) The remaining claims	610
	a) The obligation of fair and equitable treatment (Article 3 (1) of the Treaty)	611
	b) The obligation not to impair investments by unreasonable or discriminatory measures (Article 3 (1) of the Treaty)	612
	c) The obligation of full security and protection (Article 3 (2) of the Treaty)	613
	d) The obligation to treat investments in con- formity with principles of international law (Articles 3 (5) and 8 of the Treaty)	614
	(7) The Reparation Claim	615
III.	Costs of the proceedings	619
J.	Decision	624

**A.**

**Background of the Dispute**

**(1) The Parties**

1. The Claimant CME Czech Republic B.V. is a corporation organized under the laws of the Netherlands. The Respondent, the Czech Republic, is a sovereign governmental entity, represented in these proceedings by its Ministry of Finance.

**(2) The UNCITRAL Arbitration Proceedings**

2. CME Czech Republic B.V. (CME) initiated these arbitration proceedings on February 22, 2000 by notice of arbitration against the Czech Republic pursuant to Art. 3 of the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).

**(3) The Netherlands / Czech Republic Bilateral Investment Treaty**

3. CME brought this arbitration as a result of alleged actions and inactions and omissions by the Czech Republic claimed to be in breach of the Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, executed on April 29, 1991 (hereinafter: "the Treaty"). The Treaty entered into force in the Czech and Slovak Federal Republic on October 1, 1992 and, after the Czech and Slovak Federal Republic ceased to exist on December 31, 1992, the Czech Republic succeeded to the rights and obligations of the Czech and Slovak Federal Republic under the Treaty.

**(4) CME's "investments" under the Treaty**

4. CME holds a 99 % equity interest in Česká Nezávislá Televizní Společnost, spol. s r.o. ("ČNTS"), a Czech television services company. CME maintains that, among other things, CME's ownership interest in ČNTS and its indirect ownership of ČNTS' assets qualify as "investments" pursuant to Art. 1 (a) of the Treaty. CME and these investments, therefore, are thereby entitled to the protection and benefits of the Treaty.

**(5) CME's shareholding**

5. CME acquired its 99 % ownership interest in ČNTS in steps. It acquired 5.8 % shares in 1997 by purchasing the Czech holding company NOVA Consulting, which owned these shares, and by purchasing, in May 1997, 93.2 % from CME's affiliated company, CME Media Enterprises B.V., which, in turn, in 1996 had acquired 22 % of the shares in ČNTS from the Česká Spořitelna a.s. (Czech Savings Bank) and 5.2 % from CET 21 Spol. s r.o. (CET 21).
6. Earlier, in 1994, CME Media Enterprises B.V. had acquired a 66 % shareholding in ČNTS from the Central European Development Corporation GmbH ("CEDC"), a German company under the same ultimate control as CME and CME Media Enterprises B.V. of an American corporation in turn controlled by Mr. Ronald S. Lauder, an American businessman with domicile in the United States of America.
7. CEDC (with a share of 66 %), CET 21 (with a share of 21 %) and the Czech Savings Bank (with a share of 22 %) were co-founders of ČNTS, formed as a joint venture company in 1993 with the object of providing broadcasting services to CET 21.

**(6) The Broadcasting Licence**

8. CME's investments (its ownership interest in ČNTS and its indirect ownership of ČNTS' assets) are related to a Licence for television broadcasting granted by the Czech Media Council, empowered to issue licences by the Czech Republic's Act on the Operation of Radio and Television Broadcasting, adopted on October 30, 1991, Act No. 468/1991 Coll. (hereinafter, the "Media Law"). This Licence was granted to CET 21, acting in conjunction inter alia with CEDC, for the purpose of the acquisition and use of the Licence for broadcasting throughout the Czech Republic. CME's and its predecessors' investments in this joint venture, inter alia between CEDC and CET 21, are the object of the dispute between the parties.
9. In late 1992 and early 1993, CEDC, on the invitation of CET 21, which was owned by five Czech nationals and advised by Dr. Vladimír Železný, a Czech national, participated in negotiations with the Czech Media Council (hereinafter: "the Council") with the goal of the issuance of the Broad-

casting Licence to CET 21 with a participation therein, either directly or indirectly, by CEDC.

10. The Council issued the Licence to CET 21 on February 9, 1993 to operate the first nation-wide private television station in the Czech Republic. The decision granting the Licence acknowledged CEDC's "substantial involvement of foreign capital necessary to begin television station activities" and the conditions attached to the Licence acknowledged CEDC's partnership with the holder of the Licence, CET 21.

#### **(7) The Formation of ČNTS**

11. Instead of CEDC taking a direct share in CET 21 (as initially contemplated), and instead of a license being issued jointly to CET 21 and CEDC (also so contemplated), the partners of CET 21 and Dr. Železný agreed with CEDC and the Media Council to establish CEDC's participation in the form of a joint venture, ČNTS. The Media Council was of the view that such an arrangement would be more acceptable to Czech Parliamentary and public opinion than one that accorded foreign capital a direct ownership or licensee interest.

#### **(8) The ČNTS Memorandum of Association**

12. The Memorandum of Association was made part of the Licence Conditions, defining the co-operation between CET 21 as the licence holder and ČNTS as the operator of the broadcasting station. CET 21 contributed to ČNTS the right to use the Licence "unconditionally, unequivocally and on an exclusive basis" and obtained its 12 % ownership interest in ČNTS in return for this contribution in kind. Dr. Železný served as the general director and chief executive of ČNTS and as a general director of CET 21. ČNTS' Memorandum of Association ("MOA") was approved by the Council on April 20, 1993 and, in February 1994, ČNTS and CET 21 began broadcasting under the Licence through their newly-created medium, the broadcasting station TV NOVA.

#### **(9) ČNTS' Broadcasting Services**

13. ČNTS provided all broadcasting services, including the acquisition and production of programs and the sale of advertising time to CET 21, which acted only as the licence holder. In that capacity, CET 21 maintained liaison with the Media Council. It was CET 21 that appeared before the Me-

dia Council, not CME, though Dr. Železný's dual directorships of CET 21 and ČNTS did not lend themselves to clear lines of authority.

**(10) TV NOVA's success**

14. TV NOVA became the Czech Republic's most popular and successful television station with an audience share of more than 50 % with US \$109 million revenues and US \$ 30 million net income in 1998. CME claims to have invested totally an amount of US \$ 140 million, including the afore-mentioned share purchase transactions for the acquisition of the 99 % shareholding in ČNTS, by 1997. The audience share, the revenues and amount of the investment are disputed by the Respondent.

**(11) The Change of Media Law**

15. As of January 1, 1996, the Media Law was changed. According to the new Media Law, licence holders were entitled to request the waiver of licence conditions (and Media Council regulations imposed in pursuance of those conditions) related to non-programming. Most of the licence holders applied for this waiver, including CET 21, with the consequence that the Media Council lost its strongest tool to monitor and direct the licence holders.

**(12) The Amendment of the Memorandum of Association**

16. As a consequence of certain inter-actions between the Media Council and CET 21, including ČNTS, the shareholders of ČNTS in 1996 agreed to change ČNTS' Memorandum of Association and replaced CET 21 's contribution "Use of the Licence" by „Use of the Know-how of the Licence“. The circumstances, reasons and events related to, and the commercial and legal effects deriving from? this change are in dispute between the parties. In conjunction with the change of the contribution of the use of the Licence, CET 21 and ČNTS entered into a Service Agreement. That Agreement thereafter was the basis for the broadcasting services provided by ČNTS to CET 21 for operating TV NOVA.

**(13) The 1999 Events**

17. In 1999, after communications between the Media Council and Dr. Železný, the character and the legal impact of these communications being in dispute between the parties, CET 21 terminated the Service Agreement on August 5, 1999 for what it maintains was good cause.

18. The reason given for this termination was the non-delivery of the day-log by ČNTS to CET 21 on August 4, 1999 for the following day. CET 21 thereafter replaced ČNTS as service provider and operator of broadcasting services by other service providers, with the consequence that ČNTS' broadcasting services became idle and, according to CME, ČNTS' business was totally destroyed.

**(14) The Prague Civil Court proceedings**

19. ČNTS sued CET 21 for having terminated the Service Agreement without cause. The Prague District Court on May 4, 2000 judged that the termination was void, the Court of Appeal, however, confirmed the validity of the termination, and the Czech Supreme Court decision was still pending when these arbitration proceedings were closed.

**(15) CME's Allegations**

20. CME claims that ČNTS, the most successful Czech private broadcasting station operator with annual net income of roughly US \$ 30 million, has been commercially destroyed by the actions and omissions attributed to the Media Council, an organ of the Czech Republic.
21. CME claims, inter alia, that an already signed Merger and Acquisition Agreement between CME's interim parent company and the Scandinavian broadcaster and investor SBS was vitiated by these actions and omissions of the Media Council. CME accordingly suffered damage in the amount of US \$ 500 million, which was the value allocated by that Agreement and by the joint venture partners to ČNTS in 1999 before the disruption of the legal and commercial status of ČNTS as a consequence of the Media Council's actions and omissions.
22. The Czech Republic strongly disputes this contention and the purported underlying facts, maintaining that, inter alia, the loss of investment (if any) is the consequence of commercial failures and misjudgments of CME and, in any event, that CME's claim is part of a commercial dispute between ČNTS and Dr. Železný, for which the protection of the Treaty is not available.

**(16) Investment Dispute and Breach of Treaty**

23. CME contends that the dispute between the parties is a dispute “between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter” as defined by Art. 8 (1) of the Treaty. As such, it is the position of CME that the dispute is subject to Arbitration pursuant to Art. 8 (2) through 8 (7) of the Treaty.
24. CME alleges that the Czech Republic has breached each of the following provisions of the Treaty:
- (a) *“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” (Art. 3 (1));*
  - (b) *“... each Contracting Party shall accord to [the investments of investors of the other Contracting Party] 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 favourable to the investor concerned” (Art. 3 (2)); and*
  - (c) *“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” (Art. 5).*

**B.**

**Relief Sought**

25. In its Notice of Arbitration, CME *“requested the Tribunal to provide a relief necessary to restore ČNTS’ exclusive rights to provide broadcasting services for TV NOVA and thereby restore to CME the economic benefit available under the arrangement initially approved by the Council” (restitutio in integrum)*. During the proceedings, CME changed the Relief Sought and requested the Tribunal to give the following Relief to the Claimant. Both

parties instructed the Tribunal that, if damages are to be awarded, the Tribunal shall not decide on the quantum at this stage of the proceedings.

**(1) Relief Sought by CME Czech Republic B.V.**

26. Claimant seeks an award:

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
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;
3. Declaring the Respondent is liable for the costs that Claimant has incurred in these proceedings to date, including the costs of legal representation and assistance.

27. Claimant confirms that it has withdrawn its request for the remedy of *restitutio in in tegrum*.

28. The Respondent sought the following Relief:



**(2) Relief Sought by the Czech Republic**

29. The Czech Republic seeks an award that:

- (1) CME's claim be dismissed as an abuse of process.
- (2) And/or CME's claim be dismissed on grounds that the Czech Republic did not violate the following provisions of the Treaty as alleged (or at all):
  - (a) The obligation of fair and equitable treatment of investments (Art. 3 (1)).
  - (b) The obligation not to impair investments by unreasonable or discriminatory measures (Art. 3 (1)).
  - (c) The obligation to accord full security and protection to investments (Art. 3 (2)).
  - (d) The obligation to treat investments in accordance with the standard of international law (Art. 3 (5)).
  - (e) The obligation to not deprive investors directly or indirectly of their investments (Art. 5).
- (3) And/or CME's claim be dismissed and/or CME is not entitled to damages, on grounds that alleged injury to CME's investment was not the direct and foreseeable result of any violation of the Treaty.
- (4) And CME pay the costs of the proceedings and reimburse the reasonable legal and other costs of the Czech Republic.

**C.**

**Procedure**

**(1) Initiation and Conduct of Proceedings**

30. After having initiated the arbitration proceedings, the Claimant appointed Judge Stephen M. Schwebel, Washington, and the Respondent JUDr. Jaroslav Hándl, Prague, as party-appointed arbitrators. Both arbitrators appointed Dr. Wolfgang Kühn, Düsseldorf, as Chairman of the Arbitral Tribunal on July 19, 2000, which appointment was accepted by the Chairman on July 21, 2000.
31. On August 4, 2000 the Tribunal issued a Procedural Order No. 1 setting dates for the parties for the Statement of Claim and the Statement of De-

fence, in accordance with Art. 23 of the UNCITRAL Arbitration Rules. The Tribunal requested the parties to annex to their statements the documents that the parties deemed relevant.

32. In accordance with Art. 17 of the UNCITRAL Rules, the Tribunal determined the language to be used in the proceedings to be English and instructed the parties that any documents annexed to the Statement of Claim or Statement of Defence and any supplementary documents or exhibits submitted in the course of the proceedings, delivered in their original language, shall be accompanied by a translation into English.
33. In accordance with Art. 16 of the UNCITRAL Rules, the place of arbitration was determined to be Stockholm. The Tribunal convened a meeting with counsel of the parties on November 17, 2000 in Stockholm in order to discuss further conduct of the proceedings and the parties were invited to give a short presentation of their case. The Tribunal also made a proposal with respect to the Arbitrators' fees.
34. The Claimant by letter dated August 10, 2000 accepted the Tribunal's proposal in respect to costs and fees, whereas no answer was received from the Respondent within the specified time. The Tribunal therefore informed the parties by letter dated September 5, 2000 that the Tribunal will proceed on the basis that the parties accept the Tribunal's proposal in Order No. 1 dated August 4, 2000. By letter dated September 25, 2000 the Respondent requested that the whole amount of the costs for the arbitration should be borne by the Claimant and therefore declined to pay the advance payment, which was requested by the Tribunal by Order No. 2.
35. On September 22, 2000 the Claimant submitted its Statement of Claim including exhibits, declarations and authorities. The Claimant made the required deposits for costs. By Order No. 3 the Tribunal requested the Claimant to make the required payment not made by the Respondent, which the Claimant did.
36. By Court Order No. 4 dated October 24, 2000 the Tribunal changed the place of the hearing on November 17, 2000, due to accommodation problems in Stockholm, to Dusseldorf. The change of the place for the hearing

did not change the seat of the arbitration, which still was denominated to be Stockholm.

37. On November 9, 2000 the Respondent submitted its Statement of Defence including witness statements, exhibits and authorities. In its Statement of Defence the Respondent raised, inter alia, the defence of jurisdiction stating that the Tribunal lacks jurisdiction, or, in the alternative, CME's claim is inadmissible.
38. On November 14, 2000 the Claimant submitted a Request for Production of Documents describing the requested documents broadly as Media Council's records related to the grant of the Licence to CET 21, the operation of TV NOVA, the administrative proceedings initiated by the Media Council against ČNTS in 1996 and the correspondence between the Media Council and CET 21, Dr. Železný, CME or ČNTS, including internal minutes for 1998, 1999 and 2000.
39. On November 16, 2000 the Respondent requested the Tribunal to refuse the Claimant's Request for Production of Documents as being too broad and unsubstantiated and, therefore, not in compliance with the International Bar Association Rules on Taking Evidence in International Commercial Arbitration adopted on June 1, 1999 ("IBA Rules").

## **(2) The Procedural Hearing**

40. For the hearing of November 17, 2000, the parties jointly submitted an agenda. Under the first topic, CME suggested the co-ordination of these arbitration proceedings with the so-called *Lauder vs. the Czech Republic* arbitration proceedings. In the *Lauder vs. the Czech Republic* proceedings, the ultimate majority shareholder of CME advanced similar claims in a pending UNCITRAL Arbitration brought against the Czech Republic under a bilateral investment treaty between the United States of America and the Czech Republic. The Tribunal did not take a decision on co-ordination because the parties did not agree to co-ordination.
41. The Claimant's proposal to have the two proceedings inter-linked in their timing was not pursued because the parties were in disagreement.

42. In respect to jurisdiction, the Respondent requested that the Tribunal should hold summary threshold proceedings whereas the Claimant's position was that the jurisdictional issues should be considered in conjunction with the hearing of the merits after the Claimant's Reply Memorial, the Respondent's Sur-Reply and the issues (in substance) had been fully presented.
43. In respect to this and other procedural issues the Tribunal, on November 17,2000, issued Order No. 5.
44. The Tribunal decided that at this point of time no hearing on jurisdiction or the admissibility of the claim was to be held.
45. In respect to Procedures for Taking Evidence, the parties proposed to apply the IBA Rules except as follows:
  - (i) In interpreting Article 4 (7 and 8), the Arbitral Tribunal can decide, taking into consideration all circumstances, whether to accept or disregard a witness statement if the witness does not appear. The Arbitral Tribunal additionally can decide whether it wants to hear testimony from all witnesses who have previously submitted a witness statement, or only testimony from certain witnesses.*
  - (ii) The Claimant did not agree to the adoption of Article 3 (2-7) (relating to requests to produce documents) or Article 3 (12) (relating to confidentiality of documents produced by a party). The Respondent, however, invited the Tribunal to adopt these articles.*
  - (iii) The parties jointly agreed that witness statements and testimony provided in the arbitration between Mr. Lauder and the Czech Republic may be referred to in this arbitration."*
46. In accordance with Art. 15.1 of the UNCITRAL Arbitration Rules, the Tribunal decided to conduct the arbitration in the manner it considers appropriate. For this purpose, the Tribunal decided, to the extent appropriate, to apply the IBA Rules.
47. In respect to the production of documents the Tribunal decided that the Claimant's Request for the Production of Documents dated November 14,2000 was not in accordance with the IBA Rules. The Tribunal, by

Order No. 5, instructed the Claimant and the Respondent to submit detailed requests for the production of documents, such documents to be produced in their original language and to be accompanied by an English translation.

- 4%. In respect to the Determination of the Amount of Any Damage Award, the parties jointly informed the Tribunal that they were in agreement that the hearing on the merits should be devoted to resolving issues of liability and the appropriate form of remedy. If the determination of a quantum of monetary damages was necessary - for example, because the Arbitral Tribunal were to order a remedy referred to in § 111 or § 112 of Claimant's Statement of Claim - that quantum should be established in further proceedings, so that the briefs and witness statements will not at this stage deal with the amount of monetary damages.
49. In respect to Confidentiality, the parties informed the Arbitral Tribunal that they were in agreement that these proceedings should not be open to the public; however, the parties indicated that they were in disagreement as to whether they are required to keep the submissions in the proceedings confidential. The Arbitral Tribunal did not comment on this subject.
50. Further, in accordance with the joint proposals of the parties, the Tribunal set dates for further submissions by the parties, for the Claimant for its "Reply" and for the Defendant for its "Sur-Reply", final witness statements to be filed and served by a set date thereafter. Further, the Tribunal set a date for a hearing from April 23, 2001 to May 2, 2001 and reconfirmed the legal seat of the arbitration as Stockholm.
51. The parties complied with the dates set. The Chairman submitted its Reply Memorial on December 22, 2000 and the Respondent its Sur-Reply on February 14, 2001.

### **(3) The Parties' Request for Production of Documents**

52. The Claimant submitted its Request for Production of Documents on December 1, 2000 invoking the Tribunal's procedural Order No. 5 and Art. 3 (3) of the IBA Rules. The Claimant requested the production of documents related to specific Media Council files related to the Licence, comprising 18 specifically described documents. The Claimant further re-

requested the production of six further categories of documents related inter alia to CET 21. These categories of documents were all defined either by dates or by specific file numbers of the Media Council. Further, the Claimant asked for the production of eleven specific documents identified by date and a further description. The Claimant gave reasons in respect to relevance and materiality and also in respect to the possession of the documents.

53. By Order No. 6 dated December 22, 2000, the Tribunal by majority-decision instructed the Respondent to produce the documents requested by the Claimant, however deleting certain documents from the list which were already in the possession of the Claimant, and further deleting a statement of the chief of the legal department of the Media Council dated July 22, 1996, which statement might have a status of privilege or confidentiality.
54. On February 14, 2001 the Tribunal issued Order No. 7 on costs and proceedings. The Tribunal set the date for the hearing beginning on April 23, 2001 in Stockholm and set out a time schedule for the hearings.

**(4) The Parties' Request for Interim Remedies or Similar Orders**

55. By submission dated January 30, 2001, the Respondent notified to the Tribunal "that the Respondent has been provided with copies of documents which indicate that Mr. Lauder/CME has been spying on the Media Council, immediately prior to this arbitration being commenced, if not earlier." The Respondent requested the Tribunal to issue an Order that Mr. Lauder/CME disclose immediately all copies of communications related to the Media Council, which have been provided by a source within the Media Council, copies of all communications from a certain investigation agency, copies of CME's instructions to this agency and further to order that Mr. Lauder/CME identify the name of the person(s) who has/have provided any communications referred to herein-above to the investigation agency. By a submission dated February 6, 2001, the Respondent extended the request for an Order and further requested the Tribunal to order that CME shall identify any other person(s) in Czech Government Departments who has/have provided, directly or indirectly, any communications of a similar nature to the investigation agency and/or CME.

56. Further, the Respondent requested permission from the Tribunal to apply for an order securing the attendance before the Tribunal of a certain employee of the investigation agency in order to give oral testimony and to produce documents (pursuant to Section 43 of the English Arbitration Act 1996).
57. By submission dated February 11, 2001, the Respondent extended its previous submissions and requested permission to subpoena the already mentioned employee of the investigation agency under Section 43 of the English Arbitration Act, should the Tribunal decide to hold a hearing in England and repeated the request under Section 26 of the Swedish Arbitration Act and Section 1050 of the German Arbitration Act.
58. By submission dated February 12, 2001, the Respondent requested the Tribunal to issue an Order that the Claimant produce the following documents:
- (1) All pleadings, submissions and evidence submitted by ČNTS in the Czech Court proceedings between ČNTS and CET 21, including both, the Prague Regional Court and Prague Czech Supreme Court (i.e. Appeal Court) proceedings.
  - (2) All pleadings, submissions and evidence submitted by CME Media Enterprises B.V. in the ICC Arbitration proceedings between CME and Dr. Železný. The Respondent stated that the requested documents are relevant to the present Arbitration proceedings.
59. By submission dated February 27, 2001, the Respondent notified to the Tribunal that, after having received from the Czech Civil Court copies of the Court file in the proceedings between ČNTS and CET 21, the request for the production of the respective documents was withdrawn, whereas the Respondent maintained its request for all pleadings, submissions and evidence "submitted by CME Media Enterprises B.V." in the proceedings against Dr. Železný.
60. On the same day, the Respondent reconfirmed that it maintains its position that it should not have to pay for parallel arbitrations brought, in effect, by the same Claimant.

61. By submission dated February 2, 2001 and submissions thereafter, the Claimant rejected the Respondent's request for an Order and accused the Respondent of unlawful use of stolen confidential documents, which allegedly had been taken from CME's offices in London in breach of English law. The Claimant requested the Tribunal to issue an Order that the Respondent be directed to cease its review of stolen CME documents and confidential CME arbitration records that have been improperly provided to it by Dr. Železný or its representatives.
62. Further, the Claimant demanded that Respondent's request for the Orders related to further information be denied and that Respondent's request for permission to subpoena an employee of the investigation agency be rejected.
63. By submission dated February 26, 2001, the Claimant further made the argument that the Respondent's request for disclosure of documents was untimely, as the subject was already substantially discussed between the parties six months prior to the first hearing of these proceedings. The Claimant further took the position that the pleadings and documents of the CME v. Železný ICC proceedings are irrelevant for this Arbitration.

**(5) The Tribunal's Decision on Interim Remedies and Similar Orders**

64. On March 3, 2001 the Arbitral Tribunal decided not to take a decision on Interim Remedies or similar Orders at the present time. The Tribunal issued the following Order No. 8 on Interim Remedies or similar Orders:
  1. *The Tribunal rejects the Respondent's request that the Tribunal order the Claimant*
    - I. to disclose*
      - (a) Copies of all communications relating to the Media Council which have been provided by a source within the Media Council, including any reports of the Council's meetings;*
      - (b) copies of all communications from Kroll to CME, relating to (a) above; and*
      - (c) a copy of CME's instructions to Kroll.*
    - II. to identify the name of the person(s) who has/have provided any communications referred to in (a) above to Kroll and the "intermediary" between Kroll and the informant;*



- III. *to identify any other person(s) in Czech government departments who has/have provided, directly or indirectly, any communications of a similar nature to Kroll and/or CME.*

*The request by the Respondent for the arbitrators' consent under Section 26 of the Swedish Arbitration Act of 1999 and/or other national laws to have Mr. Morgan-Jones testify before the respective countries' civil courts is rejected.*

*The Claimant's request dated February 8, 2001 that the Respondent to be directed "to cease its review of stolen CME documents and confidential CME arbitration records that have been improperly provided to it by Dr. Železný or its representative" is rejected.*

*The Tribunal is of the opinion that any flow of information between the Media Council and the Claimant and/or its intermediaries and its usage as alleged by the Respondent, and any flow of information from the Claimant to the Respondent and its usage as alleged by the Claimant are not subject of these proceedings and the respective Claimant's and Respondent's requests should be addressed to the appropriate authorities / courts of the countries involved.*

2. *In respect to the Respondent's request regarding the disclosure by the Claimant of all pleadings, submissions and evidence submitted by CME Media Enterprises B.V. in the ICC Arbitration Proceedings between CME Media Enterprises B.V. and Dr. Železný, the Tribunal is not in a position to order the requested discovery, as the Parties of the ICC Arbitration Proceedings are different from the Parties to these proceedings. The Tribunal understands, however, that the ICC Award of the afore-mentioned proceedings was published on the internet on the CME pages. The Arbitral Tribunal, therefore, instructs the Claimant to submit as soon as possible to the Arbitral Tribunal and to the Respondent the ICC Award to the extent available to the public on the internet. The Tribunal assumes that the Respondent's demand for disclosure of the ICC proceeding will be sufficiently met by the disclosure of the ICC Award.*

#### **(6) Further Conduct of Proceedings**

65. The Claimant in accordance with Order No. 8 submitted to the Tribunal the ICC Award CME Media Enterprises B.V. vs. Dr. Železný
66. By submission dated March 14, 2001 and upon receipt of Order No. 8 dated March 6, 2001 the Respondent maintained its position in respect to the Court Order requested and declared:

*“The Czech Republic continues to participate in this Arbitration under protest and reserves all its rights, in particular its rights under Swedish Arbitration Act, Art. V (2) (b) of the New York Convention 1958 and principles of public policy generally.”*

67. On March 19, 2001 the Respondent declared that without prejudice to its position that it should not have to pay for two parallel arbitrations brought in effect, by the same Claimant; and without prejudice to its protest communicated in its fax of March 14, 2001 the Czech Republic is willing to pay the requested down payment for costs of the Stockholm hearing.
68. Thereinafter the Respondent complied with further Tribunal's request for down payments of costs equally with the Claimant.
69. On April 16, 2001 the Claimant as requested by the Chairman submitted a chronological list of the executives of ČNTS, CEDC/CME and CET 21 and a diagram showing the sequence of shareholdings in ČNTS, including the dates of the share transfer and enclosed a similar diagram showing the sequence of shareholdings in CET 21.

#### **(7) The Submission of Witness Statements**

70. In conjunction with their submissions, the parties have submitted to the Tribunal the following witness statements:

#### **(8) Declarations in Support of the Statement of Claim**

1. Declaration of Richard Bacek dated 22 September 2000 (without attachments)
2. Declaration of Laura DeBruce dated 22 September 2000
3. Declaration of Michel Delloye dated 20 September 2000
4. Declaration of Fred T. Klinkhammer dated 20 September 2000
5. Declaration of Martin Radvan dated 22 September 2000
6. Declaration of Jan Vavra dated 20 September 2000
7. Statement of Ing. Jiří Brož dated 5 December 2000
8. Supplemental Declaration of Laura DeBruce dated 15 December 2000
9. Declaration of Leonard M. Fertig dated 7 December 2000
10. Supplementary Declaration of Fred T. Klinkhammer dated 13 December 2000
11. Declaration of PhDr Marina Landová dated 15 December 2000
12. Supplemental Declaration of Martin Radvan dated 15 December 2000
13. Declaration of Nicholas G. Trollope dated 21 December 2000
14. Supplemental Declaration of Jan Vavra dated 15 December 2000
15. Declaration of Ing. Miroslav Pýcha dated 21 December 2000

16. Second Supplemental Declaration of Laura DeBruce dated 27 February 2001

### **(9) Statements in Support of the Statement of Defence**

1. Statement of Doc. Ing. Pavel Mertlík CSc dated 7 November 2000
2. Statement of Josef Josefík dated November 6 November 2000
3. Statement of RNDR. Josef Musil, PhDr. dated 6 November 2000
4. Statement of PhDr. Helena Halvíková dated 6 November 2000
5. Second Statement of Josef Josefík dated 28 February 2001
6. Statement of Mgr. Milan Jakobec dated 28 February 2001

### **(10) Documents and Authorities**

71. The parties attached to their submissions copies of some 300 documents comprising several thousand pages. They further attached binders comprising several thousand pages of authorities in support of their respective memorials.

### **(11) The Stockholm Hearing**

72. From Monday, April 23, 2001 to Wednesday, May 2, 2001 the hearing took place in Stockholm. At the beginning of the hearing, the parties' representatives submitted to the Tribunal the verbatim record of the examination of witnesses taken in London at the Lauder vs. Czech Republic UNCITRAL proceeding under US / Czech Republic BIT. At the Stockholm hearing the parties presented their case and the following witnesses were examined:

- Claimant's witnesses: Laura DeBruce  
Michel Delloye  
Fred T. Klinkhammer  
Martin Radvan  
Jan Vavra  
Leonard M. Fertig  
Marina Landová
- Respondent's witnesses: Josef Josefík  
Josef Musil  
Helena Havlíková

73. At the end of the hearing, the parties' representatives summarized orally their respective positions. The Tribunal in agreement with the parties declared the hearing closed (Art. 29 UNCITRAL Rules). The Claimant submitted to the Tribunal Claimant's post-hearing brief on May 25, 2001. The Respondent submitted its written Closing Submissions on the same day.

**D.**

**Position of the Claimant**

74. CME's claims arise out of the Czech Republic's treatment of its investments in the first private nation-wide commercial television station in the Czech Republic. CME maintains that the Czech Republic breached its obligations under the Treaty by actions and inactions of the Media Council which destroyed the Claimant's investment in the Czech Republic.

**I. The Claimant's Investment in the Czech Republic**

75. In 1992, the Czech National Council decided to issue a Licence for the first nation-wide commercial television station. The Licence was to be awarded through a tender process administered by the Czech Media Council which the Czech National Council had created in 1992 as a separate State agency, subject exclusively to the sovereignty of the Czech Republic, to be responsible for regulating the broadcasting industry and ensuring compliance with laws relating to radio and television broadcasting.
76. The Media Law required the Media Council to take into consideration the extent of Czech ownership and management when considering a Licence application from a company with foreign equity participation, but no provision in the Media Law expressly barred (or now bars) foreign parties from holding television licences.
77. CEDC, the Claimant's predecessor, pursued an application for the Licence.
78. Initially, CEDC and CET 21 pursued a joint application for a Licence, contemplating that they would act together to administer the Licence. On January 5, 1993, CEDC and the Czech investors in CET 21 executed an agreement providing that upon the award of a Licence to CET 21, CEDC would "provide financing needed . . . to establish[ ] a commercial television station in Prague through an equity investment in CET 21," in return for a 49 % ownership share in CET 21, with the Czech investors in CET 21 holding 14 % and the remaining equity reserved for further investors.

79. CET 21's Project Proposal, submitted to the Media Council as a centerpiece of the application, presented CEDC as a desirable "direct participant in CET 21's application for the Licence" on the basis that CEDC was "a quality foreign partner," which had "investment experience" in Central Europe, knew how to "advantageously combine[] a commercial . . . TV station with a programme of a higher standard, and with the participation of cultural foundations," offered "sensitive respect for local traditions and a well-qualified understanding of the needs of the Central European region," was financially supported by "prominent entrepreneurial personalities and groups (e.g. the Lauder group)," and offered valuable links to sources of programming. The minutes of a January 25, 1993 public hearing on the Licence application reflect the centrality of CEDC's role and the need for long-term foreign investments.
80. The Media Council publicly announced on January 31, 1993, that after public hearings and full deliberation concerning the twenty-six candidates who had submitted applications for a Licence, it had determined to issue the Licence to CET 21, with CEDC as "a direct participant of the Licence application." In its letter to CET 21 announcing its decision, the Media Council similarly noted that CEDC was "a direct party to the application," listing the proposal's "adequate financing with capital about whose origin and reliability there can be no doubt" as one of the main factors in its decision. Likewise, in a public statement on February 1, the Media Council's chairman, Mr. Daniel Korte, repeated this language and stressed that the choice of the successful Licence applicant had taken into account that "the project has proved sufficiently financially backed by the capital whose origin and reliability cannot be doubted."
81. In the face of intense political pressure, though, the Media Council decided that it would not permit foreign ownership of the Licence. This requirement created a significant practical difficulty because foreign capital was plainly needed to fund the development of the station. As CET 21 had explained in the Project Proposal it submitted to the Media Council, "[i]t would be a . . . pretense to say that the financial funds in terms of millions and billions [of Czech crowns] which must be invested in relatively short time [to establish the station] are available in the Czech Republic, and that CET 21 (as any other starting TV station) will do without foreign partners."

82. In close consultation with the Media Council, CEDC and the Czech investors in CET 21 sought to resolve this difficulty through the creation of ČNTS - an entity that would be jointly owned by CEDC (which would contribute the majority of the cash needed to fund the establishment of the station), CET 21 (as the party that would contribute the use of the Licence), and a Czech bank (as a third investor). Each contributor was to obtain an equity interest in ČNTS corresponding to the economic value of its contribution, and ČNTS was to establish and manage the television station. The Media Council participated actively in negotiating this solution that maintained domestic ownership of the Licence while providing for the obtaining of needed foreign capital from a desirable source.
83. The Media Council openly acknowledged, prior to this dispute, that it had played a central role in directing the formation of ČNTS, and that its motivation for doing so had arisen from its determination that the Licence not fall directly into the hands of a non-Czech investor. In a January 31, 1998 report to the Czech Parliament, for example, the Media Council explained its 1993 insistence on the ČNTS structure, and the reasons for that insistence, as follows:

The reason why this model came into existence [was] the Council's fears of a majority share of foreign capital in the licence-holder's Company.

. . .

When granting the Licence to the Company CET 21, for fear that a majority share of foreign capital in the licence-holder's Company might impact the independence of full-format broadcasts, the Council assumed a configuration that separates the investor from the licence-holder himself. That is how an agreement came into existence (upon a series of remarks from the Council) by which the Company ČNTS was established the majority owner of which is CEDC/CME.

84. The Media Council thus approved the arrangements between ČNTS and CET 21. It realized that direct foreign investment in television would be unacceptable. It, therefore, blessed a structure that gave the foreign investment the economic benefits of Licence ownership through carefully considered and negotiated contractual arrangements, in the formulation of which, leading to the approval it gave, it actively participated.

85. CEDC was entitled to rely and did rely on the Media Council's strong official assurances that ČNTS's role and economic position would be closely integrated with that of CET 21 (as the nominal licence-holder) in the formation, management, operation and broadcasting of the new commercial television station.

## II. The Role of ČNTS

86. On February 3 and 5, 1993, after CET 21 and CEDC had been informed of the award of the Licence but before the Licence was actually issued, they entered into a pair of nearly identical agreements describing their relationship and establishing the framework under which ČNTS would operate. Each of these agreements described CEDC as "a direct contractual participant within the terms and conditions of this Licence." The February 3 agreement, entitled "Overall Structure of a New Czech Commercial Television Entity," further stated:

1. CET 21 and CEDC will jointly create a new Czech company which will be *the only Commercial Company to create and run the TV station*. CET 21 and CEDC agree to allow the Commercial Company to have *exclusive use of the Licence* as long as CET 21 and CEDC have such a Licence.
2. CET 21 and CEDC confirm that *neither party has the authority to broadcast commercial television without the other*.

(Emphasis added)

87. The February 3 agreement further provided that "[a]ll operating personnel [of the station] will be employees of the Commercial Company." The agreement stated that within two months following the execution of the conditions to the Licence, CET 21 and CEDC would enter into a more complete agreement respecting the organization of the "Commercial Company" that ultimately became ČNTS. This agreement was submitted to the Media Council which requested changes. It became part of the official file of CET 21's application. The February 5 agreement, entitled "Basic Structure of a New Czech Commercial Television Entity," substantially identical, contained the changes.

88. After receiving the agreements setting out the terms of the ČNTS structure, the Media Council formally issued Broadcasting Licence No. 001/1993 (the "Licence") on February 9, 1993. The Licence documentation included the "Licence Certificate," the "Licence Decision" and the "Licence Conditions."
89. Each of these documents expressly linked CEDC and ČNTS to the Licence grant. The Licence Certificate required CET 21 to "ensure that the broadcasting is in accordance with the information stated in the application on the basis of which this Licence was issued." That "information" included the terms of the arrangements between CET 21 and CEDC that had been described to the Media Council and had been specified in the February 5 agreement submitted to the Media Council before the Licence was issued. That "information" also included the Project Proposal that described CET 21 and CEDC as "partners" in the project.
90. The Licence Decision observed once again the importance of CET 21's "contractual partner, the Company CEDC" to the Licence application process. In listing critical features of the winning applicant, the Media Council explained that the applicant had "demonstrated adequate financing with capital about whose origin and reliability there can be no doubt", and acknowledged with approval "the substantial involvement of foreign capital necessary to begin television station activities".
91. The Licence Conditions which were labelled "Appendix to Licence" and were made a part of the Licence through the Licence Certificate's requirement that the licensee "observe the conditions stated in the appendix to this Licence", provided a more specific presentation of the rules under which the Licence would operate. Condition 17 expressly required that the Licence be used in accordance with the arrangements between CET 21 and CEDC that had been described to the Media Council during the application process and recorded in the February 3 and 5 agreements. In relevant part, it provided:

The licence-holder agrees:

*"17/ that it will submit to the Council for its prior consent any changes in the legal entity that is the licence-holder,*



*capital structure of investors and provisions of the business agreement between the licence-holder and investors. Parties to the business agreement are the licence-holder, CEDC and Česká spořitelna, in the scope and under the conditions set by the business agreement which will be submitted to the Council within 90 days after the decision to issue the Licence takes legal effect; the business agreement will observe the provisions of the "agreement on the business agreement" between the licence-holder and CEDC [i.e. the February 3/5 agreements that had been submitted to the Council] which is an appendix to the Licence conditions. "*

*"18/ that CEDC, as a party to the business agreement specified in the Licence conditions, and other investors specified by the business agreement, will not in any way interfere in the programming of the television station, and, in particular, will not interfere with the editorial independence of newscasting employees. "*

92. With this language, the Media Council not only endorsed, but also made explicitly a part of its Licence grant, the basic contractual agreement between CEDC and CET 21, including the provisions that CET 21 would contribute the "exclusive use of the Licence" into ČNTS, that neither CET 21 nor CEDC would have "the authority to broadcast commercial television without the other," and that all business of the project would be transacted through ČNTS (which would employ all staff). Because the Licence Conditions expressly implicated the rights, obligations and interests of CEDC, and because CEDC was a "direct participant" in the application process, Mark Palmer, the president of CEDC, executed the Licence Conditions for CEDC.

### **III. The Memorandum of Association**

93. Over the next several months, CET 21 and CEDC negotiated a Memorandum of Association and Investment Agreement (the "MOA") to flesh out the February 3/5 agreements that the Media Council had incorporated into the Licence in Condition 17. The Media Council participated actively in this process, providing comments on drafts before the MOA was finalized to ensure that the MOA reflected the Media Council's views about how the ČNTS arrangement was to be structured. For example, on April 9, 1993, the Media Council wrote CET 21 to request (i) that CET 21 provide a final draft of the MOA for its approval by April 19, (ii) that "the final draft of the

contract proposal be in accord with the effective legal status” (making particular reference to “certain comments in the Appendix” containing the Licence Conditions), and (iii) that the parties amend certain provisions of the draft to conform with the requirements of Licence Condition 18. Condition 18 provided that CEDC will not interfere in the programming of the television station with the editorial independence of newscasting employees.

94. CET 21, CEDC and the Czech Savings Bank agreed upon the final terms of an MOA for ČNTS in April 1993 and submitted it to the Media Council for approval. The MOA provided that CEDC would contribute 75 % of ČNTS's capital and obtain a 66 % ownership interest in return, while the Czech Savings Bank would contribute 25 % of the capital and obtain a 22 % ownership interest. CET 21 contributed no cash, contributing instead “the right to use, benefit from, and maintain the Licence . . . on an unconditional, irrevocable and exclusive basis,” in return for a 12 % ownership interest. *Id.* at art. 1.4.1. Dr. Vladimír Železný, a shareholder of CET 21, who would eventually become its 60 % shareholder and one of its Executives, was appointed to serve as ČNTS's General Director.
95. Reflecting the parties' discussions with the Media Council, the MOA recognized that ČNTS would be the operating company for the new television station. Article 3.1 recited that ČNTS's business would include the “development and operation of a new, independent, private national television broadcasting station.” Paragraph D of the Preamble similarly confirmed that the station would be “managed” by ČNTS.
96. On April 21, 1993, the Media Council released a letter confirming that “in accordance with Article 17 of the Conditions to the Licence,” it had approved “the submitted version of the Business Agreement between” CET 21, CEDC and Czech Savings Bank at its April 20 meeting. CEDC and the other parties executed the MOA shortly afterward, on May 4, 1993. The Media Council confirmed its official approval of the MOA and all its provisions on May 12, 1993, when it issued a decision changing the wording of the Licence to add, among other amendments, a new sentence in Licence Condition 17 expressly stating that the MOA “is an integral part of the Licence terms.”

97. As a result of its actions, the Media Council gave the imprimatur of the State to CME's investment. The Media Council, established by law to "supervise[] the observance of legal regulations governing . . . television broadcasting" (i) approved the ČNTS arrangement, by requiring in the Licence Certificate that the licensee act in accordance with the facts set forth in the application, (ii) required as a Condition to the Licence that CET 21 and CEDC operate in accordance with the February 3/5 agreements, (iii) expressly approved the MOA, including the provision in which CET 21 contributed the exclusive use of the Licence, and (iv) amended the Licence Conditions to make the MOA an "integral part of the Licence."
98. The arrangement between ČNTS and CET 21 was thus known to and approved by the State organ responsible for administering television licences. No organ of the Czech Republic challenged it or asserted that it was illegal. Claimant's entire investment in ČNTS being based on this arrangement, it is legally entitled under the Treaty (and under Czech law) to rely on these approvals and to expect the Czech Republic to adhere to the legal arrangements that the Media Council had itself proposed and had formally and publicly endorsed.
99. The Media Council documents clearly reflect not only substantial Media Council involvement in the negotiation and finalization of the MOA's terms, but also the Media Council's adherence to its original approvals of the ČNTS arrangement until changing political winds prompted a reversal in 1996. In a 1994 opinion responding to a challenge that it had acted improperly in approving the ČNTS arrangement, for example, the Media Council publicly stated:

ČNTS is, by duly registered Memorandum of Association, authorized by the holder of the Licence to perform *all acts related to the development and operation of the NOVA TV television station*. Participation of CET 21 in the company consists of a non-financial contribution, i.e., *the financial valuation of the Licence*. The Licence as such has not been contributed to ČNTS and is separate from all other activities of ČNTS.

This is a standard business procedure which was duly discussed and approved by the licensing body, i.e., by the [Media] Council, and does not violate any effective legal regulations. [*The Media Council*] consulted with a

number of *leading legal experts*, both Czech and foreign [before approving the arrangement].

100. Similarly, in a report to Parliament for the period from February 1-September 30, 1996, the Media Council explained that it was fully aware of and accepted the ČNTS structure:

At the time when [the CET 21-ČNTS] arrangement was made, *there were no doubts about its legitimacy*; in regard to many related steps that were taken, *the Council, as it was then constituted and based on its experience at the time, took a position of consent*.

101. The Media Council's January 1998 Report to Parliament equally acknowledged that it had intended for ČNTS to be a co-participant with CET 21 in all TV NOVA broadcasting:

July 1993: ČNTS . . . gets registered in the Companies register. It[s] general director is V. Železný. As its subject of activity, ČNTS states "full-format television broadcasts." *Two Companies thus appear around one Licence; one that has obtained it, and another that is supposed to co-participate in implementing the broadcasts*. The majority partner of ČNTS is CEDC/CME. This model later appears elsewhere too . . . *and the Council considers it to be legal*, it raised legal doubt only later. . . .

Thus, next to the licence-holder's Company, directly linked to it, a new Company was established which was to co-participate in implementing the broadcasts.

*From the legal viewpoint, this construction did not and does not contradict any law*, but it created a basis for problems . . . .

(Emphasis supplied.)

102. Given the Media Council's discriminatory position as to foreign investment and ownership of the Licence, neither CEDC nor CET 21 intended that ČNTS would hold the actual Licence. All recognized that the Licence would have to be held nominally by a company owned by Czech nation-

als. The parties nevertheless envisioned and sought to structure a symbiotic relationship in which the actual operations of TV NOVA, and all of its economics, would be centered in ČNTS, with the contributing partners enjoying the benefit of the station's success in accordance with their equity interests in ČNTS. The documentary record demonstrates conclusively that the Media Council participated substantively in developing this arrangement, formally endorsed its legality, and gave Claimant every reason to conclude that it could commit funds to the project based on this arrangement without fear that the arrangement would later be forcibly dismantled by Media Council actions.

#### **IV. The Formation of TV NOVA**

103. Following the Media Council's approval of the ČNTS structure, CEDC provided capital to ČNTS for the formation and development of the new television station, TV NOVA. ČNTS registered in the Czech Companies Register in July 1993, indicating that one of its activities was "nation-wide television broadcasting," and in February 1994 ČNTS and CET 21 began broadcasting TV NOVA under the Licence.
104. TV NOVA quickly became the Czech Republic's most successful and profitable private television station, with audience shares consistently above 50 %. In contrast to the experiences of most start-up television operations, TV NOVA became profitable within a year after beginning operations, and grew quickly. By 1995, ČNTS's net income was approximately US \$ 23 million, on revenues of approximately US \$ 98 million. ČNTS's net income climbed to nearly US \$25 million, on revenues of approximately US \$109 million, in 1996, and would ultimately exceed US \$ 30 million on revenues of slightly under US \$ 109 million in the year before ČNTS was shut down and destroyed.
105. As provided by the MOA and contemplated in all of CEDC's dealings with the Media Council, ČNTS from the beginning performed all of the activities associated with operating and broadcasting TV NOVA. ČNTS acquired all programmes, or produced them in its TV NOVA studios and other facilities, and employed all the personnel needed to operate the station. Editorial decisions were made by CET 21 through Dr. Železný,

who became its 60 % shareholder and Executive while also serving as ČNTS's General Director. Pursuant to a June 2, 1994 agreement, ČNTS was authorized by CET 21 to enter into an agreement with Czech Radio-communications (České radiokomunikace) which would perform the technical tasks of transmitting TV NOVA's signal. All other operational, advertising and programming activities took place exclusively within ČNTS. ČNTS also gathered all revenues associated with the television station, using a portion of the revenues to pay all expenses of running TV NOVA and retaining the balance as profit and return on its members' cash and non-cash investments. CET 21, meanwhile, had no separate operations. Its offices consisted of two rooms in a different building, it held no assets other than the Licence, and its only employee was a secretary whose compensation was paid by ČNTS.

106. As ČNTS grew and became a prosperous investment, its Czech investors began seeking to realize the profits from their investments by selling their ownership interests in ČNTS. On July 17, 1996, CME purchased the 22 % interest in ČNTS held by the Czech Savings Bank, at the Bank's request, bringing the bank a profit of well over US \$ 30 million on an investment of slightly more than US \$2 million over the 38 months of its participation in ČNTS, and raising CME's ownership interest in ČNTS to 88 %. In December 1996, CME acceded to a request from CET 21's shareholders that it purchase a 5.2 % interest in ČNTS from CET 21, to accelerate a portion of their return on the investment's success. This transaction raised CME's interest in ČNTS to over 93 %. The shareholders of CET 21 then arranged to pool all but 1% of their remaining interests in ČNTS in a special purpose entity wholly owned by Dr. Železný. At Dr. Železný's insistence, CME purchased this entity (and the 5.8% interest in ČNTS that was its only asset) on August 11, 1997, for US \$28.5 million, thereby increasing its ownership interest in ČNTS to 99 %, while the local Czech investors retained only the remaining 1 %. As a result of these transactions, virtually the entirety of any gain or loss experienced by ČNTS belonged to CME.

## V. The Media Council's Reversal of Position

107. Three years after the Media Council mandated the creation of and gave express approval to the ČNTS structure, it abruptly reversed its position, repudiated the arrangement it had officially approved, and forced ČNTS to surrender the exclusive right to use the Licence that CET 21 had contributed in return for its equity interest. By a letter dated July 23, 1996, but not sent to ČNTS until August 30, 1996, the Media Council commenced administrative proceedings against ČNTS claiming that ČNTS was “operating television broadcasting without authorization.”
108. The Media Council founded its claim of unauthorized broadcasting on assertions that ČNTS had improperly arrogated power to itself by (i) participating in the “agreements” (and, particularly, the MOA) with CET 21, (ii) including “nation-wide television broadcasting” as one of its recited business activities in its Commercial Register entry, and (iii) entering into contracts with an authors’ organization and Czech Radiocommunications in its own name. The Media Council claimed that the Czech Academy Institute of State and Law (the “Academy”) had issued an opinion concluding that ČNTS was carrying out “unauthorized broadcasting” based on these three concerns, but the Media Council refused to provide that asserted opinion to ČNTS. The Media Council also indicated that the Czech police had launched a criminal investigation “for suspicion of committing the crime of ‘unauthorized conduct of business’ and ‘distorting facts in economic and business records,’” that turned on the same determination as was presented in the administrative proceedings.
109. The Media Council offered no reason why the activities of ČNTS that it had approved and had permitted to proceed for several years had suddenly become objectionable. While the Czech Parliament had amended the Media Law as of January 1, 1996, Act No. 301/1995 Coll., the Media Council identified no provision of the new law that could serve as justification for its reversal of position under Czech law.
110. The central motivating concern behind the Media Council’s action appears to have been that ČNTS was simply becoming too prosperous, and that Czech political circles looked with disfavour on permitting a company overwhelmingly owned by foreigners to obtain such substantial

wealth from an investment in such a conspicuous Czech company using a broadcast Licence allocated by the State.

111. ČNTS vigorously defended itself against the Media Council's proceedings, contending that it had been operating as agreed with the Media Council in 1993 and had violated no law. As part of this defence, ČNTS contacted the Academy to inquire about the opinion that the Media Council had indicated was a foundation for its proceedings. ČNTS was told that the Academy had not released an opinion at all, and that the Media Council had merely been inaccurately characterizing as an Academy opinion an expression of views by a single individual, Dr. Jan Bárta. In expressing these views, moreover, Dr. Bárta was responding to a hypothetical question put to him by the Media Council that took no account of the history or specific nature of the CET 21-ČNTS arrangements and was worded in conclusory terms calculated to solicit a response unfavourable to ČNTS.
  
112. On August 13, 1996 the Academy released its only real opinion on the issues presented by the administrative proceeding which concluded that ČNTS's activities did not violate the Media Law. In direct rebuttal to the Media Council's contention that ČNTS's activities constituted unauthorized broadcasting based on the Licence that had been granted to CET 21 rather than ČNTS, the Academy Opinion asserted that the Media Law permitted a "broadcasting operator" as that term is used in the Media Law (such as CET 21) to use another party (such as ČNTS) to carry out broadcasting, stating:

The realization of broadcasting, through third parties is . . . not excluded by the [Media Law] . . . . This means that also somebody else than the operator may ensure broadcasting by conclusion of contracts with third parties . . . .

The relationship of [ČNTS] with the licence-holder is in our opinion just such ensuring of broadcasting through third persons.

113. While the Academy explained that it was not authorized "to assess opinions prepared by [legal] experts" (id. at 2), it made clear that Dr. Bárta's opinion was not an expression of the Academy's views, was directed entirely to the Media Council's irrelevant hypothetical question of what rules



should apply if a licence failed to broadcast and an unlicensed party did broadcast, and unwarrantedly failed to address whether a licensee could arrange to have a third party carry out the operational mechanics of broadcasting so long as the operating company did not interfere with the licensee's editorial functions (as had always been ČNTS's practice). ČNTS submitted the Academy Opinion to the Media Council, but that submission did not alter the Media Council's position or even prompt the Media Council to release the opinion by Dr. Bárta on which it had claimed to rely.

## **VI. The Council Compels ČNTS to Alter the MOA**

114. In opposing the Media Council's proceedings, ČNTS had to weigh the risk that if it failed to dissuade the Media Council, ČNTS could face the fines authorized by Section 20 (5) of the Media Law, plus criminal charges against its statutory representatives and Executives, plus revocation of the Licence. Claimant's representatives recognized that while such actions by the Media Council or other Czech authorities might be subject to court challenges, TV NOVA could be destroyed by any such actions even before any such challenge could be resolved. Moreover, there was the risk, acute in light of the political pressures in the Czech Republic arising from the resentment of ČNTS's profitability, that the Media Council's reversal of position, although violative of the Treaty, might be found by a Czech court to satisfy Czech law.
  
115. In these circumstances, ČNTS had no choice but to make changes to the MOA to obtain the termination of the administrative proceedings. CME and ČNTS capitulated to the Media Council because they quite reasonably believed they could not win if they opposed the Media Council. Thus, its hand forced by the Media Council, CME agreed to amend Article 1.4.1 of the ČNTS MOA, in which CET 21 had contributed the "right to use" the Licence on an exclusive basis, to provide that CET 21 contributed to ČNTS only the "know-how" connected with the Licence, albeit still on an exclusive basis. ČNTS also amended the description of its business activities in the Czech Commercial Register to delete the reference to "nation-wide broadcasting," again yielding to the Media Council's insistence that ČNTS could not be involved in broadcasting because that was the exclusive province of the licensee.

116. As part of the package of contractual changes coerced by the Media Council, on May 21, 1997, ČNTS and CET 21 also entered into a new Agreement on Co-operation in Ensuring Service for Television Broadcasting (the “Co-operation Agreement”, hereinafter also the “Service Agreement”). This agreement expressly identified CET 21 as the licence-holder and the “television broadcasting operator” of TV NOVA. It further provided that ČNTS had the “rights and obligations . . . to ensure, according to this contract, service for the television broadcasting that is conducted on the basis of the Licence issued to CET 21, and that ČNTS is authorized to keep an agreed income from this activity.” An annex identified the “agreed income” as advertising and related revenues, less CZK 100,000 per month paid to CET 21. The Co-operation Agreement further addressed the Media Council’s concerns by stating that ČNTS would enter contracts with the Czech Radiocommunications and authors’ organizations on “behalf of CET 21 as the licence-holder and operator of television broadcasting” while providing that ČNTS would continue to pay all the costs of those contracts. Once again, the Media Council reviewed and approved this agreement which was a direct response to the administrative proceedings.
  
117. The Media Council dismissed the administrative proceeding against ČNTS in September 1997. Its order of dismissal expressly declared that it had obtained the concessions it required from ČNTS. In a September 1999 opinion to the Czech Parliament, the Media Council made clear that the amendment of the MOA had been a primary condition for the Media Council’s termination of the proceedings, stating that through the 1996 proceedings “the Council made the licence-holder to remedy certain legal faults in the Memorandum of Association.” In connection with the resolution of the administrative proceedings, the Media Council cancelled Condition 17 of the Licence.
  
118. The agreements for the creation of ČNTS that the Media Council originally approved had not characterized ČNTS as a mere provider of “services,” but rather as the manager of the station and as a co-participant in broadcasting with exclusive rights to use the Licence. Nonetheless, at the time when ČNTS made the concessions compelled by the Media Council, Claimant’s representatives were hopeful, and expected, that the

resulting amendments to the MOA would not alter ČNTS's position as the exclusive manager of TV NOVA and as the economic and operational center-piece of the enterprise. They did not yet know that the changes that the Media Council had lawlessly extorted would become the basis for the destruction of ČNTS.

## **VII. The Destruction of Claimant's Investment**

119. The consequences to the Claimant of the Media Council's actions in 1996 and 1997 began to become apparent in 1998. At that time, CET 21 and Dr. Železný - having virtually no remaining economic interest in ČNTS - began taking steps to dismantle the exclusive arrangement between ČNTS and CET 21 that had been the foundation for CEDC's original investment in TV NOVA and had been in place since TV NOVA began operations. Those steps were made possible by the Media Council's prior actions, and were carried out with the Media Council's connivance and active assistance.
120. In mid-1998 and continuing thereafter, Dr. Železný began to demand with increasing frequency and intensity that CME agree to fundamental changes in the arrangement between ČNTS and CET 21. While the specific changes Dr. Železný was demanding varied over time, all would have required CME to make substantial economic and contractual concessions to its great financial detriment. Various proposals would have required, for example, that CME agree to delete all references to exclusivity in agreements between CET 21 and ČNTS and permit CET 21 to obtain business from other providers, that CME pay a portion of TV NOVA's revenues to CET 21, and that CME agree to release all obligations from CET 21 to ČNTS at the end of the current Licence period, while surrendering its existing rights to participate in any Licence renewal.
121. The Media Council's actions in 1996, along with the threat of future Media Council action against ČNTS, formed Dr. Železný's primary foundation for these demands. In discussions with Michel Delloye (then CME's President and Chief Executive Officer) and later with Mr. Delloye's successor, Fred Klinkhammer, Dr. Železný repeatedly insisted that the changes he demanded were needed because the Media Council's 1996

administrative proceedings and the resulting amendments to ČNTS's MOA had ended any contractual obligation of exclusivity in the relationship between ČNTS and CET 21. He also contended that the Media Council strongly disfavoured exclusivity, was continuing and would continue to pressure ČNTS to surrender all exclusive arrangements with CET 21, and would take further action if CME refused to make these changes. In late 1998, Dr. Železný caused CET 21, without CME's consent, to begin acquiring programming through sources other than ČNTS.

122. The agreement between the parties that ČNTS would manage TV NOVA and gather all revenues, and the commitment that CET 21 would use its best efforts to obtain the renewal of the Licence in 2005 and to continue the relationship between CET 21 and ČNTS, had been the predicates for CME's investment. Therefore, CME could not let ČNTS be bullied by Dr. Železný into accepting an arrangement according to which CET 21 would elect whether to use ČNTS or some other service provider for each particular line of activity, and pay ČNTS only for the work CET 21 might ask it to perform. Likewise, it could not agree to a termination of the relationship between ČNTS and CET 21 at the end of the current Licence period which Dr. Železný was insisting on. Each of these changes would have had an enormously adverse effect on the value of CME's investment.
123. Over time, Dr. Železný began to threaten that CET 21 would sever all relations with ČNTS if CME did not capitulate to his wishes, relying again on the Media Council's 1996 actions terminating CET 21's contribution to ČNTS of the exclusive "right to use" the Licence and on the continuing pressure assertedly being exerted by the Media Council to alter the relationship. At a February 24, 1999 ČNTS board meeting, for instance, Dr. Železný demanded that CME agree to pay CET 21 4 % of TV NOVA's gross revenues and replace the Co-operation Agreement with a collection of new agreements directed to separate areas of service being provided by ČNTS. These proposed new agreements would have permitted CET 21 to acquire services from sources other than ČNTS and to pay ČNTS only for particular services acquired from ČNTS, would have eliminated ČNTS's right to collect and keep all revenues from advertising, and would have provided that CET 21's relationship with ČNTS would extend only until the end of the current Licence period on Janu-

ary 30, 2005. These changes were needed, Dr. Železný asserted, because the Media Council continued to disapprove of any exclusive arrangement between CET 21 and ČNTS and would shortly issue a statement that the arrangement was “not correct.” Dr. Železný threatened that if CME did not agree to this “ultimatum,” CET 21 would hire another company to sell TV NOVA’s advertising time and shift advertising revenues away from ČNTS - a step that Dr. Železný asserted CET 21 was free to take because the changes to the MOA mandated by the Media Council in 1996 had left CET 21 with no obligation of exclusivity toward ČNTS.

124. The arrangements demanded by Dr. Železný in 1998 and 1999, based on the Media Council’s past actions and threatened future actions, were a far cry from the original arrangement, in which (in the Media Council’s words) “two companies” would “appear around one Licence,” with ČNTS, as a “co-particip[ant] in implementing the broadcasts, “performing“ all acts relat[ing] to the development and operation of the NOVA TV” in an exclusive bond with CET 21 that was to last as long as CET 21 held the Licence.
125. In fulfilment of the threats by Dr. Železný, in early 1999 the Media Council went beyond its 1996 reversal of position leading to the forced amendment of the MOA. Now it provided active assistance to Dr. Železný in his campaign to eliminate ČNTS’S exclusive position respecting CET 21. On March 3, 1999, a few days after threatening CME that the Media Council would issue a letter supporting his position, Dr. Železný surreptitiously wrote the Media Council to solicit a declaration from it that exclusive relations between the licensee and service provider were legally impermissible, particularly as a result of the Media Council’s 1996 action “withdrawing the use of the Licence from a service organization [ČNTS] and taking it back for the licensed holder”. Dr. Železný’s letter asked the Media Council to confirm in writing that:

Relations between the operator of broadcasting and its service organizations must be established on a nonexclusive basis, because exclusive relations between the licence-holder and the service organization may encourage the transfer of some functions and rights that are dependent on the Licence and that are not transferable by law.

126. Dr. Železný further sought confirmation that “CET 21 s.r.o. will act, function, and proceed as an operator, and therefore, it has to carry out relevant managerial, administrative and accounting tasks, and must build up its own company structure” - an express request for a mandate that ČNTS should no longer perform the managerial functions it was created to perform. He additionally sought a declaration that revenues from advertisements “must be revenues of CET 21,” although they had always been collected and, after payment of expenses, retained exclusively by ČNTS.
127. Dr. Železný did not hide his motives for seeking these confirmations in the form of a Media Council declaration. He told the Media Council that “[w]e would like to use this opinion for discussions with our contractual partners, without disclosing other internal matters of our company.” Brazenly, he explained that he wished to use the Media Council’s declaration to restructure the arrangement with ČNTS in critical ways, including not only by “build[ing]-up” CET 21 to perform management functions previously performed by ČNTS and by having CET 21 rather than ČNTS collect all advertising revenues, but also by replacing existing contracts with ČNTS with new short-term contracts that would permit the use of new service providers other than ČNTS and would terminate all obligations to ČNTS upon any Licence renewal.
128. Instead of refusing to make the proclamations Dr. Železný had proposed on the basis that they were flatly at odds with entitlements for ČNTS that the Media Council had expressly approved, the Media Council sent Dr. Železný a letter on March 15, 1999, parroting nearly verbatim from his request the language respecting exclusivity:

Business relations between the operator of broadcasting and service organizations are built on a nonexclusive basis. Exclusive relations between the operator and the service organization may result in de facto transfer of some functions and rights pertaining to the operator of broadcasting and, in effect, a transfer of the Licence.

129. The Media Council also stated that CET 21 “operates, functions and acts as an operator, *i.e.*, carries out relevant administrative and accounting tasks,” and that all advertising revenues must be treated as revenues of CET 21. In issuing this letter, the Media Council did not disclose that it

was adopting the language and the analysis Dr. Železný had proposed, or that it had received a letter from Dr. Železný asking it to express these views.

130. The Media Council stated in its March 15 letter that the fulfilment of these so-called “requirements” had been the “precondition” for its termination of the 1996 administrative proceedings against ČNTS, and that it believed these requirements had been “confirmed by changes in the Memorandum of Association.” The positions set forth in the letter, like the 1996 administrative proceedings, were wholly at odds with the Media Council’s 1993 approval of the MOA which gave ČNTS the exclusive right to use the Licence and established ČNTS as the manager of TV NOVA, and on the basis of which approval ČNTS had acted for years as the exclusive source of managerial, administrative and other business activity for TV NOVA. The issuance of the letter was also beyond the scope of the Media Council’s authority under the Media Council Act which authorizes the Media Council only to adjudicate rights and obligations in the context of administrative proceedings - not to issue *ex parte* declarations in support of one party to a dispute.
  
131. Dr. Železný used the Media Council’s letter as conclusive proof that the existing exclusive arrangement between ČNTS and CET 21 had to be changed. Based on the letter, over the succeeding weeks he continued to take steps to destroy that exclusive arrangement. On April 19, 1999, CME concluded that given Dr. Železný’s lack of loyalty - indeed, given his outright hostility to CME’s essential interests and those of ČNTS - it had no alternative but to recall Dr. Železný from his position as General Director of ČNTS. Dr. Železný responded by publicly pursuing the development of entities whose mission was to replace ČNTS in the performance of the activities necessary to operate TV NOVA. Finally, on August 5, 1999, three and a half months after his termination, Dr. Železný caused CET 21 to sever its dealings with ČNTS altogether, and to begin broadcasting TV NOVA using the services of new companies under his direction. Since that date, ČNTS has performed no services for CET 21 and has generated no revenues. It has been forced to lay off nearly all of its workforce. It has essentially gone out of business.

132. The pivotal role that the Media Council played in bringing about this State of affairs is apparent from CET 21's August 16, 1999 letter to CME's shareholders. In it, CET 21 again pointed to the Media Council's actions in 1996 and 1999 as the basis for the August 5 termination of its dealings with ČNTS, echoing many of the statements in the Media Council's January 1998 report to the Czech Parliament. CET 21 recited, for instance, that the "partnership structure" that the Media Council approved in 1993 had been "consistently criticized" by "legislati[ve], regulatory and State bodies of the Czech Republic" in succeeding years, on the basis that it provided "excessive powers to foreign investors." These criticisms, CET 21 alleged, combined with the "serious political and social problems" caused by the perception of CME's "extraordinarily high revenues," were the forces that had prompted the Media Council to open the 1996 administrative proceedings against ČNTS and demand that ČNTS amend its MOA. CET 21 also asserted that it was not required to maintain the exclusive relationship with ČNTS, because the "exclusive link" between the two companies had been "terminated" with the 1996 amendment of the MOA. CET 21 additionally referred to the Media Council's March 15, 1999 letter as proof that the Media Council would not tolerate an exclusive arrangement, not only because of the Media Council's view of the Media Law, but also on the ground of CME's focus "on its immediate short-term profit."

### **VIII. The Media Council's Failure to Fulfil its Obligation to Protect Claimant's Investment**

133. As the authority charged with ensuring compliance with the Czech Republic's television broadcasting laws, the Media Council had both the power and the obligation under Czech law to remedy CET 21's unlawful actions to sever its exclusive relationship with ČNTS. The Media Law requires the Media Council to impose an appropriate penalty if it determines that a licence-holder has "violat[ed] the duties specified by this Act or the conditions of the granted Licence." The "duties specified" by the Media Law include an obligation to obtain the Council's advance approval for any "change concerning data stated in an application" for a Licence. *Id.* at §§14(1), 20(4)(g) (requiring a fine for any breach of this obligation). The Media Law further authorizes the Media Council to revoke



a Licence if, among other things, the licence-holder “seriously violates the conditions given by a decision to grant a Licence” or the “duties set by this Act or other legal regulations.” *Id.* at § 15 (2) (a).

134. CET 21’s actions were in direct violation of the Licence which explicitly required CET 21 to broadcast in accordance with the premises described in its Licence application, and were in violation of the undertakings by CET 21 that the Media Council had expressly identified as a basis for issuance of the Licence in Condition 17. The statement of facts submitted with the Licence application included an explanation of the proposed “partnership” with CEDC in the Project Proposal. The same facts as to the arrangement between CET 21 and CEDC were addressed in discussion during oral hearings before the Media Council. The statement in the original version of Condition 17, that the February 3/5, 1993 agreements were attached as an appendix to the original Licence, makes clear that the agreement between CET 21 and CEDC was part of the set of critical “facts” on which the Media Council based its Licence grant. After CET 21 repudiated its exclusive relationship with ČNTS, it was no longer broadcasting through TV NOVA in compliance with the facts set forth in its application for the Licence. The Media Council consequently could and should have acted under the Media Law - even apart from its obligations under the Treaty - and forced CET 21 into compliance with its obligations under the threat of the revocation of the Licence.
135. However, the Media Council has repeatedly refused to take such action, and other organs of the Czech Republic have equally refused to intervene, despite the pivotal role that the Media Council played in bringing about the loss of ČNTS’s exclusive right to use the Licence. Since June 1999, ČNTS and CME have repeatedly asked the Media Council and other Czech bodies to redress these breaches of the Licence, the Media Law and the Treaty:
  - In a June 24, 1999 letter to the Media Council, ČNTS identified the Media Council’s approval of the ČNTS arrangement as the basis for the issuance of the Licence, and asked the Media Council to intervene against the unlawful actions by Dr. Železný and CET 21 to repudiate that arrangement. ČNTS followed this request with a letter specifically pointing out that ČNTS’s continued participation in CET 21’s broadcasting was a requirement of the Licence.

- On August 2, 1999, ČNTS and CME wrote to the Permanent Committee of the House of Representatives of the Czech Parliament (“Parliamentary Media Committee”) challenging the Media Council’s policy of passivity in respect to Dr. Železný’s actions and asking that the Media Council (which is answerable to Parliament) be directed to take action. This letter was accompanied by a detailed factual summary with supporting documentation.
  - On August 6, 1999, the day after Dr. Železný caused CET 21 to terminate all dealings between CET 21 and ČNTS, ČNTS asked the Media Council to commence Licence revocation proceedings against CET 21 “due to its . . . material breach of the conditions arising out of the decision granting the Licence, of the obligations stipulated by the [Media Law] and obligations stipulated by other above-stated legal acts.”
  - On August 13, 1999, ČNTS again asked the Media Council to address CET 21’s breaches of the conditions to the Licence and the Media Law, including the failure “to perform the broadcasting in accordance with the facts which it stipulated in the application.”
136. In response to these repeated requests for action, the Media Council publicly characterized the actions of CET 21 and Dr. Železný as mere manoeuvres in a commercial dispute that should be resolved by the private parties, and not by State action. With its July 26, 1999 letter to ČNTS, the Media Council enclosed an excerpt from its most recent report to the Parliamentary Media Committee, in which it stated that the dispute between CME and CET 21 was of a “commercial nature,” in which the Media Council had “no legal reason or right to interfere.” The Media Council has continued to adhere to this position in subsequent public statements. Thus, the Media Council failed to take responsibility for the role it had played in igniting the dispute, ignored its own regulatory obligations to address the resulting violations of the Licence and the law, and has refused to fulfil its obligation, binding on all organs of the Czech Republic, to comply with the Treaty.

## **IX. The Czech Republic’s Additional Continuing Violations of the Treaty**

137. Since this arbitration was filed, the Czech Republic has continued to breach its obligations to provide Claimant’s investment full security and protection, and has continued to take actions (or has refused to act) in ways that, at Claimant’s expense, improperly favour the Czech investors in CET 21. For example, the Media Council has affirmatively assisted

Dr. Železný in evading the effectiveness of orders of an ICC arbitral tribunal. On November 10, 1999, CME obtained an order of interim measures in an ICC arbitration initiated against Dr. Železný, directing him to use his control over CET 21 as its Executive and majority shareholder to restore the partnership between CET 21 and ČNTS to its prior position of economic exclusivity. Dr. Železný refused to comply with this order.

138. ČNTS gave the Media Council a copy of the ICC tribunal's order. Nevertheless, the Media Council approved, on December 21, 1999, a plan by which Dr. Železný, in a sham transaction, transformed his majority shareholding in CET 21 into a minority shareholding, so as to be able to foil the ICC tribunal's order by asserting that he could no longer exercise a 60 % shareholder's power over CET 21. The sham was apparent: Close associates of Dr. Železný agreed to contribute only CZK 4.8 million (less than US \$ 150,000) to the capital of CET 21, paid nothing to Dr. Železný, and were issued large nominal interests in CET 21 designed to dilute Dr. Železný's interest to approximately 12 %. The Media Council had full knowledge of the ICC tribunal's order, and ČNTS explained the sham to the Media Council in a letter dated November 18, 1999. CET 21 was required to obtain the Media Council's approval for the transaction. The Media Council approved this recapitalization. The Media Council's approval brought Dr. Železný the goal he had sought: In an April 17, 2000 ruling, the ICC tribunal amended its order by withdrawing the directive that Dr. Železný use his control over CET 21 to restore ČNTS'S exclusivity, stating that Dr. Železný no longer possessed the majority control over CET 21 that he needed to comply with the order.
139. In addition to helping Dr. Železný avoid his obligations to the foreign investors in ČNTS, the Czech Republic has disregarded criminal wrongdoing by Dr. Železný directed against CME's investment. On October 14, 1999, ČNTS filed a criminal complaint against Dr. Železný with the Prague State Attorney's Office. To date, neither the Czech police nor the City or State Attorney's Office has taken any action with respect to ČNTS's complaint.

## **X. Other Legal Actions by CME or ČNTS Apart from this Arbitration**

140. Several actions have been brought in Czech court by both ČNTS and CET 21. On May 4, 2000, the Prague Regional Commercial Court held in an action initiated by ČNTS that CET 21 was obligated under the 1997 Co-operation Agreement to procure all services for the operation of TV NOVA exclusively through ČNTS.
141. CET 21 has refused to comply with this decision. Despite a request by ČNTS, the Media Council has refused to take any action based on the Court's decision.
142. CME's ICC arbitration against Dr. Železný alleges that he personally breached the August 11, 1997 Share Purchase Agreement pursuant to which CME acquired a 5.8% interest in ČNTS held by an entity that Dr. Železný owned. On February 9, 2001 the ICC International Court of Arbitration rendered the Award ordering Dr. Železný to pay US \$23.35 million to CME Media against the return of the NOVA Consulting shares.
143. Ronald S. Lauder, the ultimate controlling shareholder of CME, has himself brought an *ad hoc* arbitration against the Czech Republic pursuant to the bilateral investment treaty in force between the United States and the Czech Republic (the "US Treaty"). The factual predicate of the claims in that proceeding are virtually identical to the factual predicate of this action. An award in favour of Mr. Lauder restoring ČNTS to the exclusive position it held before Respondent's breaches and providing him damages for the losses he has suffered as a result of those breaches could be of substantial assistance to CME and reduce the damage suffered by CME as a result of Respondent's breaches. Such an award would not, however, make CME itself whole.
144. Claimant, ČNTS and Mr. Lauder have properly taken multiple measures to seek to protect their interests and recover for the harm they have suffered in this matter. The existence of other claims neither erases Respondent's egregious violations of binding international obligations nor excuses Respondent from its obligation to remedy those breaches and their proximate results.

**E.**

**Claimant's Argument**

**I. CME's Entitlement to Assert a Claim under the Treaty**

145. As a "legal person[] constituted under the law" of The Netherlands, CME is an investor subject to the protections of the Treaty. Exh. CI at art. I(b). CME directly holds a 99 % ownership interest in ČNTS.
146. The Treaty protects "investments" in the Czech Republic that are made by Dutch investors. The Treaty defines "investment" broadly, to include "every kind of asset." Treaty at art. 1(a). Examples of protected investments enumerated in the Treaty include "movable and immovable property . . . rights," "shares . . . and other kinds of interests in companies and joint ventures, as well as rights derived therefrom," "title to . . . assets and to any performance having an economic value" and "intellectual property, also including technical processes, goodwill and know-how." Id.
147. CME's ownership interest in ČNTS, and all that CME has directly or indirectly invested to obtain that ownership interest and cause it to grow, plainly constitutes an investment in the Czech Republic within the meaning of the Treaty. The investment assets of CME in the Czech Republic also plainly include ČNTS's tangible and intangible property - including its buildings, studio equipment, and intellectual property rights, such as its rights to air licensed programmes - and CME's and ČNTS's legal interest in maintaining the exclusive business arrangement between ČNTS and CET 21, all of which CME owns either directly or indirectly by virtue of its 99 % ownership interest in ČNTS.

**II. The Czech Republic's Obligations under the Treaty**

148. The Treaty imposes five central obligations on the Czech Republic: (i) not to deprive investors of their investments, directly or indirectly, if such deprivation is unlawful or without compensation; (ii) to treat investments fairly and equitably; (iii) not to impair the enjoyment of investments by unreasonable or discriminatory measures; (iv) to provide investments full security and protection; and (v) to ensure treatment of investments that complies with the standards of international law.

## 1. The Obligation Not to Deprive Investors of Their Investments

149. Article 5 of the Treaty provides that “[n]either Contracting Party shall take any measures depriving, directly or indirectly, investors of the other Contracting Party of their investments,” unless the deprivation is “taken in the public interest and under due process of law,” is carried out non-discriminatorily, and is accompanied by just compensation.
150. The Treaty’s provision regarding “deprivation” tracks the broadest expropriation provisions in bilateral investment treaties, specifically, and in international law, generally. A “deprivation” thus occurs under the Treaty whenever a State takes steps “that effectively neutralize the benefit of the property for the foreign owner.” Such expropriations may be deemed to have occurred regardless of whether the State “takes” or transfers legal title to the investment. It is also immaterial whether the State itself (rather than local investors or other third parties) economically benefits from its actions. These rules arise under the well-established principle that State interference with an investor’s use of property should be deemed an actionable “deprivation” regardless of the form that the interference takes.
151. The Treaty avoids any narrow definition of expropriation in part by avoiding the use of that word altogether. The Treaty focuses on the interference in the investor’s ownership, rather than any transfer of the investment to the State, by prohibiting “deprivations” rather than “takings.” Article 5 further expressly adopts the international rule against unlawful indirect expropriations (measures may not be taken “depriving, directly or indirectly,” investors of their investments).
152. A deprivation effected by coercing an investor’s agreement to changes in its investment’s status violates the Treaty in the same measure as a direct taking. Attempts by State defendants to use “consent” obtained from an investor on pain of administrative sanction to defend State conduct have a long pedigree in expropriation cases. States often “take the circuitous route of expropriation by consent,” either due to a “recognition of the existence of an international [prohibition against expropriation] or out of a practical desire not to advertise their defiance of it.”

153. The Czech Republic's actions in this case - threatening destruction of CME's investment through regulatory proceedings once the foreign investor's profits appeared too large - fall within this recognizable pattern:
154. The "expropriation by consent" that the Czech Republic extorted from ČNTS through its administrative proceedings is no more permissible under international law than the outright appropriation of an investment.

## **2. The Obligation of Fair and Equitable Treatment**

155. The Treaty further provides that investments are to be ensured "fair and equitable treatment." Treaty at art. 3 (I). The Treaty's Preamble underscores the importance of this obligation, acknowledging that "fair and equitable treatment" of investments plays a major role in realizing the Treaty's goal of encouraging foreign investment.
156. The broad concept of fair and equitable treatment imposes obligations beyond customary international requirements of good faith treatment. The Treaty makes this plain by separating the requirement of "fair and equitable treatment" in article 3(1) from the obligation to adhere to "obligations under international law" in article 3(5). The obligation of fair and equitable treatment is a specific provision commonly at the heart of investment treaties that may prohibit actions - including State administrative actions - that would otherwise be legal under both domestic and international law.
157. Whether conduct is fair and equitable depends on the factual context of the State's actions, including factors such as the undertakings made to the investor and the actions the investor took in reliance on those undertakings. This requirement can thus prohibit conduct that might be permissible in some circumstances but appears unfair and inequitable in the context of a particular dispute.

## **3. The Obligation Not to Engage in Unreasonable and Discriminatory Treatment**

158. The Treaty similarly provides that a State shall not "impair, by unreasonable or discriminatory measures, the operation, management, mainte-

nance, use, enjoyment or disposal” of investments. Treaty at art. 3 (1). As with the fair and equitable standard, the determination of reasonableness is in its essence a matter for the arbitrator’s judgment. That judgment must be exercised within the context of asking what the parties to bilateral investment treaties should jointly anticipate, in advance of a challenged action, to be appropriate behaviour in light of the goals of the Treaty.

#### **4. The Obligation of Full Security and Protection**

159. The Treaty further requires that, “[m]ore particularly, each Contracting Party shall accord to such investments full security and protection.” Treaty at art. 3 (2). Under this provision, each State is required to take all steps necessary to protect investments, regardless of whether its domestic law requires or provides mechanisms for it to do so, and regardless of whether the threat to the investment arises from the State’s own actions or from the actions of private individuals or others.
160. The provision imposes an *obligation of vigilance* under which the State must take all measures necessary to ensure the full enjoyment of protection and security of the foreign investment. The State may not invoke its own legislation to detract from any such obligation.
161. The Treaty stresses the primacy of its “full security and protection” standard over domestic limitations by making clear that the more favourable of domestic or most favoured nation protections is a necessary, but not of itself sufficient, component of what must be accorded to investors of the other Contracting Party. Exh. CI at art. 3 (2).

#### **5. The Obligation of Treatment in Accordance with Standards of International Law**

162. The Treaty contains a broad provision requiring the Contracting Parties to treat investments at least as well as required by “obligations under international law existing at present or established hereafter between the Contracting Parties . . . whether general or specific.” Treaty at art. 3 (5). In addition to all obligations under treaties or otherwise, general principles of international law require host States to provide certain minimum protections to international investments.



### **III. The Czech Republic Has Violated Its Treaty Obligations**

#### **1. The Czech Republic Is Responsible for the Media Council's Conduct**

163. The Media Council is an official organ of the Czech Republic established as an administrative body by the Media Council Act. The Czech Republic is responsible under the Treaty for the Media Council's conduct, based on the well-established principle that a State is responsible for the wrongful acts of its instrumentalities or agents.
164. A State bears international responsibility for the actions of its instrumentalities or agents even if the conduct at issue was beyond the agent's authority under domestic law.
165. The Media Council's official endorsement of the MOA and related agreements which led to Claimant's initial investment thus gave Claimant legally enforceable rights under the Treaty irrespective of whether the endorsement was valid under Czech law (as it was) or whether the Media Council's subsequent reversal of position and failure to intervene to protect ČNTS were valid under Czech law (as they were not).

#### **2. The Media Council's Conduct has Violated the Czech Republic's Treaty Obligations**

166. Respondent has violated each of the foregoing Treaty obligations with respect to CME's investment. The 1993 structuring of the investment through ČNTS was the product of the Media Council's own instigation and approval. The Media Council's 1996 reversal of its own 1993 action approving the partnership between ČNTS and CET 21, as spelled out in the February 1993 agreements and the MOA, violated its obligations not to deprive Claimant of its investments, to provide fair and equitable treatment, not to take unreasonable and discriminatory actions, to provide full security and protection for Claimant's investment, and to act in compliance with principles of international law.
167. The Media Council's continued connivance with Dr. Železný to destroy the exclusive relationship between ČNTS and CET 21 constituted a further breach of its Treaty obligations, including particularly its obligations

to provide full security and protection to Claimant's investment. Indifferent to the Czech Republic's affirmative obligation of protection, the Media Council actively assisted Dr. Železný's efforts, most notably by issuing its March 15, 1999 declaration to support Dr. Železný's avowed effort to eliminate the exclusive economic relationship between ČNTS and CET 21 that had been the foundation of CME's investment. The Media Council's willingness to put forward Dr. Železný's views as its own was unambiguously calculated to gut the "partnership" that had been entered between ČNTS and CET 21 in 1993 at the Media Council's instigation and with its full support.

168. Respondent further breached its obligation to provide full security and protection to Claimant's investments when both the Media Council and the Parliament refused all requests for intervention to protect ČNTS, although at the time of such requests ČNTS was being destroyed by the Media Council's reversal of its original approval of the exclusive arrangements it had brought about between ČNTS and CET 21.
169. ČNTS did not lose its entire business and revenues simply as the result of market forces or a private business dispute, as the Media Council has asserted. The ground for Dr. Železný's termination of the relationship between ČNTS and CET 21 was laid by the amendments to the MOA that the Media Council coerced, since CET 21 could not have severed an arrangement in which ČNTS was entitled to the exclusive right to use the Licence. Even after that wrongful severance which the Media Council facilitated, ČNTS would not have been forced to discontinue its business operations if the Media Council had fulfilled its obligations under the Treaty and Czech law by restoring ČNTS to the exclusive position with respect to CET 21 that the Media Council had approved in 1993.
170. The Media Council's course of dealings - including its initial requirement that the Licence be held by Czech nationals, its commencement of the unfounded administrative proceedings against ČNTS, its actions forcing ČNTS to weaken the contractual underpinnings that were the basis of Claimant's investment, its articulation of a policy disfavoring the exclusive economic relationship it had helped to structure and had approved, and its failure to act to protect ČNTS's interests - enabled Dr. Železný to take actions that have destroyed the value of Claimant's investment. The

Media Council's actions and refusals to act have effected a deprivation of Claimant's investment by the Czech Republic that fails to meet the Treaty's requirements of public purpose, due process, non-discrimination and adequate compensation.

#### **IV. The Czech Republic Is Required to Remedy Its Breaches of the Treaty**

171. The Czech Republic has an obligation under international law to remedy its Treaty violations. The Permanent Court of International Justice recognized more than seventy years ago that States must be required to remedy violations of international treaties, noting that "[i]t is a principle of international law that the breach of an engagement involves an obligation to make reparation" in an adequate form.

#### **F.**

##### **Position of the Respondent I. Introduction**

172. The Czech Republic acknowledged its obligations under the Treaty and confirms that it is committed to providing fair and equitable treatment to investment by Dutch nationals and companies. The Czech Republic's position is, however, that it is an abuse of the protection afforded by the Treaty for CME to have brought this arbitration against the Czech Republic.
173. The claims brought by CME relate to a private commercial dispute between the CME group and its former business partner, Dr. Vladimír Železný. The essence of CME's complaint is that Dr. Železný procured the wrongful termination of the contractual relationship between the broadcast licence-holder CET 21 and a provider of broadcast services ČNTS. The Czech Republic is not a party to any contract involving ČNTS. The Treaty is not intended as a means of resolving commercial disputes arising out of private contractual arrangements between two private parties.

174. CME/ČNTS brought legal proceedings against Dr. Železný/CET 21 in the Czech courts alleging wrongful termination of this contractual relationship. In those proceedings, CME/ČNTS alleged that Dr. Železný/CET 21 deprived CME/ ČNTS of their investment in the Czech Republic.
175. On 4 May 2000 the Regional Commercial Court in Prague has held that CET 21 wrongfully terminated the Service Agreement with ČNTS and that ČNTS is to be the exclusive service provider to CET 21. (The judgment was reversed in 2000 by the Court of Appeal). Dr. Železný/CET 21 caused the loss of which CME complains in this arbitration. Those proceedings confirm that there is no substance in CME's argument that it is the Czech Republic that has deprived CME of its investment. Those proceedings raise a *res judicata* and issue estoppel in respect of the issues pleaded and decided therein.
176. The judgment discloses no wrongdoing by the Czech Republic which could give rise to a cause of action under the Treaty.
177. As a further abuse of the Dutch Treaty, Mr. Lauder, who purportedly controls CME, has brought arbitration proceedings under the "US Treaty" in which Mr. Lauder makes identical allegations and seeks identical relief.
178. CME fails to establish that the contractual relationship between ČNTS and CET 21 constitutes an asset of CME invested in the Czech Republic.
179. The Czech Republic requests dismissal of CME's claims on grounds of lack of jurisdiction:
  - (a) CME has not established that it has an asset invested in the Czech Republic as defined in the Treaty;
  - (b) CME's claim is not an investment dispute as defined in the Treaty, but is of a private commercial nature with Dr. Železný/CET 21; and
  - (c) CME may not concurrently pursue the same remedies in different fora;

further and/or alternatively, on grounds of lack of admissibility:

- (a) CME has pursued the same remedies in other fora; and
- (b) CME has failed to plead any loss.

180. The Czech Republic denies that there has been any breach of the Treaty or of Czech law by the State or any of its instrumentalities.

## II. The Treaty

181. The Czech Republic relies on the terms of the Treaty for its full terms and effect and agrees that it is bound by the Treaty as from 1 January 1993.

## III. The Media Law

182. The Media Law of 30 October 1991 provided, amongst other things, for the issuing of a Licence by the Media Council to a “broadcasting operator”.

183. Article 10 set out the “*Conditions for granting a Licence*” and provided, inter alia:

- "(1) *A Licence authorizes its holder to broadcast in the scope and under the conditions set in it.*
- (2) *A Licence is not transferable.*
- ...
- (4) *In evaluating the application (§ 11), the licence-granting bodies give consideration to ensuring the conditions for plurality and balance in the programme services offered, especially local programme services, equal accessibility of cultural values, information and views, as well as ensuring the development of the culture of the nations, nationalities and ethnic groups in the Czech and Slovak Republic, and the extent of the applicant's previous business activities in the area of mass media.*
- (5) *In evaluating the application, the licence-granting bodies see to it that none of the applicants will gain a dominant position in the mass media.*
- (6) *In evaluating applications from companies with foreign equity participation, the licence-granting bodies take into consideration the applicant's contribution to the development of original domestic work, as well as the equity holdings of Czechoslovak natural persons and legal entities, and their representation in the company's bodies. “*

184. Article 11 concerned the “*Licence application*” and provided, inter alia:

„(3) *Only the person or entity who is applying for a Licence is a party to the Licence proceedings.*”

185. Article 12 concerned the “*Decision to grant a Licence*” and provided, inter alia:

“(3) *In addition to conditions stated in paragraph 2, the decision to grant a Licence also includes conditions which the licence-granting body will set for the broadcasting operator.*”

The power to impose conditions was, however, removed in 1996.

186. Article 14 concerned “*Changes in the licence*” and provided, inter alia:

“(7) *A broadcaster is required to notify the body which issued the Licence of all changes relating to the data stated in the application or the fulfilment of the conditions set in the licence and submit documentation of them within 15 days after these changes occur . . .*

(2) *On the basis of the notification under paragraph 1, the licence-granting body, depending on the circumstances of the case, will decide on a change in the granted Licence or will revoke the Licence (§ 15). ”*

187. Article 15 concerned “*Revoking a Licence*” and provided, inter alia:

“(1) *The body which granted the Licence shall revoke it from the licence-holder if:*

(a) *the licence-holder no longer meets the prerequisites for granting a Licence specified in § 10 par. 6 and 7;*

...

(c) *changes have occurred concerning the licence-holder which do not permit fulfilment of the conditions set in the Licence [this provision was removed in 1996]*

...

(2) *The body which granted the Licence may revoke it if*  
(a) *the licence-holder violates in a serious manner the conditions set in the Licence, duties specified by this Act or by other generally binding legal regulations;”*

188. Article 20 concerned “*Fines*” and gave the Media Council the power to impose fines if the licence-holder violated its duties set by the Media Law or the Conditions to the licence. In addition, Article 20 (6) provided that a fine will be imposed on anyone who broadcasts without being authorised to do so. The fine could be between CZK 10,000 and CZK 2,000,000.

#### **IV. The Media Council**

189. On 21 February 1992, the Czech Parliament passed an Act (Act No. 103/1992 COll.) establishing the Media Council or "Council". The function of the Council was to supervise the observance of legal regulations governing radio and television broadcasting, including the observance of the Media Law.
190. The Council has at all times been an autonomous body, independent of the Government and answerable to the Czech Parliament under Article 3 (5) of the Media Law and Article 29 of the Act on Competencies of State Institutions. It has nine members elected by the Czech Parliament. Members of the Council may not be members of Parliament, nor hold offices in political parties or political movements, nor be members of companies that do business in the field of mass media, nor represent business interests that might be in conflict with the performance of their office or that could adversely affect their impartiality and the objectivity of their decision making.

#### **V. Grant of the Licence to CET 21**

191. In 1992, the Council commenced proceedings for the issue of a new Licence for broadcasting commercial television, pursuant to the procedures prescribed in the Media Law. The Council had special regard to the urgency and importance of such task at a time when no competition existed in Czech television broadcasting.
192. The Licence was not to be issued through a tender process (in the sense that it would be awarded to the bidder with the most advantageous financial package to the Government). The Licence was to be issued after a public enquiry which examined the viability and suitability of all submitted bids.

193. The Council invited bidders. Over 20 applications were received, one of which was CET 21, represented by Dr. Železný. In April 1993, Dr. Železný acquired a 17 % interest in CET 21. In August 1996 he increased his interest to 60 %.
194. The Media Law did not bar foreign parties from effectively holding television licences. The Media Law merely stipulated, as many countries do, that a legal entity could only become a licence-holder if it had a registered office on the territory of the Czech Republic and was registered in the Commercial Register. CEDC never applied to the Media Council for a Licence. CME has failed to establish that it assumed the rights and obligations of CEDC as a matter of law.
195. CEDC could have applied for a Licence on its own through a Czech registered company. CEDC chose not to. Neither CEDC (nor later CME) ever raised any formal complaint with the Council or the Government at the time. The Czech Republic has also no knowledge of whether CEDC and CET 21 contemplated pursuing a joint application for a Licence. In any event, only CET 21 submitted an application, dated 27 August 1992.
196. CET 21's application was supported by a document entitled "*Project for an independent Television Station*". It explained that, inter alia, financial backing would be provided by CEDC, the shareholders of which were said to be part of the "Lauder group". CET 21 stated in the Project Proposal, submitted with its application, that CEDC was a "*direct participant in CET 21's application for the Licence*". However, neither the Media Law, nor Czech law in general, recognises any legal term or gives any legal definition to the term "*direct participant*". The Project Proposal itself made clear that it was CET 21, and CET 21 only, that was applying for the Licence. The applicant for the Licence was named as CET 21.



197. In mid January 1993, CET 21 provided the Council with a “business plan” which set out in detail the expected revenues and expenses of CET 21 and ČNTS.
198. The Council received assistance from a Council of Europe expert mission. It evaluated the business plans of the projects. CET 21 and two other companies had the best plans. The Council then had to choose one of the three shortlisted applicants, having regard to the criteria in Article 10 of the Media Law. CET 21 was chosen.
199. The Council, by letter dated 30 January 1993, informed CET 21 that it had been granted a Licence for nation-wide broadcasting. It was clearly understood by Council members such as Dr. Josefík that the applicant for the Licence was CET 21 alone and that CEDC would be a future investor. The letter referred to CEDC being a “*direct participant to the application*”. That reflected the understanding that CEDC would be an investor in the project, and this phrase had no legal significance under the Media Law. In addition to the financial considerations, members of the Council such as Dr. Josefík voted in favour of CET 21 because their broadcasting format appeared most likely to provide competition to the existing public television stations and to provide a plurality of views.
200. Accordingly, as a matter of Czech law, any rights and obligations prescribed by the Media Law and the Licence are only given to and assumed by the party that made the application and is named in the Licence.
201. The Council did not violate the Treaty including in particular by not permitting foreign ownership of the Licence. No political pressure took place. The Media Law does not preclude foreign investment in the broadcasting industry. It only requires that the broadcasting Licence be held by an entity which has a registered office in the Czech Republic and which is registered in the Commercial Register.
202. After the announcement of the decision, CET 21 and CEDC entered into two agreements: the “*Overall Structure of a Czech Commercial Television Entity*” of 3 February 1993 and the “*Basic Structure of a New Czech*

*Commercial Television Entity*” of 5 February 1993. Both agreements provided that CET 21 and CEDC would create a new company to manage the TV station, with investments to be made by CEDC and the Czech Savings Bank. The earlier agreement stated that CET 21 and CEDC agreed to allow the new company to have exclusive use of the Licence but this was omitted from the later agreement. The earlier agreement confirmed *“that neither party has the authority to broadcast commercial television without the other”* but in the later *“CET 21 acknowledges that it is not entitled to carry on broadcasting without the direct participation of CEDC”*.

203. The two agreements were different in certain material respects. Moreover, they were both significantly different from the *“Terms of Agreement”* between CEDC and CET 21 dated 5 January 1993 which provided that CEDC was to be a major shareholder of CET 21.
204. The Council did not participate actively in negotiating a solution which led to the creation of ČNTS. It did not play a central role in directing the formation of ČNTS. It did not discriminate against foreign investors in Czech television. The Council did not bless the arrangements between CET 21 and ČNTS or give its approval to those arrangements or actively participate in their formulation. The Council could not and did not provide any official assurances to CEDC.
205. The Council's Decision and the separate Licence (containing 31 Conditions) were formally issued in writing to CET 21 on 9 February 1993. The Decision stated that the Council *“awards a Licence for nation-wide television broadcasting on the territory of the Czech Republic to the limited liability company CET 21.”*
206. The *“Reasoning”* referred to CET 21's *“contractual partner, the company CEDC”*. The *“Reasoning”* stated that *“the CET 21 proposal best suited the aim to create a project for television broadcasting by a private operator which respects the public interest, contributes to the creation of a democratic society, and reflects a plurality of opinion and will provide objective and balanced information necessary to form opinions free/y.”*

It also noted that the proposal demonstrated adequate financing, but it added that *"[d]espite the substantial involvement of foreign capital necessary to begin television station activities, the proposal clearly guarantees the intent to preserve the national character of programming. "*

It concluded:

*"... Through the formulation of Licence conditions and through inspection of their observance, [the Council] intends to ensure that the aims stated in the proposal which convinced the Council that this proposal is the best, will be observed. "*

207. The Licence itself named the "licence-holder" as "CET 27". It stated:

*"The licence-holder is required to ensure that the broadcasting is in accordance with the information stated in the application on the basis of which this Licence was issued. It also agrees to observe the conditions stated in the appendix to this Licence. "*

208. The Licence Conditions 17 and 18 (the complete wording already cited above) provided that "any change in the legal entity" of the licence-holder and the investors CEDC and the Czech Savings Bank required the prior approval of the Media Council (Condition 17) and that the investors shall not interfere into "the programming and the editorial independence of the newscasting employees" (Condition 18).

209. The purpose of the Licence Conditions was, to monitor the business arrangements between CET 21 and the investors (CEDC and Czech Savings Bank) and to ensure that the investors actually became parties to the project. At that time (1992/93), many foreign investors promised to fund huge projects in the Czech Republic, but when it came to pay the money they disappeared. Condition 18 also emphasized the requirement of editorial independence (a key attribute of any Licence). Similar conditions were imposed upon other licence-holders. The Czech Republic contends that the wording of Condition 17 has very little legal significance as far as the investors were concerned. It conferred no right on the investors (or ČNTS) vis-à-vis the Czech Republic. The legal effect of the Conditions was exactly according to their terms: they imposed obligations on CET 21. And the Licence and the Conditions were expressly accepted by CET 21, and only by CET 21.

210. The specific reference to the MOA was recognition that the requirement in the original Condition 17 that CET 21 submit the MOA within 90 days had been fulfilled. It also identified the contractual structure which the licence-holder had entered into with its investors and over which the Council intended to exercise regulatory supervision (pursuant to Condition 17). The Council was concerned to ensure that the editorial independence of CET 21 was secured (Condition 18). The Council was responsible for ensuring that this independence remained intact, and it therefore imposed reporting requirements in Condition 17.
211. Thus, the Council envisaged, as reflected in the Licence Conditions, that CEDC and Czech Savings Bank would be “investors” in a company established to manage and operate the television station. The Czech Republic contends that this terminology has no legal significance in the sense contended by CME and does not confer any rights upon CEDC, or the Czech Savings Bank, or ČNTS. Such wording recognised the fact that the licence-holder, CET 21, intended to obtain funding and know-how from CEDC; and that CEDC’s rights vis-à-vis CET 21 were to be contractual. It does not elevate CEDC to the status of co-licence-holder. In the Conditions to the Licence, CEDC is referred to as an “investor”.
212. The Council did not contemplate that CET 21 would transfer the Licence to CEDC or any other entity or person. Indeed, the Media Law forbade it. Neither the Decision nor the Licence required CET 21 to enter into any relationship with CEDC or anyone else whereby it would lose control of broadcasting and programming, nor did the Decision or the Licence approve any such relationship made by CET 21.
213. The Council did not take into account the February agreements when it issued the Licence. The Licence documentation did not link CEDC and ČNTS to the Licence issued to CET 21 in any manner beyond acknowledging that CEDC was to be an investor in the project.

## VI. The Formation of ČNTS

214. CET 21, Czech Savings Bank and CEDC established and became shareholders in ČNTS.
215. Condition 17 of the Licence Conditions required the submission to the Council of a Business Agreement (herein: the "MOA"). A text was submitted to the Council. By letter dated 21 April 1993 the Council notified CET 21 that the Council affirmed in its meeting of April 20, 1993 "in accordance with the Article 17 of the Conditions to the Licence" the submitted version of the MOA between CET 21, CEDC and the Czech Savings Bank.
216. In respect to the formation of ČNTS and its MOA, the Czech Republic's position is that the Council did not participate actively in the negotiation of the MOA. The Council did not have the power or authority to approve the MOA submitted to it. It simply acknowledged that Condition 17 of the Licence had been complied with. The Council did neither approve the arrangements between ČNTS and CET 21, nor proposed them, nor publicly endorsed them. No actions of the Council could release CET 21 and ČNTS from conducting their arrangements in compliance with the Media Law. The Council was not substantially involved in the negotiation and finalization of the terms of the MOA and the adherence to these arrangements until 1996. The Council was not influenced by "changing *political winds*".
217. In 1996, the Council commenced administrative proceedings because there was clear evidence of a violation of the Media Law which ČNTS was unwilling to remedy. The Council was not fully aware of and did not accept the ČNTS structure. The Council never agreed that CET 21 could transfer the Licence to ČNTS. The Council did not take a discriminatory position towards foreign investment and/or ownership of the Licence. The Council did not participate substantively in developing the arrangement between CET 21 and ČNTS, did not formally endorse its legality and did not forcibly dismantle the arrangement.
218. On 4 May 1993 CET 21, Czech Savings Bank and CEDC executed the "*Memorandum of Association*" (the MOA). CET 21 was to have a 12 %

ownership interest in ČNTS; Czech Savings Bank a 22 % ownership interest; and CEDC a 66% (and therefore controlling) ownership interest.

219. The MOA recorded that the subject of ČNTS's business activity was "*the development and management of a new independent private, country-wide television broadcasting station in compliance with the Licence and the conditions attached thereto*". The MOA noted that CET 21 had been "*granted and became the holder of a Licence for nation-wide broadcasting*" and referred to CEDC as an "*investment company*". In addition, the MOA provided (at para. 1.4.1):

*"[CET 21] shall contribute to [ČNTS] unconditionally, unequivocally, and on an exclusive basis the right to use, exploit and maintain the Licence held by [CET 27]."*

The Czech Republic's position is that no specific legal entitlements derive for ČNTS or CME from the MOA and in particular from CET 21's contribution of the use of the Licence to ČNTS. The meaning and effect of the Memorandum of Association is a matter governed by Czech law. CME would have the Tribunal conclude that it allowed ČNTS to broadcast without a Licence. The Czech Republic contends that the wording in the Memorandum of Association did not, and in any event could not, equate to a transfer of the Licence to ČNTS, as that would have been in clear breach of Article 10 (2) of the Czech Media Law. CME may have had a different understanding or expectation: in its Statement of Claim, CME states that "*... the Media Council expressly approved the agreement under which CET 21 assigned the exclusive right to use its Licence to ČNTS*". That premise, namely that ČNTS became assignee of all rights associated with the Licence, is an essential element of CME's case. But that premise is fundamentally wrong both in fact and law.

The Council's understanding of the contribution of the Licence to ČNTS was explained in its Report of May 1994:

*"The Licence as such has not been contributed to ČNTS and is separate from all other activities of ČNTS . . . The Memorandum of Association and the Licence terms specify the relationships between ČNTS and CET 21 and contain a number of mechanisms that prevent the potential non-permissible involvement of ČNTS in the rights and obligations of the licence-holder"*.

In the opinion of the Council, and contrary to CME's contention, the Licence Conditions and in particular, Conditions 17 and 18, were in fact intended to prevent ČNTS becoming the broadcaster.

220. ČNTS was to have a Programming Council consisting of seven (7) members of whom three (3) were to be appointed by CET 21, two (2) by Czech Savings Bank, and one (1) by CEDC. The seventh was to be the Programming Director (para 8.1). This implied that CEDC would not control the programming (as required by Condition 18 of the Licence).
221. At paragraph 10.4, CEDC, Czech Savings Bank and CET 21 expressly agreed *"to be bound and to respect all of the conditions of the Licence, mandated by the Council. In particular, CEDC and [Czech Savings Bank] agree to abide by condition No. 18 not to interfere by any means with the programming of Television station and especially not to interfere with journalistic independence of the news department."*
222. The Council did not consider that it had the power to disapprove the wording of the commercial arrangements between the parties, including the words of CET 21's contribution to ČNTS. But the Council was concerned as to how the arrangement between the various parties would be implemented in practice, and how CET 21 would perform its obligations as broadcaster under the Media Law. The Council understood that ČNTS would provide services to CET 21, but the Council did not foresee that the scope of exclusivity between the licence-holder and the service provider would be so great that CET 21, far from being the broadcaster, would become a mere shell company, the entire operation lying in practice in the hands of ČNTS. Even if the Council had been actively involved in drafting the MOA, that cannot be interpreted as approval of unauthorized broadcasting by ČNTS.
223. At the request of CET 21, the Council issued a Decision dated 12 May 1993 changing the wording of the Licence Conditions. The relevant Conditions which were changed were Conditions 17 and 18:

*"The licence-holder obliges itself:*

- ...  
(17) to submit [to] the Council for approval any changes of legal person which has been the licence-holder, or of the capital structure of the investor which result in a change of control over their activities, and of the provisions of partnership*

*agreement between the licence-holder and investors. The partnership agreement is an integral part of the Licence terms. The partners of this partnership agreement are the licence-holder, CEDC and Česká spořitelna, in the scope and under the conditions stipulated by this Memorandum of Association.*

- (18) *to ensure the CEDC specified as the partner to the partnership agreement in the Licence terms and other investors specified therein will in no way interfere in television station programmes, particularly in editorial independence of news service workers. "*

224. ČNTS was registered on 8 July 1993. ČNTS entered in the Commercial Register that the subject of its business activity was “*nation-wide television broadcasting under Licence no, 001/1993*”. This was unknown to the Council. Dr. Železný was appointed General Manager. TV NOVA commenced broadcasting in February 1994.

## **VII. The Unlawful Implementation of the Licence**

225. Soon after broadcasting commenced, the Council became concerned about the role of ČNTS. The Council was contacted by an independent producer of programmes who complained that two television broadcasting licence-holders, TV NOVA and Premiéra TV, were only re-broadcasting existing programmes and not developing domestically produced programmes. It was also observed that the broadcaster was not clearly identified at the end of each TV NOVA programme. The Council started to investigate these issues.
226. On 1 February 1995, the Council received a letter from a law firm claiming that their client believed his reputation had been damaged as a result of a programme broadcast on TV NOVA and intended to start defamation proceedings. They wanted to know the identity of the broadcaster. The letter also referred to a judgment of the Regional Commercial Court in Prague dated 13 September 1994 and a decision of the Municipal Court of Prague 1 which stated that ČNTS was the actual operator of the broadcasting.
227. Following this, the Council requested the Commercial Court to clarify the scope of the registered business activities of CET 21 and ČNTS.



228. Further, it came to the attention of the Council that CME had apparently replaced CEDC (in August 1994) as a party to the business agreement but that no approval had been sought from the Council as required by Condition 17 of the Licence.
229. The Media Council also discovered that it was ČNTS, rather than the licence-holder, CET 21, that had entered into agreements with Czech Radiocommunications which was transmitting the signal, and with OSA and Integram which represented authors and producers respectively and protected their copyright. The Media Law required the broadcaster to enter into these agreements.
230. It thus became evident to the Council that CET 21 was just an empty shell company performing none of the obligations of the licence-holder and that ČNTS was in fact acting as licence-holder and receiving all the revenues therefrom. The Council concluded there had been a de facto transfer of the Licence to ČNTS and that ČNTS was broadcasting without a Licence, in breach of the Media Law.
231. The Council sought an independent legal opinion from the Institute of State and Law of the Academy of Sciences (the "Institute") concerning the arrangements between CET 21 and ČNTS. In February 1996, the Institute issued a legal opinion concluding that ČNTS was not authorised to broadcast as the Licence was issued to CET 21 and therefore ČNTS was in breach of the law. The opinion recommended that the Council initiate administrative proceedings against ČNTS for unlicensed broadcasting and that the Council consider the revocation of CET 21's Licence.
232. On 13 March 1996, the Council met CET 21 to discuss the issue of unlicensed broadcasting by ČNTS and the changes to CET 21's shareholders which had not been notified to and approved by the Council. In April 1996, CET 21 provided the Council with two alternative draft agreements between CET 21 and ČNTS regarding the services to be performed by ČNTS for CET 21. The Council again referred the question of lawfulness to the Institute. On 2 May 1996, the Institute issued a further legal opinion commenting on the draft agreements.
233. The Institute concluded that Draft No. 1 "*basically correctly resolves the situation.*" In summary, the Institute found decisive not so much the text of the agreement but the factual fulfilment of two points:

- (a) CET 21 (and not ČNTS) was to become a party to the agreement with Czech Radiocommunications; and
  - (b) Advertising revenues were, in terms of "accounting and taxes, to be revenues of CET 21 (and not ČNTS), and CET 21 was to pay fees to ČNTS for its services.
234. In its second opinion, the institute set out at some length the conditions which had to be satisfied for the issue of unlicensed broadcasting to be resolved. On 4 June 1996, the Council wrote to CET 21 requesting CET 21 to amend the description of the business activities of CET 21 and of ČNTS, and commented on the two draft agreements submitted by CET 21 in April 1996, and requested CET 21 to notify properly the changes to its shareholders. On 27 June 1996, the Council was provided by CET 21 with a copy of an agreement between CET 21 and ČNTS (in fact dated 23 May 1996). It was different to the drafts provided in May. The arrangements between CET 21 and ČNTS still did not satisfy the concerns of the Council.
235. The new Media Law entered into force on 1 January 1996. A licence-holder could request the Council to delete those conditions of its Licence which did not concern control of the programming. On 2 January 1996, CET 21 had applied for the removal of most of the conditions to its Licence, including Conditions 17 and 18. If that were done, the Council would no longer be able to request information on the arrangements between CET 21 and ČNTS, and thereby monitor those arrangements.
236. During 1996, the Council had also been investigating Premiéra TV and Rádio Alfa, discovering that the arrangements between the respective licence-holders and their service providers were not as the Council thought they should be.

### **VIII. Administrative Proceedings Against ČNTS**

237. At a meeting on 23 July 1996, the Council decided to commence administrative proceedings against the service providers involved in TV NOVA, Premiéra TV and Rádio Alfa.

238. By letter dated 23 July 1996, the Council advised ČNTS that, as recommended by the Institute in its Opinion, the Council was commencing administrative proceedings against ČNTS seeking the imposition of financial sanctions for unauthorised broadcasting in breach of the Media Law. There were three grounds for such proceedings: (i) the incorrect description of the business activities of ČNTS in the Commercial Register; (ii) that ČNTS rather than CET 21 had entered into contracts with Czech Radiocommunications and OSA; and (iii) the lack of control by CET 21 over the disseminated programmes.
239. Article 20 (5) of the Media Law provides for fines between CZK 10,000 (approximately US \$ 250) to CZK 2,000,000 (approximately US \$ 50,000). It is determined by the Council after a decision on liability is reached. In fact, the Council's intention was not to impose a fine, because that would not solve the problem, but to ensure that the relationship between the licence-holder and the service provider was corrected.
240. It was not relevant to the Council whether the service provider (of TV NOVA, Premiéra TV or Rádio Alfa) was owned or controlled by a foreign entity. It was concerned only with the relationship between the broadcaster and the service provider. Its key concern was that the attributes of the licence-holder were not transferred to the unlicensed service provider. In fact, Premiéra TV a.s. which was a service provider similar to ČNTS, had no foreign ownership (as far as the Council was aware).

### **IX. CME Takes Secret Control of CET 21**

241. About this time in 1996, no doubt aware that the arrangements between CET 21 and ČNTS violated the Media Law and would have to be changed, CME secretly sought to acquire control of CET 21. CME provided a loan to Dr. Železný of US \$4.7 million to enable him to buy an additional 43 % stake in CET 21 (from four of the original five shareholders) thus increasing his holding from 17 % to 60 % which he did. The loan agreement, dated 1 August 1996, provided that Dr. Železný would exercise his voting rights only as directed by CME. The secret control by CME of CET 21 was in clear breach of the requirements of the Media Law and the Licence. The Council was not informed either of Dr. Žel-

ezný's acquisition of a controlling interest in the licence-holder, or of the terms of the loan agreement giving voting control over CET 21 to CME. Condition 17 of the Licence required the Council's prior approval of both arrangements.

242. Upon discovering in late 1996 the Loan Agreement between CME and Dr. Železný, the Council initiated a meeting with CET 21 and Dr. Železný in order to find out more about the loan agreement. Dr. Železný assured the Council that the Agreement was not going to be fulfilled. In fact, as appears from an Amendment to the Loan Agreement, dated 11 March 1997, the Conditions of the original Loan Agreement had been fulfilled and Dr. Železný was released from the obligation to repay the loan.

#### **X. Change of Memorandum of Association of ČNTS and Service Agreement**

243. By letter dated 4 October 1996, ČNTS and CET 21 made a joint proposal to the Council involving a sequence of several steps which it hoped would resolve the Council's concerns over the CET 21/ČNTS relationship. ČNTS and CET 21 asked that the proposal be taken as "*an expression of our goodwill, openness to discussion, and forthcoming attitude.*" CET 21/ČNTS offered, inter alia: to submit to the Council for their information a new business agreement between CET 21 and ČNTS; that ČNTS would conclude in the name of CET 21 agreements with Czech Radiocommunications and agencies representing authors and performing artists (i.e. OSA and Intergram); to change the description of ČNTS's business activities in the commercial register; and to submit for approval by ČNTS's General Assembly a change to Article 1.4.1 of its Memorandum of Association whereby CET 21 contributed the Licence on an exclusive basis. ČNTS and CET 21 also sought the cancellation of Condition 17 of the Licence. These proposals were in principle agreeable to the Council.
244. ČNTS provided the Council with a copy of an agreement between CET 21 and ČNTS, dated 4 October 1996 which was said to govern the relationship between them.

245. In November 1996, the MOA of ČNTS was amended to read that CET 21:

“contributes to [ČNTS] unconditionally, irrevocably and on an exclusive basis, the right to use, make a subject of [ČNTS'S] benefit and maintain, know how related to the Licence, its maintenance and protection”.

246. In December 1996, Condition 17 was removed with legal effect from February 1997.

247. In February 1997, the change of business activities of ČNTS was registered with the Commercial Register. ČNTS deleted “*nation-wide television broadcasting pursuant to Licence no. 001/1993*” from its activities.

248. On 15 May 1997, the investigation by the State Prosecution Office which had commenced in April 1996, was stopped.

249. In May 1997, the 4 October 1996 agreement between CET 21 and ČNTS was superseded by a further agreement dated 21 May 1997 (which was stated to reflect the changes in the Commercial Register). An Addendum to that Agreement was also agreed on the same date. These became known as the “Services Agreement” or “Co-operation Agreement”. This new agreement provided:

*“The parties confirm that the holder of Licence 001/1993 and operator of television broadcasting with the Licence under Act no. 468/1991 Co/l., as amended, is CET 21 and that the Licence is non-transferable. [Art. 1]*

...  
*The parties have agreed that from prior agreements ČNTS has authorization to arrange, under this agreement, services for television broadcasting which is operated on the basis of the licence issued to CET 21 and that ČNTS is authorized to keep an agreed profit from this activity. [Art. 2 (1)]*

...  
*ČNTS shall conduct the activity stated in para. 1 in accordance with generally binding legal regulations, as well as with the content of the Licence whose holder is CET 21. [Art. 2 (3)]*

...  
*If broadcasting on TV NOVA violates obligations to which CET 21, as the licence-holder and broadcasting operator, is bound by law or the Licence, CET 21 is authorized to interfere with program-*

*ming through persons named by the general assembly of CET 21 and whose names CET 21 will announce to the company ČNTS immediate/y after their appointment [Art. 5]"*

250. Also during this period, CET 21 concluded agreements with Czech Radiocommunications, OSA and Intergram.
251. The formal arrangements between CET 21, CME and ČNTS were now considered to comply with the Media Law. Accordingly, the Council stopped the administrative proceedings by its Decision dated 16 September 1997.
252. Premiéra TV and Rádio Alfa eventually made similar changes to their arrangements and the administrative proceedings against their respective service providers stopped on 14 December 1998.

#### **XI. The Media Council did not reverse its Position**

253. The Council did not abruptly reverse its position or repudiate the arrangement it had officially approved or force ČNTS to surrender the exclusive right to the use of the Licence.
254. The Council became concerned that there had been a de facto transfer of the Licence to ČNTS in violation of the Media Law. Such violation could not and was not approved by the Media Council. When it discovered the violation, it first held negotiations with CET 21 and ČNTS in an attempt to persuade them to change their arrangements. When this was unsuccessful, the Council commenced administrative proceedings against ČNTS for unlawful broadcasting. Similar proceedings were commenced against the service providers to Premiéra TV and Rádio Alfa. CET 21 and ČNTS subsequently proposed changes to their arrangements and relationship which appeared to comply with the Media Law.
255. The activities of ČNTS were in violation of the Media Law. They had never been approved by the Council. They did not "*sudden/y become objectionable*". The Council had been concerned for many months that there may have been unlawful broadcasting by ČNTS, and had raised its

concerns with CET 21 and ČNTS. The relevant legislative provisions were those in the original Media Law which forbade a transfer of the Licence. Political factors did not motivate the Council.

256. The Council did receive an Opinion from the Institute, not from Dr. Bárta in his individual capacity. Dr. Jan Bárta was the head of the public law Section at the Institute and thus had to issue legal opinions on Institute letterhead on behalf of the Institute. The Institute's letter dated 13 August 1996 relied on by CME does not support its assertion that the institute disowned the Opinions of Dr. Bárta. The letter addressed to Dr. Železný dated 13 August 1996 was not the Institute's "only *real opinion*".

## **XII. The Media Council did not Compel ČNTS to Alter the MOA**

257. The Council did not "force" ČNTS and CET 21 to amend the Memorandum of Association. ČNTS and CET 21 no doubt "*capitulated*" because they recognised that their implementation of the Licence did, in fact, violate the Media Law. The Council did not insist that ČNTS "could *not be involved in broadcasting*" but rather, the Council insisted that ČNTS could not be the de facto licence-holder.
258. The contractual changes were not "*coerced*" by the Council. This assertion is contradicted by ČNTS's pleadings in the recent Czech Court proceedings against CET 21 in which ČNTS relied on the validity of, inter alia, the amended Memorandum of Association and the Service Agreement dated 21 May 1997.
259. The Czech Republic relies on the "*Reasoning*" which is included in the "*Decision*" of the Council dated 16 September 1997. The Czech Republic is not responsible for the consequences of changes to commercial arrangements required to be made by the parties thereto in order to comply with Czech law.
260. ČNTS could have contested the Council's interpretation of the Media Law through the administrative proceedings or through the Czech courts. Alternatively, it could amend the business arrangements with CET 21 and have the proceedings dropped. It chose voluntarily to amend the business arrangements, and has since relied in the Czech courts upon

those amended agreements as a valid expression of the clear will of ČNTS and CET 21.

### **XIII. March 15,1999 Letter**

261. In response to a request by CET 21, the Council met with Dr. Železný on 2 March 1999 which was in compliance with a licence-holder's right to request a meeting with the Council in order to discuss issues relating to its Licence. They discussed a number of matters relating to CET 21, including its relationship with its service provider.
262. The Council's policy in connection with the arrangements between licence-holders and service providers was discussed. This was a topic of public debate. The Council had expressed its views at meetings of a special Media Panel which had been set up by a number of broadcasters to discuss a new Media Law then being drafted by the Ministry of Culture. Dr. Železný and his lawyer had attended most of those meetings. It was a matter of public record that the Council did not favour exclusive relationships between licence-holders and service providers because that might lead to a de facto transfer of the Licence. That policy was based on its experience with TV NOVA, Premiéra TV and Rádio Alfa.
263. The next day (3 March), Dr. Železný wrote to the Council, setting out his summary of the Council's policy and asking for confirmation. The Council replied by letter dated 15 March 1999. Dr. Železný's summary was generally an accurate summary of the Council's policy, as expressed at the 2 March meeting and elsewhere. The Council wrote a similar letter to at least one other licence-holder.
264. This letter represented the Council's policy and applied to all licence-holders. However, since the Council no longer had the power to impose conditions through which it could monitor the arrangements between the licence-holder and its service provider(s), the Council could not enforce this policy.



#### XIV. The Dispute Between CET 21 and ČNTS

265. In or about October 1998, CET 21 had informed ČNTS that activities performed by ČNTS would in future be performed by a company called AQS a.s. The effect of this on the relations between ČNTS and Dr. Železný is not known, but on 19 April 1999, CME dismissed Dr. Železný from his position as General Manager of ČNTS. Then on 5 August 1999, CET 21 withdrew from the Services Agreement (of 21 May 1997), on the ground that ČNTS's failure to provide daily broadcasting schedules constituted a material breach of contract, and stopped using the services of ČNTS.
266. On 9 August 1999, ČNTS commenced proceedings against CET 21 in the Regional Commercial Court in Prague. The Court decided:
- "[CET 21] is obligated to procure all services for television broadcasting performed on the basis of Licence No. 001/1993 for the operation of a full-coverage television broadcasting station granted to him by the Council exclusively through [ČNTS], and by means of services provided by [ČNTS], in accordance with the terms and conditions of the [Services Contract] concluded between [ČNTS] and [CET 21] on 5/21/1997, ..."*
267. The Court stated that the arrangements between CET 21 and ČNTS had been voluntarily amended.
268. The Services Agreement was not *"part of the package of contractual changes coerced by the Media Council"*. On the contrary, ČNTS relied upon the Services Agreement as the basis of its claim against CET 21. The Regional Commercial Court recorded that ČNTS had submitted that *"[t]he change in the definition of the contribution to the capital stock was not understood by [ČNTS] and [CET 21] as a change altering their legal relationship, but only as a change meeting the requirements of the Council and resulting in staying the administrative proceedings."* The Court noted that, *"[a]ccording to an expert opinion [of ČNTS] valuing this non-monetary contribution [of the Licence know-how], the value of this contribution remain unchanged. "*

The Court stated that CET 21 was not entitled to withdraw from the Services Agreement. The judgment was reversed by the Court of Appeal.

269. The proceedings before the Prague Regional Commercial Court deprive this Tribunal of jurisdiction. CME must be assumed to have elected to pursue ČNTS's commercial rights before the Czech courts. CME cannot refer that same dispute to arbitration under the Treaty. Moreover, the pleadings and judgment in those proceedings confirm that the Czech Republic is not responsible for any harm which CME may have suffered to its alleged investment.

#### **XV. The alleged Destruction of Claimant's Investment**

270. The Council is not responsible for the actions of private parties in their dealings with their contractual partners. The steps taken by Dr. Železný and CET 21 were not taken with the Council's "*connivance and assistance*".
271. The Czech Republic cannot comment on the dealings between Dr. Železný and ČNTS/CME. Any action taken by Dr. Železný in relation to ČNTS/CME is part of their private commercial dispute. It is irrelevant to the Czech Republic's obligations under the Treaty. The Council did not threaten further action. The dispute escalating between Dr. Železný and CME has led to any "investment" by CME being harmed.
272. The Council did not provide "*active assistance to Dr. Železný in his campaign to eliminate ČNTS's exclusive position respecting CET 21*". All actions of the Council, including responding to Dr. Železný's request in his letter of 3 March 1999, were carried out in fulfilment of its role of broadcasting regulator. The Czech Republic cannot comment on Dr. Železný's motivations or intentions in writing to the Council.
273. In the Council's letter of 15 March 1999 to Dr. Železný, the Council reiterated its policy concerning the relationship between licence-holders and service providers. That policy had been expressed publicly in meetings of the Media Panel and in its submissions to the Ministry of Culture on

- the proposed new Media Law. The Council wrote a similar letter to at least one other licence-holder.
274. The Council's policy in early 1999 as reflected in its letter of 15 March 1999 was not in conflict with its previous practice. The Council's policy was consistently not to favour exclusive relationships between licence-holders and service providers because that might lead to a de facto transfer of the Licence. The Council's experience with TV NOVA, Premiéra TV and Rádio Alfa was evidence that this might happen. However, the Council had no power to intervene unless a violation of the Media Law occurred.
275. The 15 March 1999 letter did not go beyond the scope of the Council's authority under the Council Act. The Council, as broadcasting regulator, was not only entitled to, but obliged to, respond to queries from licence-holders. The Council was not issuing an ex parte declaration in support of one party to a dispute.
276. The Council did not play a negative role in the events leading to the estrangement of Dr. Železný/CET 21 and Mr. Lauder/ČNTS/CME. The Council was to monitor and enforce the Media Law, as it was empowered and obliged to do under Czech law.

#### **XVI. The Media Council did not Fail to Protect Claimant's Investment**

277. The Council does not have the power to police and enforce private commercial contracts. Nor can it dictate to a licence-holder whom it should choose as a service provider.
278. The Council and other organs of the Czech Republic did not fail to respond as appropriate to complaints made by ČNTS and CME. The Council, inter alia, reported to the Permanent Commission for Media of the House of Deputies of Parliament concerning the dispute between Dr. Železný and ČNTS, and wrote to ČNTS and CET 21 (letters dated 26 July and 29 July 1999).
279. The actions of CET 21 and Dr. Železný of which ČNTS had complained in its letters in June, July and August 1999 to the Council were part of a

commercial dispute that should be resolved by the parties concerned, with resort to the courts, if necessary.

280. The Council is not responsible in any way for the dispute between CET 21 and ČNTS. It did not ignite the dispute, ignore its own regulatory obligations, or refuse to comply with its obligations under the Treaty.

## **XVII. The Czech Republic's Alleged Additional Continuing Violations of the Treaty**

281. The Czech Republic did not continue to breach its obligations under the Treaty since the instigation of this arbitration. It did not favour the Czech investors in CET 21. The Council has not "*affirmatively assisted Dr. Železný in evading the effectiveness of orders of an ICC arbitral tribunal*". The Czech Republic has enacted legislation relating to the recognition and enforcement of arbitral awards in accordance with its obligations under the New York Convention.
282. The Council considered the request to increase the share capital of CET 21 and to transfer certain shares. The Council concluded that there was no legal obstacle preventing the transactions and therefore gave its approval.
283. The Czech Republic did not disregard criminal wrongdoing by Dr. Železný directed against CME's investment. Respective complaints have been properly investigated by the Czech police authorities.

### **G.**

#### **The Respondent's Argument**

##### **I. The Interpretation of the Treaty and Burden of Proof**

284. The Treaty must be interpreted according to the ordinary rules of treaty interpretation as established by State practice and as codified in Article 31 of the *Vienna Convention on the Law of Treaties (1969)*.
285. In respect to the breach of the Treaty as alleged, the burden of proof is on the Claimant to demonstrate that both the breach and the responsibility of the Czech State is engaged: a "[p]arty having the burden of proof

*must not only bring evidence in support of his allegations, but must also convince the Tribunal of their truth, lest they be disregarded for want, or insufficiency, of proof".*

## **II. The Governing Law**

286. Article 6 of the Treaty provides:

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

287. The Respondent's view is that Czech law should be given primacy in determining whether or not the Czech Republic has breached its obligations under the Treaty.

## **III. The Tribunal Lacks Jurisdiction**

288. The Tribunal has jurisdiction in respect of *"All disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter"* (Art. 8).

289. *"Investment"* is defined as *"every kind of asset invested either directly or through an investor of a third State . . ."* (Art. 1 (a)).

290. The Tribunal lacks jurisdiction, on the grounds that:

- (i) CME has failed to establish that it has an asset invested in the Czech Republic;
- (ii) CME's claim is not an investment dispute under the Treaty; and
- (iii) CME may not concurrently pursue the same remedies in different fora.

### **1. CME has Failed to Establish that It has an Asset Invested in the Czech Republic**

291. The Claimant's assertion of a claim under the Treaty is unclear and unparticularized. CME is not entitled to bring a claim under the Treaty.
292. CME fails to identify the "investment" which it alleges gives rise to rights under the Treaty. CME failed to identify, whether CME's "investment" is its alleged shareholding in ČNTS or some contractual right allegedly enjoyed by ČNTS or some right conferred on CEDC.
293. Further, CME fails to establish that it has assumed the rights and obligations of CEDC.

### **2. CME's Claim is Not an Investment Dispute under the Treaty**

294. CME'S claim demonstrates a fundamental misunderstanding of the purpose and ambit of the Treaty (and, indeed, BITs in general). The Czech Republic considers that the attempt to use the dispute settlement provisions of the Treaty in order to settle private disputes in the manner sought by CME distorts the Treaty and if successful would represent a grave threat to the stability of the entire network of BITs.
295. This is a private commercial dispute and not an investor-host State dispute.
296. CME seeks to utilise the Treaty regime as an alternative or additional means for the resolution of a dispute arising from a falling out between two business partners, CME/ ČNTS and Dr. Železný/CET 21. The contractual rights and legal rights referred to are exclusively those made between ČNTS or CME and CET 21 or Dr. Železný. The Czech Republic is a party to none of them.
297. It is the contractual arrangements between CET 21 and ČNTS, and not the Licence, upon which the claimed exclusivity that CME seeks to secure in these proceedings is based. The Council did not impose the claimed exclusivity arrangement, and had no power to do so. The grant of the Licence signified no more than that the Council considered, on the basis of the information then available to it, that CET 21 was a proper re-

recipient of the Licence. The Council attached conditions to the Licence that required CET 21 to advise the Council of the business arrangements it entered into with CEDC and the Czech Savings Bank but the Council did not have the power, nor did it, approve or endorse those arrangements.

298. The dispute between Mr. Lauder (and his companies including CME) and Dr. Železný (and his companies) has already been, and is still being, pursued through various courts and arbitral tribunals. The Czech Republic is not a party to that dispute, and it takes no position on the merits of the arguments advanced on either side in the continuing litigation (save as articulated in judgments of the Czech courts). But it is clear from CME's own Statement of Claim that Mr. Lauder's claim against the Czech Republic relates to the withdrawal by Dr. Železný and his companies from various contractual arrangements to which the State was not a party. The Prague Commercial Court has upheld ČNTS's claim that Dr. Železný/CET 21 wrongly withdrew from those arrangements. It is therefore Dr. Železný / CET 21 that has allegedly injured CME's interests within the Czech Republic. The Czech Republic is not responsible for the actions of private parties.
299. In the relief originally sought, CME asked the Tribunal to restore the exclusivity of the relationship between ČNTS and CET 21. CME dropped this request during the proceedings. The relationship of exclusivity is a contractual one for which the parties must bargain and agree, within the limits of the law, and which they must enforce using the procedures of the law. The courts may uphold and enforce such contractual relationships (and it is to the courts which ČNTS has turned to obtain such relief). But contractual relationships between a licence-holder and service provider(s) cannot be imposed or enforced via the licensing procedures of the Czech Republic.
300. This is not a dispute concerning the treatment by the Czech Republic of an investment: it is a dispute concerning an alleged breach of a commercial contract made by private parties. That dispute should be settled either according to procedures agreed by the parties (such as arbitration), or through courts in the Czech Republic or some other State within the jurisdiction of whose courts the dispute falls. Treaty procedures were not intended to be used in these circumstances. If they were allowed to be so used, every commercial dispute involving a foreign investor could be

elevated to the level of a dispute within the Treaty procedures. That is plainly not the intention of the Treaty.

301. CME's claim must be dismissed on grounds that CME's claim is not an investment dispute within the scope of the Treaty.

### **3. CME May Not Concurrently Pursue the Same Remedies in Different Fora**

302. It is an abuse of the Bilateral Investment Treaty regime for Mr. Lauder, who purportedly controls CME, and, subsequently, CME to bring virtually identical claims under two separate treaties. The Czech Republic does not consider it appropriate that claims brought by different claimants under separate Treaties should be consolidated and the Czech Republic asserts the right that each action be determined independently and promptly.

As recognized by CME in its Statement of Claim, the action commenced by Mr. Lauder *"may not provide the full relief to which CME is entitled because it is brought on behalf of only a single controlling ultimate shareholder of CME . . . Only this Tribunal can declare that the Czech Republic has breached its Treaty obligations to [CME] and can provide full relief to [CME] for those breaches"*. In these circumstances, it is an abuse for Mr. Lauder to pursue his claim under the US Treaty and the Czech Republic is fully entitled to insist that CME make good its claim under the Dutch Treaty in separate proceedings.

303. The dispute between CME/ČNTS and Dr. Železný/CET 21 has been conducted as a private dispute. Several actions, in courts and arbitral tribunals, have according to CME itself, already been instituted, including one ICC arbitration and ten law suits at the Regional Commercial Court in Prague.
304. In particular, ČNTS has sought a ruling from the Czech Court upholding its claim to exclusivity under the Services Agreement made with CET 21. That is essentially the same remedy as is sought in the present proceedings. Thus, CME/ČNTS has already taken the present dispute before a competent court. The Regional Commercial Court has ruled in CME/ČNTS's favour and upheld the claim to exclusivity in relations between ČNTS and CET 21, precisely in terms that *"restore the initial eco-*



*conomic and legal underpinnings of [CME's] investment*", as those underpinnings were set out in the Services Agreement. The Prague Court of Appeal meanwhile reversed the judgment. The lawsuit is pending at the Czech Supreme Court. That Services Agreement was said by ČNTS itself to be *"the expression of a clear will of both contractual parties to determine the mutual relationship on an exclusive basis"* between them. CME/ČNTS is seeking at the Prague Civil Courts the remedy that it seeks from this Tribunal. Seeking the same remedy again is a plain abuse of process; and it conflicts with the spirit, if not with the letter, of the *res judicata* principle.

305. The Regional Commercial Court found that CET 21 had acted in breach of the contract, and whatever losses might have been suffered by ČNTS clearly derive from ČNTS's departure from the exclusivity arrangement. There is no suggestion, in the present claim or elsewhere, that there is any compensable loss that is not attributable to the breakdown of the exclusivity arrangement.
306. If a Claimant chooses to pursue a contractual remedy in the local courts or private arbitral tribunals, he should not be allowed concurrently to pursue a remedy under the Treaty.
307. The claims by investors under a BIT depend upon assertions that the State has treated the investment in a manner incompatible with the treaty. "The State" includes also the State's courts. If an investor takes the complaint of mistreatment before the State's court, it cannot be determined how "the State" has treated the investment until the State's courts have finally disposed of the case initiated by the investor. There can be no complaint that "the State" has mistreated the investment until the litigation has run its course.
308. An investor should not be allowed to switch to a treaty procedure which has the result of depriving the other party to the proceedings in the local court of the opportunity of arguing its case before the treaty tribunal.
309. The Tribunal is faced with the danger of incompatible and ostensibly "final" decisions being made not only in the various Czech court proceedings but also by another tribunal set up under the US Treaty and by the ICC arbitral tribunal ruling between CME and Dr. Železný. This is precisely the prospect of disorder that the principle of *lis alibi pendens* is designed to avert.

310. Therefore, the Tribunal lacks jurisdiction, or in the alternative, CME's claim is inadmissible.

#### **IV. CME Czech Republic B.V. has no claim in substance**

311. CME invested in ČNTS only after the broadcasting of TV NOVA commenced in February 1994. CME must have considered the commercial risk of investing in ČNTS as well as the legal framework in which this investment would be made, when it decided to acquire CEDC's rights and obligations in the Memorandum of Association to CME. This assignment was not notified by the Council as required by Condition 17.

#### **V. The Czech Republic's Obligations under the Treaty**

312. CME's claim should be dismissed on grounds that its Statement of Claim does not disclose a prima facie case that the Czech Republic has breached the Treaty having regard in particular to Czech law.
313. Essentially, CME claims that a Czech public body having granted a licence and had filed with it a contractual scheme which on its face did not infringe the law, may not take action when implementation of the Licence clearly does infringe the law. That proposition is patently incorrect, and must be clearly rejected if the entire balance of international instruments for the protection of foreign investment is to be maintained. The Czech Republic owes duties to investors, foreign and domestic, other than CME and Dr. Železný, and to the Czech people. The Czech Republic, like other States, must have the power to enact laws and regulate industries, such as broadcasting, pursuant to those laws, for the good order of the State and its economy. The Treaty was not intended to remove that power and does not remove that power.
314. The very core of the argument advanced by CME is fundamentally misconceived, because it denies the right of States to regulate their own economies, and to enact and to modify the laws, and to secure the

proper application of the law. It is no exaggeration to say that CME's argument involves a repudiation of the Rule of Law.

315. The facts show that the Council consistently applied the Media Law (in particular Article 10 (2) which proscribes the transfer of a Licence) and took action when the implementation of the Licence by CET 21 and ČNTS infringed the law. It took similar action against Premiéra TV and Rádio Alfa. Its position remains the same today: The transfer of a broadcasting Licence to a service provider is contrary to the Media Law. The Czech Republic has done no more than regulate its economy in a normal and entirely proper way. The impact of that regulation upon private contractual relations between investors is solely a matter for such investors.
316. The Czech Republic accepts its obligations under the Treaty.

### **1. The Obligation Not to Deprive Investors of Their Investments**

317. The Treaty provides at Article 5 that "*[n]either 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. "*
318. In accordance with customary international law, the Treaty does not provide that the deprivation (or expropriation as it is often referred to) of investments is unlawful *per se*. Such deprivation is unlawful only if certain conditions are not met. It is acknowledged that the Treaty includes both "direct" and "indirect" forms of deprivation: however, no deprivation in either form has taken place in this case. There has been no taking attributable to the State.

319. Deprivation or expropriation clearly involves a "*compulsory transfer of property rights*". It is said to occur if a State interferes with property rights "*to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated*".
320. In the legal literature, it is said that, *the essence of the matter is the deprivation by State organs of a right of property either as such, or by permanent transfer of the power of management and control. State measures, prima facie a lawful exercise of powers of government, may affect foreign interests considerably without amounting to expropriation. Bona fide regulation must also be distinguished from expropriation or deprivations of property.*
321. The meaning of *deprivation* may be drawn from the *Convention Establishing the Multilateral Investment Guarantee Agency*. Article 11 (a) (ii) defines that expropriation is not given by
- "non-discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories. "*
322. The Council's actions do not fall within the definition of deprivation or expropriation of investments.
323. The Czech Republic's involvement in this dispute was as follows: (i) the Council issued a Licence to CET 21 in light of the information provided to it; (ii) it reviewed compliance with the Media Law; (iii) the Council commenced administrative proceedings against ČNTS on the basis of unlawful broadcasting in breach of the Media Law; (iv) it withdrew the administrative proceedings in light of the amended arrangement between ČNTS and CET 21; (v) the jurisdiction of Czech courts have been invoked in respect of disputes arising out of the arrangements between ČNTS and CET 21.
324. In addition, a deprivation requires that there has been governmental interference with a property right of CME. It is not enough for CME to say that it is less well off than it thinks that it should be because ČNTS changed its arrangements with CET 21 at the insistence of the Council.

The Respondent refers to the Permanent Court of International Justice stated in the *Oscar Chinn Case*:

*"The Court, though not failing to recognize the change that had come over Mr. Chinn's financial position, a change which is said to have led him to wind up his transport and ship-building businesses, is unable to see in his original position - which was characterised by the possession of customers and the possibility of making a profit - anything in the nature of a genuine vested right. Favourable business conditions and good-will are transient circumstances, subject to inevitable changes. "*

325. CME's complaint is this. CME had an initial arrangement with CET 21 which, it says, gave ČNTS the arrangements of an exclusive supplier to CET 21. That arrangement was amended at the behest of the Council. The amended arrangement, CME fears, does not give ČNTS the rights of an exclusive supplier. But what CME says it has lost is not property, nor even rights under the initial or amended contracts. What CME says it has lost is the measure by which the business advantage to it of the initial agreement exceeds that of the amended agreement. That is not a property right. The law recognises and upholds rights created by contract, but there is no legal concept of a separate property right to the maintenance of a particular balance of commercial power.
326. The Council's actions have been the lawful exercise of the power of Government, carried out as part of the regulation of economic activity in the Czech Republic.
327. The Czech Republic has taken no property of CME, of ČNTS, or of any company owned or controlled by Mr. Lauder. The only property right granted by the Czech Republic, the Licence issued to CET 21, remains in the hands of CET 21 as it has done at all material times.
328. The Czech Republic did not agree, and could not agree, to CET 21 transferring the Licence to ČNTS. The Czech Republic did not create or confirm any rights for ČNTS. ČNTS's rights, and CME's alleged interests, arose solely under contracts made with CET 21. The rights asserted by CME in this case were created and defined by those contracts and were necessarily constrained by Czech law: those rights could not amount to a

transfer of the Licence to ČNTS. ČNTS is correct to look to CET 21, rather than the State, as the source of any remedy for unlawful injury to its rights.

329. The authorities cited by CME do not support the case it has advanced. The Czech Republic denies that it had any intention of injuring CME or its investment.
330. There is no *a priori* limit on the kind of State measure or action that may amount to deprivation or expropriation. CME has, however, entirely failed to explain why it considers that the actions of the Czech Republic do so.
331. Although in some circumstances a coerced capitulation may constitute an expropriation, a review of the authorities indicates that there is no solid or wide consensus on coercion outside of the cases dealing with physical force.
332. Far from maintaining that ČNTS was coerced into the making of a new agreement with CET 21 in 1997, in the proceedings in the Prague Commercial Court, ČNTS stated, "*that the Services Agreement as well as the agreements previously concluded between [ČNTS] and [CET 21] on 6/2/1994, 5/23/1996 and 10/4/1996 determining the rights and obligations relating to operating the television broadcasting facilities, have always been the expression of a clear will of both contractual parties to determine the mutual relationship on an exclusive basis.*"
333. ČNTS makes no suggestion that the Services Agreement, described in CME's Statement of Claim as "*part of the package of contractual changes coerced by the Media Council,*" was coerced or was invalid. On the contrary, it was used as the basis of ČNTS's claim; and the Regional Commercial Court upheld its validity (meanwhile reversed by the Court of Appeal).

CME has failed to establish a prima facie case of deprivation or expropriation.

334. The Respondent's position is that expropriation has not occurred due to the fact that
- (1) the Claimant invested in ČNTS after the 1996 changes had been made; therefore, it cannot have lost the 1993 safety net by expropriation;
  - (2) it is a matter of pure speculation, whether the 1996 safety net was materially better or more effective than the 1993 safety net;
  - (3) that, in any event, the 1996 changes were voluntarily, if reluctantly, made by ČNTS; and
  - (4) that the institution of the 1996 administrative proceedings could not, in the absence of proof of abuse of power or mala fides, or some such defect, amount to coercion. In essence, it is not established that anything was taken from the Claimant or that the Respondent forced the Claimant to give anything up.

## **2. The Obligation of Fair and Equitable Treatment**

335. The Treaty provides that investments shall be accorded fair and equitable treatment (Art. 3 (1)). The support given for this principle in its Preamble provides:

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

336. There is no precise definition of the requirement contained in Article 3 (1) of the Treaty to provide investments with *"fair and equitable treatment"*. What is fair and equitable is an issue to be interpreted on the facts in each individual case.
337. CME does not point to the facts relied upon in order to support the allegation that this obligation has been breached. No case is made out to which the Czech Republic can respond.

338. It is denied that the Czech Republic treated CME's alleged interests less than fairly and equitably. The Media Law has been applied according to its terms. Unlawful broadcasting by ČNTS has been treated in the same way as that by other service providers, in particular Premiéra TV and Rádio Alfa. Due process has been respected.
339. CME has failed to establish a prima facie case that the Czech Republic breached its obligation of fair and equitable treatment.
340. In particular in respect to the March 15, 1999 letter addressed by the Media Council to Dr. Železný, the Czech republic is of the opinion that there is no unfair or non-equitable treatment. The Council could not ignore Dr. Železný's request for giving guidance and had to consider CET 21's right to be heard. Further, the letter was addressed to TV NOVA, being also represented by Dr. Železný at that time. The letter itself had no legal effect. No proceedings were connected to it. The Media Council explained its general policy.
341. Also, the 1996 administrative proceedings did not breach the obligation on fair and equitable treatment as other broadcasters were treated in the same way. Until 1996, both, CET 21 and ČNTS were joined in a continuing duty to comply with the terms of the Media Law, and that included a duty not to effect a de facto transfer of the Licence. ČNTS appeared to be breaking that obligation. The Media Council simply tried to bring it back into line with the law.

### **3. The Obligation Not to Engage in Unreasonable and Discriminatory Treatment**

342. The Treaty provides that a State party shall not "*impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal*" of investments (Art. 3 (1)).
343. The term "*unreasonable*" is not defined in the Treaty. It is insufficient to show discrimination; unreasonable conduct must also be demonstrated. In any event, the actions of the Czech Republic have been neither unreasonable nor discriminatory.
344. CME's claim fails at two levels.



345. First, CME does not explain why it considers that the Czech Republic behaved unlawfully. In the view of the Czech Republic, the Council acted at all times in conformity with Czech law. The Czech Republic notes that CME did not seek to raise in the Czech courts at the time of the administrative proceedings, or subsequently, arguments that the Council had violated Czech law. Second, CME does not explain what unreasonableness it finds in the allegedly unlawful conduct of the Council.
346. The term “discriminatory” is not of itself defined in the Treaty.
347. The complete failure to indicate what facts are alleged to amount to discrimination prevents a reasoned response by the Czech Republic. The Czech Republic notes, that it cannot be seriously suggested that administrative proceedings to stop unlicensed broadcasting lacked any legal basis in Czech law or bona fide governmental purpose. It should also be noted that ČNTS and CET 21 were treated in accordance with the Media Law, and in the same manner as Premiéra TV and Rádio Alfa were treated in similar proceedings at the same time.
346. CME’s assertion that the requirement that the licence-holder had to be Czech is a violation of the Treaty’s prohibition against discrimination, is wrong. It is routine in international practice that foreign investors invest in the State through the medium of a locally incorporated company, which is a regulation stipulating how foreign investment is to be organized.
349. CME’s Statement of Claim refrains from any explaining as to why the Council’s reconsideration of the initial arrangement and agreement with ČNTS and CET 21 of the amended arrangement might be thought unreasonable and discriminatory.
350. CME has failed to establish a prima facie case that the Czech Republic breached its obligation not to engage in unreasonable and discriminatory treatment.

#### 4. The Obligation of Full Security and Protection

351. The Treaty provides that “*each Contracting Party shall accord to such investments full security and protection*” (Art. 3 (2)).
352. The phrase “*full security and protection*” has received attention in both arbitral and judicial bodies. The cases indicate that CME must demonstrate both that the standard contained in the phrase “*full security and protection*” has been breached; and that the breach is the result of the actions of the Czech Republic.
353. The requirement to provide constant or full security and protection *cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed*. Similarly an obligation to provide the nationals of the other Contracting State to a BIT with “*full protection and security*” is not an absolute obligation *in the sense that any violation thereof creates automatically a ‘strict liability’ on behalf of the host State*. A government is only obliged to provide protection which is reasonable in the circumstances.
354. CME asserts a failure to provide full security and protection for its investment. CME is arguing that it was the responsibility of the Czech authorities to maintain and enforce the contractual arrangements into which ČNTS entered with CET 21. That is absurd. The obligation of “*full security and protection*” is an obligation of due diligence relating to the activities of the State. No Czech authority was a party to the contracts between ČNTS and CET 21. It was for ČNTS to enforce its rights under those contracts, as it is doing through the Czech courts.
355. Also, CME’s argument that the alleged change of position of the Council in 1996 deprived ČNTS of benefits that it had enjoyed by virtue of the alleged previous position of the Council in 1993, is untenable. The Council did not change its position between 1993 and 1996. At all times the Council has taken the view that the Media Law forbids the transfer of licences, and has sought to apply that law. What changed was the nature of the relationship between CET 21 and ČNTS. On the basis of facts

discovered in 1994 - 1996, the Council reacted so as to ensure that CET 21 and ČNTS complied with Czech law.

356. CME contradicts the position that ČNTS has taken in its successful litigation in the Czech courts. It cannot be argued that investors have any right to suppose that positions taken by State authorities and provisions of State law are forever unalterable. Nor can it be argued that every regulatory change made by a State in accordance with its laws must be accompanied by compensatory payments to anyone whose profits are adversely altered by the change. There can be no legitimate expectation that provisions and laws become frozen the minute that they touch the interests of a foreign investor.
357. CME fails to identify any factual circumstances that could support its allegation that the Czech Republic failed to provide full security and protection for its investment, or that the Czech Republic breached the obligations of full security and protection.
358. Further, it should be noted that the Media Council simply had no competence to act outside administrative proceedings. Condition No. 17 of the Licence was to be lifted under the new Media Law as of January 1, 1996; the Media Council had no influence any more on the relationship between CET 21 and ČNTS. There was and is full protection and security for ČNTS's legal rights available under the Czech legal system provided by Czech courts.

## **5. The Obligation of Treatment in Accordance with Standards of International Law**

359. The Treaty provides that if "*obligations under international law . . . entitling investments by investors . . . to a treatment more favourable than is provided for by the present Agreement, such rules shall to the extent that they are more favourable prevail over the present Agreement,*" (Art. 3 (5)).

360. CME has quoted from the decision in the International Court of Justice in the *Barcelona Traction Case* to affirm that "[w]hen a State admits into its territory foreign investments, . . . it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded them." The judgment in the *Barcelona Traction Case* continues with the sentence, "These obligations, however, are neither absolute or unqualified." The Court's comment was made in the quite different context of a State's right to provide diplomatic protection to shareholders of entities incorporated in a third State. The Court did not set up absolute standards for treatment of foreign investment.
361. No argument is presented to indicate why it is thought that the Czech Republic has violated its obligations to treat CME in accordance with general international law. CME mentions this obligation, but it is not possible to discern what, if any, argument CME seeks to make in relation to it. This obligation has not been breached.

## **VI. The Czech Republic has not Violated its Treaty Obligations**

### **1. The Czech Republic is Responsible for the Media Council's Conduct**

362. The Czech Republic accepts responsibility for the actions of the Council for the purposes of this case. The Czech Republic does not accept the characterisation of the Council activities made by CME, and denies any breach of the Treaty by reason of the Council's actions.

### **2. The Council's Conduct did not Violate the Czech Republic's Treaty Obligations**

363. CME must demonstrate that the State has acted in breach of its Treaty obligations, i.e. unlawfully, so as to harm its "investment". Here, nothing that the State has done, through the Council or the Institute or the courts, can be described as unlawful or otherwise a breach of the Treaty. On the contrary, the Council has sought to uphold the law by ensuring that the implementation of the Licence was in accordance with the Media Law; and that it was the licensee, CET 21, not the unlicensed ČNTS which controlled broadcasting by TV NOVA.

364. The administration of the law or insistence upon compliance with the law cannot be described as “*unreasonable*” or “*discriminatory*” conduct by the Council. Neither can they be characterised as actions “*tantamount to deprivation*” by the Czech Republic.
365. CME knew the Media Law from the start of its involvement in the Czech Republic. CME cannot complain about the consequences of its acting unlawfully. CME’s own case and the facts known to the Council suggest that CME was fully aware of the legal conditions under which television broadcasting was licensed; and sought by various means to ensure its control over the Licence despite the provisions of the Media Law and of the Licence itself.
366. CME abandoned its attempts to circumvent the Media Law in 1997, when ČNTS voluntarily agreed new contractual terms with CET 21. Subsequent events have shown that CME’s loss of control of the Licence and TV NOVA may have harmed its investment in ČNTS. But this cannot be attributed to the Czech Republic.
367. CME now claims that the actions of the Council in addressing the ways in which CET 21 and ČNTS were implementing the Licence, and in bringing administrative proceedings against ČNTS for unlawful broadcasting in 1996, constitutes an unlawful deprivation and otherwise breaches the obligations of the Czech Republic under the Treaty. This ignores the fact that the response of CET 21 and ČNTS was voluntarily to agree between themselves to change their relationship so as to comply with the law. The Media Law, in common with the laws and procedures of many other nations, licences scarce broadcast spectrum on the basis of prudential and public interest considerations; and does not permit unlicensed broadcasting. Under no circumstances can it be held that the conduct of the Council gave rise to any breach by the Czech Republic of the Treaty.
368. The Council in its letter of 15 March 1999 was not supporting Dr. Železný’s effort to eliminate the exclusive economic relationship between ČNTS and CET 21; it did not put forward Dr. Železný’s views as its own. The Council was stating the policy which it had publicly declared in the meetings of the Media Panel and in submissions on the proposed new Media Law, as well as to individual licence-holders.

369. CME does not indicate what specific obligations it considers the Council and Parliament to have in respect of ČNTS's requests. The Czech Republic notes that three of the four requests were made in the fortnight preceding the filing of Mr. Lauder's Notice of Arbitration in mid-August 1999, and the fourth some six weeks before that. Under no circumstances is it reasonable to expect a Parliamentary Committee to take action within two weeks on the basis of "a detailed factual summary with supporting documentation". The requests were intended to establish a record for the purpose of the dispute which had by then broken out between CME and Dr. Železný.
370. The Council did not fail to fulfil its obligations under the Treaty and the Council did not cause ČNTS's business operations to be discontinued. The Council only ever took action to ensure that broadcasting was conducted in accordance with the Media Law.
371. The Council's course of dealings did not enable Dr. Železný to take actions that may have affected CME's investment. The Council was merely fulfilling its obligations under Czech law by requiring that the Licence not be transferred and by commencing the administrative proceedings against unauthorised broadcasting. The Council's actions did not force ČNTS to weaken the contractual arrangements under which CME's investment was made. The Council did not adopt a policy disfavouring the exclusive economic relationship between CET 21 and ČNTS. The Council did not fail to act to protect ČNTS's interests.

## **VII. CME Failed to Plead Any Loss**

372. The Czech Republic has an obligation under international law to remedy any violations under the Treaty for which it is responsible. However, CME failed to plead any loss. CME must demonstrate that it has in fact suffered damage. No plea has been made addressing questions of the nature of the loss, causation, the identity of the specific companies or individuals that are alleged to have suffered loss, the ownership and control of the companies at the material times and of the heads of damages.
373. The remedies which the companies owned or controlled by Mr. Lauder, allegedly including CME which may be obtained in the various fora in

which his dispute with Dr. Železný/CET 21 is being fought out, may compensate for any losses which such entities may be found to have suffered. It may be found that no damage has been suffered by any of the entities involved in this affair, including CME. Thus the failure to plead that CME has suffered damage not only strikes at the heart of the claim, but is an inevitable consequence of the realities of the dispute. If CME has suffered no damage, this claim fails *in limine*. CME must show that it has suffered damage for the claim to be admissible under the Treaty.

### **VIII. Respondent's Conclusion**

374. The Czech Republic requests that CME's claim be dismissed on grounds of lack of jurisdiction; alternatively on grounds of lack of admissibility; alternatively on grounds that CME has failed to establish any breach of the Treaty; alternatively on grounds that CME has failed to plead any loss.

#### **H.**

#### **The Analysis of the Tribunal**

##### **I. Jurisdiction**

##### **(1) The Claimant's Investment**

375. The Tribunal has jurisdiction to decide this dispute under Article 8 of the Treaty. According to Article 8.2 of the Treaty, each Contracting Party consents to submit an investment dispute as defined in Article 8.1 to arbitration. Investment disputes covered by this arbitration clause are disputes between one Contracting Party and an investor of the other Contracting Party concerning an investment of the latter. The Claimant is an investor in accordance with Article 1 (b) of the Treaty, as the Claimant is a legal person constituted under the law of one of the Contracting Parties, the Kingdom of the Netherlands. The dispute concerns an investment of the Claimant within the terms of Article 1 (a) of the Treaty. Article 1 (a) provides that the term investment shall comprise every kind of asset invested either directly or through an investor of a third State. The investment can be (inter alia) shares, other kinds of interests in companies and joint ventures, as well as rights deriving therefrom, title to

money and other assets and to any performance having an economic value.

376. The Claimant is the 99 % shareholder of ČNTS. These shares as well as all rights deriving therefrom qualify as an investment of the Claimant under Article 8.1 and Article 1 (a) (ii) of the Treaty.
377. CME, the Claimant, acquired its 99 % ownership interest in ČNTS in two steps. CME acquired 93.2 % in May 1997 from its parent company, the Czech Media Enterprises B.V. The Claimant further acquired 5.8 % shares in 1997 by purchasing the Czech holding company NOVA Consulting, which held a 5.8 % shareholding in ČNTS.

## **(2) The Claimant's 1997 Share Acquisition**

378. The Respondent, for the first time at the Stockholm hearing, expressed its view that the investment of the Claimant in the Czech Republic within the meaning of the Treaty was (only) made when it purchased in 1997 the ČNTS shares held by CME Media Enterprises B.V. The Respondent, in respect to this investment of the Claimant in the Czech Republic, expressly did not raise the defence of lack of jurisdiction. The Respondent is, however, of the opinion that Claimant's investment in 1997 limits timewise the Claimant's claim in substance which, therefore, will be dealt with hereafter, when dealing with the merits of the Claim.
379. Any possible defence in respect to lack of jurisdiction related to the Claimant's acquisition of the ČNTS shares in 1997, therefore, must be deemed as waived. That also would be consistent with Rule 21.3 of the UNCITRAL Rules, according to which objections in respect to jurisdiction must have been made in the Statement of Defence.
380. The Arbitral Tribunal considered whether (by disregarding the Respondent's waiver of a defence of lack of jurisdiction in respect to the 1997 share acquisition), the Tribunal is obligated ex officio to decide on this subject. The majority of the Tribunal is of the opinion that, disregarding possible Czech national law requirements, the clear provision of the UNCITRAL Rules must supersede national law, if deviating. According to



the UNCITRAL Rules, a defence of jurisdiction is deemed to be waived, if not raised in time. This concept derives from the assumption that defences on jurisdiction can be waived by the Parties, with the consequence that a Tribunal is not able to set aside or disregard a Party's waiver in respect to the defence of lack of jurisdiction.

381. Therefore, the Respondent's argument that the investment of the Claimant in the Czech Republic was not made until May 21, 1997 must be dealt with by the Tribunal in accordance with the Respondent's express pleadings as a substantive defence, not as a defence to jurisdiction.

### **(3) The Claimant's Predecessor's 1994 Share Acquisition**

382. The Respondent in its Statement of Defence dated November 9, 2000 raised the defence of lack of jurisdiction in respect to the Claimant's predecessor's share acquisition. The Respondent claimed inter alia that CME has failed to establish that it has an asset invested in the Czech Republic as defined under the Treaty. The Respondent's position is that the Claimant did not sufficiently identify its investment by leaving open whether CME's investment "is its alleged shareholding in ČNTS or some contractual right allegedly enjoyed by ČNTS or some right conferred on CEDC". According to the Respondent, CME fails to establish that it has assumed the rights and obligations of CEDC as a matter of law. This defence of lack of jurisdiction, even if accepted as sufficiently specified, is not justified. The Claimant's investment is vested in its shareholding in ČNTS which is an investment covered by Article 1 (a) (ii) of the Treaty.

383. As recounted in Section A. 5 of this Award, CME acquired its 99 % ownership interest in ČNTS in 1997, an acquisition which, in respect to jurisdiction is not in dispute between the Parties (as described above). CME's predecessor, its parent company, Czech Media Enterprises B.V., had acquired in 1994 66 % of ČNTS from CEDC, a German company under the same ultimate control as CME of an American corporation, in turn controlled by Mr. Ronald S. Lauder. The transfer document done in Prague on July 28, 1994 between CEDC and CME Media Enterprises B.V. gives sufficient proof that CME Media Enterprises B.V. acquired CEDC's 66 % shareholding in ČNTS. Under this Assignment Agreement and

Declaration on Accession to Memorandum of Association of ČNTS, the Claimant's predecessor CME Media Enterprises B.V. acquired CEDC's shares in ČNTS, comprising all rights and obligations thereto.

384. The acquired shares, including all rights and legal entitlements, are protected under the Treaty. Upon the acquisition, the Claimant's predecessor became owner of the investment in the Czech Republic. The Treaty does not distinguish as to whether the investor made the investment itself or whether the investor acquired a predecessor's investment. In this respect, Article 8 of the Treaty defines an investment dispute as existing, if a dispute concerns an investment of the investor. Article 1 of the Treaty clearly spells out that an investment comprises every kind of asset invested either directly or through an investor of a third State, which makes it clear that the investor need not make the investment himself to be protected under the Treaty.

**(4) The 1994 Share Assignment not notified**

385. The Respondent did not expressly argue in these arbitration proceedings that the assignment of the 66 % ČNTS shares from CEDC to CME Media Enterprises B.V. was void. The Respondent stated, however, that the assignment was not notified to the Media Council which, in the view of the Respondent, was necessary under Condition 17 of the Licence.
386. The non-notification of the assignment did not remove the Claimant's protection under the Treaty. Under Section 12.1 of the MOA, the assignment of shares to an affiliated company was permitted without requesting the Media Council's approval. Under Condition 17 of the Licence as amended as of May 12, 1993, the Media Council stipulated that the partnership agreement (the MOA) is an integral part of the Licence terms. Further, the Media Council prescribed that the partners of the MOA are the licence-holder (CET 21), CEDC and the Czech Savings Bank in the scope and under the conditions stipulated by the MOA.
387. CET 21 was obligated to submit to the Council for approval any changes of the legal person which has been the licence-holder, or of the capital structure of the investor which results in a change of control over the ac-

tivities and of the provisions of the partnership agreement between the licence-holder and investors (the MOA). The change-of-control clause of the MOA (Section 12.1) linked the shareholding in ČNTS to the Licence. Article 12. 1 of the MOA stated that, in accordance with the terms and conditions of the Licence, CEDC, CET 21 and the Czech Savings Bank cannot and shall not assign their shares to any third Party without obtaining in advance the express consent of all partners and the Council, which would be given after a full disclosure of the intended transaction.

388. However, this provision does not apply to any “direct family member or associated persons”. An associated company was defined as an entity controlled by the same last partner of the shareholders. Therefore, the MOA, being an integral part of the Licence, did allow a change of control without having obtained in advance the express consent of the Council.
389. The Council requested by its resolution of April 9, 1993, the submission of the final draft of the MOA for approval and by its resolution of April 9, 1993, requested final changes. At the Council Meeting on April 20, 1993, the Council approved the final wording of the MOA which was implemented accordingly. On May 12, 1993, the Council approved Licence Condition 17 which referred to the amended MOA as approved by the Council. This sequence of events is not in dispute between the Parties, although the Parties interpret these facts differently.
390. In respect to jurisdiction, it is clear that CEDC’s investment in ČNTS could be assigned to CME Media Enterprises B.V. without requesting prior approval from the Council. On the contrary, it is clear that CEDC’s investment in ČNTS included the right to freely transfer this investment to an affiliated company. The assignment by CEDC of its shares in ČNTS to CME Media Enterprises B.V. was made with express reference to the MOA. It is therefore clear that CME Media Enterprises B.V. (as a permitted successor under the MOA, which was approved by the Council), when acquiring CEDC’s investment in the Czech Republic, acquired full protection for this investment under the laws of the Czech Republic which include the bilateral investment treaties the Czech Republic had entered into, including the Treaty.

**(5) The Claimant's Predecessor's 1996 Share Acquisitions**

391. The acquisition of 22 % of the shares in ČNTS by CME Media Enterprises B.V. in 1996 from the Czech Savings Bank also qualifies as an investment under the Treaty. The same applies to the acquisition of 5.2 % shares in ČNTS from CET 21, also in 1996. These further acquisitions were not the subject of any judicial dispute by the Parties in these arbitration proceedings. These shares were part of the same initial investment made by the founding shareholders, CEDC (with a share of 66 %), CET21 (with a share of 21 %) and the Czech Savings Bank (with a share of 22 %) as co-founders who formed the joint venture company ČNTS in 1993.
392. In respect to jurisdiction, CEDC's and CME Media Enterprises B.V.'s acquisition of shares qualify as an investment within the meaning of Article 8 of the Treaty in conjunction with Article 1 (a) (ii) of the Treaty. When initiating these arbitration proceedings, the Claimant was and still is owner of 99 % of these shares in ČNTS. It is true that the shares themselves were not directly affected by the Respondent's alleged breach of the Treaty. The dispute to be defined as an investment dispute under Article 8 of the Treaty does not necessarily relate to the shares themselves, but to the value of the shares, which, the Claimant alleges, have been eviscerated by the Respondent. It is the Claimant's case that the Respondent, in breach of the Treaty, expropriated (inter alia) ČNTS' legal and commercial assets and rights. Such an expropriation of assets and, in particular, legal rights and entitlements of ČNTS, a joint venture of the Claimant with Czech nationals (the Czech Savings Bank and CET 21), could and allegedly did affect the value of CME's shares in the joint venture, such shares clearly being an "investment" in accordance with Article 1 of the Treaty. Therefore, the Arbitral Tribunal will have to examine whether the Czech Republic expropriated the joint venture company ČNTS as alleged by the Claimant (see *Tradex Hellas S.A., Greece vs/ Republic of Albania*, ICSID Arbitration Award, April 29, 1999).

**(6) CME's Predecessor's Original 1993/1994 Contributions qualify as Investment under the Treaty**

393. The original contributions by CEDC, the Czech Savings Bank and CET 21 were made on the basis of the Memorandum of Association and Investment Agreement (the MOA) notarized in front of a Czech notary on/or about May 4, 1993 and submitted for registration on/or about July 8, 1993. The registered capital of ČNTS was 148 million Czech Crowns. CET 21's non-monetary contribution, evaluated at 48 million Czech Crowns, was to contribute to ČNTS "unconditionally, unequivocally and on an exclusive basis the right to use, exploit and maintain the Licence held by CET 21." The Czech Savings Bank contributed 25 million Czech Crowns and CEDC contributed 75 million Czech Crowns. The ownership interests were allocated as follows: CEDC 66 %, Czech Savings Bank 22 %, CET 21, 12 %.
394. According to Sec. 2 of the MOA, CEDC and the Czech Savings Bank agreed to provide additional financing to ČNTS as additional contributions to the registered capital of up to 400 million Czech Crowns. Thereafter, the shareholders agreed to provide additional financing up to 900 million Czech Crowns as needed through bank loans. This obligation to provide additional financing either by share capital or by bank loans was secured under Section 2.5 of the MOA by 20 % interest on the debt sum in respect to which a shareholder was in default. CEDC, therefore, and the Czech Savings Bank obligated themselves to make substantial contributions for the future of ČNTS, dedicated for "the development and management of the Television Station".
395. The Claimant's predecessor's investments, by acquiring in 1994 and thereafter ČNTS' founders' shares and by consummating their obligations under the MOA, qualify as an investment under the Treaty.
396. The Respondent, in this context, raised the defence that the Claimant exercised some kind of (unacceptable) forum shopping. The Respondent characterized the initiation of parallel treaty proceedings by Mr. Lauder and by the Claimant as an abuse. In respect to jurisdiction, this defence is not persuasive. CEDC, when making the investment in ČNTS in 1993/1994, was under the protection of the German-Czech Republic In-

vestment Treaty which, in essence, provides a similar protection as the Treaty. The assignment of the investment in ČNTS from a German corporation to a corporation having its legal seat in the Netherlands does not have, on the face of it, the stigma of an abuse. The Respondent characterized the initiation of parallel treaty proceedings by Mr. Lauder and by the Claimant as an abuse.

397. The Arbitral Tribunal's view is that the contribution made by CEDC and the assignment thereof in compliance with the investment structure approved by the Media Council to CME Media Enterprises B.V., qualifies as an investment under Article 8 of the Treaty. The Respondent's argument in respect to an alleged forum (or treaty) shopping is not sustainable.
398. In this context, the Tribunal refers to the FEDAX Award on jurisdiction dated July 11, 1997, an ICSID arbitration (37 I.L.M. 1378/1998). In that case, the FEDAX tribunal accepted ICSID jurisdiction for a claim under promissory notes which had been transferred and endorsed to subsequent holders and to the claimant outside of the host country of the original investment. The FEDAX tribunal rejected the argument that the foreign owner of the promissory notes did not qualify as an investor, because it has not made an investment in the territory of the host country and accepted that, although the identity of the investor will change with every endorsement, the investment itself will remain constant, while the issuer of the notes will enjoy a continuous credit benefit until the time the notes become due.
399. In the Claimant's case, the situation is even clearer. CEDC made the investment by making its shareholder's contribution at the formation of ČNTS in 1993. ČNTS enjoyed the benefit of the investment during its corporate life-time. TV NOVA started broadcasting in February 1994 by using CEDC's invested funds (together with the funds invested by the Czech Savings Bank). By mid-1994, when the Claimant's predecessor acquired the investment, the investment was at full risk and it was not until one year later that the investment turned out to be a success for the investors.
400. Further, CEDC's investment in ČNTS must be seen in its legal entirety as approved by the Media Council. A company affiliated to the investor,

being an acknowledged (permitted) successor under the investment structure approved by the Media Council, is protected by the investment protection laws of the host country. Article 8 of the Treaty does not set specific requirements related to the circumstances under which an investment can be regarded as belonging to the investor protected by the Treaty. This is in accord with the great majority of modern bilateral investment treaties (see Antonio R. Parra in "Economic development, foreign investment and the law", published by Kluwer 1996, page 35). In respect to jurisdiction, therefore, the Claimant enjoys the full protection of the Treaty, having acquired through its predecessor CEDC's investment 66 % shareholding in ČNTS in 1994. The same applies to the further shareholding in ČNTS acquired thereafter by the Claimant and the Claimant's predecessor.

#### **(7) The Investment Dispute under the Treaty**

401. The dispute between the parties as alleged by the Claimant derives from the destruction of the joint venture's assets and the devaluation of its factual and legal position connected with the use of the broadcasting Licence, contributed by CET 21 to ČNTS as a founding shareholder of ČNTS. This dispute qualifies as an investment dispute within the meaning of Article 8 of the Treaty. In particular, it is not disqualified as an investment dispute because it is not, as alleged by the Respondent, a private commercial dispute but an investor-host State dispute.
402. ČNTS' disputes and legal proceedings with CET 21 and Dr. Železný also do not transform the dispute between the Claimant and the Czech Republic into a commercial dispute unrelated to the Treaty. Commercial disputes and proceedings between private parties, though one party be the investor and/or his joint venture company, do not per se exclude the existence of an investment dispute under the Treaty.
403. The investment dispute under the Treaty and the commercial dispute between the investors' joint venture company in the Czech Republic and its shareholders and/or business partners must be distinguished. The Claimant's position is that the Czech Republic, represented by the Media Council, violated its duties under the Treaty in various ways. The Arbitral

Tribunal has jurisdiction over such an investment dispute, whereas jurisdiction over private commercial disputes between ČNTS and CET 21 / Dr. Železný is vested in the Czech Republic's courts or in arbitration as the case may be.

404. The private commercial disputes in question are different in respect to the parties, certain basic facts and underlying legal rights and obligations. This Tribunal has jurisdiction in respect to the dispute concerning the alleged violation of the Treaty by the Czech Republic. The Tribunal has no jurisdiction related to commercial disputes, regardless of whether the respective civil court proceedings, in particular as initiated by ČNTS vs. CET 21, may provide a remedy to ČNTS (depending on the final judgment of the Czech Supreme Court). These civil court proceedings may effect the quantum of the damage as claimed by CME in these arbitration proceedings. The civil court proceedings, however, have no effect on the jurisdiction of this arbitral Tribunal under the Treaty.
405. Although the contractual arrangements between CET 21 and ČNTS could be decisive for the Claimant's claim under these arbitration proceedings, this does not take away jurisdiction from this Tribunal. The Claimant's claim is based on the Czech Republic's interference and non-protection of the Claimant's and its predecessor's investment which is clearly an investment dispute and not a private commercial dispute. The fact that a contractual arrangement between CET 21 and ČNTS is also the basis for civil law proceedings between these contractual parties does not deprive the Claimant of its claims under the Treaty deriving from the alleged breach of the Treaty committed by the Czech Republic acting through the Media Council.
406. The Czech Republic's position that the grant of the Licence signified no more than the Council considered, on the basis of the information then available to it, that CET 21 was a proper recipient of the Licence, is irrelevant for the qualification of these arbitration proceedings as investment treaty proceedings.
407. Whether the Media Council, as the Czech Republic stated, did not have the power to approve or endorse the business arrangement between



CEDC, the Czech Savings Bank and CET 21 is a question of the substance of the claim and not a question of jurisdiction.

408. Furthermore, the Respondents position, according to which the prejudice to the Claimants and its predecessor's investment was caused not by the Media Council but by Dr. Železný, is a matter of substance and not of jurisdiction. Decisive for the matter of jurisdiction is only the issue of whether the Czech Republic by the Media Council's action breached the Treaty and caused injury to the Claimant's and/or its predecessor's investment. The Arbitral Tribunal is aware that it may well be that a variety of circumstances may have caused the debasement of the Claimant's investment. That will not take away jurisdiction from this Tribunal, which is obliged to investigate and adjudicate the case restricted to the investment treaty dispute, whereas civil law claims might be sorted out between the respective parties in other proceedings.

#### **(8) Parallel Proceedings**

409. The Czech Republic's view that Treaty procedures were not intended to be used in these circumstances is not sustainable. Treaty proceedings are barred by civil law proceedings only if the respective investment treaty contains such a provision. Modern bilateral investment treaties usually do not contain judicial limitations like that. Modern investment treaties tend to allow a broad and extended access in the same way as modern treaties avoid any kind of restrictions which may provide uncertainties for the identification of the protected investment (Giorgio Sacerdoti "Bilateral Treaties and Multilateral Instruments on Investment Protection" in *Recueil des Cours* 1997).
410. The Respondent's contention that the Claimant exploited a dispute under a commercial contract to pursue Treaty proceedings must be rejected. The Claimant based its claim on the alleged breach of the Treaty. In parallel the Claimant's subsidiary in the Czech Republic has pursued its civil law claims in front of the Czech Civil Courts. The fact that the object of the two proceedings, compensation for injury to the Claimant's investment, is the same, does not deprive the parties in the Treaty proceedings nor in the civil court proceedings of jurisdiction. An affirmative award

and/or judgment may have impact on the quantum of the damages adjudicated in the proceedings or give the right to the respective defendant to raise legal defences in the respective enforcement proceedings with the argument that the adjudicated damage claim has been already remedied under the award and/or judgment of the respective other proceeding. However, jurisdiction is not affected by this incidence of parallel proceedings.

411. The Respondent's defence that the Claimant may not concurrently pursue the same remedies in different fora is, therefore, rejected. Further, it is understood and agreed between the Parties that the Claimant is not obligated under the Treaty to exhaust local remedies in the Czech Republic.

**(9) No abuse of Treaty Proceedings**

412. There is also no abuse of the Treaty regime by Mr. Lauder in bringing virtually identical claims under two separate Treaties. The Czech Republic views it as inappropriate that claims are brought by different claimants under separate Treaties. The Czech Republic did not agree to consolidate the Treaty proceedings, a request raised by the Claimant (again) during these arbitration proceedings. The Czech Republic asserted the right to have each action determined independently and promptly. This has the consequence that there will be two awards on the same subject which may be consistent with each other or may differ. Should two different Treaties grant remedies to the respective claimants deriving from the same facts and circumstances, this does not deprive one of the claimants of jurisdiction, if jurisdiction is granted under the respective Treaty. A possible abuse by Mr. Lauder in pursuing his claim under the US Treaty as alleged by the Respondent does not affect jurisdiction in these arbitration proceedings.

**(10) Outcome of Civil Court Proceedings have no Effect on Jurisdiction**

413. Moreover, the Respondent's further contention that the outcome of the civil court proceedings between ČNTS and CET 21 will finally determine

whether the Claimants shareholding in ČNTS was prejudiced, is not conclusive. The final judgment by the Czech Supreme Court may reinstate the Czech Regional Commercial Court judgment which ruled that CET 21 did not validly terminate the Service Agreement and that CET 21 is obligated to exclusively have broadcasting services supplied by ČNTS. The outcome of the civil court proceedings was open at the closing of the hearing of these proceedings. The civil law suit was still pending at the Czech Supreme Court. However, even if the Czech Supreme Court were to reinstate the Regional Commercial Court judgment, this would not remedy the harm to the Claimant's investment.

414. On the contrary, the dependence of the Claimants investment on the contradictory Civil Court judgments clearly shows how fragile the Claimant's investment is (the alleged consequence of the Czech Republic's breaches of the Treaty). Even if the regional Commercial Court's judgment is reinstated by the Czech Supreme Court, this will not remedy the Claimant's investment situation. CET 21 may well, at any time, terminate again the Service Agreement for good cause, whether given or not, thereby recurrently jeopardizing the Claimant's investment.
415. The Claimant was, therefore, not obligated to wait for the Czech Supreme Court's decision before instigating Treaty proceedings. The outcome of the civil court proceedings is irrelevant to the decision on the alleged breach of the Treaty by the Media Council acting in concert with the Respondent. It may affect the quantum of a damage claim which, pursuant to agreement between the parties, is not a subject of this Partial Award.

**(11) Respondent's Defence that no Loss Occurred**

416. The Respondents' argument that under the Claimant's pleadings there is no suggestion that there is any compensable loss that is attributable to the breakdown of the exclusivity arrangement should be dealt with on the merits of the claim, not in respect to jurisdiction. The Respondents' position that an investor's complaint of a mistreatment in investment proceedings cannot be determined before the State has treated the investment finally including through judicial process, is a position which is not sustainable. It is generally accepted that claims under investment trea-

ties can be and shall be dealt with separately from the judicial process in local courts, unless otherwise specifically provided for in the respective Treaty. Such a requirement to exhaust local remedies is not found under this Treaty and the initiating of a judicial process in the Czech Republic does not bear upon proceedings under the Treaty. This is the understanding also of the Respondent, as specifically stated by Prof. Lowe, the Respondent's representative at the Stockholm hearing, when he said that there was plainly no requirement under the Treaty for the Claimant to exhaust local remedies.

417. The Respondent's position was, as submitted by Prof. Lowe, a slightly different one. The Respondents' view is that the Claimant cannot prove any loss as long as the Claimant did not exhaust the legal remedies under the Czech Civil Court system. This contention is not acceptable. A purpose of an international investment treaty is to grant arbitral recourse outside the host country's domestic legal system. The clear purpose is to grant independent judicial remedies on the basis of an international, accepted legal standard in order to protect foreign investments. An investment treaty therefore may even grant indemnification in case of expropriation where the domestic law does not (see *Sacerdoti* as cited above at page 289 referring to a decision of the Italian Supreme Court on this subject). As the Treaty is silent on the obligation of exhaustion of local remedies, the Claimant is entitled and in the position to substantiate its loss without being obligated to have its subsidiary ČNTS obtain a final civil law court decision by the Czech Supreme Court.

**(12) Claimant itself made no Investment**

418. The Respondent's further argument that the Claimant itself never made an investment in the Czech Republic is rejected for the reasons already mentioned above. The Treaty does not require that the assets or funds be imported from abroad or specifically from the Netherlands or have been contributed by the investor itself. (As *Sacerdoti* as cited above observes, this requirement is rarely found in recent bilateral investment treaties. This is in compliance with the above-cited *FEDAX Award* which held that the acquisition of promissory notes by the Dutch claimant was a foreign investment despite the fact that *FEDAX* itself never transferred

funds to Venezuela. FEDAX N.V. vs. Republic of Venezuela ICSID Case no. ARB 96/3, the award on jurisdiction dated July 11, 1997 published in ILM 37 (1998), 1378/1390 and the award in substance of March 9, 1998 published in ILM 37 (1998), 1391/1398.)

## **II. The Substance of the Claimant's Case**

### **1. Admissibility / Timewise Limitation**

#### **(1) Parallel Treaty Proceedings**

419. The same reasons for the Tribunal to acknowledge jurisdiction apply to the admissibility of the Claimant's case. The Respondent's argument that the Claimant's case is not admissible, submitted by the Respondent as an alternative to the defence of non-jurisdiction, is rejected. The inadmissibility argument is predominantly based on the fact that Mr. Lauder in parallel to the Claimant initiated other Treaty proceedings. However, the Claimant is free to initiate the Treaty proceedings, if there is an investment dispute in the meaning of Article 8 of the Treaty. The argument of abusive Treaty shopping is not convincing. A party may seek its legal protection under any scheme provided by the laws of the host country. The Treaty as well as the US Treaty are part of the laws of the Czech Republic and neither of the treaties supersedes the other. Any overlapping of the results of parallel processes must be dealt with on the level of loss and quantum but not on the level of breach of treaty. The Claimants' case is admissible.

#### **(2) No restriction of the Claimant's case timewise**

420. There is no time bar to the Claimant's case. The Respondent's position is that the investment of the Claimant in the Czech Republic was not made until May 21, 1997, when it purchased the shares held by CME Media Enterprises B.V. in ČNTS. This, as the Respondent clarified, is the Respondent's defence on the merits. However, this defence, whether in substance or in respect to admissibility, cannot succeed.

421. The Claimant acquired the shares held by CME Media Enterprises B.V. under the Agreement on Transfer of Participation Interest. The Claimant,

under the MOA, was an authorized transferee and the transfer did not need the consent of the Media Council under Condition 17 of the Licence which referred to the MOA of ČNTS, because the transferor and transferee of the assignment had the same ultimate shareholder, Mr. Ronald S. Lauder. The Claimant acquired the participation interest as it was at the day of transfer. The purchase price was US \$52,723,613 and the acquired participation interest reflected a contribution of 344 million Czech Crowns. The Agreement on Transfer expressly stipulated that the Claimant, being the transferee, declared its consent with the MOA without any reservation. The Claimant, therefore, acquired its parent company's shares in ČNTS without any reservation or limitation. The participation interest transferred the legal status as it was, including all rights and liabilities connected thereto.

422. The Respondent's view that the Claimant, by declaring its consent to the MOA, may only advance claims in respect of violations of the Treaty that occurred after May 21, 1997, is not sustainable. The consent to the MOA which is required by Czech law has effect only between the shareholders. The consent is not a waiver of claims which derive from the Respondent's violations of the Treaty already incurred at the transfer date and the consent did not waive the Claimant's protection under the Treaty, should such protection derive from acts and circumstances that occurred before the transfer of shares took place.
423. The Respondent's view that the transfer of shares deprived the Claimant of the protection under the Treaty, because the investment changed hands from one (Dutch) shareholder to the other is not convincing. The Memorandum of Association was approved by the Media Council in 1993 and thereafter again, when the new MOA was implemented on November 14, 1996 without providing for any change of the change-of-control clause. Therefore, any claims deriving from the Claimant's predecessor's investment (also covered by the Treaty) follow the assigned shares.
424. Article 8 of the Treaty, therefore, does not debar the Claimant's claims on the ground advanced by the Respondent. In accordance with Article 8 of the Treaty, an investment dispute under the Treaty is covered, if the dispute derives from an investment of the investor. As already shown above under the issue of jurisdiction and now, and in respect to the ad-

missibility of the claims, it is the Tribunal's view that the investment need not have been made by the investor himself. This conclusion is supported by Article 1 of the Treaty which defines an investment as "any kind of asset invested either directly or through an investor of a third State". This indicates a broad interpretation of the investment which also allows the (Dutch) parent company's investment to be identified as an investment under the Treaty. If the Treaty allows - as it does - the protection of indirect investments, the more the Treaty must continuously protect the parent company's investment assigned to its daughter company under the same Treaty regime.

### **(3) Admissibility of the Claimant's case in respect to the 1994 Share Acquisition**

425. The Parties did not specifically address under the aspect of admissibility of the Claimant's claim or elsewhere the Claimant's predecessor's acquisition of shares from CEDC in 1994. The reason for not addressing this subject might be that the alleged violations of the Treaty took place thereafter. Therefore, this 1994 transfer need not specifically be dealt with under the aspect of admissibility of the Claimant's case. However, it is obvious that the Claimant's predecessor, when acquiring the ČNTS shares from CEDC (as admitted transferee under the MOA's Change of Control clause), acquired CEDC's full investment, including all ancillary rights and obligations.
426. In respect to this share transaction, the Respondent raised the view that the Claimant's predecessor CME Media Enterprises B.V., when acquiring the shares in 1994, "must have considered the commercial risk of investing in ČNTS as well as the legal frame work, in which this investment would be made, when it decided to acquire CEDC's rights and obligations in the MOA". It is undisputed between the Parties to these arbitration proceedings that CME Media Enterprises B.V. understood the legal framework of CEDC's investment when acquiring the ČNTS shares. This knowledge, however, has no influence on the investment's protection under the Treaty. It is not the case that the Claimant and its predecessors entered willingly into the risk that their investments in ČNTS will be eviscerated by acts of the Media Council. On the contrary, it became

clear from the documents and other written communications submitted by the Parties to these proceedings that the Claimant and its predecessors relied on the protection of their investments by the Czech legal system, including the Czech Republic's obligations under the Treaty. Therefore, the Claimants case is admissible and there is no time bar to CME's claim related to the Claimants and its predecessor's investment in the Czech Republic.

## **2. The Merits of the Claimant's Case under the Treaty**

427. The Claimant's case is justified in substance. The Czech Republic violated the Treaty by actions and inactions of the Media Council which led to the complete collapse of the Claimants and the Claimants predecessor's investment in the Czech Republic.

### **(1) CME's and CME's predecessor's investments in the Czech Republic**

428. The 66 % shareholding in ČNTS which was acquired by CME's predecessor from its affiliated company CEDC in 1994 qualifies, as explained above, as an investment under the Treaty. The same applies to the further 33 % shareholding in ČNTS acquired by the Claimant and the Claimant's predecessor. CEDC made a capital contribution under the MOA for the initial share capital in the amount of 75 million Czech Crowns. A further investment obligation obligated CEDC and the Czech Savings Bank to invest further 1.3 billion Czech Crowns. The purpose of the investments was to develop and manage the television station TV NOVA, for which the broadcasting Licence was granted to CET 21 by the Media Council, acting as the statutory regulator of the Czech Republic. CEDC's investment was made under an investment scheme which was developed in close liaison with and under approval of the Media Council. It was also CEDC which had to provide the know-how for developing the new TV station, as neither the Czech Savings Bank as co-founder of ČNTS, nor CET 21 and its shareholders had relevant experience. The five Czech nationals who were the shareholders of CET 21 which initiated the joint project never worked in the broadcasting indus-



- try. The investment structure was developed by CEDC, jointly with its Czech Republic joint venture partner CET 21 in close conjunction with the Media Council. While the broadcasting Licence was granted to CET 21 (having no foreign shareholder), the operation of the TV station was in its totality vested in the joint venture company ČNTS.
429. The documents submitted by the Parties in these proceedings, in particular, the Media Council's own statements to the Czech Parliament leave no doubt that the investment, made by CEDC for the exclusive use of the broadcasting Licence granted to CET 21, was monitored, directed and approved by the Media Council. The basis for the investment structure with the participation of CEDC is the broadcasting Licence as awarded by decision of the Media Council of February 9, 1993 to CET 21. Its reasoning clearly spells out that the substantial involvement of foreign capital and broadcasting know-how was necessary to begin and operate television station activities. The legal tool to safeguard the public interest was to require that the leading positions in the television station were taken by Czech nationals, that the programming was not influenced by the foreign investor and that journalistic independence was safeguarded. These were the Licence conditions designed to ensure the national character of the programming of the new television station.
430. The Media Council further, in its justification for the Licence, stated that the Media Council created sufficient mechanisms through which it could monitor the observance of the schedule for implementation of the new TV station. Through the formulation of Licence conditions and through the inspection of their observance, the Media Council ensured that the aims of the Media Council were realized.
431. The basis for the Media Council's decision to grant the Licence to CET 21 was the "all-over structure" of a new Czech commercial television entity dated February 5, 1993 which was submitted jointly by CET 21 and CEDC to the Media Council. This "all-over structure" clearly described the separation of the broadcasting operation vested in a new legal entity ("the Commercial Company") to be formed by CEDC, the Czech Savings Bank and CET 21, whereas the broadcasting Licence was granted to CET 21 as the holder of the Licence for nation-wide television broadcasting under the legal Act No. 468/1991 Col. The "all-over

structure” clearly spelled out that CET 21 and CEDC (CEDC as “direct participant” in the contract under the conditions of that Licence) agreed on the structure of the new entity which was formed with the purpose to finance and run the commercial, technical, management and other activities of the station. It was further clearly spelled out that the new company would be authorized to carry out these activities as long as CET 21 held the television Licence.

432. Further, it was stated that CET 21 acknowledged that it does not have the authority to perform broadcasting “without the direct participation of CEDC”. The “all-over structure” provided that a Board of Directors shall govern the basic decisions in respect to the economic management of the corporation. The day-to-day management and administration as well as the programming of the station was to be performed by the operating management. All operating personnel must be employees of the joint venture company. 90 % of the employees and the management of the station must be citizens of the Czech Republic. This management was to be complemented by the best foreign experts talented in engineering and technology, marketing and other areas to assist and train the local personnel.
433. The “all-over structure” of February 5, 1993 was made an integral part of the Licence granted by the Media Council to CET 21 by reference in the Licence conditions to an appendix to it. In Licence conditions Nos. 17 and 18, CET 21 as licence-holder agreed

*17/ that is will submit to the Council for its prior consent any changes in the legal entity that is the licence-holder, capital structure of investors and provisions of the business agreement [i.e. the Memorandum of Association] between the licence-holder and investors. Parties to the business agreement are the licence-holder, CEDC and Česká Spořitelna a.s., in the scope and under the conditions set by the business agreement which will be submitted to the Media Council within 90 days after the decision to issue the Licence takes legal effect; the business agreement will observe the provisions of the “agreement on the business agreement” between the licence-holder and CEDC which is an appendix to the licence conditions;*

*18/ that CEDC, as a party to the business agreement specified in the Licence conditions, and other investors specified by the business agreement, will not in any way interfere in the programming*

*of the television station , and, in particular will not interfere with the editorial independence of newscasting employees;”*

434. The reference to the “agreement on the business agreement” was a reference to the “all-over structure” of February 5, 1993, as was confirmed by witnesses at the Stockholm hearing. This is consistent with the minutes of the meeting of the Media Council on February 4 and February 5, 1994, where CET 21 submitted “only one of the requested materials, the agreement on the structure of broadcasting between CET 21 and CEDC”. The witness Mr. Josefík, who was in 1993 member of the Council and later its chairman, confirmed that on February 5, 1993 the Council received “a new organizational structure of the future commercial broadcasting”. The witness confirmed that the appendix to the Licence condition was the February 5 agreement. It is, therefore, clear that the “all-over-structure” of CEDC’s investment was made part of the Licence. Mr. Josefík further confirmed that the Council discussed the future arrangement between CET21 and CEDC. The Council expressed its opinion on proposals made by CET 21 in respect to the structure and, based on the Council’s comments, CET 21 submitted the amended structure dated February 5, 1993 which was made part by reference of Licence condition No. 17.
435. The various witness statements clarified that the “over-all structure” dated February 5, 1993 was a carefully designed scheme to allow the foreign investor CEDC take part in the operation of the TV station without becoming a shareholder of licence-holder CET 21. The scheme was developed in close inter-action between the Media Council and CET 21. It was developed from the an initial proposal submitted by CET 21 to the Council dated February 3, 1993 which was prepared by CEDC’s representative, Mr. Fertig, and submitted to the Council by Dr. Železný. Both papers follow the same idea, having the holder of the broadcasting Licence separated from the operator.
436. The separation of the licence-holder CET 21 and the operator became necessary after the Council’s decision to grant the Licence to CET 21 was published on January 31, 1993. This decision created an uproar in the Czech Parliament and the Czech public. Members of the Parliament in particular criticised the grant of the Licence to CET 21. The Council developed the view that, accordingly, it would not be feasible to transfer

a share in CET 21 as originally contemplated to the foreign investor CEDC.

437. This sequence of events is supported by the underlying documents related to the application for the broadcasting Licence by CET 21, including personal presentations by CEDC's representatives in front of the Media Council before the Council decided to grant the Licence to CET 21.
438. The justifications of the decision to award the Licence of February 9, 1993 expressly stated that the Council's decision is based on the application by CET 21 for the broadcasting Licence, the written documents submitted to the Council and also the facts presented in the public hearing by CET 21 and CEDC. The documents submitted as part of the CET 21 application for the broadcasting Licence comprised inter alia the "project of an independent television station CET 21" which spelled out that CEDC is "a direct participant in CET 21's application for the Licence" and, in the enclosed Letter of Intent, it was made clear that CEDC was going to acquire a 49 % shareholding in CET 21 in exchange for its commitment to fund the broadcast station and provide the seed capital.
439. The agreement between CET 21 and "its foreign partners and experts" was communicated by CET 21 on December 21, 1992 to the Council. At the Council hearing on December 21, 1992, Mr. Palmer and Mr. Fertig represented CEDC and submitted the proposal to the Council according to which an "extensive share [was] reserved for foreign capital" and it was clearly indicated that this would be "a direct capital share, not credit". The financing to be provided by CEDC was an amount of US \$10 million which was confirmed in the Letter of Intent issued by CEDC to CET 21 as an attachment to the application documents.
440. After the grant of the Licence to CET 21 was released to the public in a press conference, followed by the uproar in the Czech Parliament, as described by the witness Mr. Fertig, the Council communicated to CET 21 that direct shareholding of CEDC was "politically impossible". Mr. Fertig stated that the Council requested the replacement of the direct shareholding by a structure which would give an equivalent level of participation from an economic standpoint and an equivalent level of influence from a business standpoint. In accordance with this request,

Mr. Fertig worked out the “over-all structure” dated February 3, 1993 which he typed on his personal computer. A Czech translation was submitted to the Council. Mr. Fertig stated that the “all-over structure” dated February 5, 1993 was developed by incorporating the changes requested by the Council.

441. The purpose of the changes was to have a separation of the Licence on the one hand and the operations on the other hand. As Mr. Fertig stated, the official “Decision to Award a Licence” at the Council meeting on February 9, 1993 was not made before the amended “all-over structure” dated February 5, 1993 was signed by CET 21 and CEDC.
442. This sequence of events as stated by the witness is confirmed by the minutes of the Council meeting dated February 4, 1993 and the “Decision to Award a Licence” dated February 9, 1993 which, in its reasoning, referred to the necessity of the substantial involvement of foreign capital for beginning television station activities and referred to the legal structure set out in the Licence conditions, “which shall fully guarantee the leading positions of domestic persons in the television station and their programming and journalistic independence” and further, by the official Licence document, including the Licence conditions and in particular the Licence conditions Nos. 17 and 18, all dated February 9, 1993.
443. The split structure of the licence-holder CET 21 and the operator ČNTS was developed on the basis of the Media Law of October 30, 1991. The Media Law of 1991 defined broadcasting as “*dissemination of programme services or picture and sound information by transmitters, cable systems, satellites and other means intended to be received by the public*”. A broadcaster under the Media Law 1991 is (inter alia) anyone, who obtained authorization to broadcast on the basis of an Act of the Federal Assembly, an Act of the Czech National Council, etc. or by being granted a Licence under this Act (a licence-holder). The Media Law 1991 did not describe the commercial or technical requirements to be performed by a licence-holder. However, according to Section 12.3 of the Media Law 1991, the Council was entitled to impose conditions on the licence-holder as part of the Licence.

444. Therefore, the Media Council, the regulator of the Czech Republic under the Media Law, decided to monitor the operation of the Licence under the split structure (CET 21 as licence-holder and ČNTS as operator) on the basis of inter alia the Licence conditions Nos. 17 and 18. This scheme was carefully designed legally and, on the face of it, in compliance with the Media Law, as the Media Law did not contain any restrictions or requirements in respect to the operation of the broadcasting system by the licence-holder or another operator. The Council, under condition No. 17, imposed as a part of the broadcasting Licence, the condition on CET 21 to submit the MOA between CET 21 and CEDC within 90 days after the decision to issue the Licence was to take legal effect. The MOA must reflect the provisions of the "agreement on the business agreement" which was the "all-over structure" dated February 5, 1993.
445. At the Council meeting dated April 8, 1993, the Council reviewed the draft MOA as submitted by CET 21. The Council declined to approve the MOA. With reference to the conditions of the Licence, the Council required that CET 21 shall provide the final version of the MOA between CET 21, CEDC and the Czech Savings Bank to the Council for approval by April 19, 1993 with the amendments required by the Council. This request for a change of the MOA was communicated by the Council to CET 21 on April 9, 1993 with reference to the terms of the Licence. Further, the Council approved Dr. Železný becoming a shareholder of CET 21. CEDC did not agree with the proposed amendments and its president and chief executive officer Mark Palmer sent a responsive letter to the Chairman of the Council on April 13, 1992. At the Council meeting on April 20, 1993, the final wording of the MOA was approved in accordance with Article 17 of the Licence conditions which was communicated to CET 21 on the next day.
446. The MOA, with the full title "Memorandum of Association and Investment Agreement", thereby became the basic document for the Claimant's predecessor's investment in the Czech Republic. The clear wording established that the television station shall be managed by the new company and that the object of the new company's business activity was "the development and operation of the new, independent, private, national television broadcasting station in compliance with the Licence and the

terms and conditions attached to it.” The purpose of the new company was to operate an independent television station and to achieve profits and ensure a high rate of return of equity for the partners, while providing a popular television channel for the Czech public.

447. The business decisions of the new company were vested in the Committee of Representatives which committee in particular had the power for decision-making on the programming principles, the programme structures and the programme plan of the TV station “in consultation with the chairman of the Programming Council”. The Programming Council had certain veto rights in respect to the programming and CET 21, despite its minority shareholding in ČNTS, was entitled to appoint three members to a Programming Council, two of its members to be appointed by the Czech Savings Bank and only one member to be appointed by CEDC, the seventh member being the programming director. The shareholders expressly agreed to be bound by and to respect the terms and conditions of the Licence granted by the Council.
448. Under Article 1.4.1 of the MOA, CET 21 was obligated to contribute to the company “the right to use, benefit from and maintain the Licence of the company on an unconditional, irrevocable and exclusive basis“. The value of the non-monetary contribution was denominated by 48 million Czech Crowns.
449. Further, the partners expressly agreed that they shall not undertake any action that would present a well-founded concern that it will make it more difficult to obtain a prolongation or renewal of the Licence in favour of the company.
450. *“In consideration of the efforts and the contributions to the Company, CET, CEDC and CS herewith commit themselves not to undertake any actions, either by assuming a contractual obligation or by negligence, that would jeopardize the granting of the Licence in general, and especially in accordance with the Act on Television Broadcasting in the Czech Republic (No. 468/1991 Sb.), to assign any right, in part or in full, relating to the aforementioned Licence to any third Party that is not a Party to this Agreement, with the exception of any successor appointed by the Company with the approval of the Council”.*

451. It is the view of the Arbitral Tribunal that this structure, as it appears from the MOA in conjunction with the Licence and its conditions Nos. 17 and 18, is a well-defined legal basis for the Claimant's predecessor's investment in the Czech Republic, granted after intensive consultations with and following requests and advice by the Media Council.
452. It is obvious that the structure of the split of the licence-holder and the operator, as specifically described and set out in this scheme, was the legal basis for the Claimant's predecessor's investment. The purpose of this scheme was to secure the Claimant's predecessor's investment in the Czech Republic in compliance with the Media Law of 1991. The scheme was recognized and developed in conjunction with the Media Council. In scrutinizing this scheme, it is apparent that the Claimant's predecessor's position was substantially more than a financial investor as suggested by the witness Mr. Josefík, who, in the eyes of the Tribunal, showed a rather selective and unpersuasive memory of the facts as the documents show them to be.
453. The Parties to these arbitration proceedings described CET 21's contribution, the right to use the Licence, as a lawful contribution. The Media Council itself in its report of October 1996 to the Czech Parliament reiterated that, *"at the time when the arrangement was made, there were no doubts about its legitimacy; in regard to many related steps that were taken, the Council, as it was then constituted and based on its experience at the time, took a position of consent"*. The Council in its report to the Czech Parliament described the structure which was used by TV NOVA, Premiéra TV and Rádio Alfa as having the following analogous features:
- "Their operation and programming are provided by other companies than the companies that were awarded the Licence, namely, on the basis of a special legal construction which captures, on the basis of a contract, their collaboration and mutual rights and duties. Therefore, there are two companies [related] to one Licence, the one that was awarded the Licence and the one that was established in order to implement it"*.
454. The witnesses confirmed that the CET 21 / ČNTS structure was used for other broadcasting stations. It was in particular used also for Pre-



miéra TV (a minor enterprise) and for Rádio Alfa (also controlled by CME).

455. Also, the report (called "opinion") of the Council to a Parliament Committee of May 1994 qualified the structure as "*standard business procedure which was duly discussed and approved by the licensing body, i.e. by the Council, and does not violate any effective legal regulations, [The Council] consulted with a number of leading legal experts, Czech and foreign*".

456. Further, the Council stated in its legal opinion to the Parliament that

*"the operation of a television station, it is of a television organization (e.g., for the production of programmes), should be in no case confused with the operation of television broadcasting, i.e. the dissemination of programmes (Article 2 para. 1, letter (a) of Act No. 468/1991 Coll.). The Memorandum of Association and the Licence terms specified the relationship between ČNTS and CET 21 and contain a number of mechanisms that prevent the potential non-permissible involvement of ČNTS in the rights and obligations of the licence-holder. CET 21 is responsible to the Council to the full extent for the operation of television broadcasting. For the reasons stated above, the Council does not share the opinion of the Committee for Science [Parliament Committee]. The Council is convinced about the correctness of the procedure and does not admit any doubts of its legitimacy. "*

457. Therefore, the Council itself viewed the CET 21/ČNTS structure when created and at least until May 1994 as a structure in compliance with the Czech Media Law. The Tribunal accordingly concludes that the Claimant's predecessor's investment was based on a carefully designed legal structure which was developed in conjunction with the Media Council and implemented with its approval. The Tribunal concludes that such structure must be regarded as a legally well-founded basis for the Claimant's predecessor's investment. It was also the legal basis for CME Media when acquiring CEDC's 60 % shareholding in ČNTS in 1994. At that point of time, the investment in TV NOVA was still at a high risk after having started the TV station in spring 1994 with a substantial investment commitment under the MOA as requested and approved by the Council. Any change of the CET 21/ ČNTS investment structure by law or by Council's interference, therefore, must be considered in the light of

whether such changes adversely affected CME's investment in the Czech Republic and whether it could be seen as a breach of the Treaty.

458. It is undisputed between the Parties that TV NOVA within one year after having started broadcasting in February 1994 became the most successful and profitable private television station in the Czech Republic with revenues which increased by 1996 to more than US \$ 100 million per year with a profit of roughly US \$30 million per year (or US \$51 million pre-tax profit). This success is to be attributed to CEDC's operational support which enabled broadcasting to start within a timetable set by the Licence, one year, which was seen as rather ambitious.
459. The witness Mr. Klinkhammer stated that CEDC and CME invested US \$ 140 million in TV NOVA which included the share acquisitions made between 1994 and 1999. In the first purchase of 5,2 % ČNTS shares from the CET 21 shareholders, CME Czech Media Enterprises B.V. had paid US \$5 million. In 1997, in the share transaction with Dr. Železný, CME paid US \$ 27,5 million for 5,8 %, evaluating ČNTS at that time at roughly US \$500 million. Also, the acquisition of 22 % interest in ČNTS held by the Czech Savings Bank for roughly US \$ 30 million on July 17, 1996 indicated that the investment in ČNTS was regarded as sound and prosperous, a success must be, to a large extent, attributed to the foreign investor CEDC and CME because the Czech nationals who initiated the joint venture as shareholders of CET 21, including Dr. Železný, never had practical experience in starting and running a TV station.

**(2) The Media Council in 1996 coerced CME to abandon the legal security for its investment in the Czech Republic**

460. In 1996, the Media Council reversed its position related to the split broadcasting structure between the licence-holder and the operator. The reason for the reversed position is clearly spelled out in the Council's report of October 1996 to the Czech Parliament. In this report, the Council made it clear that the split structure was in compliance with the Media Law as long as it could be controlled by the Council via the Licence conditions. *"... in 1995 there existed a sufficient tie, in the form of Licence terms [Licence conditions] between the licence-holder and the other*

*company, to make it possible for the Council to intervene in the event the existing split became truly problematic. "*

461. *"At the beginning of 1996, however, the amended law on broadcasting that came into effect included the mandatory abolishing Licence terms, and the operators of broadcasting reacted to it by requesting some changes in the Licence. That meant a weakening and/or nullification of the above-mentioned tie as a certain guarantee of the legality of the existing situation".*
462. Indeed, as the Council stated in its report to the Parliament, all three broadcasting companies TV NOVA, Premiéra TV and Rádio Alfa requested that the relevant condition be abolished, which would have had the effect that the Council would have lost control of the operator of the Licence under the split Licence/operator scheme. The Council, in its report to Parliament, identified the problem as follows: *"The focus of the problem is a subtle legal question of who is the operator of broadcasting, which activities [it] may provide itself and which ones it may delegate to other entities without actually transferring the Licence to them. The Law on Broadcasting [Media Law], which stipulates inter alia the basic rules for this very specific business activity, suffers from deficient shortcomings in this respect;"*
463. The Arbitral Tribunal's clear view and understanding is that the Council, in order to avoid loss of control of the operator of the split licence-holder/operator scheme in 1996, decided to put pressure on the participants of the split scheme in order to change it. This transpires from the facts, in particular the Council's own statements in this respect, the documents and the witness statements.
464. As one step of its strategy, the Council did not comply with CET 21 request to delete condition No. 17 of the Licence which is "the tie" in the words of the Council to the Parliament, to safeguard the split structure of licence-holder and operator.
465. On February 12, 1996, the Council instructed Dr. Jan Barta of the State and Law Institute of the Academy of Science of the Czech Republic to render a legal opinion on the split structure. Dr. Barta rendered a legal

opinion submitted under the letterhead of the institute of the State and the Law within one week, on February 19, 1996, which concluded that CET 21 does not operate broadcasting and never did, whereas ČNTS was broadcasting without authority. Dr. Barta stated that the approval of the MOA by the Council has no significance as the Council has not issued any resolution on this subject. In Dr. Barta's view, the MOA expressly stated that the law would be violated (*the Licence-holder pledges not to broadcast, and the company that is being established carries on unauthorized broadcasting*). This was a violation of the law and the Council was not in the position to permit that which is not permitted by the law. Dr. Barta suggested initiating administrative proceedings for unauthorized broadcasting against ČNTS and he suggested as an alternative to withdraw the Licence from CET 21. He further stated "*the given group of investors can be excluded from broadcasting in accordance with the law by these methods*". Further, as an alternative, Dr. Barta suggested to compel CET 21 through penalties to initiate broadcasting at its own expense and to modify contractual relations with the group of investors accordingly. As a further alternative, Dr. Barta suggested to issue a new Licence for ČNTS. "*Until such Licence is legally effective, however, the broadcasting is still unauthorized and the fine has to be levied in such a case as well*".

466. The circumstances of the rendering of Dr. Barta's legal opinion are dubious. It is quite obvious that this legal opinion was rendered in response to the Council's instruction letter of February 12, 1996 with the purpose of laying the ground for the Media Council's reversal of position which was opposite to the Media Council's view that the CET 21/ČNTS split structure was in compliance with the Media Law, when implemented. Dr. Barta's legal opinion had serious deficiencies. Contrary to Dr. Barta's statement under Section 4 of his opinion, the Media Council by resolution of May 11, 1993 topic 2 by unanimous vote approved Licence condition No. 17, which decision was certified under the date of May 12, 1993 in full form. Further, the legal opinion did not deal with the question whether an official State body, when reversing its decision by declaring a legal structure for the use of a broadcasting licence illegal, must pay compensation to the foreign investor who, in reliance on the validity of the split structure, made large investments in the television station. Dr. Barta was of the opinion that the Council at that time (1993) from a

formal point of view, acted incorrectly as administrative body. Dr. Barta's legal conclusion was that the Council is obligated to disregard the MOA and that a decision of the Council shall "simply (be) *based on the determined facts described above.*"

467. This suggestion for the application of administrative law shall not be dissected by the Arbitral Tribunal. Dr. Barta's opinion, however, is unacceptable under the requirements of the Treaty which does not allow reversal and elimination of the legal basis of a foreign investor's investment by just taking the view that an administrative body's formal resolution, the corner-stone for the security of the investment, was simply wrong. The Tribunal is not to decide on the Czech Administrative Law aspect of this question. However, Dr. Barta's legal opinion is not in compliance with the Respondent's obligations under the Treaty.
468. On the face of it, Dr. Barta's opinion was requested by the Media Council simply as a tool to cover up the reversal of the Council's legal position towards CET 21 and the foreign investor CEDC/CME. This view of the Arbitral Tribunal is supported by the sequence of events, ending with CME being forced to change the MOA and to give up the "safety net" (as it was described by the Respondent's representative Prof. Lowe at the Stockholm hearing) by replacing in the MOA the "use of the Licence" as CET 21's contribution in ČNTS by the "use of the know-how of the licence".
469. It is clear that the replacement of the "use of the Licence" (which ČNTS enjoyed under the split structure) by the "use of the know-how of the licence" vitiated the Claimant's protection for its investment in the Czech Republic. The Tribunal need not decide whether the contribution of the "use of the Licence" in 1993 was legally valid under Czech law. The parties to these proceedings are in agreement that (in contrast to Dr. Barta) the contribution of the use of the Licence was legally not questionable. This view of the Respondent is supported by the Media Council's legal opinions and reports to Parliament cited above.
470. However, the Respondent at the Stockholm hearing took the position that the 1993 "safety net" (use of the Licence) was not better than the amended structure (use of know-how of the licence and conclusion of a

Service Agreement). The Respondent's position on this subject is unsustainable. The use of "know-how" of a broadcasting Licence is meaningless and worthless. The obvious purpose for replacing the wording of "use of the licence" by "use of the know-how of the licence" was to buttress a wording in the MOA which could sustain the interpretation that CET 21 did not receive a pay-back of its share capital made by a contribution in kind.

471. The Respondent's position that the waiver of the "use of the Licence" was counterbalanced by the new Section 10.8 of the new 1996 MOA is unsustainable. The wording of Section 10.8 speaks against it:

*"[CET 21] hereby undertakes not to entrust the subject matter of its contribution, or any other right connected with the Licence, or the Licence itself, to the ownership or use of another legal entity or natural person, or to enter into any legal relationship with any legal entity or natural person other than the Company, by which it would give that, or another, person or entity any right to the subject matter of its contribution to the Company or to CET 21 as such which would result in the creation of rights similar to those which the Company has, and undertakes not to even begin any negotiations with another legal entity or natural person about the creation of such a legal relationship."*

472. The "subject matter of its contribution" which, under Section 10.8 is restricted in respect to transfer or even negotiations, is nothing else than the "use of the know-how of the Licence" which, as indicated above, was a rather meaningless and worthless right. Further, CET 21's undertaking not to assign the Licence itself was useless as the assignment of the Licence is not permitted under the Media Law anyway. The only important issue was, whether CET 21 as licence-holder was obligated to contribute the use of the Licence to ČNTS which contribution alone was the "safety net" for ČNTS, ensuring that CET 21 would exclusively use the operational services of ČNTS.

473. Moreover, the Respondent's argument that the waiver of the "use of the Licence" under the 1993 split structure was fully compensated by the Service Agreement entered into between CET 21 and ČNTS 1996/1997, is unsustainable. The contribution of the use of the Licence under the MOA is legally substantially stronger than the Service Agreement, as was demonstrated by the further sequence of events. A Service Agree-

ment could be terminated much more easily for good cause at any time by CET 21 compared with a change or amendment of CET 21's contribution in kind as shareholder of ČNTS under the MOA. Such contribution cannot be recalled by an unilateral act of the shareholder who made the contribution. This may not always apply, e.g. if ČNTS as user of the Licence by its conduct would have jeopardized the Licence, which was never seriously suggested, either by CET 21 or by the Media Council.

474. In 1999, the legal weakness of the 1996 arrangements materialized. On August 5, 1999, CET 21 terminated the Service Agreement for good cause with the effect that the alleged non-delivery of the daily work log for one (!) day (August 4, 1999) gave sufficient reason to terminate the Service Agreement. Thereby, the legal basis for the co-operation between CET 21 and ČNTS was vitiated with the consequence that the Claimant's investments of purportedly US \$ 140 million, evaluated at US \$ 500 million, was put at the risk of civil court decisions which ended up with the first instance Regional Commercial Court decision which decided that the termination was void, which decision was reversed by the Appellate Court with the consequence that the dispute was still pending at the Czech Supreme Court without a final decision having been obtained at the time of the closing of the hearing of these arbitration proceedings, the Claimant's investment meanwhile having been totally destroyed.
475. The Arbitral Tribunal cannot accept the argument that the 1996 "safety net" was a real safety net in comparison with the 1993 safety net. Even if the Czech Supreme Court were to reverse the Appellate Court's decision and re-instate the first instance court decision, this would not change the Tribunal's assessment. Even if ČNTS would be in the position to restore the status of the TV station as it was on August 5, 1999, CET 21 could easily jeopardize the arrangement by repeating the same procedure, terminating the Service Agreement for purported good cause and again dragging ČNTS into Civil Court proceedings.
476. It is not the Tribunal's role to pass a decision upon the legal protection granted to the foreign investor for its investment under the Czech Civil Law and civil court system.

477. Nevertheless, the Tribunal, after having studied the first instance judgment and the Court of Appeal judgment, cannot conceal its opinion that the Court of Appeal inadequately dealt with the facts and circumstances. It permitted a US \$ 500 million value investment to be destroyed by the purported non-delivery of a one-day day-log under a Service Agreement imposed on the investor by the Media Council, which circumstances and facts were set out in detail by the first instance Court judge.
478. The Arbitral Tribunal is charged with assessing whether the amendment of the legal structure of the Claimant's investment in 1996 prejudiced the protection of the Claimant's investment in the Czech Republic and whether this was a breach of the Treaty.
479. The facts in respect to the change of the so called "safety net" themselves are to a large extent undisputed, whereas the Parties' legal and factual interpretation of these facts is controversial. The Respondent's view that the change of the "safety net" in 1996 did not change or prejudice the protection of the Claimant's investment is, as explained, unsustainable.
480. The events in 1996 as documented by the exhibits to the parties' submissions are decisive in sustaining the conclusion that the Media Council in 1996 forced ČNTS and CME to agree to undermine the legal protection of CME's investment. Considering the interpretation of the documents and the witness statements, the Tribunal is of the view that the Council, in order to re-establish its control over the broadcasting operations of CET 21/ČNTS (which operations were disconnected from the licence-holder by the 1993 split structure), "made a very intensive effort" (Mr. Josefík's oral report to the Standing Committee of Parliament on September 30, 1999) to force CET 21 / ČNTS and its shareholders to surrender the 1993 split structure.
481. At the March 13, 1996 Council Meeting, the representatives for CET 21 were confronted in the presence of Dr. Barta with the request to enter into a different contractual relation; Dr. Barta acting in a rather inquisitorial function. He requested that measures be taken so that the physical operator will be CET 21. After the cancellation of Licence condition No. 17, a trade contract between CET 21 and ČNTS was necessary as,



in Dr. Barta's view, "CET 21 does not operate broadcasting". The conclusion to this part of the meeting was:

*"Lawyers of the Council and CET 21 will prepare the first version of a contract on provision of performances and services between CET 21 and ČNTS, so that the first version of this contract will be prepared by CET 21 within 10 days and submitted to the Council for discussion. "*

482. Keeping Dr. Barta in the process, Dr. Barta rendered a further legal opinion dated May 2, 1996 which would have turned the existing 1993 split structure, CET 21 being the licence-holder and ČNTS the operator, upside-down. This legal opinion stipulated, in particular, that all payments for advertising are the income of CET 21 which would deprive ČNTS of its original source of income. The Council asked for a consequent change of the MOA which was discussed at the Council Meeting of May 7, 1996. On May 15, 1996, CME's legal counsel, Laura DeBruce, circulated a letter to the lawyers of CET 21 and ČNTS, expressing CME's concern about the Council's recent proposal that the MOA be amended so that the CET 21 contribution of the "exclusive use" of the Licence would be deleted from the MOA and replaced by a Service Agreement. Laura DeBruce made clear that ČNTS as a consequence of the change requested by the Council would be in rather weak legal position, should CET 21 simply claim that ČNTS was in breach of the Service Agreement and terminate it.
483. The Council at that time involved itself in the draft of the Service Agreement, sending comments to the parties to the agreement with the request to incorporate the comments in the agreement or to comment on them within five business days of receiving the Council's request which dated June 4, 1996.
484. The Council put the issue of CET 21's legal structure on the agenda of the Council Meeting on June 28 and June 29, 1996 and decided at that meeting in respect of ČNTS that a warning of illegality of broadcasting shall be sent to ČNTS, which shall include a time-period for remedy, ending on August 27, 1996. Further, the Council decided to postpone a decision on a cancellation of Condition No. 17 of the Licence, "because of the preliminary question of proceedings before a court and proceedings at the State Prosecutor's Office".

485. On July 23, 1996, the Council initiated administrative proceedings to impose a fine for operating television broadcasting without authorization against ČNTS. In the letter addressed to ČNTS which reached ČNTS in September 1999, the Council set out three reasons.

- The first reason was that the Commercial Register for ČNTS showed it to be operating television broadcasting on the basis of the Licence as its business activity.
- The second reason was that the agreement with the Authors' Protection Union was concluded by ČNTS and not by CET 21.
- The third reason was described as follows:

*"Another basis are the agreements between ČNTS and the company CET 21 spol. s. r. o. which indicate, among other things, that ČNTS is arranging the broadcasting on its own account. There is no control by the broadcasting operator over the disseminated programming; the broadcasting operator's liability is rendered unclear by the Agreement. "*

486. In support, the Council, in its letter to ČNTS, referred to Dr. Barta's legal opinion rendered in the name of the Institute of State and Law of the Academy of Sciences of the Czech Republic.

487. Mr. Josefík, who was Member of the Council and later Chairman of the Council, stated at the Stockholm hearing that *"the agreements between ČNTS and the company CET 21"*, referred to in the Council's letter to ČNTS, were the MOA. This interpretation of Mr. Josefík confirms the wording of the Council's letter, taking into account that no other agreements between CET 21 and ČNTS related to the use of the Licence were in existence at that point of time.

488. The letter of July 23, 1996 and Mr. Josefík's interpretation are in clear contrast to the Respondent's view and position that not the contractual basis of the 1993 split structure but its implementation violated the Media Law. Indeed, Dr. Barta's opinion also did not suggest that the implementation of the 1993 split structure was a violation of the Media Law. Dr. Barta maintained that the 1993 split structure itself was illegal.

489. Therefore, the Media Council reversed its legal position in 1996, taking the view that the 1993 split structure was illegal. The Respondents interpretation of the events as an unlawful implementation of a lawful structure is, in the light of the facts, unsustainable.
490. The purpose of initiating administrative proceedings against ČNTS was solely to put pressure on CET 21 and ČNTS, with the aim of elimination of the 1993 split structure. This assessment, although contested by the Respondent and some of the Respondent's witnesses in these proceedings, is confirmed by the Media Council's own written documents, reports and legal opinions. The legal opinion of the Media Council's legal department dated November 6, 1996 stated in its review of the draft Service Agreement::

*"It may be stated that the said Agreement undoubtedly reacts to the commencement of administrative proceedings against ČNTS for illegal broadcasting with the aim of making it seem that ČNTS has not been committing such illegal acts."*

491. In the report to Parliament of January 31, 1998, the Council repeated its position, stating that the Council halted the proceedings with ČNTS in September 1997 because, in its opinion, once the scenario of actions agreed with ČNTS and CET 21 was fulfilled, the reasons for which the proceedings about unauthorized broadcasting were conducted ceased to exist.
492. In this report, the Council also confirmed the legality of the original 1993 split structure, which the Council considered to be *"legal and which raised legal doubts only later"*.
493. *"The reasons why this model came into existence were the Council's fears of a majority share of foreign capital in the licence-holder's company. The licensing conditions were an insurance of this configuration that the Council considered to be a sufficient tool for regulating the broadcast, even after the softening of them"*.
494. In a sequence of events, the Council initiated administrative proceedings after CET 21 and ČNTS presented a proposal for an amicable solution in

individual legal steps (which did not please the Council). In this respect, the Council reported to the Parliament that, in December 1996, *“after a partial success regarding the legal documents of CET 21 as well as ČNTS, the Council abolished the licensing conditions according to the application. The proceedings concerning unjustified broadcast against ČNTS, however, continue”*. In the period from January till July, 1997, according to the Council’s report to Parliament, CET 21 and ČNTS gradually documented the implementation of the promised steps. On June 3, the Council concluded that the premises for stopping the proceedings were thus fulfilled.

495. On September 15, 1997 (as the Council further stated to the Parliament), having examined the remaining legal issue, the Council stopped the proceedings against ČNTS.

496. The Council, in its report to Parliament of January 31, 1998 reiterates that the original 1993 construction “from the legal view-point did not and does not contradict any law, but it created a basis for problems ...”.

*“When it came into existence, such a construction was just right and had its logic, on top of that, an integral part of this configuration were the licensing conditions set by the Council by means of which inadmissible influences on the broadcasting, emanating from the procurement organization ČNTS, were ruled out.”*

497. The Council (in the response to Parliament’s request) fully disclosed the motivation for the 1993 split structure:

*“When granting the Licence to the company CET 21, for fear that a majority share of foreign capital in the licence-holder’s company might impact the independence of full-format broadcasts, the Council assumed a configuration that separates the investor from the licence-holder himself That is how an agreement came into existence (upon a series of remarks from the Council) by which the company ČNTS was established the majority owner of which is CEDC/CME. Thus, next to the licence-holder’s company, directly linked to it, a new company was established which was to co-participate in implementing the broadcast.*

498. This is clear. The alleged unlawful implementation was not referred to. The Respondent’s view that the structure itself was legal, whereas the

implementation was illegal, is not supported by the Council's own report to Parliament on January 31, 1998.

499. From the witness statements at the Stockholm hearing, it became apparent that CME had to take Council's threat against ČNTS seriously. As an ultimate possibility which was already mentioned in Dr. Barta's legal opinion, the Council could have imposed substantial fines on ČNTS in order to stop ČNTS operating TV NOVA and, furthermore, the Council could have withdrawn CET 21's broadcasting Licence.
500. Dr. Železný, who, at this point of time was in full accord with CME and ČNTS, informed the Representative Committee of ČNTS that the broadcasting Licence will be seriously endangered as a consequence of administrative proceedings and there was a substantial risk for the Licence, should CET 21/ ČNTS not comply with the Media Council's request for change of the legal structure. From the minutes of this meeting, confirmed by the witness statements at the Stockholm hearing, it becomes clear that, at that point of time, Dr. Železný was not acting in conflict with ČNTS and/or CME. On the contrary, he fully supported the joint position of ČNTS and CME towards the Council.
501. By a joint letter of ČNTS and CET 21 dated October 4, 1996, both companies gave in to the pressure of the Council and submitted a proposal to amicably resolve the prolonged differences, *"which arose in addressing the legal situation concerning the arrangement of legal relationship between ČNTS and CET 21, as well as around the cancellation of Licence conditions in connection with Act No. 301/1995 Col."*
502. The proposal was:
- *"First, to enter into a Service Agreement between CET21 and ČNTS related to television broadcasting services to be provided by ČNTS to CET 21;*
  - *second, to amend ČNTS's entry in the Commercial Register;*
  - *third, to delete radio broadcasting from CET 21's registration and*
  - *fourth, to obligate ČNTS "to submit to the Council a draft amendment to Article 1.4. 1 of the Memorandum of Association of ČNTS*

*which will be submitted to the ČNTS General Assembly for approval.*”

503. By letter dated October 4, 1996, Dr. Železný, acting as “General Manager and Agent” on behalf of TV NOVA, summarized the legal view and situation on behalf of ČNTS. This letter fully explained ČNTS’ position in respect to the legality of the ČNTS/CET 21 structure, supported by a legal opinion of the Institute of State and Law of the Academy of Science which confirmed that the licence-holder, in compliance with the Media Law, may broadcast through other persons.
504. In reference to the proposal submitted by ČNTS by its joint letter with CET 21 of October 4, 1996, in which they proposed steps for a conciliatory settlement to the administrative body, ČNTS requested termination of the administrative proceedings.
505. The shareholders of ČNTS did not give in on a voluntary basis. The amendment of the MOA on November 14, 1996, and the implementation of the Service Agreement was the result of the Council’s threat to discontinue ČNTS’ broadcasting operations. CME decided to disregard its own counsel’s legal advice according to which the replacement of the CET 21 contribution “use of the Licence” by the “right to use, benefit and maintain the know-how concerning the Licence” will be detrimental for ČNTS’ position as exclusive supplier of broadcasting services to CET 21, the basis of ČNTS’ business. CME carefully considered this advice, however it was clear that without the amendment requested by the Council the broadcasting Licence would be endangered. The change lifting CME’s legal “safety net” for its investment was made because of coercion exerted by the Council.
506. This clearly transpires from the submitted documents, in particular the Council’s own report to the Parliament, and this position was supported by Mr. Fertig. The witness, who communicated through Dr. Železný with the Media Council, confirmed that the danger of losing the licence as final consequence of the Media Council’s action was to be taken seriously, if an amicable solution were not reached. The Council demonstrated the seriousness of the threat by initiating administrative proceedings against ČNTS, when ČNTS tried to negotiate and delay the amendment of the MOA.

507. The witness stated that only because of the exercise of coercion was the legal basis for the investment changed. Only the amendment of the MOA to be redrafted along the lines that would satisfy the Media Council could have solved the situation which otherwise would have been destructive for CME's investment.
508. Also, the witness Ms. Landová, who, in the years 1993 to 1997 worked as a senior member of the staff of the office of the Council, supported this position. She clearly stated that the Council initiated administrative proceedings for unauthorized broadcasting against ČNTS in order to put pressure on ČNTS to change the MOA and to make the other changes requested by the Council.
509. The witness Mr. Radvan, a Czech lawyer who represented CEDC, also testified that the Council insisted on deletion of the use of the Licence from the MOA. Dr. Železný's efforts to change the wording without changing the substance had no success. According to Mr. Radvan's witness statement, it was clear that, in respect to the legal protection of ČNTS, it made a huge difference between the use of a licence and the contractual relationship which was introduced in 1996 instead of it, and that it was abundantly clear for everybody involved that the use of the Licence was different from the use of the know-how. By changing the MOA, CET 21's contribution to ČNTS in the eyes of this witness was almost eliminated and the witness stated that the new Article 10.8 did not adequately protect ČNTS.
510. The witness Mr. Musil who was at the relevant time a member of the Media Council, also confirmed to a large extent the sequence of events. His interpretation of the events was that the Media Law of 1991 was unclear in respect to the definition of the "broadcasting operator". He was of the opinion that the administrative proceedings against ČNTS achieved a better status for the Council which was a stricter distinction between the broadcasting operator and the service company. Also, his witness statement made clear that the Council had the clear target of changing the legal structure which was the basis for the Claimant's investment.

511. According to the statement of Mr. Josefík, who later became the Chairman of the Media Council, the administrative proceedings must have been seen in the eyes of ČNTS as a real threat. The witness stated that, on the same basis as the Council initiated administrative proceedings against ČNTS, the Council, in accordance with the legal opinion of Dr. Barta, could initiate proceedings to withdraw the Licence from CET 21.
512. This threat was not a theoretical threat, as the Council in its notification of the initiation of administrative proceedings to ČNTS, referred explicitly to the legal opinion of Dr. Barta which opinion was made known to all respective parties involved and which clearly spelled out the possibility for the Council to initiate proceedings to withdraw the Licence from CET 21.
513. This threat was fundamental because a withdrawal of the Licence in the same way as interference with ČNTS' broadcasting operations would have destroyed the Claimant's investment in the Czech Republic.
514. CME, at this point of time, could not take the risk of entering into long-lasting legal battles, civil law and/or administrative law proceedings, as such proceedings would carry the danger that, if the lawsuits were to be lost, CME's investment would have been irreversibly destroyed.
515. The Claimant decided to give in, which is a normal commercial consequence in any situation of unlawful pressure, when the affected victim of such pressure has to make a careful assessment.
516. Such a decision for a compromise, however, does not make the Council's unlawful acts legal and cannot be deemed as a waiver of CME's rights under the Treaty. This is the considered conclusion of the Arbitral Tribunal.
517. This view is supported by prominent legal authors such as Professor Detlev F. Vagts "Coercion and Foreign Investment Re-Arrangements" 1978, published in the American Journal of International Law. Professor Vagts pointed out that, for example:



*"The threat of cancellation of the right to do business might well be considered coercion . . . Such coercion might be found, even where a "clean" waiver of rights is signed".*

518. The Respondent's contention that CME voluntarily and of its own free will amended the basis for its investment is unsustainable. The (unlawful) situation of coercion is documented by the Media Council's above-cited reports and opinions to Parliament and, furthermore, in the Media Council's letter dated March 15, 1999 to Dr. Železný in his capacity as CEO of TV NOVA and as Executive Director of CET 21. In this letter, which was described by the Respondent as a letter containing the Council's general policy in respect to the relationship between a broadcasting operator and a service organization, the Chairman of the Media Council stated:

*"I confirm the fulfilment of the Council's requirements that were a pre-condition for the termination of the proceedings on unauthorized broadcasting by the ČNTS company. "*

*"The Council terminated the administrative proceedings on unauthorized broadcasting, because most of the above-mentioned material characteristics of the operator were respected and documented, by CET 21. According to the report and documents submitted by CET 21, this cause was also confirmed by changes in the Memorandum of Association and its business contracts. "*

519. The Media Council, also by this letter, gave an authentic interpretation of the reasons for initiating administrative proceedings against ČNTS. The purpose of the proceedings was to force ČNTS to release CET 21 from its contribution, the exclusive use of the broadcasting Licence. The Council's aim was to bring back the right of the use of the Licence to CET 21 which as the licence-holder, was, under the new Media Law in force since 1996, the only legal entity which the Council could control, whereas ČNTS, enjoying the exclusive use of the Licence under the 1993 split structure, could not be monitored and controlled any more by the Council, since Condition No. 17 of the 1993 Licence was to be cancelled under the new Media Law.
520. The Media Council violated the Treaty when dismantling the legal basis of the foreign investor's investments by forcing the foreign investor's joint venture company ČNTS to give up substantial accrued legal rights. The clear alternative available for the Media Council in this situation was to abstain from any pressure on CME/ČNTS and allow the foreign investor

to maintain its investment on the basis of the legal structure which was developed jointly with the Media Council and which was the basis for the foreign investor's investment decision. Any consequences deriving from such coercion against the foreign investor and/or its investment company ČNTS must be remedied. The Respondent's contention that the change of the legal basis of the Claimant's investment was made voluntarily or was the result of a commercial dispute between CME and/or ČNTS and Dr. Železný is unsustainable and must be rejected.

521. It is speculation whether the Media Council would finally have exercised its powers to the full, or whether CME could have gained support through the Czech Republic's administrative and/or civil courts. A threat does not become legal upon the victim's surrender to the threat and the surrender cannot be deemed as a waiver of its legal rights. The possibility that the threatening State Authority would not exercise its powers or that law courts would grant sufficient relief do not qualify the victim's surrender as voluntary.
522. A reasonable investor, having invested financial funds deriving from public placements, such as the CME group, the parent group of which was listed on the New York Stock Exchange, cannot jeopardize the funds raised in the public financial markets by taking unforeseeable risks. The Respondent's suggestion that CME could have sorted out the problem with the Media Council, if any, in the law courts is therefore unacceptable.
523. The Respondent's further contention that the coercion in reality did not take place as the communication between CME and the Media Council was, to a large extent, channelled through Dr. Železný who followed his own target which was, to regain the usage of the licence for CET 21, of which he was majority shareholder, is unsustainable. Not a single document or witness statement proves that in 1996, Dr. Železný exploited the situation of being communicator between CET 21/ČNTS and the Media Council. On the contrary, more than one witness stated that, at that period of time, Dr. Železný acted as an honest representative of both corporations, pursuing the business interest solely of these corporations.
524. The Arbitral Tribunal is aware that coercion claims suffer significant practical difficulties as they may raise the suspicion that the Claimant has

been playing a too clever game, first taking what he could get from the deal with the foreign government and then, coming for a second bite under the Treaty proceedings (see Professor Vagts as cited with similar concern on page 34). The Arbitral Tribunal is of the view that such danger does not exist in these arbitration proceedings.

525. Should the Claimant's joint venture company ČNTS receive a remedy through Czech Republic civil or administrative court proceedings, this may have an impact on the quantum of the damage claim. This issue however, must clearly be distinguished from the question whether the 1996 treatment of ČNTS and CME by the Media Council was a breach of the Treaty. The Arbitral Tribunal's response to this question is affirmative. The danger that the coercion claim under the Treaty in these arbitration proceedings will grant compensation in addition to ČNTS Civil Court claim (if granted), is not present, as the Parties instructed this Tribunal not to deal with the quantum at this stage of the arbitration proceedings.
526. Professor Vagts made the following suggestion for the elements of a code of unfair bargaining practices during investor-government negotiations (page 34 of Professor Vagts' publication as cited above) which, inter alia, prohibits a government from the following acts:

*“Cancellation of the franchise, permit, or authorization to do business in which the investor relies, except in accordance with its terms; and Regulatory Action without bona fide governmental purpose (or without bona fide timing) designed to make the investor's business unprofitable.”*

This seems to be a reasonable threshold which is passed by the Council's actions in this case.

527. The Respondents argument that a breach of the Treaty by coercion did not take place, because ČNTS' business under the amended 1996 MOA and the Service Agreement was even more profitable than before is unsustainable. The effect of the coercion was that CME lost its legal protection for the investment. It is not necessary that the economic disadvantage, as a consequence of the loss of legal protection, occurred immediately after the Media Council's intervention into the contractual relationship between CET 21 and ČNTS took place. Causation arises if the

damage or disadvantage deriving from the deprivation of the legal safety of the investment is foreseeable and occurs in a normal sequence of events. The protection of rights in corporate life does not materialize before a commercial conflict arises. This may occur years later. The mere lapse of time does not diminish the Claimant's rights as a consequence of the Media Council's unlawful interference in ČNTS' basic legal right to operate TV NOVA on the basis of the exclusive use of the Licence. The negative effects of the loss of the legal security of the investment materialized and surfaced in 1999 which is roughly 30 months later. This is not a long time neither in corporate life nor in respect to a long-term investment in a TV station.

528. The Respondent's further contention is that the 1996 change of CME's investment protection is not a breach of the Treaty, as the 1993 investment protection, if construed in any legal action in accordance with Czech law, would not have been enforced by a court as the Media Law prohibited the transfer of the Licence under Article 10.2 of the Media Law. The Respondent's actions therefore, as Professor Lowe at the Stockholm hearing argued, did not violate any legal disposition.
529. This contention is unsustainable. The Media Council jointly with CEDC developed the investment scheme by creating the 1993 split structure which was thereafter also used by other broadcasters. CME and its predecessor as foreign investor could reasonably rely on this structure which was developed in close conjunction with and approved by the Media Council.
530. Whether a Czech National Court would support and defend this structure is not dispositive. The Media Council was obligated to defend and secure this structure, after having attracted foreign investment on the basis of it. This placed the obligation on the Media Council not to interfere with the legal foundation of the Claimant's predecessor's investment.
531. The Respondent's position, also submitted by Professor Lowe at the Stockholm hearing, that CET 21, by law, was always in the position to use and exploit the Licence itself, is in clear contradiction to the MOA, under which CET 21 contributed the exclusive use of the Licence to ČNTS. The legality or non-legality of the 1993 split structure is not at

- stake. At stake is the protection of the structure and the Council's obligation not to undermine this structure by pressing the investor to give up basic rights which secured his investment.
532. The Respondent's further contention submitted by Professor Lowe that the efficiency of the 1996 arrangement has never been tested is not convincing. The lack of efficiency of the 1996 arrangement was seriously displayed in civil law court proceedings. The Regional Commercial Court protected the validity of the Service Agreement after it was terminated by CET 21 on questionable grounds. The first instance judgment was however overturned by the Appellate Court by a highly unconvincing judgment, leaving the final decision to the Czech Supreme Court. This unacceptable legal and commercial risk of prolonged legal battles was exactly what CEDC as foreign investor tried to avoid, when making its investment decisions in 1996. Such risk for the investor's investment is unacceptable and demonstrates the inadequacy of the 1996 arrangements (in contrast to Professor Lowe's submissions).
533. The Czech Republic and/or the Media Council are as a matter of principle not debarred from amending or altering the basis for CME's investment, subject to acquired rights and treaty obligations. This is a question of the Czech Republic's national sovereignty. However, any such action should have been done under due process of law, providing just compensation to the deprived investor (Art. 5 of the Treaty). The silent and coerced vitiation of CME's basis for its investment does not fulfil such a requirement and is, therefore, under the standards of the Treaty, and the rules of international law, a breach of treaty obligations.
534. The Respondent's further contention that ČNTS could have avoided the pressure from administrative proceedings: it only had "to stop breaking the law", is unsustainable. The Arbitral Tribunal cannot identify a breach of law by ČNTS, having scrutinized the documents submitted in these proceedings and the witness statements made, as well as the testimony of witnesses.
535. The Respondent's contention that CET 21 / ČNTS improperly implemented the 1993 legal arrangements is not supported either by documents or by witness statements. On the contrary, as shown in detail

above and also later in this Award, administrative proceedings were initiated not to enforce the proper implementation of the 1993 legal arrangements but to undo these arrangements. Otherwise, the Media Council could have requested a change of the implementation without requesting the change of the MOA and without requesting the implementation of the new Service Agreement. This was not the case. The Media Council requested a complete change of the basic legal protection of CME's investment by substituting for "the use of the licence" contributed by CET 21 to ČNTS the (useless) use of know-how of the licence.

536. Therefore, the final argument of the Respondent at the Stockholm hearing, in particular alleging the "hand-over of the reins from CET 21 to ČNTS", is not convincing. The reins were not handed over by CET 21 to ČNTS in the years 1993 to 1996. The legal basis for the investment was not changed before 1996. The implementation of the 1993 legal arrangements conformed to the legal documents of its formation.
537. The legal arrangements between CET 21 and ČNTS were implemented in accordance with the wording and the intentions of the Parties, including the Media Council, which co-designed and approved the structure in 1993.
538. The Media Council, acting on behalf of the Czech Republic, in 1996 breached the Treaty by coercing CME and ČNTS into giving up legal security for CME's investment in the Czech Republic.

### **(3) The Media Council supports the destruction of CME's investment**

539. In 1999, the Media Council actively supported the destruction of CME's investment in ČNTS. This conclusion is based predominantly on the documents submitted to the Arbitral Tribunal and by the statements of the witnesses. According to the minutes of the Council Meeting of March 2, 1999, Dr. Železný, at that time CEO of TV NOVA (ČNTS) and Executive Director of CET 21, visited the Media Council on the so-called "Visitation Day". According to the minutes, the reasons for the visit were "the current relationships with the foreign investor, current internal situa-

tion of the investor". Dr. Železný informed the Council about purported financial difficulties of ČNTS' 99 % shareholder CME (1 % shareholding by CET 21). Dr. Železný informed the Council about the conflict between CET 21 (Dr. Železný having a majority of 60 % shareholding in this company at that time) and ČNTS and that CET 21 had set a deadline for CME for changing the MOA. Otherwise, CET 21 would sell its 1 % share in ČNTS and withdraw the broadcasting Licence from ČNTS, unless ČNTS were prepared to enter in a new set of agreements "on the sale of advertisements, technology operations and technology support". If CME would not accept this solution by March 20, CET 21 will enforce this "clean alternative". Dr. Železný, in his capacity as Executive Director and shareholder of CET 21, requested the support of the Council against ČNTS, in spite of being the CEO of this company as well:

*"CET 21 would like to ask the Council to repeat some statements of the Council (exclusivity, withdrawal of the Licence) in relation to all steps within the logic of the development of the relationships between CET 21 and the Council. If and when harming the interests of ČNTS, Železný will need to be supported by a formal or informal letter. They are interested in a long-term stability, also in connection with a re-granting of the Licence. They ask the Council, whether it would be willing to remind of the principles which it had discussed with NOVA during various administrative proceedings and other negotiations".*

540. Dr. Železný further gave details for the contemplated new legal structure which he was going to impose on ČNTS.

*"It is a shift from a general [Service] Agreement to 5 specific agreements. The only exception - exclusivity in case of re-granting of the Licence. Železný asks for a letter redefining the general principles on the basis of which a package of sufficiently specific agreements could be proposed to the partners. If the Council decides that such letter is not suitable, because it would pre-conceive some formulations of the act, Železný will solve the situation. He would need as one of the documents a relevant document with a new date, the partners consider it more convenient not to reflect to it and not to risk a criminal recourse for not having reported correctly on changes (amendment) . . . "*

541. In the further discussions, the Council suggested to Dr. Železný to put concrete questions to the Council. Further, the minutes say:

*"We have a common interest. It is not a problem for Železný to formulate the questions. The current version of the agreement will be attached. They are willing to hand-over the agreements which have been prepared in order to make the matter more transparent. "*

542. On the next day, on March 3, 1999, Dr. Železný, under the letterhead of CET 21, sent the questionnaire to the Council. The letter spelled out that the communication between the Council and Dr. Železný should not be disclosed:

*"It is extremely important for us to receive the formulated principles in the form of an independent report of the Council as a reply to our request. We would like to use this opinion for discussions with our contractual partners, without disclosing other internal matters of our company . . . "*

*"We consider this type of co-operation with the regulatory body, in the form of a preliminary inquiry and professional consultation, to be very suitable, and we would like to apply it in the future as well . . . "*

543. Further, Dr. Železný offered (as promised) to supply to the Council the new set of contracts to be implemented for the future co-operation with ČNTS. Further, Dr. Železný asked for the confirmation of his principles:

*"These are formulations of general principles, on which we want to base our activities. We ask you to confirm their validity in the form of the Council's opinion:*

*"CET 21 will act, function and proceed as an operator, and, therefore, it has to carry out relevant managerial, administrative, and accounting tasks, and must build up its own company structure to include functions that cannot be transferred to service organizations. Employees responsible for programming and programme composition must be persons appointed or authorized directly by the CET 21 company.*

*Relations between the operator of broadcasting and its service must be established on a non-exclusive basis, because exclusive relations between the licence-holder and the service organization may encourage the transfer of some functions and rights that are dependent on the Licence and that are not transferable by law. In our opinion, CET 21, the operator, should order services from service organizations at regular prices so as to respect rules of equal competition. The selection of services should be decided by the licensed company independently, so that services are in ac-*



*cordance with the profile of the television station stipulated in the Licence and the quality of the services meet the requirements of the licensed company, For the level of provided services to agree with the terms of the Licence and Czech regulatory requirements, the licensed subject must have the ability to select relevant services anytime and anywhere at will which consideration ensues from the responsibility to operate television broadcasting.*

*Because the broadcasting time reserved for advertisements is by law a direct function of the Licence, and broadcasting business activity is registered by the operator only, revenues from advertisements that result from the sale of broadcasting time must be revenues of CET 21, from which proportional profit is reported and properly taxed in accordance with the Commercial Code. The accounting methodology for the company should be adapted to this fact. Of course, the right of the CET 21 company to pay fees for services ordered by CET 21 is not affected by this fact.*

*CET 21 will unequivocally decide on the composition of broadcasting, on programming and allotted time slots and genre, on the ratio of domestically produced and foreign programmes, and on questions of journalistic independence, objectivity, and balance in news reporting. The right to use programme Licences and copyrights in the form of broadcasting is exclusively within the scope of the operator who, for this purpose, must acquire Licences and rights from servicing organizations or directly from the owners of such rights and Licences. "*

544. The Council responded to this letter on March 15, 1999 by a letter signed by the Chairman of the Council, Josef Josefik, on the Council's official letterhead. The Council confirmed the "general principles" by six bullet points which, in essence, repeat (to some extent word by word) the proposal of Dr. Železný, the main difference being that the Council generalized the principles by replacing "CET 21" by "operator" or "licence-holder". In essence, the contents of the bullet points and the "general principles" as proposed by Dr. Železný are identical:

*"In regard to the preparation of the Annual Activity Report of the Council for Radio and Television Broadcasting, the Council also dealt with the current status of private television broadcasting.*

*I refer to your personal visit to the Council during which you informed us about the current situation in broadcasting and I confirm the fulfilment of the Council's requirements that were a precondition for termination of the proceedings on unauthorized broadcasting by the ČNTS company.*

*Because the Council was also asked by the Parliamentary Media Committee to issue an opinion on whether commercial television broadcasting complies with the Act on Broadcasting and valid Li-*

cences, we would like to summarize requirements that, in our opinion, express the contents of television broadcasting:

*An operator operates, functions and acts as an operator, i.e. carries out relevant administrative, and accounting tasks. Employees responsible for programming and composition of programmes are persons employed and appointed (authorized) directly by the licence-holder;*

*Business relations between the operator of broadcasting and service organizations are built on a non-exclusive basis. Exclusive relations between the operator and the service organization may result in de facto transfer of some functions and rights pertaining to the operator of broadcasting and, in effect, a transfer of the licence;*

*The operator is fully responsible for the structure and composition of programme and carries full editorial responsibility. The operator broadcasts programme in its own and on its own account and responsibility. The operator, therefore, must unequivocally decide on the content of broadcasting, its time and genre composition, and the ratio between domestic and foreign programmes;*

- *The operator concludes contracts in its own name with protection organizations for authors and performing artists.*

*The redemption of programme rights and copyright in the form of broadcasting shall be from the exclusively by the operator. For that purpose, the operator is obliged to obtain Licences and rights from commission organizations or directly from their owners;*

- *The operator concludes contracts in its own name with organizations providing technical transmission of television signals;*

*Revenue from advertising is the result of the sale of advertising time which is directly connected to the Licence; therefore, it must be reported and taxed by the entity performing the actual fulfilment [Translator's Note: broadcasting the commercials], i.e., the operator. (Of course, it is permitted with respect to this area of business that the operator concludes a contract with an agency which will purchase the advertisement for the operator).*

*The Council terminated the administrative proceedings on unauthorized broadcasting because most of the above-mentioned material characteristics of the operator were respected and documented, by CET 21 s.r.o. According to the report and documents submitted by CET 21, this course was also confirmed by changes in the Memorandum of Association and its business contracts,*

*We ask you to inform us about the current status of the implementation of the above-mentioned procedures and to document the manner of the actual implementation of the above-mentioned points in the current wording of the Memorandum of Association*

*and related business contracts concluded by the operator of broadcasting, CET 21, s.r.o.*

*The Council inspects the current status of private television broadcasting and monitors whether the broadcasting of commercial television stations complies with the Act on Broadcasting and whether these stations broadcast on basis of valid Licences.*

*Therefore, we ask you to submit the current programme composition and broadcasting schedule, in accordance with the Licence terms.*

*[illegible signature]  
Josef Josefík*

545. The Parties' interpretation of the March 15, 1999 letter differs. While the Claimant is of the opinion that the letter is a Treaty violation, the Respondent's view is that the letter expressed the Council's general policy, not binding in the specific situation of ČNTS. The witness Josef Josefík, at that time Chairman of the Council, interpreted the letter as a recommendation and the witness Musil said that the letter reflected the Council's model, the Council's policy and that this letter was used as a model by the Council.
546. The Arbitral Tribunal's assessment is that the letter cannot be interpreted without taking the circumstances into consideration. The letter was addressed and sent to Dr. Železný in both of his capacities: as CEO of TV NOVA and as Executive Director of CET 21. The letter stated general principles of the current status of private television broadcasting and, in this letter, the Council summarized "requirements that, in our opinion, express the contents of television broadcasting." The principles summarized under six bullet points are, therefore, not recommendations. The Council summarizes "requirements". Specifically addressed to CET 21 and TV NOVA, the Council requested TV NOVA and CET 21 *"to inform the Council about the current status of the implementation of the above-mentioned procedures and to document the manner of the actual implementation of the above-mentioned points in the current wording of the Memorandum of Association and related business contracts concluded by the operator of broadcasting, CET 21."*
547. This letter, therefore, as its clear wording demonstrates, is not just the expression of the Council's general policy. It is directly addressed to ČNTS and CET 21 and deals with their specific contractual situation.

Moreover, the Council stated that *“it terminated the administrative proceedings on unauthorized broadcasting because **most** of the above-mentioned material characteristics of the operator were respected and documented by CET 21. According to the report and documents submitted by CET 21, this course was also confirmed by changes in the Memorandum of Association and its business contracts”*.

548. A neutral reader of this letter must interpret this letter as a clear request by the Council to CET 21 and ČNTS to comply with all of the “requirements” because the 1996/1997 contractual changes had fulfilled most but not all of the “characteristics”. The reference to administrative proceedings was a clear warning by the regulator about possible consequences, should CET 21 and ČNTS not comply with the “characteristics” or “requirements”.
549. The “characteristics” or “requirements” in the six bullet points substantially deviate from the 1993 legal concept (the above so-called 1993 split structure) and further, they also substantially deviate from the 1996/1997 required amendment of the legal structure between CET 21 and ČNTS. The first bullet point stipulates that the licence-holder has to carry out relevant administrative and accounting tasks. The second bullet point stipulates that the business relations between the operator of broadcasting and service organizations are built on a non-exclusive basis (which was in clear contrast to the exclusive Service Agreement between CET 21 and ČNTS) and, the sixth bullet point stipulates that revenues from advertising must be reported and taxed by the entity performing the actual fulfilment, i.e. the operator (in the meaning of the licence-holder).
550. This letter of the broadcasting regulator was a further blow to the already fragile 1996/1997 contractual basis of CME’s investment (the exclusive use of the know-how of the Licence as stipulated in the MOA and the exclusive Service Agreement). It was a clear interference by the Council with the 1996/1997 structure as implemented under the pressure of the Council by ČNTS being forced to enter into the Service Agreement and agree on the amendment of the MOA. It was a serious interference, as it contained the Regulator’s threat to enforce the requested changes, referring to the administrative proceedings for unlawful broadcasting by

ČNTS. The waiver of exclusivity would clearly destroy the legal basis for CME's investment in the Czech Republic.

551. This interference by the Media Council in the economic and legal basis of CME's investment carries the stigma of a Treaty violation. The Media Council was obviously working hand-in-hand with Dr. Železný when supporting Dr. Železný in his attack upon CME's already fragile basis for CME's investment in ČNTS. The March 15, 1999 letter refers to the personal visit of Dr. Železný to the Media Council. It, however, conceals Dr. Železný's letter dated March 3, 1999 which provided the wording for the bullet points. As the witness Mr. Klinkhammer stated, the letter of March 3 was found in Dr. Železný's papers by the company's auditors after Dr. Železný was dismissed later in the year. The March 3, 1999 letter was not seen by Mr. Klinkhammer, CME's representative in the Czech Republic, when it was communicated. The Respondent's witnesses (including Mr. Josefík and Mr. Musil) could offer no explanation for the failure of the Council's letter of March 15 to refer to Dr. Železný's letter of March 3, despite the former letter in fact being a reply to the latter.
552. Dr. Železný, at the meeting with the Media Council on March 2, 1999 openly disclosed to the Council that the purpose of the requested intervention by the Council was "to harm ČNTS". Dr. Železný further openly discussed with the Council his conflict of interest ("*Dr. Železný - I am sitting on two chairs which move off one from the other*"). The Media Council, the Czech Republic's broadcasting regulator, at the Council Meeting on March 2, 1999, when dealing with the topic "the current relationship with the foreign investor", did not abstain from actively supporting Dr. Železný who clearly and openly violated his duties as CEO of ČNTS, the joint venture company, the beneficiary of the foreign investor's investment. This unconcealed violation by Dr. Železný of his duties under corporate and civil law cannot be seen as a harmless commercial difference between the majority shareholder and Executive Director of CET 21 on one side and the service company ČNTS on the other side. It is a massive, clear and intentional breach by Dr. Železný of his director's duties, a breach of law that must be assessed as a serious criminal offence in any functioning judicial system.

553. The minutes of the March 2, 1999 Council Meeting which disclosed the foregoing facts are from the Media Council's files, remitted to the Arbitral Tribunal by its Order at the request of the Claimant. The parties are in agreement on the translation submitted to the Arbitral Tribunal. The parties disagree on the interpretation, but they do not dispute the wording of the minutes. This wording is consistent with the witness statements, according to which written minutes were in conformity with the facts or speeches of what was heard at the Council Meeting.
554. The Arbitral Tribunal's conclusion is that the sole purpose of the March 15, 1999 letter was to support Dr. Železný in putting pressure on the foreign investor CME in order to achieve a re-arrangement of the contractual relations between CET 21 and ČNTS as desired by Dr. Železný, an arrangement that would destroy the legal basis (the safety net) of the foreign investor's investment. There was no other purpose. In particular, there was no serious follow-up to this letter. In response to the specific question by the Tribunal at the Stockholm hearing, Mr. Josefík stated that he could not recall off the top of his head that the Council had received a response to the part of the letter that asked CET 21 to inform the Council about the current status of the implementation of the requirements. On the face of it and quite obviously, the Media Council did not pursue any regulatory purpose with the letter. The only object was to put the letter with the agreed wording into Dr. Železný's hands, the purpose of which was clearly described by Dr. Železný to the Media Council at the Council meeting on March 2, 1999, which was "harming the interest of ČNTS".
555. The March 15, 1999 letter was not a private matter of the Council's Chairman. According to Mr. Josefík, the letter was drafted in a standard procedure, cleared through individual departments and then presented to the Council. The letter referred to Dr. Železný's visit at the Council Meeting on March 2, 1999, but did not reveal that the bullet points were prepared by Dr. Železný in his letter of March 3, 1999. The March 15, 1999 letter, a regulatory letter of the broadcasting regulator, was fabricated in collusion between Dr. Železný and the Media Council behind the back of ČNTS (TV NOVA) to give CET 21 a tool to undermine the legal foundation of CME's investment.

556. The Respondent's view, supported by Mr. Josefík, according to which the Council did not intend to support Dr. Železný in his dispute with CME, is not convincing. The clear facts and circumstances speak against it. In this context, the Arbitral Tribunal is constrained to observe again that Mr. Josefík showed a selective memory. Specifically questioned on his personal contacts with Dr. Železný in 1999, he responded on page 48 of the Stockholm hearing outprint of day 7: *"However, I do not recall that I had any other talk than a courtesy talk"*. When further interrogated as whether he talked to Dr. Železný over the telephone in 1999, he admitted that telephone conversations took place about the relationship between CET 21 and ČNTS, Dr. Železný carrying on a monologue on the subject. *"However, I do not recall any specific topic."* The witness Mr. Josefík was vague in recollecting these communications, whereas in respect to other details of the March 15, 1999 letter, his recollection was precise and clear.
557. The Arbitral Tribunal's impression was that Mr. Josefík's witness statements were coloured voluntarily or involuntarily by his desire not to qualify the Media Council's actions as a breach of the Treaty, taking into account that Mr. Josefík prepared his written witness statements at a time when he was still holding the position of the Chairman of the Council.
558. The Tribunal, therefore, is of the opinion that the Respondent's witness' statements and the Respondent's suggestions for the interpretation of the minutes of March 2, and the March 3 and the March 15, 1999 letters do not overturn the plain wording of these documents which speak for themselves. The Czech Republic, acting through its broadcasting regulator, the Media Council, massively supported Dr. Železný in his efforts to destroy CME's investment in the Czech Republic by eliminating ČNTS as the exclusive service provider for CET 21.

**(4) ČNTS' dismantling as exclusive service provider supported by Council's actions and inactions**

559. With the Media Council' letter of March 15, 1999 in his hands, Dr. Železný fulfilled the threats of his ultimatum which he had given to CME at the meeting of the Board of Representatives of ČNTS on February 24, 1999. At this meeting, Dr. Železný had requested a change of the

Service Agreement by eliminating exclusivity. Otherwise, he threatened, he would change the contractual relation between CET 21 and ČNTS unilaterally. In that case, Dr. Železný announced, CET 21 will hire another advertising agency for the sale of the advertisement time and procure broadcasting services from other providers on the basis that the Service Agreement between CET 21 and ČNTS was not exclusive. This was, de facto, the withdrawal of the use of the Licence, what Dr. Železný later at his visit at the Media Council, according to the minutes of this meeting, described as “the clean alternative”.

560. Dr. Železný, at the Board Meeting, further announced that *"the Council wants to change its original decision and to write a letter with the statement that the present relationship between CET 21 and ČNTS is not correct"*. In particular, due to the announcement of this yet-to-be-written letter of the Media Council, it is obvious that, in contrast to the Council's chairman Mr. Josefík's rather vague and evasive oral witness statement at the Stockholm hearing, Dr. Železný had prepared his ultimatum and the implementation of his threats in communications with the Council, which communications were confirmed by Mr. Josefík (who denied any talk of substance) and which communications are also confirmed by Mr. Klinkhammer's witness statement, according to which Dr. Železný in this critical period, as revealed by company telephone charges, made numbers of telephone calls on the ČNTS mobile phone to the Council.
561. The witness Mr. Klinkhammer, who took over as a Chief Executive of CME on March 23, 1999, stated that CME made substantial efforts to prevent the dismantling of ČNTS by Dr. Železný by making various commercial approaches to bring to him such as merging CET21 and ČNTS in order to retain the use of the licence for the joint venture company. The witness stated that, as part of these efforts, CME and/or its ultimate shareholder Mr. Lauder, offered to pay to Dr. Železný up to US \$ 200 million in order to find a suitable arrangement securing the continued exclusive use of the Licence which was the basis for the investment of CME in the Czech Republic. These efforts failed and it appears obvious that Dr. Železný had gained the Media Council's legal support for CET 21's view that the Service Agreement was not exclusive. This legal position of the Regulator provided the basis for Dr. Železný to



dismantle the Service Agreement relationship and take over TV NOVA without compensating the foreign investor CME.

562. According to Mr. Klinkhammer's witness statement, ČNTS' majority shareholder CME at the shareholder's meeting on April 19, 1999 dismissed Dr. Železný as CEO of ČNTS after having confronted Dr. Železný with documents proving that CET 21 through Dr. Železný's actions already had breached the exclusive Service Agreement with ČNTS, inter alia submitting a letter which Dr. Železný had written announcing that ČNTS had been withdrawn from the business of programme acquisition and that this would now be handled by a company AQS, a clear breach of the Service Agreement.
563. Dr. Železný's breach of contract was strongly supported by the Council's letter dated March 15, 1999. This view is supported by the further sequence of events as derived from the documents and confirmed inter alia by the witness Mr. Klinkhammer. Mr. Klinkhammer, as representative of CME, appeared in front of the Council in April 1999 and gave a two-hour presentation on CME's/ČNTS' factual and legal position as basis for CME's investment. Mr. Klinkhammer explained the events that led to Dr. Železný's dismissal. This presentation, according to Mr. Klinkhammer, made the situation abundantly clear for the Media Council. CME made the clear statements about CME's/ČNTS's conviction and intent to continue to operate within the broadcasting and all other laws of the Czech Republic and all regulations imposed on ČNTS, the MOA and the Service Agreement of 1997. CME, also according to Mr. Klinkhammer, put the Council on notice that CME thought that the Council's action of March 15, 1999 *"had confiscated at least a portion of our investment in the Czech Republic"*.
564. At the latest at this point of time the Media Council, the broadcasting regulator in the Czech Republic, must have clearly understood the consequences of its interference in the legal relations between ČNTS as service provider and CET 21 as licence-holder. The Council, at the latest at this point of time, could have clarified the legal situation and remedied its interference by recalling its letter of March 15, 1999.

565. The Council did not respond to CME's two-hour-presentation which, according to Mr. Klinkhammer, was accompanied by a written communication which was handed over, after the presentation was finished.
566. By letter dated June 24, 1999, signed by both its new executive and general director and its lawyer, ČNTS repeated its position to the Media Council with copies to the Vice-Chairman of the Permanent Media Committee of the House of Representatives of the Parliament of the Czech Republic, to the Vice-Chairwoman of the same Committee and with copies to three Vice-Chairpersons of the Media Council. ČNTS, again, described the legal basis for CME's investment in the Czech Republic in 1993 which was amended in 1996 as approved and adopted by the Council in 1997. ČNTS referred to the exclusivity of the legal arrangement and described Dr. Železný's breaches of CET 21's obligations under the various agreements, in particular under the MOA and the Service Agreement. ČNTS requested the Media Council to explain its legal position in respect of the legal structure of the inter-relation between CET 21 and ČNTS and CME or *"to take measures which would resolve the current dispute between CET 21, ČNTS and CME in connection with the legal structure of these relationships and prevent their violation on the part of CET 21 and Dr. Vladimír Železný"*.
567. The Media Council disregarded CME's and ČNTS' request for clarification of the legal situation and abstained from any action or intervention, thus tolerating CET 21's breach of contract, supported by and based on the Council's March 15, 1999 letter.
568. By letter of July 13, 1999 ČNTS, again, requested the Council's evaluation of the exclusivity of the relationship between CET 21 and ČNTS. ČNTS, in full detail, referred to the history of the contractual relation, the Council's involvement and the inter-relation between the exclusive Service Agreement and the foregoing agreements between the contractual parties, as the basis for the Claimant's investment in the Czech Republic.
569. ČNTS concluded its request as follows:

*"We hope the above specified facts ... will help to evaluate the legal relationship between ČNTS and CET 21 impartially, and thus to conclude that the relationship between ČNTS and CET 21 is an*

*exclusive relationship which was as such established, construed, and, up until the creation of the dispute with Dr. Železný, as such respected by all participated physical and legal entities and by concrete legal acts was being fulfilled”.*

570. The Media Council did not reverse its unlawful interference. On the contrary, the Tribunal increased its pressure on ČNTS. In a response letter dated July 26, 1999, the Council referred to a legal opinion which the Council had prepared at request of the Permanent Commission for Media of the Parliament on the dispute between ČNTS and CET 21 with special regard to disputed matters regarding the exclusivity of agreements between ČNTS and CET 21, and which the Council provided to the Parliament on the same day. The Council attached an excerpt of this opinion to the letter to ČNTS requesting ČNTS *“to stop immediate/y your media campaigns in connection with a trade dispute and to inform the Czech Media Council by August 15, 1999 on new steps that shall minimize the risks mentioned and shall lead to a final settlement of the dispute in compliance with the applicable laws”.*
571. The legal opinion submitted to the Parliament referred to the *“risk of a breach of the Media Law taking the position that as long as the dispute did not deviate from its commercial nature, the Council had no legal reason or right to interfere in it.”* The Media Council neither addressed the issue of the non-exclusivity of the Service Agreement nor did it revoke its letter of March 15, 1999.
572. This non-response and inaction by the Media Council aggravated the deterioration of CME’s legal basis for its investment in the Czech Republic by reiterating and further supporting the elimination of the contractual exclusivity of the Service Agreement, the (already fragile) basis for the protection of CME’s investment in the Czech Republic. In August 1999 and thereafter, the Media Council, although recurrently informed by ČNTS and CET 21 of Dr. Železný’s further acts to dismantle ČNTS’ legal and factual position as exclusive service provider to CET 21 (including the termination of the Service Agreement on August 5, 1999), disregarded ČNTS’ request to protect the legal arrangement which was the basis for CME’s investment in the Czech Republic.

573. The Media Council, after having coerced the 1996/1997 change in the legal basis for CME's investment and after having further jeopardized in conjunction with Dr. Železný the (already) fragile legal arrangements between ČNTS and CET 21 by the Council's letter dated March 15, 1999, was obligated to re-establish and secure the legal protection for CME's investment. As a minimum measure to clarify the legal uncertainty for the Claimant's investment (caused by Council's acts), the Council should have recalled its collusive March 15, 1999 letter by confirming the exclusive service relation between CET 21 and ČNTS. The Council, in its capacity as broadcasting regulator, was bound to have abstained from supporting the dismantling of CME's investment by Dr. Železný.
574. After the Council by its acts had jeopardized the legal basis of CME's investment, it was not sufficient for it to keep silent and abstain from any regulatory clarification of the legal situation when, beginning in July 1999 and thereafter, Dr. Železný and CET 21 exploited the vitiation of the legal protection of CME's investment by eliminating ČNTS as exclusive service provider, which was the basis of CME's investment in the Czech Republic.

#### **(5) Causation of damage by Council's actions and omissions**

575. The collapse of CME's investment was caused by the Media Council's coercion against CME, in requiring in 1996 the amendment of the legal structure as the basis of its investment and by aggravating the Media Council's interference with the legal relationship between CET 21 and ČNTS by issuing an official regulator's letter which eliminated the exclusivity of the Service Agreement, an exclusivity that was the cornerstone of CME's legal protection for its investment. The destruction of CME's investment after the termination of the Service Agreement on August 5, 1999 was the consequence of the Media Council's actions and inactions. The legal disputes, proceedings and actions between CET 21, ČNTS and CME thereafter do not affect the qualification of these actions and omissions as breach of the Treaty.
576. The key question of these arbitration proceedings, whether the Council by coercion forced CME to give up its legal "safety net" in 1996, is to a

large extent answered by the Council's own interpretation of the sequence of events. In contrast to the Respondent's submission in these arbitration proceedings (according to which CME 1996 voluntarily agreed on the change of ČNTS' Memorandum of Association and on the implementation of the Service Agreement), the Media Council's own description of the events is probative. In the Report of the Council for the Czech Parliament of September 1999, the Council made it abundantly clear that the Council was successfully requiring CME to change the MOA by threatening it with administrative proceedings. In respect to the exclusivity of the use of the Licence, which was a cornerstone for the protection of the Claimant's investment in the Czech Republic, the Council reported to the Parliament as follows:

*"Each party has its own version of the heart of the issue based on a different interpretation of concluded agreements. CME insists on exclusivity and claims that CET 21 is obliged to broadcast exclusivity through ČNTS whereas CET 21 denies exclusivity and claims its right to conclude service agreements with any companies it pleases. As in the past, the Council's position in this matter is close to the opinion that an exclusive relationship between the licence-holder and a service company is not desirable as it gives an opportunity to manipulate with the licence. However, in this dispute the Council will not provide interpretation of relevant provisions of agreements concluded between the two parties of the dispute as it is not its authority from the nature of matters. The Council can only state that results of past administrative proceedings, when the Council made the licence-holder to remedy certain legal faults in the Memorandum of Association and to adhere to laws, are currently showing in this matter".*

577. This is a very modest description of the Regulator's pressure put on CME/ČNTS in order to change the legal basis for the co-operation between CET 21 and ČNTS, now describing this as *"the remedy of certain legal fault"* in the MOA which, in 1993, the Council (at that time composed of other Council members) had jointly developed and implemented in order to attract the investment and support of the foreign investor CEDC.
578. Also, the oral report of the Chairman of the Council, Mr. Josefík, at the meeting of the Standing Committee for Mass Media of the Parliament of September 30, 1999, as reported by the minutes of the meeting, explained the background for the Council's reversal of its legal position in

respect to the 1993 split structure, taking the ex-post-view that the 1993 structure was the illegal transfer of the licence to ČNTS:

*“The arrangement between the service organization and the operator was quite unclear from the very beginning, and the Council was criticized for insufficient control of whether, for example, the licence was being transferred from the licensed entity to the ČNTS company. In May 1994 the Council was recalled precisely because, in the opinion of the House of Representatives, it had accepted a situation in which the provisions of the Act on Broadcasting were constantly violated in the case of the operation of nation-wide broadcasting by a subject that was not authorized to perform such activity. Therefore it tolerated the illegal transfer of the licence to ČNTS.*

*Then came a period in which the Council, in its new composition, made a very intensive effort to achieve clear relationships between the service organization and the operating company which would be in compliance with the Act on Broadcasting. After an unsuccessful attempt to delete an activity entered in the Commercial Register for the ČNTS company, the Council initiated an administrative proceeding concerning violation of the Act on Broadcasting by this company’s unauthorized broadcasting. . . . [in the following Mr. Josefík dealt with the new Media Law of 1996.] ...however, it then proceeded with administrative proceedings concerning unauthorized broadcasting and terminated them only when the operator, CET 21, proved that the broadcasts were in compliance with the law. These changes were also reflected in the Memorandum of Association and the modification of relationships between CET and ČNTS”.*

579. The Respondent’s position in these arbitration proceedings, according to which the original 1993 split structure did not violate the Media Law, that (only) its implementation was unlawful and (further) that, in 1996, CME/ČNTS voluntarily agreed to change the MOA is unsustainable, in the light of the Media Council’s and its Chairman’s own reports to the parliament. The Media Council required CME to give up its legal protection for its investment and aggravated its so doing by interfering in conjunction with Dr. Železný into the contractual relationship between CET 21 and ČNTS in 1999. These acts caused the complete destruction of CME’s investment in the Czech Republic, ČNTS holding now idle assets without a business operation after Dr. Železný and his company CET 21 established new service providers for TV NOVA.

580. The Respondent further argued that no harm would have come to CME's investment without the actions of Dr. Železný; hence, the Media Council and the Czech State are absolved of responsibility for the fate of CME's investment. This argument fails under the accepted standards of international law. As the United Nations International Law Commission in its Commentary on State responsibility recognizes, a State may be held responsible for injury to an alien investor where it is not the sole cause of the injury; the State is not absolved because of the participation of other tortfeasors in the infliction of the injury (*Articles on the Responsibility of States for Internationally Wrongful Acts, adopted on second reading by the United Nations International Law Commission, 9 August 2001, Article 31, "Reparation", Commentary, paragraphs 9-10, 12-13*).

581. This approach is consistent with the way in which the liability of joint tortfeasors is generally dealt with in international law and State practice:

*"It is the very general rule that if a tortfeasor's behaviour is held to be a cause of the victim's harm, the tortfeasor is liable to pay for all of the harm so caused, notwithstanding that there was a concurrent cause of that harm and that another is responsible for that cause ... . In other words, the liability of a tortfeasor is not affected vis-à-vis the victim by the consideration that another is concurrently liable"* (J.A. Weir, "Complex Liabilities", in A. Tunc (ed.), *International Encyclopedia of Comparative Law*. (Tubingen, Mohr, 1983), vol. XI., p. 41).

582. The Media Council's actions in 1996 interfered with CME's investment by depriving ČNTS's broadcasting operations of their exclusive use of the broadcasting licence, which was contributed by CET 21 to ČNTS as a corporate contribution. This interference with ČNTS' business and the Media Council's actions and omissions in 1999 must be characterized similar to actions in tort. The Tribunal therefore is of the view that the above described principles apply in this case. CME as aggrieved Claimant may sue the Respondent in this arbitration and it may sue Dr. Železný in separate proceedings, if judicial protection is available under Czech or other national laws. In this arbitration the Claimant's claim is not reduced by the Claimant's and/or ČNTS's possible claims to be pursued against Dr. Železný in other courts or arbitration proceedings, although the Claimant may collect from the Respondent and any other

potential tortfeasor only the full amount of its damage. This question is not dealt with in this Partial Award, It could be decided when deciding on the quantum of the Claimant's claim or by national courts when dealing with the enforcement of an award or judgment, which adjudicates the recovery for the same damage.

583. The U.N. International Law Commission observed that sometimes several factors combine to cause damage. The Commission in its Commentary referred to various cases, in which the injury was effectively caused by a combination of factors, only one of which was to be ascribed to the responsible State. International practice and the decisions of international tribunals do not support the reduction or attenuation of reparation of concurrent causes, except in cases of contributory fault. The U.N. International Law Commission referred in particular to the *Corfu Channel case*, according to which the United Kingdom recovered the full amount of its claim against Albania based on the latter's wrongful failure to warn of mines at the Albanian Coast, even though Albania had not itself laid the mines (see *Corfu Channel, Assessment of the Amount of Compensation*, I.C.J. Reports 1949, p. 244 at p. 350). "*Such a result should follow a fortiori in cases, where the concurrent cause is not the act of another State (which might be held separately responsible) but of private individuals*", (UN International Law Commission as cited). The U.N. International Law Commission further stated:

*"It is true that cases can occur where an identifiable element of injury can properly be a/located to one of several concurrently operating causes alone. But unless some part of the injury can be shown to be severable in causal terms from that attributed to the responsible State, the latter is held responsible for all the consequences, not being too remote, of its wrongful conduct."*

584. Various terms are used for such allocation of injury under international law.

*"The allocation of injury or loss to a wrongful act is, in principle, a legal and not only a historical or causal process. Various terms are used to describe the link which must exist between the wrongful act and the injury in order for the obligation of reparation to arise. For example, reference may be made to losses "attributable [to the wrongful act] as a proximate cause", or to damage which is "too indirect, remote, and uncertain to be appraised."*



*"In some cases, the criterion of "directness" may be used, in others "foreseeability" or "proximity". But other factors may also be relevant: for example, whether State organs deliberately caused the harm in question or whether the harm caused was within the ambit of the rule which was breached, having regard to the purpose of that rule (see U.N. international Law Commission with further extensive citations).*

585. Pursuant to these standards, the allocation of injury or loss suffered by CME to the Media Council's acts and omissions is appropriate. The Media Council, when coercing ČNTS in 1996 to amend its MOA and to implement the Service Agreement must have understood the foreseeable consequences of its actions, depriving CME of the legal "safety net" for its investment in the Czech Republic. Also in 1999 the Media Council must have foreseen the consequences of supporting Dr. Železný, in dismantling the exclusiveness of ČNTS' services for CET 21 by the Council's regulatory letter of May 15, 1999, which supported Dr. Železný's actions "to harm ČNTS."

#### **(6) The Respondent breached the Treaty**

By the Media Council's actions and failures to act, the Respondent has violated its obligations towards the Claimant and its predecessors under the Treaty.

586. The Respondent's violation of the Treaty relates only to the Media Council's actions and omissions, although the Czech Parliament had substantial influence on the Media Council. For example *"In May 1994, the Council was recalled precisely because, in the opinion of the House of Representatives, it had accepted a situation, in which the provisions of the Act on Broadcasting were constantly violated in the case of the operation of nation-wide broadcasting by a subject that was not authorized to perform such activity"* (minutes of the 6th meeting of the Standing Committee for Mass Media of September 30, 1999, page 9 of the translation). Thereafter, the Council "in its new composition" reviewed the situation and took certain steps to reverse the relationship between the service company and the operating company.

587. Further, the Council was obligated to render regular reports to the Permanent Commission for the Media of the Lower House of the Parliament and further, was obligated to give special reports on certain issues such as *“the situation of the television station NOVA”* as requested by the Permanent Commission in its resolution of September 30, 1999.
588. Moreover, the Czech Parliament, by implementing the new Media Law in force as of January 1, 1996, strongly affected broadcasting licences already granted by the Media Council, in particular by allowing the licence-holder to request the waiver of licence conditions. This amendment of the Media Law had substantial influence on the 1993 split structure as developed by the Media Council for CET 21/ČNTS and other broadcasters to secure the proper co-operation of the licence-holder and the service provider. By this amendment of the Media Law, the Media Council lost its tool to monitor and supervise this co-operation. It remained a broadcasting regulator responsible for the fulfilment of the legal requirements and duties under the Media Law, whereas the service provider, providing the broadcasting operation, as a consequence of the new Media Law, escaped the Council’s survey and control.
589. It transpires from the documents submitted to the Arbitral Tribunal in these proceedings that the Media Council clearly understood and deplored this development. However it is also clear that the Czech Parliament has the authority to organize national broadcasting in any way it feels suitable, subject to any relevant international obligations of the Czech State. The acts of the Czech Government, the Czech Parliament or its Commissions are not under scrutiny by the Arbitral Tribunal in these proceedings.
590. The Czech State acted towards the Claimant and its predecessors as investors under the Treaty solely by acts of the regulator, the Media Council. It is not the task of the Arbitral Tribunal to judge whether these acts were in compliance with Czech law and regulations. The only task for this Tribunal is to judge whether the actions and omissions of the Media Council were in compliance with the Treaty. The Tribunal’s considered conclusion is that the actions and failures to act of the Media Council as described above, affecting CME and ČNTS, were in breach of the Treaty.

**(i) The obligation not to deprive the Claimant of its investment  
(Treaty Article 5)**

591. The Claimant's expropriation claim under Article 5 of the Treaty is justified. The Respondent, represented by the Media Council, breached its obligation not to deprive the Claimant of its investment. The Media Council's actions and omissions, as described above, caused the destruction of ČNTS' operations, leaving ČNTS as a company with assets, but without business. The Respondent's view that the Media Council's actions did not deprive the Claimant of its worth, as there has been no physical taking of the property by the State or because the original Licence granted to CET 21 always has been held by the original Licensee and kept untouched, is irrelevant. What was touched and indeed destroyed was the Claimant's and its predecessor's investment as protected by the Treaty. What was destroyed was the commercial value of the investment in ČNTS by reason of coercion exerted by the Media Council against ČNTS in 1996 and its collusion with Dr. Železný in 1999.
592. The reversal of the Media Council's position in respect to CME's investment (after Council members were replaced by the Czech Parliament in response to criticism of the Licence granted to CET 21 in conjunction with the foreign investment in ČNTS) might have been motivated by the new Media Law as of January 1, 1996. However, this does not justify the Council's new interpretation of the legal situation or other regulatory necessities seen by the Council in 1996 and there is no justification for the Council's actions in 1996, enforcing the amendment of 1993 arrangements.
593. The Respondent's defence that this interference in 1996 did not do any harm, as *"the Czech Court determined that, as a matter of law as well as a matter of fact, ČNTS had the exclusive right to provide certain television services to CET 21 before ČNTS took the step that terminated the 1997 Service Agreement and that step, of course, was the withholding of the daily programme log on the 4th August 1999"*, is not convincing. In particular, the Defendant's view: *"That step plainly had nothing whatever to do with the Czech Authorities"*, is unsustainable. The amendment of the MOA by replacing the licence-holder's contribution of the Licence by

the worthless “use of the know-how of the Licence” is nothing else than the destruction of the legal basis (“the safety net”) of the Claimant’s investment. This destruction was clearly caused by the Czech State, acting through the Media Council.

594. The Respondent’s claim that the Media Council has never reversed its attitude to exclusivity, as it accepted exclusivity in 1993, but also accepted exclusivity in the amended provisions in 1996, is not supported by the clear wording of the documents. The contrary is the case, as already explained above. The Respondent’s contention that the Media Council consistently tried to make clear that it was not concerned by the question of exclusivity but by the question of the danger that an exclusive arrangement may lead to an unlawful transfer of the Licence, is not convincing. The clear facts speak against it. The Council, according to its own interpretations in its reports to the Czech Parliament, reversed its assessment of the legal situation in respect to the validity of the 1993 split ‘structure and took the necessary steps to implement this view by coercing the change in the 1993 legal arrangements.
595. The Respondent’s further argument that the Council, in its internal deliberations, never discussed the matter of exclusivity until recently, might well be the case. Indeed, the Council’s interference in 1996, enforcing the amendment of the MOA, was much more far reaching. The Council forced the shareholders of ČNTS to replace CET 21’s contribution of “use of the Licence” by a worthless substitute, carrying a similar name. The amendment was extracted from ČNTS by the institution of administrative proceedings which sprung from the Media Council’s own assessment of the events. As already dealt with above, the Respondent’s argument that the 1993 arrangement was not better than the 1996 amended arrangement is not convincing.
596. The Respondent’s further argument, also already rebutted above, that the 1993 legal arrangements did not prevent CET 21 from obtaining broadcasting services from other providers, goes against the exclusivity of the 1993 arrangement in the MOA.
597. The Respondent’s further argument, according to which the efficacy of the 1993 arrangement has never been tested, is also not convincing.

The Czech Civil Courts tested the arrangements. The Czech Appeal Court's view that ČNTS' refusal to deliver the 4th August daily log gave good cause for CET 21 to terminate the Service Agreement is a clear proof of the fragile character of the (coerced) 1996 amendment. Since 1996, the legal safety net for the investment was based on the fragile structure of a Service Agreement which could be terminated by CET 21 under any given or invented reason, creating by this an intolerable uncertainty for a long-term investment.

598. In this respect, it would be superfluous to say that the contribution of "the use of a Licence" (approved by the regulator) provided substantially more legal safety for ČNTS than the bilateral Service Agreement whose legal uncertainty is demonstrated by the sequence of the following events and the differing court decisions on this subject by the Regional Commercial Court of Prague, the Appellate Court of Prague and the Czech Appeal Court's decision pending when the hearing of these arbitration proceedings were closed.
599. The Respondent's argument that no loss occurred in 1996 and 1997 as a direct consequence of the legal changes in 1996 and that CME was in the position to equally enjoy its investment after the implementation of the 1996 arrangements, is not convincing. Legal protection (and safety nets, as the Respondents representatives said) prove their strength not at the day of implementation but at the day of breach. The enforced or coerced waiver of legal protection was per se a substantial devaluation of the Claimant's investment. The persons involved, including the representatives of the Media Council, CET 21 and ČNTS and also ČNTS' shareholders, clearly understood the character and the impact of the enforced changes on the protection of ČNTS' operations as exclusive service provider for CET 21. The Media Council deprived the Claimant of its investment's security by requiring CME in 1996 to enter into a new MOA and thereby giving up the exclusive right to use the Licence and further, in 1999, by actively supporting the licence-holder CET 21, when it breached the exclusive Service Agreement with ČNTS.
600. The Council, after having issued on March 15, 1999 a regulatory letter to ČNTS and CET 21 requesting the implementation of the non-exclusive service arrangement in support of Dr. Železný's openly disclosed inten-

tion to harm the foreign investor, was obligated to rectify the situation. In the least, the Council should have withdrawn the March 15, 1999 letter and made clear that the 1996 contractual relations were not in breach of the Media Law. However the Media Council, although frequently notified by ČNTS and CME of the consequences of its actions and failures to act, remained silent or disclaimed jurisdiction and so supported the vitiation of the Claimant's investment.

601. The basic breach by the Council of the Respondent's obligation not to deprive the Claimant of its investment was the coerced amendment of the MOA in 1996. The Council's actions and omissions in 1999 compounded and completed the Council's part in the destruction of CME's investment.
602. The Media Council, by its actions and omissions in 1996 and 1999, caused the damage suffered by the Claimant. Causation arises because the Media Council intentionally required ČNTS to give up the right of the exclusive use of the Licence under the MOA. The Media Council's possible motivation for such action -- to obtain regulatory control again over the broadcasting operation of CET 21 after the new Media Law came into force in 1996 -- is irrelevant. A change of the legal environment does not authorize a host State to deprive a foreign investor of its investment, unless proper compensation is granted. This was and is not the case. Furthermore, it must be noted that the change of the 1993 legal arrangement in 1996 as required by the Media Council, for whatever reasons, does not justify the Council's collaboration in the assault on CME's investment by supporting CET 21's breach of the Service Agreement in 1999. The Respondent, therefore, is obligated to remedy the damages which occurred as a consequence of the destruction of Claimant's investment.
603. Of course, deprivation of property and/or rights must be distinguished from ordinary measures of the State and its agencies in proper execution of the law. Regulatory measures are common in all types of legal and economic systems in order to avoid use of private property contrary to the general welfare of the (host) State. The Council's actions and inactions, however, cannot be characterized as normal broadcasting regulator's regulations in compliance with and in execution of the law, in par-

ticular the Media Law. Neither the Council's actions in 1996 nor the Council's interference in 1999 were part of proper administrative proceedings. They must be characterized as actions designed to force the foreign investor to contractually agree to the elimination of basic rights for the protection of its investment (in 1996) and as actions (in 1999) supporting the foreign investor's contractual partner in destroying the legal basis for the foreign investor's business in the Czech Republic. The actions and inactions affected the value of CME's shares in ČNTS, such shares being clearly a "foreign investment" in accordance with the Treaty, as already dealt with above (see also the TRADEX case as cited above).

604. The expropriation claim is sustained despite the fact that the Media Council did not expropriate CME by express measures of expropriation. De facto expropriations or indirect expropriations, i.e. measures that do not involve an overt taking but that effectively neutralize the benefit of the property of the foreign owner, are subject to expropriation claims. This is undisputed under international law (G. Sacerdoti page 382 as cited above, referring to numerous precedents such as the German Interests In Polish Upper Silesia case, 1926, PCIJ, Series A, No. 7, reprinted in M. Hudson, ed., I World Court Reports 475 (1934); see also Southern Pacific Properties (Middle East) Ltd. v. Egypt, ICSID Case No. ARB/84/3 (1992), 32 I.L.M. 993, 1993, dealing also with the expropriation of contractual rights of the operating company).
605. Furthermore, it makes no difference whether the deprivation was caused by actions or by inactions. [See Biloune, et al. v. Ghana Investment Centre, et al. 95 I.L.R. 183, 207-10 (1993); also published in the Yearbook Commercial Arbitration XIX (1994, page 11) and see also the International Technical Products Corp. v. Iran Award No. 196-302-2 (1985), 9 Iran-US CTR Rep. 273, page 239].
606. In the Metalclad Corporation v. United Mexican States case (ICSID Case No. ARB (AF)/97/1 (2000) in respect to NAFTA Article 1110 (expropriation), the ICSID Tribunal stated that an expropriation under this provision included not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with use

of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably to be expected economic benefit of property even if not necessarily to the obvious benefit of the host State. Thus, by permitting or tolerating the conduct of the municipality, which the tribunal had held amounted to an unfair and inequitable treatment that breached Article 1105, and by participating or acquiescing in the denial to the investor of the right to operate, notwithstanding the fact that the project had been fully approved and endorsed by the federal Government, the State Party must in the tribunal's opinion have taken a measure tantamount to expropriation in violation of Article 1110 (1). This view of the ICSID Tribunal is supported by the Biloune award as cited above.

607. Expropriation of CME's investment is found as a consequence of the Media Council's actions and inactions as there is no immediate prospect at hand that ČNTS will be reinstated in a position to enjoy an exclusive use of the licence as had been granted under the 1993 split structure (even if the Czech Supreme Court would re-instate the Regional Commercial Court decision). There is no immediate prospect at hand that ČNTS can resume its broadcasting operations, as they were in 1996 before the legal protection of the use of the licence was eliminated.

608. In this respect, the Iran-United States Claims Tribunal stated:

*"A deprivation or taking of property may occur under international law through interference by a State in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected. [Citations omitted.] While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact."*

(see Tippetts, Abbett, McCarthy, Stratton v. TAMS/Affa Consulting Engineers of Iran et al. of 29.06.1984; 6 Iran-United States CTR, 219 et seq. page 225 as confirmed by Phelps Dodge Corp. et al v. 2. Iran, Award



No. 217-99-2 (1986), reprinted in 10 Iran - U.S. Cl. Trib. Rep. 121 (1987); see also *Sea-Land Service, Inc. v. Iran*, 6 Iran-United States C.T.R. 149 at 166):

*"A finding of expropriation would require, at the very least, that the Tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea-Land's operation, the effect of which was to deprive Sea-Land of the use and benefit of its investment."*

609. In the case before this Tribunal, the situation is even clearer. The object of the Media Council in 1996 was to amend the 1993 split structure by removing the exclusive use of the licence from ČNTS to CET 21, the only company which under the new Media Law in force as of January 1, 1996 was under control of the Council. This deprivation of ČNTS' "exclusive use of the Licence" was compounded by the Media Council's actions and inactions of 1999. This qualifies the Media Council's actions in 1996 and actions and inactions in 1999 as expropriation under the Treaty.

**(ii) The remaining claims**

610. The remaining claims are based on the same facts as the expropriation claim.

**a) The obligation of fair and equitable treatment (Article 3 (1) of the Treaty)**

611. The Media Council's intentional undermining of the Claimant's investment in ČNTS equally is a breach of the obligation of fair and equitable treatment. The Respondent's position that the Media Council also required other broadcasters in the same way to revise the structure of the 1993 split legal arrangements between licence-holder and service provider is irrelevant. The facts and circumstances of the legal arrangements of the other broadcasters were not a subject of these arbitration proceedings. Should the Media Council have interfered with the contractual relations of other broadcasters in the same way as it did between CET 21 and ČNTS, these other actions might also be qualified as a breach of law as the case may be. These other cases, however, to the

extent that they are realistic, do not legitimate the Media Council's actions and inactions versus CME/ČNTS as being fair and equitable. The standard for actions being assessed as fair and equitable are not to be determined by the acting authority in accordance with the standard used for its own nationals. Standards acceptable under international law apply, e.g. the threshold test of Professor Vagts as cited above. The Media Council breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon with the foreign investor was induced to invest.

**b) The obligation not to impair investments by unreasonable or discriminatory measures (Article 3 (1) of the Treaty)**

612. The same considerations set out under the expropriation claim govern the claim for unfair and inequitable treatment as well. On the face of it, the Media Council's actions and inactions in 1996 and 1999 were unreasonable as the clear intention of the 1996 actions was to deprive the foreign investor of the exclusive use of the Licence under the MOA and the clear intention of the 1999 actions and inactions was collude with the foreign investor's Czech business partner to deprive the foreign investor of its investment. The behaviour of the Media Council also smacks of discrimination against the foreign investor.

**c) The obligation of full security and protection (Article 3 (2) of the Treaty)**

613. The Media Council's actions in 1996 and its actions and inactions in 1999 were targeted to remove the security and legal protection of the Claimant's investment in the Czech Republic. The Media Council's (possible) motivation to regain control of the operation of the broadcasting after the Media Law had been amended as of January 1, 1996 is irrelevant. The host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor's investment with-

drawn or devalued. This is not the case. The Respondent therefore is in breach of this obligation.

**d) The obligation to treat investments in conformity with principles of international law (Articles 3(5) and 8 of the Treaty)**

614. The Media Council's actions as described above are not compatible with the principles of international law, which the Arbitral Tribunal is charged with applying. On the contrary, the intentional undermining of the Claimant's investment's protection, the expropriation of the value of that investment, its unfair and inequitable treatment, the Media Council's unreasonable actions, the destruction of the Claimant's investment security and protection, are together a violation of the principles of international law assuring the alien and his investment treatment that does not fall below the standards of customary international law.

**(7) The Reparation Claim**

615. The Respondent, as a consequence of the breach of the Treaty, is under an obligation to make full reparation for the injury caused by the Media Council's wrongful acts and omissions as described above. A causal link between the Media Council's wrongful acts and omissions and the injury the Claimant suffered as a result thereof, is established, as already stated above. The Respondent's obligation to remedy the injury the Claimant suffered as a result of Respondent's violations of the Treaty derives from Article 5 of the Treaty and from the rules of international law. According to Article 5 subpara. c of the Treaty, any measures depriving directly or indirectly an investor of its investments must be accompanied *"by a provision for the payment of just compensation. Such compensation shall represent the genuine value of the investments effected."* A fortiori unlawful measures of deprivation must be remedied by just compensation.

616. In respect to the Claimant's remaining claims, this principle derives also from the generally accepted rules of international law. The obligation to

make full reparation is the general obligation of the responsible State consequent upon the commission of an internationally wrongful act (see the Commentary to the Articles on the Responsibility of States for Internationally Wrongful Acts adopted by the U.N. International Law Commission as cited above). The general principle of the consequences of the commission of an internationally wrongful act was stated by the Permanent Court in the Factory at Chorzów case:

*“It is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form. Reparation therefore is the indispensable complement of a failure to apply a convention itself. Differences relating to reparations, which may be due by reason of failure to apply a convention, are consequently differences relating to its application.”* (Factory at Chorzów, Jurisdiction, 1927, P.C.I.J., Series A, No. 9, para. 21).”

617. In a subsequent decision the Permanent Court in the Factory at Chorzów case went on to specify in more detail the content of the obligation of reparation. It said:

*“The essential principle contained in the actual notion of an illegal act - a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals - is that reparation must, so far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it - such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.”* (Factory at Chorzów, Merits, 1928, P.C.I.J., Series A, No. 17, para. 47).

618. This view has been accepted and applied by numerous arbitral awards (Commentary of the Articles on the Responsibility of States for Internationally Wrongful Acts with further citations). The Respondent is obligated to “wipe out all the consequences” of the Media Council’s unlawful acts and omissions, which caused the destruction of the Claimant’s investment. Restitution in kind is not requested by the Claimant (as restitution in kind is obviously not possible, ČNTS’ broadcasting operations having been shut down for two years). Therefore, the Respondent is obligated

to compensate the Claimant by payment of a sum corresponding to the value which a restitution in kind would bear. This is the fair market value of Claimant's investment as it was before consummation of the Respondent's breach of the Treaty in August 1999. In accordance with the parties joint request, the quantum of the Claimant's claim shall not be determined by this Award. Therefore, on request of the Claimant, the amount of the Claimant's claim is to be determined in a second phase of this arbitration.

### **III. Costs of the proceedings**

619. The parties instructed the Arbitral Tribunal to render an Award, if affirmative in respect to the Claimant's claims, that does not decide on the quantum of the claims. The parties further requested the Arbitral Tribunal to adopt a decision in respect to the costs of the proceedings incurred by the rendering this Partial Award. The Arbitral Tribunal, however, cannot, at this stage, judge to what extent the Claimant will be successful in respect of the quantum of its damage claims although the decision on the quantum would provide a better basis for the allocation of costs. In respect to costs, the Tribunal, therefore, makes an assessment on the basis of the present status of the proceedings without by this assessment pre-judging the quantum of damages, and on the basis as well of Article 40, paragraph 1 of the UNCITRAL Rules, which says that "the arbitral tribunal may apportion each of such costs between the parties, if it determines that apportionment is reasonable, taking into account the circumstances of the case."
620. In assessing what costs of the Claimant to be refunded by the Respondent are acceptable and reasonably incurred, the Tribunal further considered inter alia that the Claimant initiated these arbitration proceedings after having initiated and partly carried through the *Lauder vs/ The Czech Republic* UNCITRAL Arbitration Proceedings which, in essence, deal with the same dispute. The parties used, as the Tribunal was informed, the work product of their advisors and the witness statements of these parallel UNCITRAL Arbitration Proceedings. The Respondent expressly stated in its Statement of Costs that the Respondent was able to use to a large extent the pleadings and witness statements originally

drafted for the use by the Respondent in the Lauder vs. Czech Republic UNCITRAL Arbitration.

621. The Arbitral Tribunal took account of this situation and also the fact that the Claimant and its ultimate shareholder, by initiating two parallel UNCITRAL Treaty Proceedings had, as the Claimant expressed it, "*two bites of the apple*", and thereby enlarged costs and risks. It is, therefore, reasonable to decide that the Respondent, although this Partial Award is wholly unfavourable to it, shall be required to refund to Claimant only a portion of the Claimant's legal fees and disbursements, which portion is determined by the Arbitral Tribunal being US \$ 750,000.
622. For the Tribunal's costs and disbursements the Tribunal charged the parties in the total amount of US \$ 1,096,498.86 for the Tribunal's services and as compensation for the Tribunal's expenses for the period until the rendering of this Partial Award. The Claimant made an advance of costs in the amount of US \$623,249.43 and the Respondent an advance of US \$400,000, all together US \$ 1,023,249.43. By letter dated August 28, 2001, the Respondent informed the Tribunal that the payment of the final advance of costs in the amount of US \$ 73,249.43 to the Tribunal as requested by the Tribunal on August 15, 2001, will be made. The Tribunal, therefore, by letter dated August 30, 2001, withdraw its instruction to the Claimant dated August 30, 2001 to pay this amount. The Tribunal dealt with the respective payment in this Partial Award as if it has been made. The Tribunal may render a further partial award on costs, should such payment fail.
623. In respect to the allocation of these costs to the parties the Arbitral Tribunal took account of the above-mentioned facts and circumstances and allocated these costs as decided below.

**J.**  
**Decision**

624. The Tribunal decides 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
2. The Respondent is obligated 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 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;
3.
  - (1) The Respondent shall bear its own legal costs.
  - (2) The Respondent shall pay to Claimant as refund of Claimant's legal costs and expenditures US \$750,000.
  - (3) The Claimant shall bear one third and the Respondent two thirds of the Arbitral Tribunal's costs and expenditures. The Respondent, therefore, shall further pay to the Claimant as refund of Claimant's payments of the Tribunal's fees and disbursements US \$257,749.81.

4. This Partial Award is final and binding in respect to the issues decided herein. The legal seat of the proceedings is Stockholm, Sweden.

The Tribunal will continue the arbitration proceedings in order to decide on the quantum of the Claimant's claim upon request of one of the Parties.

**K. Statement in accordance with Article 32 (4) UNCITRAL Arbitration Rules related to Dr. Hándl's failure to sign the Partial Award**

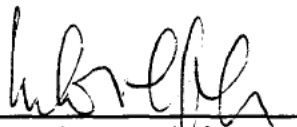
625. By letter dated September 11, 2001, Dr. Hándl requested the Chairman to attach to the Award (whose issuance he delayed) an explanation of his failure to sign the Award, as well as a dissenting opinion. Dr. Hándl refused to sign the Award with the following remark:

*"Partial Award not signed by Dr. Hándl as expression of his protest and dissenting from this Award - dissenting opinion enclosed, date: 11.9.2001, signature Dr. Hándl"*

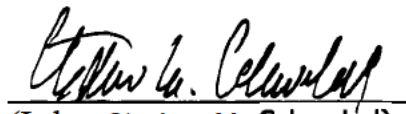
The Chairman of the Tribunal, on his behalf and that of Judge Schwebel, pointed out to Dr. Hándl that his failure to sign would be in breach of his obligations as arbitrator. In the event, it is also a breach of his repeated recent assurances to the Chairman, in writing, that he "will sign" the Award.

The UNCITRAL Rules that govern this arbitration provide, in Article 32 (4), that: *"An award shall be signed by the arbitrators . . ."* (emphasis supplied). The Tribunal is confirmed in the conclusion that an arbitrator's failure to sign the award is a violation of the arbitrator's professional responsibilities by its examination of the rules and practice of the principal arbitral institutions as well as the papers and proceedings of the Stockholm and Paris Congresses of the International Council on Commercial Arbitration. Dr. Hándl's failure to perform his responsibilities as arbitrator is matched by the intemperance and inaccuracy of his dissent. He makes charges about the conduct of the hearings and the deliberations that are groundless. His position on the merits of the dispute speaks for itself.

Stockholm, 13 September 2001



(Dr. Wolfgang Kühn)  
Chairman of the  
Arbitral Tribunal)



(Judge Stephen M. Schwebel)  
Arbitrator

(JUDr. Jaroslav Hándl)  
Arbitrator



**CLA-019**

# The Law of Investment Treaties

Second Edition

JESWALD W. SALACUSE

OXFORD  
UNIVERSITY PRESS

Italy–Venezuela Mixed Claims Commission in 1903 had to adjudicate whether Venezuela was monetarily liable to Italian nationals for damage resulting from the acts of revolutionaries operating in Venezuelan territory. Article 4 of the Italy–Venezuela Treaty of 1861 stated that each state's citizens should enjoy 'the fullest measure of protection and security of person and property, and should have in this respect the same rights and privileges accorded to nationals' of the territory. The umpire in the case declared that he 'accepts the rule that if in any case of reclamation submitted to him it is alleged and proved that Venezuelan authorities failed to exercise due diligence to prevent damages from being inflicted by revolutionists, that country should be held responsible'.<sup>15</sup> He ultimately denied Italy's claims that the treaty imposed strict liability.

Probably the most authoritative case interpreting the FCN treaty provisions on protection and security was a 1989 decision of a chamber of the International Court of Justice (ICJ) in the *ELSI* case.<sup>16</sup> In that case, the United States brought a claim against Italy under the US–Italy FCN treaty for injuries incurred by Raytheon, a US company, with respect to its subsidiary in Sicily. A factory of Raytheon's subsidiary in Palermo was taken over by workers and then requisitioned by the mayor in order to forestall its closure by the investor for economic reasons. The United States alleged that such actions violated Italy's obligation to give US investors 'the most constant protection and security', as required by Article V(1) of the FCN treaty. The United States did not contend, however, that the obligation constituted a guarantee resulting in strict liability. Instead, it pointed to the 'well-established aspect of the international standard of treatment... that States must use "due diligence" to prevent wrongful injuries to the person or property of aliens within their territory'. The ICJ Chamber found that the Italian government had taken adequate measures to protect the investor and its property, stating that '[t]he reference in Article V to the provision of "constant protection and security" cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed'.<sup>17</sup>

In general, jurisprudence relating to the FCN provisions on protection and security recognizes that this standard requires host countries to take steps to protect investors against physical injury to their persons or properties, whether by government agents or third persons. However, the FCN provision does not make the host state a guarantor of the safety of the investor or its property. It requires only that the host state exercise due diligence in carrying out its obligations under the treaty. As one commentator has observed, the decisions of tribunals and the other sources offer no definition of 'due diligence', noting: 'No doubt the application of this standard will vary according to the circumstances, yet, if "due diligence" be taken to denote a fairly high standard of conduct the exception will overwhelm the rule.'<sup>18</sup> A host state satisfies its due diligence obligation when it

<sup>15</sup> *ibid* 534.

<sup>16</sup> *Eletronica Sicula SpA (ELSI) (United States v Italy)* (Judgment) (20 July 1989) [1989] ICJ Rep 15.

<sup>17</sup> *ibid* ¶108, p 65.

<sup>18</sup> J Crawford, *Brownlie's Principles of Public International Law* (8th edn, OUP, 2012) 552.

tal  
me

(c)

Wi

inc

bec

Ch

Ag

inv

app

juri

sc

j

(A/

shri

tior

aga

gua

ard

prot

enta

tor's

prot

ary

part

19

ment

"due

well-

Freem

des C

(Fina

20

acco

includ

21

in par

52

invest

and se

requir

protec

23

June

invest.

takes all the reasonable measures of protection that a well-administered government would take in a similar situation.<sup>19</sup>

### (c) Full protection and security in the modern era

With the development of bilateral and other investment treaties since 1960, the inclusion of provisions granting investors some form of protection and security has become standard. It can thus be found in countless BITs, NAFTA,<sup>20</sup> the Energy Charter Treaty (ECT),<sup>21</sup> and the 2009 ASEAN Comprehensive Investment Agreement,<sup>22</sup> among others. These provisions have also been the basis of several investor–state arbitrations, and so arbitral tribunals have had to interpret and apply them in a new era. In doing so, contemporary tribunals have relied on the jurisprudence interpreting FCNs to a significant extent but have also extended the scope of protection in certain instances.

The first such BIT case was *Asian Agricultural Products Limited v Sri Lanka (AAPL)*.<sup>23</sup> In *AAPL*, an ICSID tribunal considered the claims of a UK investor in shrimp farming in Sri Lanka which had suffered injuries as a result of the destruction of its facilities by Sri Lankan security forces during an alleged operation against rebels. The claimant maintained that the UK–Sri Lanka BIT's provision guaranteeing 'full protection and security' went beyond the minimum standard of customary international law and imposed an unconditional obligation of protection on the host country. Therefore, failure to comply with the obligation entailed 'strict or absolute liability' for the host state once damage to the investor's property was established. In response, Sri Lanka contended that the 'full protection and security' standard incorporates, rather than supplants, the customary international legal standard of responsibility requiring due diligence on the part of states and reasonable justification for the destruction of property, but not

<sup>19</sup> On the meaning of due diligence, tribunals and scholars have often referred to the statement of Professor AV Freeman in his lectures at the Hague Academy of International Law: 'The "due diligence" is nothing more nor less than the reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances.' AV Freeman, 'Responsibility of States for the Unlawful Acts of Their Armed Forces' (1956) 88 *Receuil des Cours* 261. See also *Asian Agricultural Products Ltd v Sri Lanka*, ICSID Case No ARB/87/3 (Final Award) (27 June 1990) ¶ 170.

<sup>20</sup> NAFTA, Art 1105, entitled 'Minimum Standard of Treatment', provides: '1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.'

<sup>21</sup> ECT, Art 10, entitled 'Promotion, Protection, and Treatment of Investments', provides in part in para 1: '[s]uch investments shall enjoy the most constant protection and security.'

<sup>22</sup> Art 11(1), on the Treatment of Investments states: 'Each member state shall accord to covered investments of investors of any other member state fair and equitable treatment and full protection and security.' Art 11 (2) further provides: 'For greater certainty... (b) full protection and security requires each Member State to take such measures as may be reasonably necessary to ensure the protection and security of covered investments.'

<sup>23</sup> *Asian Agricultural Products Ltd v Sri Lanka*, ICSID Case No ARB/87/3 (Final Award) (27 June 1990). The Sri Lanka–United Kingdom Agreement on the Promotion and Protection of Investments (entered into force 18 December 1980) (1980) 19 ILM 886.

**CLA-020**

International Centre for  
the Settlement of Investment Disputes  
(ICSID)

June 27, 1990

In the Matter of Arbitration between

ASIAN AGRICULTURAL PRODUCTS LTD.  
(AAPL)

v.

REPUBLIC OF SRI LANKA  
CASE No. ARB/87/3

FINAL AWARD

*President* : Dr. Ahmed Sadek EL-KOSHERI  
*Members of the Tribunal* : Professor Berthold GOLDMAN, and  
: Dr. Samuel K.B. ASANTE  
*Secretary of the Tribunal* : Mr. Bertrand P. MARCHAIS

In Case No. ARB/87/3,

*Between* Asian Agricultural Products Ltd. (AAPL),  
represented by:  
Dr. Heribert Golsong, as Counsel  
[of the law firm of Fulbright & Jaworski]

And

The Republic of Sri Lanka  
represented by:  
[Messrs. William Rand, Robert Hornick, Paul Friedland and Evan  
Gray of the law firm of Coudert Brothers, as Counsel; and Messrs.  
M.S Aziz and A. Rohan Perera, as Agents]

THE TRIBUNAL  
Composed as above,  
After deliberation,  
Made the following Award:

1. On July 8, 1987, the International Centre for the Settlement of Investment Disputes (hereinafter called "the Centre" or "ICSID") received a Request for Arbitration from Asian Agricultural Products Ltd. (Hereinafter called "AAPL" or "the claimant"), a Hong Kong corporation.

The Request stated that AAPL wished to institute arbitration proceedings against the Democratic Socialist Republic of Sri Lanka (hereinafter called "Sri Lanka" or "the Respondent") under the terms of the ICSID Convention to which Sri Lanka is a contracting Party, and in reliance upon Article 8.(1) of the Agreement between the Government of the United Kingdom of Great Britain and Northern-Ireland and the Government of Sri Lanka for the Promotion and Protection of Investments of February 13, 1980 (hereinafter called "the Bilateral Investment Treaty") which entered into force on December 18, and was extended to Hong Kong by virtue of an Exchange of Notes with effect as of January 14, 1981.

2. Article 8.(1) of the Bilateral Investment Treaty, invoked as expressing Sri Lanka's consent to ICSID Arbitration, reads as follows:

Each contracting Party hereby consents to submit to the International Centre for the Settlement of Investment Disputes (...) for settlement by conciliation or arbitration under the Convention on the settlement of Investment Dispute between States and Nationals of the Other States opened for signature at Washington on 18 March, 1965 any legal disputes arising between that Contracting Party and national or company of the other Contracting Party concerning an investment of the latter in the territory of the former.

3. The Claimant indicated in the Request for Arbitration that a dispute arose directly out of an officially approved investment by AAPL in Sri Lanka that took place in 1983 under the form of participating in the equity capital of SERENDIB SEA-FOODS LTD. (hereinafter called "the Company" or "Serendib") a Sri Lankan public company established for the purpose of undertaking shrimp culture in Sri Lanka.

According to the Claimant, the Company's farm, which was its main producing center, was destroyed on January 28, 1987, during a military operation conducted by the security forces of Sri Lanka against installations reported to be used by local rebels. As a direct consequence of said action, AAPL alleged having suffered a total loss of its investment, and claimed from the Government of Sri Lanka compensation for the damages incurred as a result thereof. The claims submitted on March 9, 1987, remained outstanding without reply for more than the three months period provided for in Article 8.(3) of the Bilateral Investment Treaty to reach an amicable settlement, and hence AAPL became entitled to institute the ICSID arbitration proceedings.

4. On July 9, 1987, the Secretary General of ICSID sent an acknowledgment of the Request to AAPL and transmitted a copy of the Request to Sri Lanka. On July 20, 1987, the Secretary General registered the Request in the Arbitration Register and notified the Parties accordingly.

5. On September 30, 1987, the Centre received a communication from AAPL to the effect that Professor Berthold Goldman has been appointed as member

of the Tribunal in conformity with Rule 5.(1) of the Arbitration Rules. He accepted his appointment as arbitrator on October 8, 1987.

The Republic of Sri Lanka appointed Dr. Samuel K. B. Asante by a letter dated October 20, 1987. He accepted his appointment on October 28, 1987.

Dr. Ahmed S. EL-Kosheri was appointed as the third arbitrator and President of the Tribunal on December 24, 1987, by the Chairman of the Administrative Council of ICSID in consultation with the Parties. He accepted his appointment on January 4, 1988.

Accordingly, the Tribunal became constituted as of January 5, 1988, and the declaration provided for under Arbitration Rule 6 was signed by each arbitrator.

6. At the first session of the Tribunal, held on February 23, 1988 at the Offices of the World Bank in Washington, D.C., the Parties declared that they were satisfied that the Tribunal had been properly constituted in accordance with the provisions of Section 2, Chapter IV of the Convention and of Chapter I of the Arbitration Rules (Minutes of said Session, Item I,(c)).

The Parties and the Tribunal established the framework within which the pleadings have to take place, comprising two consecutive rounds of written submissions followed by oral hearings to be electronically recorded without requiring the production of verbatim transcripts (Items 10-12 of the Minutes).

It was also agreed upon in that First Session that the Arbitration Rules in effect after September 26, 1984, shall apply (Item 2); that the language of the proceeding would be English (Item 8); and that the place of the proceedings will be Washington, D.C. at the seat of the Centre (Item 9).

7. The Claimant's Memorial, submitted on April 13, 1988, focused mainly on the "bases for the claim", consisting of:

- (i) - the unconditional obligation of "full protection and security" provided for in Article 2 of the Bilateral Investment Treaty;
- (ii) - the more specific and clearly defined obligation stated in Article 4(2) of that Treaty requiring adequate compensation of the destruction of the Claimant's property under circumstances not justified by combat action or necessities of the situation; and
- (iii) - finally, the Claimant indicated that the Government's liability extends to cover "damage caused under customary rules of international law on State responsibility" (lines 9 and 10 on page 6 of the Claimant's Memorial).

The remedy required was expressed by the Claimant in terms of evaluating "the market value of the undertaking on the basis of discounted cash flow (DCF) theory", in order to establish the "going concern value" of Serendib Seafoods Ltd on January 28, 1978, the date of the destruction of its property.

8. The Respondent's Counter-Memorial, submitted on June 18, 1988, placed the emphasis on different aspects; mainly to illustrate that the Serendib venture "was a failure from the outset", and its "fitful efforts to restructure was overtaken in

January 1987, by the civil war between Tamil separatists and the Sri Lankan Government". Thus, the large majority of AAPL's claimed damages should be denied since they are based on "the illusion of expected profitability."

Moreover, according to the Respondent's account of the facts, the destruction of Serendib's property was due to intense combat action between the Tamil rebels known as the "Tigers", who were allegedly operating out of Serendib's farm and reported by Governmental sources as having violently resisted the counter-insurgency operation conducted by the Special Task Force (STF), and which aimed to drive the Tiger rebels out of the area,

Equally, with regard to the relevant dispositions of the Bilateral Investment Treaty, the Respondent's Counter-Memorial gave the Treaty an interpretation different from that advanced by the Claimant. Particularly, the expression "full protection and security" used in Article 2 has to be construed as simply incorporating the standard which requires "due diligence" on the part of the States, and does not impose strict liability. As to Article 4.(2), the Government's liability thereunder would not arise except in case the Claimant succeeds in providing the proof that the counter-insurgency actions were not reasonably necessary or that the governmental security forces caused excessive destruction during their combat against the Tamil rebels.

9. The Claimant's Reply to the Respondent's Counter-Memorial was duly submitted on August 18, 1988. The first part of the Reply contained an elaboration of the factual aspects of the case from the Claimant's point of view, especially those related to the events of January 28, 1987. According to Claimant, there was no "battle" at the farm site, but rather "a murderous over-reaction by the STF which led to the destruction and civilian deaths".

Furthermore, no access to the farm was permitted before February 10, 1987, either by the Batticaloa Citizens's Committee for National Harmony or by Serendib's staff, in order that "all evidence of the brutal actions in area could be obliterated".

In the second part of the Reply, the Claimant started by indicating that the Sri Lanka/U.K. Bilateral Investment Treaty "should be considered tantamount to" an agreement between the two Parties as to the applicable rules of law, within the context of Article 42 of the ICSID Convention. Nevertheless, it has to be understood that the Treaty itself is not limited to the explicit statement of certain substantive rules, but renders applicable additional rules incorporated therein, either by reference or by implication. Moreover, the Claimant's Reply states that the "rules of customary international law", as well as the "Law of Sri Lanka as the host country", may be regarded as supplementary "alternative source of applicable law" (p. 29 of the Reply).

With regard to the specific issue of the Standard of Liability under the general pattern followed by Bilateral Investment Treaties, the basic argument developed by the Claimant amounts to an assertion that the traditional "due diligence" criterion applicable under the *minimum standard* of customary international law had been replaced by a new type of "strict or absolute liability not mitigated by concepts of due diligence" (p. 54 of the *Claimant's Reply*).

In case the strict liability argument based on Article 2 and on the most-favoured nation clause contained in the Bilateral Investment Treaty, would not be assessed by the Tribunal, the Claimant presented "as an *alternative submission* only" another argument based on Article 4.(2) (p. 56 of the *Claimant's Reply*), and ultimately on article 4.(1) "which remains the fall-back provision in cases of war destruction" (*Ibid.*, p. 57).

Under this alternative argument, the applicability of Article 4.(2) cannot be avoided except in case Sri Lanka would succeed in carrying out its *onus probandi* by providing convincing proof that the destruction of January 28, 1987 was caused "in combat action", and was required by "the necessity of the situation".

At the end of the Claimant's reply, AAPL's submissions were formulated as requesting the Tribunal to:

1. Determine the liability of the Government of Sri Lanka to compensate AAPL for the unlawful requisition and destruction of its investments;
2. Award to AAPL restitution or adequate compensation in the amount of freely transferable U.S. Dollars of not less than \$ 8,067,368 (eight million sixty-seven thousand three hundred sixty-eight) on account of the requisition and destruction of its investment, increased by the additional costs, including all direct and indirect costs of the present proceedings, as well as interest at commercial rates;
3. Order the Respondent to assume the guarantee which AAPL had accepted for the loan by EAB/Deutsche Bank to SSL, or to pay in escrow the additional amount of U.S. \$ 888,000 (eight hundred-eighty thousand), representing the principal of the outstanding loan amount to be paid by AAPL if and when Deutsche Bank prevails in a call on the guarantor for the guarantee subscribed on September 15, 1984;
4. Deny the Counter-claim by the Respondent for costs and attorneys-fees.

10. On October 20, 1988 the Government of Sri Lanka submitted its Rejoinder mainly devoted to emphasizing two issues: (i)—on the one hand, the incorrectness of AAPL's construction of the interrelation between Article 2.(2) and Article 4.(2) of the Sri Lanka/U.K. Bilateral Investment Treaty; and (ii)—on the other hand, the refutation of AAPL's claimed damages.

According to the Respondent's Rejoinder, Article 4.(2) is not an exemption from the rule contained in Article 2.(2), since both articles "share a common standard of liability (that of governmental negligence)", but "the two provisions concern damages arising in distinct situations and caused by distinct parties" (p. 6 of the *Rejoinder*). Moreover, Article 4.(2) could not be considered superseded by operation of Article 3 (the most-favoured-nation clause) as a result of the subsequent conclusion of the Sri Lanka/Switzerland Investment Treaty. In the Respondent's own words, such convention "meets the same problem as AAPL's absolute liability theory; because Article 4 of the Treaty creates potential liability, and does not limit liability, its exclusion from a subsequent treaty could not increase U.K. investor's rights under the Treaty" (p. 10 of the *Rejoinder*).

The Respondent's propositions concerning the claimed damages are composed of three elements:

- (a) - Serendib's desperate financial situation as reflected in the Memorandum of Understanding dated December 22, 1986 could hardly become reversed to evidence future expected profitability;
- (b) - the inclusion of assets and other elements which were never touched by the destruction, such as the hatchery on the west coast;
- (c) - the speculative nature of the projections concerning any possible future profitability.

The Respondent's position on the various legal and factual issues led to the following conclusions:

- (i) - that the STF operation on January 28, 1987, was a legitimate exercise of sovereignty;
- (ii) - that any damage which occurred at the Serendib shrimp farm on that date was either necessary under the circumstances or not caused by the Government;
- (iii) - that AAPL's financial loss due to destruction of assets remains unproven; and
- (iv) - that AAPL suffered *no* loss of any reasonably foreseeable future profits (p. 39 of the *Rejoinder*).

11. The oral phase of the proceedings took place from April 17 to April 20, 1989 at the seat of the Centre in Washington, D.C.

As indicated in the Summary Minutes of the Hearing of the Arbitral Tribunal, oral presentations were made by counsels to both Parties, and counsel to each party was given the opportunity to respond to the presentation made by the other.

The Tribunal heard also an oral presentation from Mr. Deva Rodrigo, advisor to the Claimant, and Mr. Victor Santiapillai, Managing Director of Serendib Seafoods Ltd., appeared before the Tribunal as witness called by AAPL. After giving his evidence, he was examined, and cross-examined by Counsel to each Party, and responded to the questions put to him by the members of the Arbitral Tribunal.

Before declaring the hearing adjourned on April 20, 1989, the Tribunal requested the Parties to submit certain additional documents and information, together with their respective comments thereon.

12. In compliance with the Tribunal's oral order fixing the dates for filing the requested submissions, the first exchange took place on May 22, 1989, and the second exchange on May 29, 1989.

13. The Arbitral Tribunal having met for deliberation in Paris on Monday 26 and Tuesday 27 June 1989, and having considered the various issues pending before it, felt necessary to request further clarifications from both Parties about certain important points deemed not sufficiently pleaded during the previous hearing. A procedural Order was issued consequently on June 27, 1989, inviting both Parties to provide the Arbitral Tribunal with their considered points of view, together with all supporting documents, on the following:



(A) - Within the context of Article 4.1 of the Sri Lanka/United Kingdom Bilateral Agreement of February 13th, 1980, for the Promotion and Protection of Investments, is there any existing precedent or established practice concerning restitution, indemnification, compensation or other settlement allocated to Sri Lanka nationals and companies, or to nationals and companies of any Third State in the circumstances specified in said Article 4.(1)? If so how was the quantum calculated?

(B) - Even if there is no precedent or established practice what are the applicable rules and standards under the Sri Lanka domestic legal system with regard to investment losses suffered by private persons owing to any of the circumstances mentioned in the said Article 4.(1)?

(C) - What are the legal obligations of Sri Lanka under international law with regard to investment losses suffered owing to any of the circumstances mentioned in Article 4.(1) by nationals of companies of Third States, whether these States have or have not concluded Bilateral Investment Agreements with Sri Lanka?

14. In compliance with the Tribunal's Order of June 27, 1989, both Parties submitted their answers to the above-stated questions by September 15, 1989, and Claimant commented on the Memorandum of the Respondent on October 27, 1989.

15. At a later stage, and as a result of consultations undertaken between the members of the Tribunal, a new invitation was addressed on December 26, 1989, to Counsel to both Parties in the following terms:

Taking into consideration that the members of the Tribunal deem appropriate receiving from Counsels of both Parties their reflections and comments about the Decision rendered in July 1989 by the International Court of Justice in the case between the U.S.A. and Italy related to the scope of protection extended to a foreign investor under bilateral treaty;

Therefore, both Counsels are kindly invited to submit within the coming four weeks their comments about the legal reasoning stated in said Decision and the what extent they deem said reasoning relevant in adjudicating the pending Arbitration Case.

Counsel to the Respondent dispatched his comments in a letter dated January 26, 1990, and Counsel to the Claimant expressed his comments in a faxed letter dated January 29, 1990.

16. Subsequent consultations undertaken between the members of the Tribunal indicated that there was no need to convene a new oral hearing, and the Tribunal held its final meeting on March 26-27, 1990.

\* \*

\*

17. As a result of said deliberations, the Tribunal is of the opinion that the pending arbitration has to be adjudicated taking into account the following:

### I - Concerning the Applicable Law

18. The present case is the first instance in which the Centre has been seized by an arbitration request exclusively based on a treaty provision and not in implementation of a freely negotiated arbitration agreement directly concluded between the Parties among whom the dispute has arisen.

19. Consequently, the Parties in dispute have had no opportunity to exercise their right to choose in advance the applicable law determining the rules governing the various aspects of their eventual disputes.

In more concrete terms, the prior choice-of-law referred to in the first part of Article 42 of the ICSID Convention could hardly be envisaged in the context of an arbitration case directly instituted in implementation of an international obligation undertaken between two States in favour of their respective nationals investing within the territory of the other Contracting State.

20. Under these special circumstances, the choice-of-law process would normally materialize after the emergence of the dispute, by observing and construing the conduct of the Parties throughout the arbitration proceedings.

Effectively, in the present case, both Parties acted in a manner that demonstrates their mutual agreement to consider the provisions of the Sri Lanka/U.K. Bilateral Investment Treaty as being the primary source of the applicable legal rules.

This basic premise relied upon heavily by the Claimant acquired full acceptance from the Respondent, who, not only based his main arguments on the provisions of the Treaty in question, but also invoked Article 157 of the Constitution of Sri Lanka emphasizing that the Treaty became applicable as part of the Sri Lankan Law.

21. Furthermore, it should be noted that the Bilateral Investment Treaty is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or by direct reference to certain supplementary rules, whether of international law character or of domestic law nature. Such extension of the applicable legal system resorts clearly from Article 3.(1), Article 3.(2), and Article 4 of the Sri Lanka/U.K. Bilateral Investment Treaty.

22. In fact, the submissions of both Parties (*supra*, § 7, iii, § 10) clearly demonstrate that they are in agreement about admitting the supplementary role of the recourse—regarding certain issues—to general customary international law, other specific international rules rendered applicable in implementation of the most-favored-nation clause, as well as to Sri Lankan domestic legal rules.

23. In spite of the Claimant's hostility to the general applicability of customary international law rules and his reluctance to admit Sri Lankan domestic law as the basic governing law under the last part of Article 42 of the ICSID Convention covering the absence of choice of law by the Parties, AAPL arrived from a practical point of view to a position similar to that adopted by the Respondent throughout the arbitral pro-

ceedings. This is particularly seen from what has been quoted in § 7, iii and § 9 herein-above.

24. Accordingly, the Tribunal is of the opinion that the “false problem” related to the preliminary determination in principle of the applicable law has no relevance within the context of the present arbitration, since both Parties agreed during their respective pleading to invoke primarily the Sri Lanka/U.K. Bilateral Investment Treaty as *lex specialis*, and to apply, within the limits required, the international or domestic legal relevant rules referred to as a supplementary source by virtue of Articles 3 and 4 of the Treaty itself.

## II – The legal grounds on which the Respondent's responsibility could be sustained

25. As indicated herein-above, both Parties invoked the Sri Lanka/U.K. Bilateral Investment Treaty as the primary applicable law. However, each Party construed the Treaty's relevant provisions in a manner which led to basically different conclusions.

### (I). The Claimant's Case

26. The main point of view relied upon by AAPL to substantiate its submissions can be summarized as follows:

(A) – By providing that the investments of one contracting Party “shall enjoy full protection and security in the territory of the other Contracting Party”, Article 2 of the Treaty went beyond the *minimum standard* of customary international law through the creation of an unconditional obligation to be borne by the host country. According to the Claimant, “the ordinary meaning of the words ‘full protection and security’ points to an acceptance by the host State of strict or absolute liability” (*Reply of Claimant to Respondent's counter-Memorial, op. cit.*, p. 46);

(B) – Within the “context” of the entire Treaty's “object and purpose”, and taking into account the “identical or very similar” language used in most of the Bilateral Investment Treaties concluded between Sri Lanka, and Third States, the comparative analysis with the different other patterns followed elsewhere indicates that the term “full protection and security” has to be considered “autonomous in character and independent of any link to customary international law” (*Ibid.*, p. 49);

(C) – By abandoning the “diplomatic protection” theory largely based on the United States' “Friendship, Commerce and Navigation” (FCN) pattern of indirect protection, the foreign investor “enjoys” under the “Bilateral Investment Treaties” (BIT's) a different method of direct protection.

According to the Claimant, “the right to protection is vested in the holder of the investment with immediate effect upon the simple coming into force of the treaty”

(*Ibid.*, p. 52). Thus, a deliberate choice is reflected to follow a new pattern in matters of protection different from that which prevailed under traditional International Law.

(D) – In implementation of the most-favoured-nation clause contained in Article 3 of the Sri Lanka/U.K. Bilateral Investment Treaty, and in the light of the fact that the Treaty concluded between Sri Lanka and Switzerland does not provide for a “war clause” or “civil disturbance” exemption from the protection and security standard, the Claimant asserts that: “the standard of treatment under the Swiss Treaty, which is obviously more favourable than the provision of the SL/UK Treaty, applies to British investments. This means that a standard of unmitigated strict liability has to be assured by Sri Lanka in favour of British Investments” (*Ibid.*, P. 56).

27. As an “alternative submission only”, the Claimant envisaged a supplementary argument based on Article 4.(2) of the Sri Lanka/U.K. Bilateral Investment Treaty which could be relied upon in case the Tribunal “unexpectedly” would deem that Article applicable.

The Claimant's position in this respect was clearly stated at page 57 of his *Reply to the Respondent's Counter-Memorial*, which reads as follows:

As stated above, Article 4(2) of the SL/UK Treaty provides for an exemption from the strict liability rule of Article 2(2). Article 4(2) provides for restitution and freely transferable compensation if the destruction of property in situation of war or civil disturbances was *not* required by the necessity of the situation. This standard of compensation goes beyond the duty of granting “restitution”, “indemnification”, or “compensation” or “other settlement” provided for by Art 4(1) of the Treaty, which remains the fall-back provision in cases of war destruction.

It is clear from the above quotation that the Claimant invokes Article 4 of the Treaty in its entirety, but considers the present case falling within the scope of the specific rule contained in Article 4.(2), which evidently provides a better type of remedy that due under Article 4.(1).

28. The reasons sustaining that alternative as to the applicability of Article 4.(2) are explained as follows:

(A) – The act complained of was “not caused in combat action”, but amounts to what the Claimant describes as “the wanton destruction of AAPL's property and the cold-blooded killing of the farm manager and the permanent staff members” which was “clearly not planned pursuant to any combat action” (page 8 of the *Claimant's Memorial*);

(B) – The property was “requisitioned” by Sri Lankan forces and was “destroyed by those same forces” under circumstances suggesting that the wanton use of force was “not required by the exigencies of the situation” (*Ibid.*, same page 8);

(C) – Moreover, the Claimant ascertains that: “the complete destruction and cold-blooded killings by the Government's security forces were completely out of proportion to what was necessary to meet the specific exigencies of the situation which actually existed at the SSL facility” (*Ibid.*, p. 9); and

(D) - In reliance upon the language of Article 4.(2), the Claimant is of the opinion that said language: "places the burden on the Respondent to demonstrate that the destruction of Claimant's property was required by the necessity of the situation" (*Ibid.*, p. 11).

Invoking what is considered "a general principle of international judicial and arbitral practice" the Claimant submitted at a later stage that:

the burden of proof shifts from the claimant to the defendant if the former has advanced same evidence which *prima facie* supports his allegation. This is particularly appropriate if the defendant wishes to derive a benefit from an interpretation or rule operating in his favor as does Sri Lanka in this case. It is submitted that rules justifying conduct which would otherwise be unlawful (such as military necessity) fall into the category of norms operating in favor of the defendant for which the defendant carries the *onus probandi* (*Reply to Respondent's Counter-claim*, at p. 58).

29. During the written phase of the procedures, the Claimant deemed sufficient to formulate his claims for "adequate compensation" on the basis of said Article 4.(2) without suggesting what could be the ultimate remedy available if the Tribunal—contrary to his submissions—would arrive to the conclusion that conditions required for the applicability of the paragraph in question are missing in the present case, and accordingly the rules referred to in paragraph (1) of Article 4 constitute the proper legal framework within which the pending issues have to be adjudicated.

The only indications provided for in the Claimant's written pleadings with regard to such alternative are limited to what was previously mentioned in two reported passages:

(i) - the short reference on page 6 of the Claimant's Memorial to the Government's liability "under customary rules of international law on State responsibility" (*supra*, § 7. (iii));

and

(ii) - the closing sentence on page 57 of the Reply to the Respondent's Counter-Memorial containing a precise reference to the remedies "provided for by Article 4.(1) of the Treaty, which remains the fall-back provision in cases of war destruction" (*supra*, § 27 at the end of the quotation).

30. In order to obtain certain necessary clarifications about the Claimant's position a question was put to the Claimant's Counsel by the President of the Tribunal at the Oral Hearing held in Washington D.C. from April 17 to April 20, 1989. According to the transcript of the tape containing Dr. Golsong's Closing Statement on April 20, 1989, the latter responded by saying:

we were told that we had not based our claim on 4(1) which therefore has to be deleted from the discussions. We have in our Memorial and in our Reply generally based our contention on the Bilateral Investment Treaty of the United Kingdom extended to Hong Kong and improved eventually by way of incorporation by reference of most-favoured-nation provisions deriving from other Investment Treaties. And we maintain this position. We have started by saying that 2. para-

graph 2 enshrines an absolute or strict standard of liability and certainly more than due diligence. And that there are some exceptions in the UK Treaty, namely the specific war situation in Article 4 in general, without making a distinction between 4(1) and 4(2). And in any way, if I refer to 4(2), I have implicitly to bring into discussion 4(1). (*Text provided by ICSID's Secretariat, as enclosure to a letter dated April 10, 1990, in response to an earlier request from the President of the Arbitral Tribunal to check the electronically recorded tapes of the hearing.*)

31. At a later stage of the proceedings, the Arbitral Tribunal issued the above-mentioned Order of June 27, 1989 (*supra*, § 130), which invited both Parties to provide the Tribunal with their considered points of view about certain aspects related to Article 4.(1) and the results that could be obtained through its implementation.

By his letter dated September 14, 1989, the Claimant's Counsel provided the Tribunal with answers to the questions put to both Parties without raising any objection to the eventual adjudication of the case under Article 4.(1). Moreover, the last sentence of said letter explicitly emphasized that:

...there can be no doubt that in the present case the provisions of Article 4(1) of the Sri Lanka/UK Agreement are applicable, and being *lex specialis*, supersede any general principle of International Law which otherwise may govern the issues at stake.

#### (II). *The Respondent's Case*

32. In Sri Lanka's Counter-Memorial, the Respondent adopted arguments aimed to contradict the Claimant's initial submissions. The Government's main arguments at that phase of the proceedings can be summarized as follows:

(A) - "The language 'full protection and security' is common in bilateral investment treaties, and it incorporates, rather than overrides, the customary international legal standard of responsibility. This international legal standard requires due diligence on the part of the States and reasonable justification for any destruction of property, but does not impose strict liability" (*Government's Counter-Memorial*, p. 27);

(B) - The "standards for liability under Articles 2.(2) and 4.(2) are essentially identical. In both instances, a requirement of reasonableness is imposed on Government action. Under the international law standard embodied in Article 2.(2), the Government incurs liability if it fails to act with due diligence. Under Article 4.(2), the Government incurs liability if its actions are not reasonably necessary" (*Ibid.*, p. 28);

(C) - "Article 4.(2) sets forth the standard for compensation in the event the Government is found to have violated its obligations under Article 2.(2). That is, if the Government could have prevented the destruction of the farm through due diligence". In case it has been proven that the Government's lack of due diligence caused "unnecessary destruction, then the Government would both have violated its obligation under 2.(2) and owe restitution or compensation under Article 4.(2)" (*Ibid.*, p. 28-29);

(D) - The burden of proof has to be assumed by the Claimant, by proving "that through due diligence, the Government could have prevented Batticaloa from

falling under terrorist control, thus obviating the need for counter-insurgency action. If AAPL fails to prove that the security action itself was avoidable, then its burden is to prove that the Government caused excessive destruction during the operation of January 28, 1987" (*Ibid.*, p. 29);

(E) - "To the extent there was excessive destruction, the Government of Sri Lanka is ready to compensate AAPL for its proportionate ownership". But, it is questionable "whether the Tribunal may determine that there was excessive destruction, without second-guessing tactical decisions made by commanders during the heat of combat" (*Ibid.*, p. 41).

(F) - "By investing in an area which it knew contained a vehement, and potentially violent, separatist presence, AAPL assumed the risk that its investment would be caught up in the Sri Lankan civil war" (*Ibid.*, p. 41).

33. The Government's Rejoinder focused essentially on the arguments developed in the Claimant's Reply, by ascertaining that:

(A) - AAPL's alleged "absolute liability theory" based on Article 2.(2) concerns damages arising in situations and caused by parties other than those concerned by Article 4.(2). In essence, according to the Respondent, Article 2.(2) "establishes the general standard of protection owed to foreign investors against damage caused by third parties"; but Article 4.(2) "applies to damages caused by the Government itself" (*Respondent's Rejoinder*, p. 6);

(B) - Contrary to the Claimant's assertion that Article 4.(2) establishes an "exemption" to the strict liability standard of Article 2.(2), Article 4.(2) "creates rather than limits liability" (*Ibid.*, p. 8);

(C) - There are no "authorities" suggesting that "full protection and security" clauses are "among the innovative provisions of modern BIT's", and there is "no historical support for AAPL's absolute liability theory" (*Ibid.*, p. 8-9); and

(D) - "The absence of liability-creating provisions analogous to Article 4 of the Treaty in other Sri Lanka BITs, such as the treaty with Switzerland, means only that under those treaties investment losses due to destruction caused by the Government in response to civil strife, whether necessary or not, are covered by the general "fair and equitable treatment" standard found in virtually every BIT, or that investors are left to their traditional remedies under customary international law" (*Ibid.*, p. 10-11).

34. Finally, it has to be noted that throughout the arbitration proceedings, the Government of Sri Lanka maintained that:

- (i) - the destruction was not attributable to the governmental security forces but caused by the rebels;
- (ii) - there was effectively a "combat" between the Government's Special Task Force (STF) and the Tigers insurgents; and
- (iii) - there is no proof that the destruction of the property was "not required by the necessity of the situation".

Therefore, from the Respondent's point of view the liability provided for in Article 4.(2) can not be sustained due to the absence of all three of its *sine qua non* conditions. Hence, the applicability of Article 4.(1) could have been logically envisaged.

Nevertheless, the Government of Sri Lanka refrained from dwelling upon its interpretation of said Article 4.(1), its scope of application, as well as the extent of the responsibility that may emerge thereunder.

The reasons for such silence became perfectly clear during the oral phase of the arbitral proceedings, since Mr. Hornick, Counsel of the Respondent, indicated during his oral argument on April 19, 1989, that there was no need to elaborate upon Article 4.(1), since in his understanding "AAPL is not claiming" thereunder (*Transcript of the electronic taping provided on April 12, 1990 by ICSID Secretariat upon request from the Tribunal's President*).

35. Only at a later stage, and in response to the Tribunal's Order of June 27th, 1989, the Respondent expressed the Government of Sri Lanka's views on the three issues related to the remedies that could be available under Article 4.(1) of the Sri Lanka/U.K. Bilateral Investment Treaty.

36. With regard to the "applicable rules and standards under the Sri Lankan domestic legal system", the letter dated September 13, 1989, addressed by the Respondent's Counsel in response to the Tribunal's Order stated the following:

1. If a Sri Lankan individual or company wished to make a claim against the Sri Lankan Government for any losses suffered owing to the war, *etc.*, it may file an action in a district court in Sri Lanka for compensation. The action will have to be based on a cause of action arising in delict (tort). The law relating to delict is based on Roman Dutch Law which provides a remedy under *lex aquiliana* principles, namely, for intentional or negligent wrongdoing. There is no special legislation or other basis whereby liability is incurred in the absence of fault. Any person making a claim against the Government would have to file an action in the district court. The prescription ordinance of Sri Lanka, which may be availed of by the Government as any other defendant, states (Sections 9):

No action shall be maintainable for any losses, injury or damage, unless the same shall be commenced within two years from the time when the cause of action shall have arisen.

2. It may also be relevant to note that the State (Liability in Delict) Act of 1969 based on the English Crown Liability in Delict Act permits an individual to file an action against the Government in respect of delicts committed by its officers or agents. Under this Act, vicarious liability attaches to the State for the wrongful acts of its servants.

37. Regarding Sri Lanka's legal obligations under international law, the last part of the Respondent's letter dated September 13, 1989 emphasized that:

with regard to investment losses suffered owing to any of the circumstances mentioned in said Article 4.1 by nationals or companies of third States, whether these States have or have not concluded bilateral investment agreements with Sri Lanka, the government refers to Appendix A of its Counter-Memorial (at 7-8) in which it is explained that Government's obligation in such circumstances un-

der customary international law is to exercise due diligence to protect alien individuals or companies from investment losses (references deleted).

Thus, the mere occurrence of investment losses by an alien, such as AAPL, does not render the Government responsible to compensate the alien for the losses. Rather, the Government is obliged to compensate the alien only in the event the alien demonstrates that the Government failed to act reasonably under the circumstances.

### III. The Tribunal's Findings

38. From the above-stated summary of the arguments advanced by each of the two Parties to sustain his position, it becomes clear that the only point on which they agree is the applicability of the Sri Lanka/U.K. Bilateral Investment Treaty as the primary source of law. Beyond that preliminary point, the two Parties are in disagreement, since each Party construes the relevant provisions of the Treaty in a manner fundamentally in conflict with the interpretation given by the other Party to the same provisions.

Therefore, the first task of the Tribunal is to rule on the controversies existing in this respect by indicating what constitutes the true construction of the Treaty's relevant provisions in conformity with the sound universally accepted rules of treaty interpretation as established in practice, adequately formulated by *l'Institut de Droit International* in its General Session in 1956, and as codified in Article 31 of the Vienna Convention on the Law of Treaties.

39. The basic rule to be followed by the Tribunal in undertaking its task with regard to the pending controversial interpretation issue has been formulated since 1888 in the Award rendered in the *Van Bokkelen* case (Haiti/USA), where it was stated that:

for the interpretation of treaty language and intention, whenever controversy arises, reference must be made to the law of nations and to international jurisprudence (*Reperory of International Arbitral Jurisprudence*, Volume I: 1794-1918, Edited by; Vincent COUSSIRAT-COUSTERE and Pierre Michel EISEMANN, *Nijhoff, Dordrecht/Boston/London*, 1989, § 1015, p. 13).

In essence, the requirement that treaty provisions "must be interpreted according to the Law of Nations, and not according to any municipal code", emerges from the basic premise expressed by Mr. WEBSTER in the following terms:

When two nations speak to each other, they use the language of nations (Quoted by the Germany/Venezuela Mixed Claims Commission in the *Christem Case*, as reproduced in the *Reperory* referred to herein-above, § 1017, p. 27).

40. The other rules that should guide the Tribunal in adjudicating the interpretation issues raised in the present arbitration case may be formulated as follows:

*Rule (A)* - "The first general maxim of interpretation is that it is not allowed to interpret what has no need of interpretation. When a deed is worded in a clear and precise terms, when its meaning is evident and leads to no absurd conclusion, there can be no reason for refusing to admit the meaning which such deed nat-

urally presents" (passage from VATTEL'S Chapter on Interpretation of Treaties—Book 2, chapter 17, relied upon in 1890 as expressing "universally recognized law" by the U.S.A./Venezuela Mixed Commission in the *Howland* case, *Reperory*, *op. cit.*, § 1016, p. 16), and the Mixed Commission did not hesitate in declaring: "to attempt interpretation of plain words... would be violative of Vattel's first rule" (*Ibid.*, p. 26). -*cf.* A. Ch. KISS, *Répertoire de la Pratique Française en Matière de Droit International Public*, Tome I, 1962, p. 399, on p. 402 § 810-Text of Prof. GROS's Pleading in the ICJ on July 15-16, 1952 in the *Morocco* case, and § 811-Text of Prof. BASDEVANT's Pleading in of the PICJ on July 5, 1923 in the *Wimbledon* case; S.BASTID, *Les Traités Dans la Vie Internationale*, 1985, p. 129, footnote no. 1—reproducing the text of the Résolution adopted by *l'Institut de Droit International*, Grenada Session, *Annuaire de l'Institut*, vol. 46, 1956, underlining that the rules adopted are only applicable "lorsqu'il y a lieu d'interpréter un traité" -; and I.M. SINCLAIR, "The Principles of Treaty Interpretation and Their Application By the English Courts", *International and Comparative Law Quarterly*, vol. 12, (1963), p. 536—referring to the decisions pronouncing that if the meaning intended to be expressed is clear the Courts are "not at liberty to go further").

*Rule (B)* - "In the interpretation of treaties... we ought not to deviate from the common use of the language unless we have very strong reasons for it (...) words are only designed to express the thoughts; thus the true signification of an expression in common use is the idea which custom has affixed to that expression" (another passage from VATTEL relied upon by the U.S.A./Venezuela Mixed Commission in the *Howland* case, *op. cit.*, p. 16—*cf.* Award of the Mexico/U.S.A. Mixed Commission of 1871 in the *William Barron* case, *Ibid.*, § 1023, p. 30, emphasizing that: "interpretation means finding in good faith that meaning of certain words, if they are doubtful, which those who used the words must have desired to convey, according to the usage of speech (*usus loquendi*)"; ALEXANDER's award of 1899 in the *Treaty of Limits* case between Costa Rica and Nicaragua *Ibid.*, § 1025, p. 31, declaring that: "words are to be taken as far as possible in their first and simplest meanings", "in their natural and obvious sense, according to the general use of the same words", "in the usual sense, and not in any extraordinary or un-used acceptance"; S. BASTID, *op. cit.*, p. 129, reproducing the Resolution adopted in 1956 by *l'Institut de droit International* according to which: "L'accord des parties s'étant réalisé sur le texte, il y a lieu de prendre le sens naturel et ordinaire de ce texte comme base d'interprétation"; and I.M. SINCLAIR, *op. cit.*, p. 537, reporting that: "the Court .... is bound to construe them (the words) according to their natural and fair meaning").

*Rule (C)* - In cases where the linguistic interpretation of a given text seems inadequate or the wording thereof is ambiguous, there should be recourse to the integral context of the Treaty in order to provide an interpretation that takes into consideration what is normally called: "le sens général, l'esprit du Traité", or "son écon-

omie générale" (Award rendered in 1914 by the Permanent Court of Arbitration in the *Timor Island* case between the Netherlands and Portugal, *Repertory, op. cit.*, § 1019, p. 28; decision of the Bulgarian/Greek Mixed Arbitration Tribunal rendered in 1927 in the *Sarrapoulos* case, *Repertory, vol. II: 1919-1945*, § 2020, p. 21-22; The 1926 *Paula Mendel* case where the Germany/U.S.A. Mixed Claims Commission disregarded "a literal construction of the language" since it "finds no support in the other provisions of the Treaty as a whole". Hence, "it cannot stand alone and must fall" *Repertory vol. II*, § 2025, p. 25; and the Decision of the Germany/Venezuela Mixed Claims Commission of 1903 in the *Kummerow* case which stated that: "it is a uniform rule of construction that effect should be given to every clause and sentence of an agreement", *Repertory, op. cit. vol. I*, § 1031, p. 38).

*Rule (D)* - In addition to the "integral context", "object and intent", "spirit", "objectives", "comprehensive construction of the treaty as a whole", recourse to the rules and principles of international law has to be considered a necessary factor providing guidance within the process of treaty interpretation. (Resolution of *l'Institut de Droit International, op. cit.*, Article 1.(2) which stipulates: "les termes des dispositions du traité doivent être interprétés dans le contexte entier, selon la bonne foi et à la lumière des principes du droit international"; Paragraph 3.(c), of Article 31 of Vienna convention on the Law of Treaties, containing reference to: "all relevant rule of international law applicable in the relations between the parties", and the Award rendered in 1928 by the France/Mexico Claims Commission in the *Georges Pinson* case, which stated among "les principes généraux d'interprétation": "Toute convention internationale doit être réputée s'en référer tacitement au droit international commun, pour toutes les questions qu'elle ne résout pas elle-même en termes exprès et d'une façon différente" *Repertory, op. cit.*, vol. II, § 2023, p. 24).

*Rule (E)* - Nothing is better settled, as a canon of interpretation in all systems of law, than that a clause must be so interpreted as to give it a meaning rather than so as to deprive it of meaning (Award of the UK/USA Arbitral Tribunal of 1926 in the *Cayuga Indians* case, *Repertory, vol. II*, § 2036, p. 35-36). This is simply an application of the more wider legal principle of "effectiveness" which requires favouring the interpretation that gives to each treaty provision "effet utile".

*Rule (F)* - When there is need of interpretation of a treaty it is proper to consider stipulations of earlier or later treaties in relation to subjects similar to those treated in the treaty under consideration" (Award of the Mexico/USA General Claims Commission of 1929 rendered in the *Elton* case, *Repertory, vol. II*, § 2033, p. 35). Thus, establishing the practice followed through comparative law survey of all relevant precedents becomes an extremely useful tool to provide an authoritative interpretation.

41. In the light of the above mentioned canons of interpretation, the relevant provisions of the Sri Lanka/U.K. Bilateral Investment Treaty have to be identified, each provision construed separately, examined within the global context of the Treaty, in order to determine the proper interpretation of each text, as well as its scope of application in relation to the other treaty provisions and with regard to the various general rules and principles of international law not specifically referred to in the Treaty itself.

In more precise terms, all appropriate measures should be undertaken in view of establishing the legal regime created by the Treaty for the protection of those investors covered by the Sri Lanka/U.K. Bilateral Investment Treaty in case their investments suffer destruction owing to activities related to the Government's counter-insurgency actions.

42. The construction of the Treaty's comprehensive system governing all aspects related to the extent of the special protection conferred upon the investors in question would permit the evaluation of the Treaty's effective contribution in this respect; *i.e.* in view of determining with regard to each issue whether the Sri Lanka/U.K. Treaty intended, merely, to consolidate the pre-existing rules of international law, or, on the contrary, it tended to innovate by imposing on the host state a higher standard of international responsibility.

Essentially, said evaluation is required, not as a conceptual doctrinal exercise, but for a practical reason related to the adjudication of the case, since in accordance therewith the following question could be adequately answered: what are the limits within which the classical international law based on the judicial and arbitral precedents could be of relevance in adjudicating the present case?

43. Taking the above-mentioned remarks into consideration, the Tribunal agrees with the Parties in considering that there are four fundamental texts in the Sri Lanka/U.K. Bilateral Investment Treaty that should be carefully considered for the purpose of determining the host State's responsibility for investment losses suffered as a result of property destruction:

*First:* The general obligation imposed by virtue of Article 2.(2), by which the host State undertook that foreign investments "shall enjoy full protection and security in the territory", since violation thereof entails a certain degree of international responsibility;

*Second:* The most-favoured-nation provision contained in Article 3, which may be invoked to increase the host State's liability in case a higher standard of international protection becomes granted to investments pertaining to nationals of a Third State;

*Third:* The special provision of Article 4.(1) which envisages the legal consequences of losses suffered by foreign investments "owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot" in the territory of the host State; and

*Fourth:* "without prejudice to" the rules applicable under the previous text (Article 4.(1), the Treaty introduced a more specific rule tailored particularly to cover two

types of "losses", which are "suffered" in any of the situations enumerated in Article 4.(1). These two categories are:

- (a) requisitioning of their property by its forces or authorities; or
- (b) destruction of their property by its forces or authorities which was not caused in combat action or was not required by the necessity of the situation.

Whenever either case is established, the Treaty provided in the concluding sentence of Article 4.(2) for a certain remedy: "restitution or adequate compensation", and that the "resulting payments shall be freely transferable".

44. Accordingly, the treaty envisaged different situations under which protection could be invoked in case of destruction of investments, and different remedies are provided for in order to meet the particularity of each situation.

The various categories of such situations that could be encountered may be classified as follows:

- (i) - Situations in which the foreign investor claims that the destruction of the property was unnecessarily caused by the governmental security forces acting out of combat, and in such case the Treaty provides for a special rule in Article 4.(2), which was tailored particularly to fit the requirements of such serious wrongful action directly attributable to the State organs;
- (ii) - In case the foreign investor fails to establish that the destruction was attributable to the governmental security forces, or in case there was effectively a "combat" during which the property was destroyed under conditions that could hardly permit assessing the unnecessary character of the destruction in a convincing manner, the type of remedy envisaged under Article 4.(2) of the Sri Lanka /U.K. Bilateral Investment Treaty has to be considered excluded. Consequently, the other provisions of the treaty become relevant;
- (iii) - In presence of such situation not possibly governed by Article 4.(2), the search has to be first directed towards investigating the existence of certain rules more favourable to the foreign investor than those provided for under Articles 2.(2) and 4.(1), since the better treatment accorded to investors of the Third State could be extended to apply by virtue of the most-favoured-nation clause stipulated in Article 3 of the Sri Lanka/U.K. Treaty;
- (iv) - In the absence of a more favourable system applicable by virtue of Article 3, the applicable rules become necessarily those governing the liability of the Host State under Article 4.(1) and Article 2.(2), whether taken together or separately as the case may be.

45. The Claimant's primary submission—as previously explained (*supra*, § 26)—is based on the assumption that the "full protection and security" provision of Article 2.(2) created a "strict liability" which renders the Sri Lankan Government liable for

any destruction of the investment even if caused by persons whose acts are not attributable to the Government and under circumstances beyond the State's control.

For sustaining said construction introducing a new type of objective absolute responsibility called "without fault", the Claimant's main argument relies on the existence in the text of the Treaty of two terms: "enjoy" and "full", a combination which sustains, according to the Claimant, that the Parties intended to provide the investor with a "guarantee" against all losses suffered due to the destruction of the investment for whatever reason and without any need to establish who was the person that caused said damage. In other words, the Parties substituted the "due diligence" standard of general international law by a new obligation creating an obligation to achieve a result ("obligation de résultat") providing the foreign investor with a sort of "insurance" against the risk of having his investment destroyed under whatever circumstances.

46. The Tribunal is of the opinion that the Claimant's construction of Article 2.(2) as explained herein-above cannot be justified under any of the canons of interpretation previously stated (*supra*, § 40).

47. In conformity with Rule (B), the words "shall enjoy full protection and security" have to be construed according to the "common use which custom has affixed" to them, their "*usus loquendi*", "natural and obvious sense", and "fair meaning."

In fact, similar expressions, or even stronger wordings like the "most constant protection", were utilized since last century in a number of bilateral treaties concluded to encourage the flow of international economic exchanges and to provide the citizens and national companies established on the territory of the other Contracting Party with adequate treatment for them as well as to their property ("Traité d'Amitié, de Commerce et Navigation", concluded between France and Mexico on November 27, 1886—*cf.* A Ch.KISS, *Répertoire de la Pratique Française* ..., *op. cit.*, Tome III, 1965 § 1002, p. 637; The Treaty concluded in 1861 between Italy and Venezuela, the interpretation of which became the central issue in the *Sambiaggio* case adjudicated in 1903 by the Italy/Venezuela Mixed Claims Commission—*U.N. Reports of International Arbitral Awards*, vol. X, p. 512 *ss.*).

48. The arbitral Tribunal is not aware of any case in which the obligation assumed by the host State to provide the nationals of the other Contracting State with "full protection and security" was construed as absolute obligation which guarantees that no damages will be suffered, in the sense that any violation thereof creates automatically a "strict liability" on behalf of the host State.

*Sambiaggio* case seems to be the only reported case in which such argument was voiced, but without success. The Italian Commissioner AGNOLI, referred in his Report to:

The protection and security...which the Venezuelan Government explicitly *guarantees* by Article 4 of the Treaty of 1861 to Italians residing in Venezuela (*U.N. Reports, op.cit.*, p. 502—underlining added).

The Venezuelan Commissioner ZULOAGA responded by indicating that:

Governments are constituted to *afford* protection, not to *guarantee* it (*Ibid.*, p. 511).

The Umpire RALSTON put an end to the Italian allegation by emphasizing that:

If it had been the contract between Italy and Venezuela, understood and consented by both, that the latter should be held liable for the acts of revolutionists—something in derogation of the general principles of international law—this agreement would naturally have found direct expression in the protocol itself and would not have been left to doubtful interpretation (*Ibid.*, p. 521).

49. In the recent case concerning *Eletronica Sicula S.P.A. (ELSI)* between the U.S.A. and Italy adjudicated by a Chamber of the International Court of Justice, the U.S.A. Government invoked Article V.(1) of the Bilateral Treaty which established an obligation to provide “the most constant protection and security”, but without claiming that this obligation constitutes a “guarantee” involving the emergence of a “strict liability” (Section 2—Chapter V of the *U.S.A. Memorial* dated May 15, 1987, where reference is made, on the contrary at page 135 to the: “One well-established aspect of the international standard of treatment... that States must use “due diligence” to prevent wrongful injuries to the person or property of aliens within their territory”).

In its Judgment of July 20, 1989, the ICJ Chamber clearly stated that:

The reference in Article V to the provision of “constant protection and security” cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed (*C.I.J., Recueil*, 1989, § 108, p. 65).

Consequently, both the oldest reported arbitral precedent and the latest I.C.J. ruling confirms that the language imposing on the host State an obligation to provide “protection and security” or “full protection and security required by international law” (the other expression included in the same Article V) could not be construed according to the natural and ordinary sense of the words as creating a “strict liability”. The rule remains that:

The State into which an alien has entered ... is not an insurer or a guarantor of his security... It does not, and could hardly be asked to, accept an absolute responsibility for all injuries to foreigners (*Alwyn V. FREEMAN, Responsibility of States for Unlawful Acts of Their Armed Forces*, Sijthoff, Leiden, 1957, p. 14).

This conclusion, arrived at more than three decades ago, still reflects—in the Tribunal’s opinion—the present status of International Law Investment Standards as reflected in “the worldwide BIT network” (*cf.* K.S. GUDGEON, “Valuation of Nationalized Property Under United States and other Bilateral Investment Treaties”, Chapter III, in the *Valuation of Nationalized Property in International Law*, Ed. by Richard B. LILLICH, vol. IV, (1987), p. 120).

50. In the opinion of the present Arbitral Tribunal, the addition of words like “constant” or “full” to strengthen the required standards of “protection and security” could justifiably indicate the Parties’ intention to require within their treaty relationship a standard of “due diligence” higher than the “minimum standard” of general international law. But, the nature of both the obligation and ensuing responsibility remain unchanged, since the added words “constant” or “full” are by themselves not

sufficient to establish that the Parties intended to transform their mutual obligation into a “strict liability”.

51. The Tribunal’s opinion arrived at in applying the established rule, according to which the words contained in a treaty provision have to be given the natural and fair meaning affixed to them by the common usage, is further supported by recourse to the other canons of interpretation.

According to *Rule (C)* (*supra*, § 40), proper interpretation has to take into account the realization of the Treaty’s general spirit and objectives, which is clearly in the present case the encouragement of investments through securing an adequate environment of legal protection. But, in the absence of *travaux préparatoires* in the proper sense, it would be almost impossible to ascertain whether Sri Lanka and the United Kingdom had contemplated during their negotiations the necessity of disregarding the common habitual pattern adopted by the previous treaties, and to establish a “strict liability” in favour of the foreign investor as one of the objectives of their treaty protection. Equally, none among the authors referred to by the Parties claimed in his commentary that the Sri Lanka/U.K. Treaty or similar Bilateral Investment Treaties had the effect of increasing the customary international law standards of protection to the extent of imposing “strict liability” on the host State in cases where the investment suffers losses due to property destruction.

Accordingly, recourse to the spirit of the Treaty and its objectives would not alter the conclusion arrived at by the Tribunal in refusing to consider that the Sri Lanka/U.K. Treaty imposed by Article 2.(2) a “strict liability” in the event of failure to provide “full protection and security”.

52. Moreover, both *Rules (D) and (E)* confirm the Tribunal’s opinion, as Article 2.(2) should not be taken separately out of the Treaty’s global context.

The Claimant’s contention that Article 2.(2) adopted a standard of “strict liability” would lead logically to the inevitable conclusion that Article 4 in its entirety becomes superfluous, in the sense that according to the Claimant’s interpretation the Parties were not serious in adding to their Treaty two provisions which are not susceptible of getting any application in practice. Such an interpretation has to be rejected in application of *Rule (E)* which requires that Article 2.(2) be interpreted in a manner that does not deprive Article 4 from having any meaning or scope of applicability.

Such an unaccepted result could have been easily avoided if the Claimant had not disregarded *Rule (D)* according to which the rules of general international law have to be taken into consideration by necessary implication, and not to be deemed totally excluded as alleged by the Claimant.

In the Tribunal’s opinion the non-reference to international law in Article 2.(2) of the Sri Lanka/U.K. Treaty should not be taken as implying the Parties’ intention to avoid its application under any aspect, including its role as supplementary source providing guidance in the process of interpretation.



The Tribunal's conclusion in this respect, is not only based on *Rule (D)* as previously indicated, but it is supported furthermore by what was expressed by an informed author who stated that:

the U.K. BIT's normally make no international law reference... This drafting device could be argued to cloud reliance on external sources of law and precedent during the life of the treaty, although this is undoubtedly not the intent. (K. Scott GUDGEON, "Valuation of Nationalized Property..." *op.cit.*, at p. 119-120).

53. Finally, it has to be recalled that in reliance upon *Rule (F)* the precedents established by the Arbitral Tribunal in the *Sambiaggio* case (1903) and by the ICJ Chamber in the *Elettronica Sicula* case (1989), both previously referred to (*supra*, § 48-49), are categoric in supporting the Tribunal's refusal to construe the words "full protection and security" as imposing a "strict liability" on the host State for whatever losses suffered due to the destruction of the investment protected under the treaty.

Therefore, and taking into consideration all the reasons stated in the previous paragraphs (*supra*, § 45-52), the Tribunal declares unfounded the Claimant's main plea aiming to consider the Government of Sri Lanka assuming strict liability under Article 2.(2) of the Bilateral Investment Treaty, without any need to prove that the damages suffered were attributable to the State or its agents, and to establish the State's responsibility for not acting with "due diligence".

54. For the same reasons, the Tribunal rejects the Claimant's argument based on the most-favoured-nation clause contained in Article 3 of the Sri Lanka/U.K. Bilateral Investment Treaty.

By invoking the absence in the Sri Lanka/Switzerland Treaty of a text similar to Article 4 providing for a "war clause" or "civil disturbance" exemption from the full protection and security standard, the Claimant based his argument on two implicit assumptions:

- (i) - that the Sri Lanka/Switzerland Treaty provides equally for a "strict liability" standard of protection in case of losses suffered due to property destruction; and
- (ii) - that the rules of general international law are totally excluded and replaced exclusively by the Treaty's "strict liability" standard.

Both assumptions are unfounded, as the Tribunal has no reasons to believe that the Sri Lanka/Switzerland Treaty adopted a "strict liability" standard, and the Tribunal is convinced that, in the absence of a specific rule provided for in the Treaty itself as *lex specialis*, the general international law rules have to assume their role as *lex generalis*.

Accordingly, it is not proven that the Sri Lanka/Switzerland Treaty contains rules more favourable than those provided for under the Sri Lanka/U.K. Treaty, and hence, Article 3 of the latter Treaty cannot be justifiably invoked in the present case.

55. Faced with the task of adjudicating the Claimant's "alternative submission", the Tribunal has to provide an answer to the various arguments raised by both Parties with regard to the interpretation of Article 4, the inter-relation between 4.(1) and 4.(2), their respective scope of application, as well as the burden of proof assumed

by each Party in evidencing the existence or non-existence of the conditions required for the applicability of the rules and standards referred to in both paragraphs of Article 4.

56. In determining the applicability of either paragraph of Article 4, the Tribunal shall be guided by the same rules of interpretation previously prescribed from (A) to (F) (*supra*, § 40).

Nevertheless, in order to handle the legal issues related to evidence, the above-stated canons have to be complemented by taking into consideration the following established international law rules:

*Rule (G)*- "There exists a general principle of law placing the burden of proof upon the claimant" (Bin CHENG, *General Principles of Law as Applied by International Courts and Tribunals*, Grotius Publications, Cambridge, (1987), p. 327, and the supporting authorities referred to therein).

*Rule (H)*- "The term *actor* in the principle *onus probandi actori incumbit* is not to be taken to mean the plaintiff from the procedural standpoint, but the real claimant in view of the issues involved" (*Ibid.*, p. 332). Hence, with regard to "proof of individual allegations advanced by the parties in the course of proceedings, the burden of proof rests upon the party alleging the fact" (*Ibid.*, p. 334; and Durward V. SANDIFER, *Evidence before International Tribunals*, University Press of Virginia, Charlottesville, (1975), p. 127, footnote 101).

*Rule (I)*- "A Party having the burden of proof must not only bring evidence in support of his allegations, but must also convince the Tribunal of their truth, lest they be disregarded for want, or insufficiency, of proof" (CHENG, *op.cit.*, p. 329- 331, with quotations from the supporting authorities).

*Rule (J)*- "The international responsibility of the State is not to be presumed. The party alleging a violation of international law giving rise to international responsibility has the burden of proving the assertion" (*The Tanger Horses* case (1924); the *Corfu Channel* case (1949), and the *Belgium Claims* case (1930) referred to by CHENG, at p. 305-306).

*Rule (K)*- "International tribunals are "not bound to adhere to strict judicial rules of evidence". As a general principle "the probative force of the evidence presented is for the Tribunal to determine" (SANDIFER, *op. cit. pp. 9 and 17; Award of 1896* rendered in the *Fabiani* case between France and Venezuela, *Repertory, op. cit.*, Vol; I, p. 412-413; and the 1903 Award rendered in the *Franqui* case by the Spain/Venezuela Mixed Claims Commission, which considered this rule as expressing "the unanimous conviction of the most conspicuous writers upon international law" and relying *inter alia* on Article 15 of the Rules for Arbitration between Nations adopted in 1875 by *l'Institut de Droit International*, and what

MÉRIGNHAC wrote at p. 269 of his *Traité de l'Arbitrage International—U.N. Reports, op.cit.*, Vol. X, p. 751-753).

*Rule (L)*- In exercising the "free evaluation of evidence" provided for under the previous Rule, the international tribunals "decided the case on the strength of the evidence produced by both parties", and in case a party "adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent (SANDIFER, *op. cit.*, pp. 125, 129, 130, 170-173, relying upon the Parker case of 1962 adjudicated by the Mexico/U.S.A. General Claims Commission, *U.N. Reports, op.cit.*, Vol. IV, p. 36-41; the ICJ's *Ambatielos* and *Asylum* cases).

*Rule (M)*- Finally, "In cases where proof of a fact presents extreme difficulty, a tribunal may thus be satisfied with less conclusive proof, i.e., *prima facie* evidence" (CHENG, *op.cit.*, p. 323-325, with quotations from the supporting authorities and cited with approval by SANDIFER, at p. 173).

57. In the light of all the legal Rules from (A) to (M) stated herein above (§ 40 and 56), it becomes clear that Article 4.(2) regulated a specific situation by adopting a standard of responsibility representing a certain degree of particularity, and which becomes applicable only in cases characterized by the cumulative existence of three factors:

- (a) - that the destruction of property not only occurred during hostilities, but more precisely such destruction has been proven to be committed by the governmental forces or authorities themselves;
- (b) - that the destruction was not caused in combat action, since the higher standard of liability ("adequate compensation" payable in "freely transferable" currency) is linked with the assumption of unjustified destruction committed out of combat; and
- (c) - that the destruction was not required by the necessity of the situation, as the existence of a combat would not be sufficient *per se* to alleviate the responsibility of the governmental forces and authorities, once it has been proven that the security forces bypassed the reasonable limits by undertaking unnecessary destruction.

58. Moreover, it has to be noted that the foreign investor who invokes the applicability of said Article 4.(2) assumes a heavy burden of proof, since he has, in conformity with *Rules (G) and (I)*, to establish:

- (i) - that the governmental forces and not the rebels caused the destruction;
- (ii) - that this destruction occurred out of "combat";
- (iii) - that there was no "necessity", in the sense that the destruction could have been reasonably avoided due to its unnecessary character under the prevailing circumstances.

59. Exercizing its discretionary power in evaluating the evidence produced by both Parties during the proceedings of the present case in conformity with the above-stated *Rules (K) and (I)*, the Arbitral Tribunal considers that:

- (a) - There is no doubt that the destruction of the premises which existed in Serendib's Farm took place during the hostilities of January 28, 1987, and the loss of the shrimps harvest occurred during the period in which the governmental security forces occupied the Farm's fields;
- (b) - Nevertheless, there is no convincing evidence produced which sufficiently sustains the Claimant's allegation that the firing which caused the property destruction came from the governmental troops, and no reliable evidence was adduced to prove that the shrimps were lost due to acts committed by the security forces;
- (c) - Equally, no convincing evidence was produced which sufficiently sustains the Respondent's allegation that the firing which caused the destruction of the property came from the insurgents resisting the security forces.

60. Therefore, the Arbitral Tribunal finds that the first condition required under Article 4.(2) cannot be considered fulfilled in the present case, due to the lack of convincing evidence proving that the losses were incurred due to acts committed by the governmental forces.

At the same time, the Tribunal cannot proceed in this respect on the basis of *prima facie* evidence adduced in function of *Rules (H) or (M)* since the existence of a legal condition as important as the attributability of the damage should, in the Tribunal's opinion, be proven in a conclusive manner.

61. Regarding the second condition which excluded from the scope of Article 4.(2) the losses suffered "in combat action", it requires first the determination of what is meant by "combat action" and subsequently whether the investment losses were effectively caused in "combat action".

In implementation of the above-stated *Rule (B) (supra, § 40)*, the term "combat action" has to be understood according to its natural and fair meaning as commonly used under prevailing circumstances, *i.e.* within the context of guerrilla warfare which characterizes the modern civil wars conducted by insurgents.

Rarely, in contemporary history actions undertaken during civil wars would take the classical form of a regular military confrontation between two opposing armed groups on a battle field where the adversaries engage simultaneously in fighting each other on the spot. In most cases, the opponents in current civil war situations would resort to sporadic surprise attacks as far as possible from their home bases, trying to avoid direct military confrontation through retreat to places where pursuit could be extremely difficult.

Hence, a "combat action" undertaken against insurgents could be envisaged comprising vast areas extending over the several square miles covering all the localities

in which the hit and run operations as well as the governmental counter-insurgency activities could take place.

62. In the light of the fore-mentioned remarks, and taking into consideration the evidence submitted by both Parties throughout the arbitration proceedings, the Tribunal is of the opinion that the operation "Day Break" undertaken on January 28, 1987, against the "Tiger" fighters belonging to the movement known as LLTE, in order to regain control of the Manmunai area, qualifies as "combat action".

Accordingly, the losses caused as a result of said "combat action" are not covered by Article 4.(2) of the Sri Lanka/U.K. Bilateral Investment Treaty, since they fall within the explicitly excluded category.

63. The third and final condition provided for in Article 4.(2) relates to the "necessity of the situation", in the sense that the State responsibility under said disposition can only be engaged if it has been proven that the losses incurred were not due to "the necessity of the situation".

The term in question follows a pattern long established in practice, as a number of arbitral precedents refused to allocate compensation for destructions that took place during hostilities on the assumption that these destructions "were compelled by the imperious necessity of war" (cf. the 1903 Award rendered by the Netherlands/Venezuela Mixed Claims Commission in the *Dania Bembelish* case, *Repertory...op.cit.*, vol. I, § 297-280; and the Special *Ad Hoc* Arbitral Tribunal adjudicating the *Hardman* case between the U.K. and the U.S.A.). The doctrinal authorities approved that reasoning mainly justified by the extreme difficulty, described as "next to impossible", of obtaining the reconstruction in front of the arbitral tribunal of all the conditions under which the "combat action" took place with an adequate reporting of all the accompanying circumstances (cf. RALSTON, *The Law and Procedure of International Tribunals*, (1926), p. 391; and C. EAGLETON, *The Responsibility of States in International Law*, (1928), p. 155).

64. In the present case, neither Party was able to provide reliable evidence explaining with precision the conditions under which the destructions and other losses, mainly of the shrimps crop, took place. Under these circumstances, it would be extremely difficult to determine whether the destruction and losses were caused as an inevitable result of the "necessity of the situation", or, on the contrary, were avoidable if the governmental security forces would have been keen to act with due diligence.

Therefore, the Tribunal deems appropriate to rely on the above-stated *Rule (j)*, according to which "the international responsibility of the State is not to be presumed" (*supra*, § 56).

Consequently, all three conditions necessary for the applicability of Article 4.(2) are proven to be non-existent in the present case, and Article 4.(1) becomes the only part of Article 4 providing remedy that could be available for the Claimant to base his claims thereunder.

65. For the applicability of Article 4.(1), the only condition required is the presence of "losses suffered".

These two key words are so clear that they do not call for interpretation in conformity with VATTEL's *Rule (A)* which renders any attempted departure from the plain meaning of the words a violation of international law rules on treaty interpretation.

Undoubtedly, the term "losses suffered" includes all property destruction which materializes due to any type of hostilities enumerated in the text ("owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory").

Equally, the mere fact that such "losses suffered" do exist is by itself sufficient to render the provision of Article 4.(1) applicable, without any need to prove which side was responsible for said destruction, or to question whether the destruction was necessary or not.

In essence, the scope of applicability of Article 4.(1) is not subject to any legal restrictions. Hence, it extends as *lex generalis* to all situations not covered by the special rule of Article 4.(2), including necessarily cases where no proof has been established to determine whether the governmental forces or the insurgents caused the property destruction.

66. The only difficulty encountered under Article 4.(1) does not relate to its interpretation or conditions of applicability, but to the type of remedy provided for thereunder.

Precisely, Article 4.(1) does not include any substantive rules establishing direct solutions; *i.e.* material rules providing remedies expressed in fixed and definitive terms. Like conflict-of-law rules, Article 4.(1) contains simply an indirect rule whose function is limited to effecting a reference (*renvoi*) towards other sources which indicate the solution to be followed.

According to the undisputed plain language of Article 4.(1), the investor—already enjoying the "full security" under Article 2.(2) of the Sri Lanka/U.K. Treaty—has to be accorded treatment no less favourable than:

- (i) - that which the host State accords to its own nationals and companies; or
- (ii) - that accorded to nationals and companies of any Third State.

Taking into account the absence of restrictions, whether explicit or implied, and the generality of the text, the "no less favourable treatment" granted thereunder covers all possible cases in which the investments suffer losses owing to events identified as including "a state of national emergency, revolt, insurrection, or riot", with regard to remedies enumerated in the text itself: "restitution, indemnification, compensation or other settlement".

67. Consequently, it could be safely ascertained that the Bilateral Investment Treaty, through the above-stated *renvoi* technique, had not left the host State totally immune from any responsibility in case the foreign investor suffers losses due to the destruction of his investment which occurs during a counter-insurgency action undertaken by the governmental security forces.

In implementation of Article 4.(1), the host State could find itself in such a situation bound to bear a certain degree of responsibility to be determined in implementation of the *renvoi* contained in that Article 4.(1).

Once failure to provide "full protection and security" has been proven (under Article 2.(2) of the Sri Lanka/U.K. Treaty or under a similar provision existing in other bilateral Investment Treaties extending the same standard to nationals of a third State), the host State's responsibility is established, and compensation is due according to the general international law rules and standards previously developed with regard to the State's failure to comply with its "due diligence" obligation under the *mininum standard* of customary international law.

68. It should be noted in this respect that in the Government of Sri Lanka's own words, its international responsibility could be engaged "if it fails to act with due diligence" (*Respondent's Counter-Memorial*, at p. 28, second paragraph).

In the sentence starting at the end of the same page and continued on the following page, it was clearly stated that:

If the government's lack of due diligence caused otherwise unnecessary destruction, then the government would ... have violated its obligation under Article 2.(2)....

The reference to the "lack of due diligence" emerges from the Government's basic assumption, according to which:

the language "full protection and security" is common in bilateral investment treaties, and it incorporates rather than overrides, the customary international legal standard of responsibility. This international legal standard requires due diligence on the part of the states, and reasonable justification for any destruction of property (*Respondent's Counter-Memorial*, at p. 27).

69. Hence, any foreign investor, even if his national State has not concluded with Sri Lanka a Bilateral Investment Treaty containing a provision similar to that of Article 2.(2), would be entitled to a protection which requires "due diligence" from the host State, *i.e.* Sri Lanka. Failure to comply with this obligation imposed by customary international law entails the host State's responsibility.

The Letter of September 13, 1989, containing the Government of Sri Lanka's response to the Tribunal's Order dated June 27, 1989, confirmed that:

The Government's obligation in such circumstances under customary international law is to exercise due diligence to protect alien individuals or companies from investment losses (paragraph (c) of said letter, with reference to authorities stating that: "A state on whose territory an insurrection occurs is not responsible for loss or damage sustained by an alien to his person or property unless it can be shown that the government of this state was negligent in the use of, or in the failure to use, the forces at its disposal for the prevention or suppression of the insurrection").

The Respondent's submission as expressed in the Letter's final paragraph reads as follows:

Thus, the mere occurrence of investment losses by an alien, such as AAPL, does not render the Government responsible to compensate the alien for the losses. Rather, the Government is obliged to compensate the alien only in the event the alien demonstrates that the Government failed to act reasonably under the circumstances.

70. Within the context of the latter alternative, the Tribunal has to envisage whether effectively Sri Lanka's responsibility could be sustained under international law which has to be considered applicable by virtue of the *renvoi* provided for in Article 4.(1), combined with the conventional standard of "full protection and security" stipulated in Article 2.(2), as well as in other Bilateral Investment Treaties concluded by Sri Lanka.

71. But, before turning to undertake that task, the Tribunal has to emphasize that the Respondent referred in the september 13, 1989 Letter to another legal ground available by virtue of the *renvoi* contained in Article 4.(1), which is the State's responsibility under the rules of the domestic legal system.

As indicated in paragraph (B) of said letter, previously quoted in its entirety (*supra*, § 36), the Sri Lankan Law provides, for the person who suffered losses owing to armed hostilities, "a remedy under *lex aquilian* principles, namely, for intentional or negligent wrongdoing".

Nevertheless, the Tribunal deems appropriate, for procedural considerations, not to delve into the domestic law responsibility, since the Sri Lankan Law was not fully pleaded during the present arbitration proceedings.

### III—The Legal and Factual Considerations on which the Respondent's Responsibility is Established

72. It is a generally accepted rule of International Law, clearly stated in international arbitral awards and in the writings of the doctrinal authorities, that :

- (i) - A State on whose territory an insurrection occurs is not responsible for loss or damage sustained by foreign investors unless it can be shown that the Government of that state failed to provide the standard of protection required, either by treaty, or under general customary law, as the case may be; and
- (ii) - Failure to provide the standard of protection required entails the state's international responsibility for losses suffered, regardless of whether the damages occurred during an insurgents' offensive act or resulting from governmental counter-insurgency activities.

73. The long established arbitral case-law was adequately expressed by Max HUBER, the *Rapporteur* in the *Spanish Zone of Morocco* claims (1923), in the following terms:

The principle of non-responsibility in no way excludes the duty to exercise a certain degree of vigilance. If a state is not responsible for the revolutionary events

themselves, it may nevertheless be responsible, for what its authorities do or not to do to ward the consequence, within the limits of possibility. (Translation from the French original text reported by CHENG, in his *general principles...*, *op.cit.*, at p. 229).

Furthermore, the famous arbitrator indicated that the "degree of vigilance" required in proving the necessary protection and security would differ according to the circumstances.

In the absence of any higher standard provided for by Treaty, the general international law standard was stated to reflect the "degree of security reasonably expected". Max HUBER indicated in this respect:

Du moment que la vigilance exercée tombe manifestement au-dessous de ce niveau par rapport aux ressortissants d'un Etat étranger déterminé, ce dernier est en droit de se considérer comme lésé dans des intérêts qui doivent jouir de la protection du droit international (*Rapport, U.N. Recueil des Sentences Arbitrales*, vol. II, p. 634; and in *Repertory ...*, *op.cit.*, p. 426).

In implementation of said standard of vigilance "qu'au point de vue du droit international l'Etat est tenu de garantir", HUBER arrived in his award rendered on May 1, 1925 (*Britanic Property* case between Spain and the U.K.) to hold Spain responsible for: "manque de diligence dans la prévention des actes dommageables" (*U.N. Recueil des Sentences...*, *op.cit.*, p. 645), and in the *Melillea-Ziat, Ben Kiran* case he went as far as to declare the authorities responsible for: "négligence qui friserait la complicité" (*Ibid.*, p. 731).

74. Another reputed arbitrator and author, RALSTON acting as Umpire in the *Sambiggo* case between Italy and Venezuela, did not hesitate to declare:

The umpire .... accepts the rule that if in any case of reclamation submitted to him it is alleged and proved that Venezuelan authorities failed to exercise due diligence to prevent damages from being inflicted by revolutionists, that country should be held responsible (*U.N. Recueil des Sentences Arbitrales*, Vol. X, p.534).

75. On various other occasions, the State Responsibility had been admitted for failure to provide the required protection, as witnessed by the following examples:

- In the 1903 *Kummerow* case, the Germany/Venezuela Mixed Claims Commission declared:

substantially all the authorities on international law agree that a nation is responsible for acts of revolutionists under certain conditions such as lack of diligence, or negligence in failing to prevent such acts, when possible, or as far as possible to punish the wrongdoer and make reparation for the injuring (*Repertory, op. cit.*, Vol I, p. 37);

- In Max HUBER's Report of 1925 on "the Individual Claims" (*Spanish Zone of Morocco* cases), he treated the failure to provide the necessary protection and security as an omission or inaction, and considered that:

l'on est fondé à envisager cette inaction comme un manquement à une obligation internationale (*Repertory*, vol. II, p. 430);

- In the 1926 *Home Insurance Company* case, the Mexico/USA General Claims Commission emphasized the importance of the "duty to protect", which required undertaking all "means reasonably necessary to accomplish that end" (*Ibid.*, p. 433).

- In three successive years (1927, 1928, and 1929), the Mexico/USA General Claims Commission declared that the Mexican Government is to be responsible for what could be characterized as "lack of protection" in case this has been proven (the *David Richards* case (1927), the *Oriental Navigation Co. case* (1928), and the *F.M. Smith* case (1929), *Repertory*, vol. II, p. 435-437).

- In the *Victor A. Ermerins* case (1929), the Presiding Commissioner, Dr. SIND-BALLE, in response to the claim that the Mexican authorities failed "to afford protection to the interest of Ermerins", arrived at the conclusion that in the circumstances of that case:

a crime of this nature could not have taken place, if the authorities of the town had properly fulfilled their duty to afford protection to the property of Ermerins (*U.N. reports of International Arbitral Awards*, vol. IV, p. 476-477);

- In both the *Chapman* case and the *Mrs. Mead* case, adjudicated in 1930 by Mexico/USA General Claims Commission, in spite of the insufficiency of the records submitted, the Commission, relied on sworn affidavits and non-official reports introduced as evidence in order "to sustain the charge of lack of protection" (*U.N. Reports, op.cit.*, Vol. IV, p. 639 and p. 656-657);

In the *Dexter Balwin* case (1933), the Panama/USA General Claims commission, condemned the local authorities's failure "to afford protection" (*Repertory*, vol. II, p. 442);

- In the 1937 two cases concerning *Mr. Braumann* and *Frances Healey* against the Republic of Turkey, the Government was declared responsible according to NIELSON's ruling on the basis that "reasonable care to prevent injuries" was not afforded (*Ibid.*, p. 443-444).

76. In the light of all the above-mentioned arbitral precedents, it would be appropriate to consider that adequate protection afforded by the host State authorities constitutes a primary obligation, the failure to comply with which creates international responsibility. Furthermore, "there is an extensive and consistent state practice supporting the duty to exercise due diligence" (BROWNLIE, *System of the Law of Nations, State Responsibility—Part I*, Oxford, 1986, p. 162).

As a doctrinal authority, relied upon by both Parties during the various stages of their respective pleadings in the present case, Professor BROWNLIE stated categorically that:

There is general agreement among writers that the rule of non-responsibility cannot apply where the government concerned has failed to show due diligence (*Principles of Public International Law*, Third Edition, Oxford, 1979, P. 453).

After reviewing all categories of precedents, including more recent international judicial case-law, the learned Oxford University Professor arrived, not only to confirm that international responsibility arises from the mere "failure to exercise due diligence"

in providing the required protection, but also to note "a sliding scale of liability related to the standard of due diligence" (*State Responsibility, op. cit.* p. 162 and p. 168).

In addition, special attention has to be given to the following passages of BROWNLIE's writings which seem to be of particular relevance to the present case:

- "Unreasonable acts of violence by police officers ... also give rise to responsibility" (*Principles, op. cit.*, p. 447);
- "Substantial negligence to take reasonable precautionary and preventive action" is deemed sufficient ground to create "responsibility for damage to foreign public and private property in the area" (*Ibid.*, p. 452);
- In commenting the ICJ Judgment rendered in the *Cofu* case (1949), the fact that "nothing was attempted to prevent the disaster" was qualified as "grave omission" which involved the international responsibility of Albania (*State Responsibility, op. cit.*, p. 154);
- With regard to the ICJ Judgment rendered in the *Hostages* case (1980), Professor BROWNLIE emphasizes Iran's failure "to take appropriate steps to ensure the protection" required under the "full protection and security" provision of the Iran/U.S.A. Amity, Navigation and Commerce Treaty (*Ibid.*, p. 157).

77. A number of other contemporary international law authorities noticed the "sliding scale", from the old "subjective" criteria that takes into consideration the relatively limited existing possibilities of local authorities in a given context, towards an "objective" standard of vigilance in assessing the required degree of protection and security with regard to what should be legitimately expected to be secured for foreign investors by a reasonably well organized modern State.

As expressed by Professor FREEMAN, in his 1957 Lectures at the Hague Academy of International Law:

The "due diligence" is nothing more nor less than the reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances (*Responsibility of States...*, *op. cit.*, p. 15-16).

According to modern doctrine, the violation of international law entailing the State's responsibility has to be considered constituted by "the mere lack or want of diligence", without any need to establish malice or negligence (*cf.* C.F. AMERASINGHE, *State Responsibility for Injuries to Aliens*, Oxford, (1967), p. 281-282; F.V. GARCIA-AMADOR, *The Changing Law of International Claims*, vol. I, (1987), p. 115,118; M. BEDJAOUI, "Responsibility of States: Fault and Strict Liability", *Encyclopedia of Public International Law*, vol. 10, (1987), p. 359; and K. ZEMANEK, "Responsibility of States: General Principles", *Ibid.*, p. 365).

78. In the light of the above-stated international law precedents and authorities, the arbitral Tribunal has to review the evidence submitted by both Parties in the present case in order to establish the proven facts, and to determine whether these facts sustain the Claimant's allegation that the Respondent Government failed to comply with its obligation under the Sri Lanka/U.K. Bilateral Investment Treaty (particularly the standard provided for in Article 2.(2), as well as by virtue of the rules governing

State responsibility under general international law (which becomes necessarily applicable by virtue of the *renvoi* contained in Article 4.(1) of the Treaty)).

79. The Claimant's case on the facts surrounding the events of January 28, 1987, as initially submitted can be summarized as follows:

- (a) - "During the later part of 1986 and into 1987, the Government of Sri Lanka was faced with grave difficulties because of terrorist activities, including terrorist activities in that part of the country which is near Serendib Seafoods, Ltd. farm" (*Claimant's Memorial*, P. 7);
- (b) - The management of Serendib company had been closely cooperating "with the security authorities in the region", and "was ready and willing to cooperate with the Government" (*Ibid.*, p. 8-9);
- (c) - The destruction and killing which took place on January 28, 1987 "was caused by special security forces", under circumstances which "strongly suggest that this incident was a wanton use of force not required by the exigencies of the situation and not planned pursuant to any combat action" (*ibid.*, p. 8);
- (d) - The burning of Serendib's "office structure, repair shed, store and dormitory", the opening of the sluice gates to the grow-out ponds, thus destroying the shrimp crop, as well as the execution of "21 staff members of Serendib Staff", was not needed since "less destructive action—short of wholesale destruction and murder— could surely have been taken by the Sri Lankan special security forces" (*Ibid.*, p. 9 and 10).

In order to substantiate the Claimant's version of the January 28th, 1987 events, a number of sworn affidavits were submitted with the Claimant's Memorial, all emanating from the former Serendib employees or relatives of dead former employees, together with copies of two letters addressed by Serendib's Managing Director to the President of the Republic on February 2, and February 9, 1987 (Exhibits form (F) to (P)).

80. In the Claimant's Reply to Respondent's Counter-Memorial, special additional emphasis was put on reiterating that "the destruction and the killings on January 28, 1987 were caused by the STF", and the following supplemental points were particularly stressed:

- "the Serendib farm was not a terrorist facility";
- "the STF did not meet with violent resistance from the farm on January 28, 1987";
- "extensive combat action did not occur at the farm between terrorists and the STF"; and
- "that Respondent has admitted its liability by offering compensation payments to families of the staff members killed by the STF" (*Claimant's Reply*, p. 72).

Among the documents attached to Claimant's Reply to the Respondent's Counter-Memorial, only one Exhibit related to the factual aspects of the events that took place on January 28, 1987, and during the following days was submitted as

"Exhibit 00". The document in question contains a letter addressed to the Managing Director of Serendib Company by the Batticaloa District Citizen's Committee about the results of the visit of the farm that took place on February 10, 1987.

81. Furthermore, the only person who gave testimony in front of the Tribunal during the oral phase of the arbitration proceedings was the Managing Director of Serendib Company, Mr. Victor Santiapillai, whose two letters to the President of the Republic were submitted as evidence by the Claimant according to what has been previously indicated (Claimant's Exhibits (M) and (P)).

Mr. Santiapillai was examined by the Claimant's Counsel and cross-examined by the Respondent's Counsel.

82. The Respondent's case provided a different version of the facts, which can be summarized as follows:

- (a) - "The Government of Sri Lanka was seeking ways to prevent the spread of terrorism and the erosion of Government control in the towns surrounding the shrimp farm" (*Government's Counter-Memorial*, p. 3);
- (b) - "that the Serendib farm was, in the months preceding the operation (of January 28, 1987), used by Tiger rebels as a base of operations and support" (*Ibid.*, p. 4);
- (c) - "That the farm's management cooperated with the Tigers (*Ibid.*, p. 4)
- (d) - "That operating out of the farm (and the surrounding area) the Tigers violently resisted the Special Task Force raid", and "intense combat action occurred at the farm between the Tigers and the special Task Force during the raid" (*Ibid.*, p. 4);
- (e) - "Any destruction of the farm which occurred was caused directly by terrorist action (in particular, mortar fire), and not by the Special Task force" (*Ibid.*, p. 41).

83. During the first exchange of the written pleadings, the Respondent's case on the facts concerning the events of January 28, 1987 relied exclusively on three Exhibits submitted with the Counter-Memorial, which contain:

- (i) - Document containing the Report of Assistant Superintendent Nimal Lewke, dated February 2, 1987, and addressed to his superior, Superintendent Karunasena, Commander of the Special Task Force (Exhibit No. 34);
- (ii) - Document dated February 1, 1987, by virtue of which the Operation's Commander Superintendent Karunasena addressed his Report to his superior, Superintendent Sumith Silva, the Coordinating Officer of Batticaloa (Exhibit No. 35); and
- (iii) - Three internal correspondence within the General Intelligence & Security Department of the Ministry of Defense, dated successively February 3, 1987, February 9, 1987, and March 18, 1987, all related to the fate of Serendib's prawns which were in the farm ponds and disappeared after the farm's destruction on January 28, 1987 (Exhibit No. 36).

84. The text of the Respondent's Rejoinder contained no new elaboration on the facts, but its enclosures comprised two additional Exhibits related to the events of January 28, 1987, which are:

- (i) - A sworn affidavit dated October 17, 1988 (Exhibit No. 38) emanating from the same Mr. Karunasena, the author of the report previously submitted as Exhibit No. 35; and
- (ii) - A sworn affidavit dated also October 17, 1988 (Exhibit No. 39), emanating from Mr. Sumith Silva, the area Coordinating Officer to whom Mr. Karunasena's Report has been previously submitted.

85. Exercising its recognized prerogatives with regard to the evaluation of the entire evidence submitted by both Parties taken as a whole, and after careful consideration of all arguments raised during the proceedings related to the factual aspects of the case, the Arbitral Tribunal came to the following conclusions:

- (A) - Both Parties are in agreement about one fact; that the infiltration by the rebels of the area in which Serendib's farm was located took such magnitude that the entire district had been for several months before January 1987 practically out of the Government's control.

Though such admitted situation would have raised logically the question of whether there was during that period failure from the Government's part to provide "full protection and security" according to the objective standard suggested to be applicable, said question remains theoretical since there were no claimed "losses suffered" due to the lack of governmental protection throughout that period.

- (B) - The Respondent never contested the evidence given by Mr. Santiapillai, neither during the written phase of the proceedings, nor when he gave his testimony at the Oral Hearing, about what he expressed in his letter of February 2, 1987, addressed the Sri Lankan President of the Republic by stating:

we maintained very cordial relationship with the senior officers of the security forces in Batticaloa, repeatedly told them that, if they had the slightest reservation about any of our Batticaloa staff they should let us know quietly and we would take action directly to get such persons out of the company.

More importantly, Mr. Santiapillai, indicated that:

On last visit to Batticaloa, (he) met Sumith de Silva, Coordinating Officer for the area, on January 17, 1987, (and) introduced (to him) the new Farm Manager (Mr. Karunary), who was appointed on 1 January 1987 Farm Manager, after having worked for the Company since its inception.

He added, that during that visit to Mr. Sumith de Silva on January 17, 1987, the latter:

assured me ... that he had no such reservation.

In his Affidavit prepared and sworn in October 1988; *i.e.* after Mr. Santiapillai's letter was produced as evidence by the Claimant in the present case, the same Mr. Sumith de Silva did not contest that the meeting in question took place at the

indicated date (just 10 days before the January 28, 1987 operation), he did not contradict the substance of the reported discussion, and he did not deny the existence of "cordial relationship" as manifested by making "enquiries from government officials" before recruiting staff and readiness to dismiss whoever the authorities have "the slightest reservation" about him.

In the light of said uncontested evidence, the Tribunal is of the opinion that reasonably the Government should have at least tried to use such peaceful available high level channel of communication in order to get any suspect elements excluded from the farm's staff. This would have been essential to minimize the risks of killings and destruction when planning to undertake a vast military counter-insurgency operation in that area for regaining lost control.

The Tribunal notes in this respect that the failure to resort to such precautionary measures acquires more significance when taking into consideration that such measures fall within the normal exercise of governmental inherent powers—as a public authority—entitled to order undesirable persons out from security sensitive areas. The failure became particularly serious when the highest executive officer of the Company reconfirmed just ten days before his willingness to comply with any governmental requests in this respect.

Accordingly, the Tribunal considers that the Respondent through said inaction and omission violated its due diligence obligation which requires undertaking all possible measures that could be reasonably expected to prevent the eventual occurrence of killings and property destructions.

- (c) There are no reasons to doubt the Respondent's submission regarding the long planned character of the January 28, 1987 operation given the code-name "Day Break" which obtained prior high level clearance. But the Tribunal does not consider the military reports prepared at a later date conclusive evidence with regard the alleged heavy firing coming "from the direction of the Prawn Farm", or that "the enemy hold up in the Farm" and resisted the security forces during a period over two hours.

The reports of the two officers are contradicted on these specific points by the information contained in the affidavits sworn by Mr. Kirupakara, the casual worker at Serendib farm (Exhibit F), and by Mr. Selbatnamby, the tractor driver at Serendib farm. Both provide more detailed account as eye-witnesses about what effectively happened on the spot with extreme rapidity between 7.45 in the morning, when gunfire came "in the direction of the office" causing the employees to "rush into the Farm office for shelter", and 8.00, when "three officers attached to the STF entered the office". The taking-over of the Farm by the security forces faced no resistance according to these two eye-witnesses, and there were no destructions at that time, as witnessed by the fact that the tractor driver returned later in the day to the Farm with four members of the security forces to take certain equipments from the Farm Office, which implies that it remained non-destroyed till then.

Moreover, it has to be noted that of the officers' reports raise certain issue of credibility with regard to their chronological order, since unexpectedly the commander of the operation, Mr. Karunasena who was observing from a helicopter reported to his superior the Area Coordinating Officer Sumith de Silva on February 1, 1987, before receiving any report from his assistant Mr. Lewke who effectively conducted on the ground the operation of taking over the farm facilities (the latter's report is dated February 2, 1987).

Therefore, the Respondent's version of the events has to be considered lacking convincing evidence with regard to the allegation that the farm became a "terrorist facility" which "violently resisted the Special Task Force" through an "intense combat action" that "occurred at the Farm".

Apparently, the officers' version of the events, which are not substantiated with any credible evidence, and which are contradicted by the Affidavits submitted by eye-witnesses, were intended to cover up their inability to prevent the destruction of the farm.

- (d) - Neither Party succeeded in providing the Tribunal with convincing evidence about: (i)—the circumstances under which the destruction of the premises took place after they came under the control of the governmental forces; (ii)—who are the persons responsible for the effective destruction of the farm premises; (iii)—how was the destruction committed; and (iv)—how the subsequent acts causing the loss of the prawns in ponds took place.

The Respondent could have at least provided the results of investigations conducted in this respect by the competent Sri Lankan authorities, particularly since all the events in question took place during the two weeks period when the farm was under the exclusive control of the security forces.

In final analysis, no conclusive evidence exists sustaining the Claimant's allegation that the special security forces were themselves the actors of said destruction causing the losses suffered.

At the same time no conclusive evidence sustains the Respondent's allegation that the destruction were "caused directly by the terrorist action".

Hence, the adjudication of the State's responsibility has to be undertaken by determining whether the governmental forces were capable, under the prevailing circumstances, to provide adequate protection that could have prevented the destructions from taking place totally or partially.

In this respect, it has been already indicated that the governmental authorities should have undertaken important precautionary measures to get peacefully all suspected persons out of Serendib's farm before launching the attack, either through voluntary cooperation with the Management of the company or by ordering the Company to expel the suspected persons.

The reports of Messrs. Lewke, Karumasena, and Silva, as well as the sworn affidavits of the last two senior officers, provide certain indications that the governmental authorities failed to undertake such measures because they were



considering as suspected guerrilla supporters the entire Management of Serendib Company, starting from the newly appointed farm manager Mr. Karunargy, up to the American Manager, Mr. Bruce Cyr. Even Mr. Santiapillai the Managing Director was accused of "complicity with LLTE as far as the management of the Prawn Farm is concerned" (Paragraph 8, of the Report of the Commandant/STF dated March 18, 1987, *Respondent's Exhibit* No. 37, which referred to "evidence" against the Managing Director to that effect).

If this had been effectively the case, in the opinion of the Tribunal, the legitimate expected course of action against those suspected persons would have been either to institute judicial investigations against them to prove their culpability or innocence, or to undertake the necessary measures in order to get them off the Company's farm. But, as previously explained, nothing of the sort took place. On the contrary, only ten days before the January 28, 1987, operation no complaints were voiced against any of them, including the newly appointed farm manager Mr. Karunargy, during the meeting of Mr. Santiapillai with the Area Coordinating Officer Mr. Sumith de Silva. The mere fact that Mr. Karunargy had been the first person who lost his life during the first hours of the operation "Day Break", under the circumstances described by Mr. Kirupakara in his Affidavit (*Claimant's Exhibit F*) and Mr. Selbathnamy in his Affidavit (*Claimant's Exhibit G*), casts serious doubts about the ability of the security forces which took control over Serendib's farm to provide the required standard of protection in preventing human losses, or a *fortiori* of property destruction, which is by far a less imperative objective.

Therefore, and faced with the impossibility of obtaining conclusive evidence about what effectively caused the destruction of the farm premises during the period in which the entire area was out of bounds under the exclusive control of the governmental security force, the Tribunal considers the State's responsibility established in conformity with the previously stated international law rules of evidence (especially *Rules (L) and (M)*, *supra* § 56).

86. For all the legal and factual considerations contained in the present section of the award, the Tribunal came to the conclusion that the Respondent's responsibility is established under international law.

#### IV—The Legal Consequences of the Respondent's International Responsibility

##### (A)—Quantum of the compensation

87. Both Parties are in agreement that whenever the State's responsibility is established, due to failure of its authorities to provide foreign investors with the full protection and security required under the relevant international law rules and standards, the interested party becomes entitled to claim the type of remedy deemed appropriate,

which takes in the present case the form of monetary compensation (*Respondent's Counter-Memorial*, p. 28-29, p. 39, p. 40, p. 42 ss; and *Government's Rejoinder*, p. 11 ss).

88. Both Parties are equally in agreement about the principle, according to which, in case of property destruction, the amount of the compensation due has to be calculated in a manner that adequately reflects the full value of the investment lost as a result of said destruction and the damages incurred as a result thereof.

The basic rule long established in this respect was clearly formulated by Max Huber in the 1925 *Melilla-Ziat, Ben Kim* case in the following words:

Le dommage éventuellement remboursable ne pourrait être que le dommage direct, à savoir la valeur de marchandises détruites ou disparues (*U.N. Reports of International Arbitration Awards*, vol. II, p. 732).

Thus, the task of the Tribunal in the present case has to focus on the determination of the "value" of the Claimant's right which suffered losses due to the destruction that took place on January 28, 1987, and throughout the following days during which Serendib's farm remained under governmental temporary occupation (unjustifiably characterized by the Claimant as *de facto* "requisition", since it has not been proven that the Government used the farm to promote its own military interests and to benefit thereof).

89. Disagreement among the two Parties to the present arbitration emerges only with regard to the following two major points:

- (i) - Which elements have to be taken into consideration in calculating the Claimant's property rights to be compensated; and
- (ii) - What quantum reflects the full value of the elements constituting the Claimant's property right to be compensated.

90. With regard to the first point, the elements enumerated in the Claimant's Memorial included the following:

- (A) - 50% of the physical direct losses sustained by Serendib Company on January 28, 1987, which comprise:
  - (1) - loss of revenue from stocks of shrimp existing by then in the ponds;
  - (2) - value of farm structure and equipment destroyed, damaged or missing;
  - (3) - loss of investment in technical staff training at the farm;
  - (4) - compensation payable to dependents of dead staff members;
  - (5) - pond rehabilitation to resume operations.
- (B) - The "going concern value" of the Claimant's 50% share-holding percentage in Serendib Company on January 28, 1987.
- (C) - 50% of the projected lost profits for a reasonable period of 18 months (*Claimant's Memorial*, p. 14-16).

91. According to the final form submitted by the end of the oral hearing on April 19, 1989, expressing the Claimant's conclusions, the Tribunal was requested to award AAPL compensation that includes the following elements:

- (A) - 48.2% of the value of assets destroyed, comprising

- (1) - physical assets;
  - (2) - financial assets;
  - (3) - intangible assets.
- (B) - 48.2% of Serendib's net projected future earnings.

92. The Respondent's Counter-Memorial, emphasized the following important aspects:

- (i) - AAPL's Claims is "largely based on the illusion of expected profitability" (*Government's Counter-Memorial*, p. 42);
- (ii) - AAPL's claim "is based on blatant double (or triple) counting. AAPL claims entitlement not only to its share of "going concern value" of Serendib, but also to indemnification for physical losses and lost prospective profits. Yet AAPL cannot be entitled to both, because any measurement of the "going concern value" of Serendib on January 28, 1987, includes a valuation of the net book value of both Serendib's assets and its future profitability" (*Ibid.*, p. 43);
- (iii) - "In the event the Tribunal finds the Government liable to AAPL for damage sustained by Serendib, the Tribunal must chose *either* to undertake a going concern valuation *or* to determine damages for "physical loss" and lost prospective profits, but cannot logically award both" (*Ibid.*, p. 43).

93. During the course of the proceedings, the Respondent added another basic objection according to which the percentage of AAPL's share-holding in Serendib is neither 50% as initially claimed, nor 48.2% as subsequently admitted, but a far lesser percentage, since the "preference shares" of the Export Development Board should be taken into consideration as an integral part of Serendib's equity capital.

94. The Parties were invited by the Tribunal to express their considered opinions and conclusions on that issue, by virtue of the Order of April 20, 1989, rendered at the end of the oral hearing, and lengthy exchanges took place in this respect on May 22, and May 29, 1989 as previously indicated (*supra*, § 12).

95. In deciding on the issues under consideration which are subject to disagreement among the Parties, the Tribunal has primarily to indicate that AAPL is entitled in the present arbitration case to claim compensation under the Sri Lanka/U.K. Bilateral Investment Treaty, on the legal grounds previously described in Part II of this award due to the fact that the Claimant's "investments" in Sri Lanka "suffered losses" owing to events falling under one or more of the circumstances enumerated by Article 4.(1) of the Treaty ("revolution, state of national emergence, revolt, insurrection", etc....).

The undisputed "investments" effected since 1985 by AAPL in Sri Lanka are in the form of acquiring shares in Serendib Company, which has been incorporated in Sri Lanka under the domestic Companies Law.

Accordingly, the Treaty protection provides no direct coverage with regard to Serendib's physical assets as such ("farm structures and equipment", "shrimp stock in

ponds", cost of "training the technical staff", etc.), or to the intangible assets of Serendib if any ("good will", "future profitability", etc...). The scope of the international law protection granted to the foreign investor in the present case is limited to a single item: the value of his share-holding in the joint-venture entity (Serendib Company).

96. In the absence of a stock market at which the price for Serendib's shares were quoted on January 27, 1987 (the day preceding the events which led to the destruction of the value of AAPL's investment in Serendib's capital), the evaluation of the shares owned by AAPL in Serendib has to be established by the alternative method of determining what was the reasonable price a willing purchaser would have offered to AAPL to acquire its share holding in Serendib.

97. Certainly, all the physical assets of Serendib, as well as its intangible assets, have to be taken into consideration in establishing the reasonable value of what the potential purchaser could have been willing to offer on January 27, 1987 for acquiring AAPL's shares in Serendib. But the reasonable price should have reflected also Serendib's global liability at that date; *i.e.* the aggregate amount of the current debts, loans, interests, etc... due to Serendib's creditors.

98. Consequently, the Tribunal is of the opinion that the determination of the percentage of AAPL's share-holding in Serendib's capital is a false problem, since the relevant factor is to establish a comprehensive balance sheet which reflects the result of assessing the global assets of Serendib in comparison with all the outstanding indebtedness thereof at the relevant time.

For the purpose of evaluating the market price of AAPL's shares on January 27, 1987, the result would be ultimately the same whether or not the "preference shares" of Sri Lanka's Export Development Board technically qualify under the domestic companies law as part of Serendib's capital. Assuming that the correct legal interpretation of the Sri Lankan Law would lead to include among Serendib's capital assets the value of the "preference shares" issued in favour of the Export Development Board as a security for the cash money funds already supplied to the Company, Serendib's capital assets would have on one hand, to be considered increased. But on the other hand, the global amount of the Development Board's disbursements together with the accruing interests due on January 27, 1987, should be taken into consideration in reflecting Serendib's global indebtedness.

In other words, in case the "preference shares" of Export Development Board decrease AAPL's percentage of share-holding in Serendib's equity capital, this would not ultimately affect the value of AAPL's share-holding.

In the language of figures, a 48% ordinary share-holding is an equity capital amounting to 21,464,241 Sri Lankan Rupees (S-L.Rs) equals 37% share-holding in an entity having a total capital of S-L.Rs 28,184,241 (*i.e.* by adding the value of the preferences shares).

At the other side of the equation, assuming 48% of loan liabilities totalling S-L.Rs 70,024,000, is the same as acquiring 37% of the global indebtedness amounting to S-L.Rs 76,744,000.

99. Taking into consideration the above stated preliminary remarks of general character, the Tribunal is faced with no legal objections in allocating to the Claimant compensation for the damages which were effectively incurred due to the destruction of a substantial part of Serendib's physical assets, thus rendering the legal entity in which AAPL invested out of business since January 28, 1987. In essence, Serendib ceased as of that date to be a "going concern" capable of realizing profits, thus causing AAPL's investment therein to become a total loss.

100. In the light of all the elements of evidence provided by both Parties, including the evaluation Report of *Coopers & Lybrand*, the additional explanation pertaining thereto (filed by AAPL as *Exhibit BB*), the Respondent's objections raised in the *Government's Rejoinder* (p. 17ss), as well as those other issues raised during the Oral Hearing, particularly in cross-examination of the Claimant's advisor Mr. Deva Rodrigo which led to revised evaluation figures submitted by the Claimant before the end of the Oral hearing, the Tribunal considers that the fair evaluation exclusively based on Serendib's tangible assets leads to value AAPL's investment in that company at a total amount of 460,000 U.S. Dollars.

101. Nevertheless, the major part of the Claimant's pleas were directed towards obtaining 5,703,667 U.S. dollars as compensation for a variety of other claimed damages, which include intangible assets, mainly "goodwill", and loss of future profits.

The admissibility of such claims raised serious legal objections from the Respondent, which are expressed in the following two quotations:

- (a) - "International arbitral tribunals are bound to project future on the basis of the past, Serendib's history offers no sound basis for projecting any future profitability" (*Counter-Memorial of the Government*, p. 49);
- (b) - "The loss of crops to be harvested in the future has usually been considered to be too speculative and indefinite to be included as a proper element of damage under international law" (*Ibid.*, p. 50).

102. In the Tribunal's view, it is clearly understood that the evaluation of the "going concern" which is Serendib Company in the present case, has for unique objective the determination of what could be the reasonable market value of the Company's shares under the circumstances prevailing on January 27, 1987. Hence, as a general rule all elements related to subsequent developments should not be taken as such into consideration, and *lucrum cessans* in the proper sense could not be allocated in the present case for which the precedents concerning unlawful expropriation claims or liability for unilateral termination of a State contract are of no relevance.

The only pertinent question in the present case would be to establish whether Serendib have had by then developed a "good will" and a standard of "profitability" that renders a prospective purchaser prepared to pay a certain premium over the value of the tangible assets for the benefit of the Company's "intangible" assets.

Consequently, the projection of future profits in function of the "Discounted Cash Flow Method" (DCF) has to be envisaged simply as a tool to assess the level of

Serendib's future profitability under all relevant circumstances prevailing at the beginning of 1987.

103. In this respect, it would be appropriate to ascertain that "goodwill" requires the prior presence on the market for at least two or three years, which is the minimum period needed in order to establish continuing business connections, and during that period substantial expenses are incurred in supporting the management efforts devoted to create and develop the marketing network of the company's products, particularly in cases like the present one where the Company relies exclusively on one product (shrimps) exportable to a single market (Japan).

The possible existence of a valuable "goodwill" becomes even more difficult to sustain with regard to a company, not only newly formed and with no records of profits, but also incurring losses and under-capitalized.

A reasonable prospective purchaser would, under these circumstances, be at least doubtful about the ability of the Company's balance sheet to cease being in the red, in the sense that the future earnings become effectively sufficient to off-set the past losses as well as to service the loans which exceed in their magnitude the Company's capital assets.

104. Furthermore, according to a well established rule of international law, the assessment of prospective profits requires the proof that:

"they were reasonably anticipated; and that the profits anticipated were probable and not merely possible" (Marjorie M. WHITEMAN, *Damages in International Law*, vol. II, (1937), p. 1837, with reference to extensive supporting precedents disallowing "uncertain" or "speculative" future profits, p. 1836-1849; The 1902 Award rendered in *EL Triunfo* case (EL Salvador/U.S.A.), *Repertory, op.cit.*, vol. I, § 1350, p. 324; The 1903 Award rendered by the Italy/Venezuela Mixed Commission in the *Poggidi* case, *Ibid.* § 1358, p. 328-329; Ignaz SEIDEL-HOHENVELDOERN, "L'Evaluation des Dommages dans les Arbitrages Transnationaux", *Annuaire Français de Droit International*, vol. XXXIII, (1987), p. 17 ss. with ample reference to the numerous decisions rendered by the Iran/USA Claims Tribunal to that effect, and interestingly the Author's reference to the DCF calculations provided by the Expert Accountants of the Parties which contain "élément de conjecture" looking: "guère moins spéculatifs et tout aussi obscurs que les prophéties de Nostradamus" P. 24).

105. The Claimant itself, in the *Reply to the Respondent's Counter-Memorial* (p. 64-68), reproduced a long quotation from the Award rendered on July 14, 1987, by the Chamber presided by the late Michel VIRALLY, in the case *AMOCO International Finance Corporation v. Iran*, which after clearly distinguishing the *lucrum cessans* from the "future prospects" of profitability that constitutes an element to be taken into consideration in evaluating the "going concern", find necessary to emphasize the need to prove that:

the undertaking was a "going concern" which had demonstrated a certain ability to earn revenues and was, therefore to be considered as keeping such ability for the future ( § 203 of the Award as quoted on p. 67 of the *Claimant's Reply*).

The fact that Serendib exported for the first time two shipments to Japan during the same month of January 1987 when its farm was destroyed, does not sufficiently demonstrate in the Tribunal's opinion "a certain ability to earn revenues" in a manner that would justify considering Serendib—by exporting for the first time in its short life—able to keep itself commercially viable as a source of reliable supply on the Japanese market.

106. In the light of the above-stated considerations, and taking into account all the evidence introduced by both Parties with regard to the existence or non-existence of "intangible assets" capable of being evaluated for the purpose of establishing the total appropriate value of Serendib on January 27, 1987, the Tribunal comes to the conclusion that neither the "goodwill" nor the "future profitability" of Serendib could be reasonably established with a sufficient degree of certainty.

107. Without putting into doubt the binding force of the rules requiring that the intangible assets including "goodwill" and "future profitability" of an enterprise have to be reflected in the evaluation of a "going concern", the Tribunal's opinion is established on considering the assumptions upon which the Claimant's projection were based in the present case insufficient in evidencing that Serendib was effectively by January 27, 1987, a "going concern" that acquired a valuable "goodwill" and enjoying a proven "future profitability", particularly in the light of the fact that Serendib had no previous record in conducting business for even one year of production.

108. Therefore, all the amounts of claimed compensation for "intangible assets", as well as for "future earnings" are rejected.

(B)—*The issue of AAPL's Guarantee to the European Asian Bank*

109. Evidently, the present Arbitral Tribunal does not have jurisdiction to adjudicate any controversy or dispute related to the interpretation of AAPL's Guarantee given for the benefit of Serendib in AAPL's capacity as share-holder in Serendib Company, in order to determine whether said Guarantee came to an end or is still operative and capable of creating potential liability on AAPL.

110. Nevertheless, the Tribunal takes into consideration that AAPL as Claimant in the present Arbitration has considered its investment in Serendib a total loss, and submitted in its final conclusions dated April 19, 1989, that:

... AAPL is willing to give up its shares of Serendib Seafoods Ltd, should the Respondent pay adequate compensation.

The Tribunal equally notes that the Respondent Government did not raise any objection, with regard to said offer.

111. Accordingly, the Tribunal deems appropriate to invite the two Parties to envisage, upon reception of the amounts becoming due to the Claimant by virtue of the present Award, to conclude an agreement according to which AAPL undertakes all the necessary steps in order to transfer free of charge all its shares in Serendib

Company to the Government of Sri Lanka or to any other entity the Government may nominate, with the understanding that said transfer of title on the shares entails in exchange the passing of any potential liability under the European Asian Bank Guarantee from AAPL to the new owner of the shares.

(C)—*The allocation Of Interest*

112. The Claimant requested interest at the rate of 10% per annum as of the date of the losses incurred (January 28, 1987), and the Respondent did not raise any objection with regard to, either the principle of entitlement to interests in case the Government's responsibility is sustained by the Tribunal, or to the suggested rate of 10% per annum.

113. In accordance with a long established rule of international law expressed since 1872 by the Arbitral Tribunal which adjudicated the *Alabama* case between the U.K. and U.S.A., "it is just and reasonable to allow interest at a reasonable rate" (*Reperory, op.cit.*, vol. I, § 1382, p. 343).

In implementation of the above-stated rule, and in view of the Parties' attitude indicated herein-above, the present Tribunal deems appropriate to allocate interest on the amount of U.S. \$460,000 granted to the Claimant as previously stipulated (§ 100), at the rate of 10% per annum.

114. The only pending issue in this respect relates to the date from which that interest starts accruing.

The survey of the literature reveals that, in spite of the persisting controversies with regard to cases involving moratory interests, the case-law elaborated by international arbitral tribunals strongly suggests that in assessing the liability due for losses incurred the interest becomes an integral part of the compensation itself, and should run consequently from the date when the State's international responsibility became engaged (*cf. R. LILLICH, "Interest in the Law of International Claims", Essays in Honor of Vade Saario and Toivo Sainio, (1983), P. 55-56.*

115. Therefore, and taking into account that Article 8.(3) of the Sri Lanka/U.K. Bilateral Investment Treaty provides that the foreign investor becomes entitled to file a recourse in front of the Centre only in case agreement with the Host State "cannot be reached within three months", and since the claimant in the present case effectively submitted his Request of Arbitration on the 8th of July, 1987, the Tribunal rules that the 10% per annum rate of interest adopted starts accruing as of July 9th, 1987, and continues to run as a part of the compensation allocated to the Claimant up to the date of the payment of the sum awarded.

*(D)—Costs*

116. In implementation of Article 61.(2) of ICSID Convention, the Tribunal exercises the discretionary power accorded thereto in the following manner:

- (i) - in assessing the fees and expenses incurred by the Claimant in preparation and presentation of its case, all the amounts figuring in AAPL's final Statement of May 7, 1990 under *Items 1, 4, 5 and 6* in the Section entitled "Statement of expenditure incurred by AAPL and its officers" have to be excluded, since they are not proven necessary "in connection with the proceedings", and the rest which is totalling U.S. \$164,917.20 (One Hundred, Sixty Four Thousands, Nine hundred Seventeen, and Twenty Cents) has to be shared on the basis of two thirds by the Claimant and one third by the Respondent;
- (ii) - the Respondent has to bear all the fees and expenses incurred in preparation and presentation of its case;
- (iii) - the costs of the arbitration, including the arbitrators' fees and the administrative charges of the Centre, have to be shared on the basis of 40% by the Claimant and 60% by the Respondent.

For the above-stated reasons:

THE TRIBUNAL DECIDES AS FOLLOWS:

1. The Republic of Sri Lanka shall pay to Asian Agricultural Products Ltd., the sum of U.S. Dollars FOUR HUNDRED AND SIXTY THOUSAND (U.S. \$ 460,000) with interest on this amount at the rate of ten percent (10%) per annum from July 9, 1987 to the date of effective payment.

2. The Two Parties are invited to envisage adopting a solution that would permit, upon reception of the payment due under the preceding paragraph, to conclude an agreement according to which Asian Agricultural Products Ltd. undertakes all the steps required in order to transfer free of charge all its shares in Serendib SEA-FOODS LTD. to the Government of Sri Lanka or any other entity the Government may nominate, provided that in exchange the new owner of the shares assumes any potential liability under the European Asian Bank Guarantee previously granted by AAPL as shareholder to the benefit of Serendib Company.

3. All other submissions of the Parties are rejected.

4. The Republic of Sri Lanka shall bear the amount of U.S. \$54,972.40 (Fifty Four Thousands Nine Hundred Seventy Two, and Forty Cents) which represents one third of the relevant fees and expenses incurred by Asian Agricultural Products Ltd. for the preparation and presentation of its case.

5. The Republic of Sri Lanka shall bear the fees and expenses it incurred for the preparation and presentation of its case.

6. The Republic of Sri Lanka shall bear sixty percent (60%) of the arbitrators' fees and expenses and the charges of use of the facilities of the Centre, and the remaining forty percent (40%) shall be borne by Asian Agricultural Products Ltd.

*Ahmed S. EL-KOSHERI*

*Berthold GOLDMAN*

Signed by both arbitrators forming the majority of the Arbitral Tribunal on 21 June 1990, after taking notice of Dr. ASANTE's Dissenting Opinion dated 15 June 1990.

**CLA-021**

TECHNISCHE UNIVERSITÄT MÜNCHEN

**JUDGMENT OF THE COURT**

21 November 1991 \*

In Case C-269/90,

REFERENCE to the Court under Article 177 of the EEC Treaty by the Bundesfinanzhof (Federal Finance Court) for a preliminary ruling in the proceedings pending before that court between

**Hauptzollamt München-Mitte**

and

**Technische Universität München**

on the validity of Commission Decision 83/348/EEC of 5 July 1983 establishing that the apparatus described as 'Jeol-Scanning Electron Microscope, model JSM-35 C' may not be imported free of Common Customs Tariff duties (Official Journal 1983 L 188, p. 22),

THE COURT,

composed of: O. Due, President, Sir Gordon Slynn, R. Joliet, F. A. Schockweiler and F. Grévisse (Presidents of Chambers), G. F. Mancini, C. N. Kakouris, J. C. Moitinho de Almeida, G. C. Rodríguez Iglesias, M. Díez de Velasco and M. Zuleeg, Judges,

Advocate General: F. G. Jacobs,  
Registrar: H. A. Rühl, Principal Administrator,

\* Language of the case: German.

after considering the written observations submitted on behalf of:

- Technische Universität München, by Mr Wachinger, Leitender Regierungsdirektor,
- Commission of the European Communities, by J. Sack, Legal Adviser, acting as Agent,

having regard to the Report for the Hearing,

after hearing the oral observations of the Commission at the hearing on 11 June 1991,

after hearing the Opinion of the Advocate General at the sitting on 11 July 1991,  
gives the following

### Judgment

- 1 By order of 17 July 1990, which was received at the Court on 6 September 1990, the Bundesfinanzhof (Federal Finance Court) referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty a question on the validity of Commission Decision 83/348/EEC of 5 July 1983 establishing that the apparatus described as 'Jeol-Scanning Electron Microscope, Model JSM-35 C' may not be imported free of Common Customs Tariff duties (Official Journal 1983 L 188, p. 22).
- 2 The question was raised in the course of proceedings between the Technische Universität München and the Hauptzollamt München-Mitte.
- 3 The proceedings concern the grant of customs exemption, for a scientific instrument imported into the Community, under Article 3(1)(b) of Council Regu-



lation (EEC) No 1798/75 of 10 July 1975 on the importation free of Common Customs Tariff duties of educational, scientific and cultural materials (Official Journal 1975 L 184, p. 1), as amended by Council Regulation (EEC) No 1027/79 of 8 May 1979 (Official Journal 1979 L 134, p. 1) in force since 1 January 1980.

- 4 Between 1 June 1979 and 23 March 1981 the Technische Universität München brought into free circulation a scanning electron microscope, model JSM-35 C, manufactured by Japan Elektron Optics Laboratory Ltd of Tokyo. The instrument was intended to be used in research work in its chemistry, biology and geology departments. It was to be used in investigating electro-chemical processes, geological, mineralogical and food chemistry problems, and research into plastics, photochemical emulsions and biological systems.
- 5 The Hauptzollamt initially admitted it free of customs duty. However, by notices of 14 and 15 April and 22 June 1982 it then demanded customs duties of DM 31 110 plus import turnover tax of DM 3 746.
- 6 Following the objection procedure commenced by the Technische Universität, the Hauptzollamt requested the intervention of the Commission pursuant to Article 7(2) of Commission Regulation (EEC) No 2784/79 of 12 December 1979 laying down provisions for the implementation of Council Regulation (EEC) No 1798/75 (Official Journal 1979 L 318, p. 32).
- 7 On 5 July 1983, the Commission adopted Decision 83/348, referred to above, according to which the electron microscope in question could not be imported free of Common Customs Tariff duties because apparatus of equivalent scientific value, capable of being used for the same purposes, was being manufactured in the Community, in particular, the PSEM 500 X instrument produced by Philips Nederland BV.

- 8 Following this decision by the Commission, the Hauptzollamt rejected the application for duty-free admission. The Technische Universität then began an action.
  
- 9 The Bundesfinanzhof, to which the case came at last instance, considers that it raises a question of the validity of Commission Decision 83/348, cited above. In its view, the Court of Justice has always held that it has only a limited power of review in relation to disputes concerning the duty-free importation of scientific apparatus. According to its case-law, given the technical nature of the questions which arise, the Court may only declare a decision of the Commission invalid where there has been a manifest error of appraisal or a misuse of power. The Bundesfinanzhof doubts whether that view can be maintained.
  
- 10 The Bundesfinanzhof considers that the fact-finding and the application of the legal criteria governing the grant of duty-free admission cannot escape judicial review. That requirement for legal protection is not affected by the fact that the comparative examination of the equivalence of scientific apparatus carried out by the competent customs authorities is mainly technical.
  
- 11 The Bundesfinanzhof therefore asks the Court whether Commission Decision 83/348 is valid.
  
- 12 Reference is made to the Report for the Hearing for a fuller account of the facts of the case, the procedure and the written and oral observations submitted to the Court, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

- 13 It must be stated first of all that, since an administrative procedure entailing complex technical evaluations is involved, the Commission must have a power of appraisal in order to be able to fulfil its tasks.
  
- 14 However, where the Community institutions have such a power of appraisal, respect for the rights guaranteed by the Community legal order in administrative procedures is of even more fundamental importance. Those guarantees include, in particular, the duty of the competent institution to examine carefully and impartially all the relevant aspects of the individual case, the right of the person concerned to make his views known and to have an adequately reasoned decision. Only in this way can the Court verify whether the factual and legal elements upon which the exercise of the power of appraisal depends were present.
  
- 15 The Court must therefore examine whether the disputed decision was adopted in accordance with the principles mentioned above.
  
- 16 With regard to the first point, it should be borne in mind that Regulation No 1798/75, cited above, implemented in the Community the Florence Agreement of 22 November 1950 (see Official Journal 1979 L 134, p. 14) in which the Contracting States undertake not to apply customs duties and import duties on scientific apparatus intended for educational or research purposes, provided that no apparatus of equivalent scientific value is manufactured in the country of importation.
  
- 17 According to the first recital of the preamble to Regulation No 1798/75, it is necessary to allow, by all possible means, the admission free of Common Customs Tariff duties of educational, scientific and cultural materials in order to facilitate the free exchange of ideas as well as the exercise of cultural activities and scientific research within the Community.

- 18 Article 3(1) of the regulation provides that scientific instruments and apparatus imported exclusively for non-commercial purposes are to be admitted free of Common Customs Tariff duties if no instruments or apparatus of equivalent scientific value are being manufactured in the Community.
  
- 19 The grant of customs exemption for scientific apparatus imported into the Community can therefore only be refused, on the grounds that apparatus of equivalent scientific value exists in the Community, if the investigation carried out by the authorities responsible for applying Regulation No 1798/75 has established that fact for certain.
  
- 20 In the procedure laid down by Regulation No 2784/79 the Commission consults the Member States and, if necessary, a group of experts. If this group's examination shows that an equivalent apparatus is manufactured in the Community, the Commission adopts a decision establishing that the conditions for duty-free importation of the apparatus are not met.
  
- 21 The Commission has admitted that it has always followed the opinions of the group of experts because it has no other sources of information concerning the apparatus being considered.
  
- 22 In those circumstances, the group of experts cannot properly carry out its task unless it is composed of persons possessing the necessary technical knowledge in the various fields in which the scientific instruments concerned are used or the members of that group are advised by experts having that knowledge. Neither the minutes of the meeting of the group of experts nor the oral proceedings before the Court have shown that the members of the group themselves possessed the necessary knowledge in the fields of chemistry, biology and geographical sciences or that they sought advice from experts in those fields in order to be able to

address the technical problems raised by the examination of the equivalence of the scientific instruments in question. Consequently, the Commission has infringed its obligation to examine carefully and impartially all the relevant aspects of the case in point.

- 23 Secondly, it must be stated that Regulation No 2784/79 does not provide any opportunity for the person concerned, the importer of scientific apparatus, to explain his position to the group of experts or to comment on the information before the group or to take a position on the group's recommendation.
- 24 However, it is the importing institution which is best aware of the technical characteristics which the scientific apparatus must have in view of the work for which it is intended. The comparison between the imported apparatus and the instruments originating in the Community must, consequently, be made according to the information about the intended research projects and the actual intended use of the apparatus provided by the person concerned.
- 25 The right to be heard in such an administrative procedure requires that the person concerned should be able, during the actual procedure before the Commission, to put his own case and properly make his views known on the relevant circumstances and, where necessary, on the documents taken into account by the Community institution. This requirement was not met when the disputed decision was adopted.
- 26 Thirdly, and finally, with regard to the statement of reasons required by Article 190 of the Treaty, the Court has consistently held (see, in particular, its judgment in Case 205/85 *Nicolet Instrument v Hauptzollamt Frankfurt am Main-Flughafen* [1986] ECR 2049) that the statement of reasons must disclose in a clear and unequivocal fashion the reasoning followed by the Community authority which adopted the measure in question in such a way as to make the persons concerned

aware of the reasons for the measure and thus enable them to defend their rights and to enable the Court to exercise its supervisory jurisdiction.

- 27 In the instant case, it must be stated that the Commission's decision does not contain a sufficient statement of the scientific reasons capable of justifying the conclusion that the instrument manufactured in the Community is equivalent to the imported instrument. The disputed decision merely reproduces the wording of one of the Commission's previous decisions, Decision 82/86/EEC of 23 December 1981 (Official Journal 1982 L 41, p. 53). It is therefore impossible for the person concerned to ascertain whether the decision is vitiated by an error of appraisal. The decision does not therefore satisfy the requirements laid down by Article 190 of the Treaty.
- 28 It follows from all the considerations set out above that the decision in question was adopted pursuant to an administrative procedure in which the obligation of the competent institution to examine carefully and impartially all the relevant aspects of the individual case before it, the right to be heard and the obligation to provide an adequate statement of reasons for the decision subsequently adopted were infringed.
- 29 Accordingly, the answer to be given to the national court is that Commission Decision 83/348 of 5 July 1983 establishing that the apparatus described as 'Jeol-Scanning Electron Microscope, model JSM-35 C' may not be imported free of Common Customs Tariff duties is invalid.

### Costs

- 30 The costs incurred by the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, in so far as the parties to the main proceedings are concerned, in the nature of a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the question submitted to it by the Bundesfinanzhof, by order of 17 July 1990, hereby rules:

**Commission Decision 83/348/EEC of 5 July 1983 establishing that the apparatus described as 'Jeol-Scanning Electron Microscope, model JSM-35 C' may not be imported free of Common Customs Tariff duties is invalid.**

Due	Slynn	Joliet	Schockweiler	Grévisse
Mancini		Kakouris	Moitinho de Almeida	
Rodríguez Iglesias		Díez de Velasco		Zuleeg

Delivered in open court in Luxembourg on 21 November 1991.

J.-G. Giraud  
Registrar

O. Due  
President

**CLA-022**



NÖLLE

JUDGMENT OF THE COURT (Fifth Chamber)  
22 October 1991 \*

In Case C-16/90,

REFERENCE to the Court under Article 177 of the EEC Treaty by the Finanzgericht Bremen (Second Chamber) for a preliminary ruling in the proceedings pending before that court between

**Detlef Nölle, trading as 'Eugen Nölle'**

and

**Hauptzollamt Bremen-Freihafen**

on the validity of Council Regulation (EEC) No 725/89 of 20 March 1989 imposing a definitive anti-dumping duty on imports of paint, distemper, varnish and similar brushes originating in the People's Republic of China and definitively collecting the provisional anti-dumping duty on such imports (Official Journal 1989 L 79, p. 24),

THE COURT (Fifth Chamber),

composed of: Sir Gordon Slynn, President of Chamber, acting as President of the Fifth Chamber, F. Grévisse, J. C. Moitinho de Almeida, G. C. Rodríguez Iglesias and M. Zuleeg, Judges,

Advocate General: W. Van Gerven,  
Registrar: D. Louterman, Principal Administrator,

\* Language of the case: German.

after considering the written observations submitted on behalf of:

- Detlef Nölle, trading as 'Eugen Nölle', the plaintiff in the main proceedings, by Frank Montag, Rechtsanwalt, Cologne,
- the Council of the European Communities by Erik Stein, Legal Adviser, acting as Agent,
- the Commission of the European Communities by Eric White, a member of the Legal Service, acting as Agent, assisted by Reinhard Wagner, a German Judge seconded to the Commission within the framework of the exchange scheme for national officials,

having regard to the Report for the Hearing,

after hearing the oral observations of Detlef Nölle, the Council and the Commission, represented by Eric White, Legal Adviser, and Claus-Michael Happe, a German official seconded to the Commission in the framework of the exchange scheme for national officials, at the hearing on 16 January 1991,

after hearing the Opinion of the Advocate General at the sitting on 4 June 1991,

gives the following

### **Judgment**

- 1 By order of 12 December 1989, which was received at the Court on 22 January 1990, the Finanzgericht Bremen (Second Chamber), referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty a question on the validity of Council Regulation (EEC) No 725/89 of 20 March 1989 imposing a definitive anti-dumping duty on imports of paint, distemper, varnish and similar brushes originating in the People's Republic of China and definitively collecting the provisional anti-dumping duty on such imports (Official Journal 1989 L 79, p. 24).

NÖLLE

- 2 The question was raised in proceedings between Detlef Nölle, trading as 'Eugen Nölle' (hereinafter referred to as 'Nölle') and the Hauptzollamt Bremen-Freihafen (hereinafter referred to as 'the Hauptzollamt') concerning the definitive anti-dumping duties imposed by the latter on Nölle's imports of paint brushes from China.
  
- 3 On 21 November 1988 and 8 and 14 February 1989, Nölle applied to the Hauptzollamt for entry for free circulation of three consignments of cleaning and paint brushes falling under Combined Nomenclature code 9603 40 10 originating in the People's Republic of China. The Hauptzollamt first demanded, pursuant to Article 1 of Commission Regulation (EEC) No 3052/88 imposing a provisional anti-dumping duty on imports of paint, distemper, varnish and similar brushes originating in the People's Republic of China (Official Journal 1988 L 272, p. 16), payment of a provisional anti-dumping duty in respect of which Nölle, in pursuance of Article 1(4) of the said regulation, lodged a security in the form of a directly enforceable bank guarantee in the amounts of DM 31 000, DM 17 000 and DM 4 400, a total of DM 52 400 for the three consignments.
  
- 4 In three notices dated 14 April 1989, the Hauptzollamt requested Nölle to pay DM 29 937.04, DM 16 972.57 and DM 4 307.79, a total of DM 51 217.40, in definitive anti-dumping duty, corresponding, in accordance with Article 1 of the said Regulation No 725/89 (hereinafter referred to as 'the contested regulation'), to 69% of the net price per brush, free-at-Community-frontier, not cleared through customs.
  
- 5 On 3 May 1989, Nölle lodged an objection with the Hauptzollamt, claiming that the notices of 14 April were illegal on the ground that the contested regulation, on which they were based, was in several respects in breach of higher-ranking Community rules. The objection was dismissed and Nölle then brought an action before the Finanzgericht Bremen for the cancellation of the three notices.

- 6 In those circumstances the national court referred the following question to the Court for a preliminary ruling:

‘Is Council Regulation (EEC) No 725/89 of 20 March 1989 invalid?’

- 7 Reference is made to the Report for the Hearing for a fuller account of the facts of the case, the procedure and the written observations submitted to the Court, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

- 8 The national court bases its doubts as to the validity of the contested regulation on the grounds pleaded by the plaintiff in the main proceedings, namely infringement of Article 2(5)(a) of Council Regulation (EEC) No 2423/88 of 11 July 1988 on protection against dumped or subsidized imports from countries not members of the European Economic Community (Official Journal 1988 L 209, p. 1) (hereinafter referred to as ‘the basic regulation’).

- 9 That article provides that:

‘In the case of imports from non-market economy countries . . . normal value shall be determined in an appropriate and not unreasonable manner on the basis of one of the following criteria:

- (a) the price at which the like product of a market economy third country is actually sold:

(i) for consumption on the domestic market of that country; or

(ii) to other countries, including the Community;

. . .’

NÖLLE

- 10 First of all it should be stressed that the aim of Article 2(5) of the basic regulation is to prevent account being taken of prices and costs in non-market-economy countries, that is to say, which are not the normal result of market forces (see the judgment in *Joined Cases C-305/86 and C-160/87 Neotype Techmasbexport v Commission and Council* [1990] ECR I-2945).
- 11 It should also be remembered that the choice of reference country is a matter falling within the discretion enjoyed by the institutions in analysing complex economic situations.
- 12 However, the exercise of that discretion is not excluded from review by the Court. The Court has consistently held that in the context of such a review it will verify whether the relevant procedural rules have been complied with, whether the facts on which the choice is based have been accurately stated and whether there has been a manifest error of appraisal or a misuse of powers (judgments in *Case 240/84 NTN Toyo Bearing Company Limited and Others v Council* [1987] ECR 1809 and *Case 258/84 Nippon Seiko KK v Council* [1987] ECR 1923).
- 13 As regards in particular the choice of reference country it is desirable to verify whether the institutions neglected to take account of essential factors for the purpose of establishing the appropriate nature of the country chosen and whether the information contained in the documents in the case were considered with all the care required for the view to be taken that the normal value was determined in an appropriate and not unreasonable manner.
- 14 Nölle claims that the normal value was not determined in such a manner since Sri Lanka, the country chosen as the reference country, satisfied none of the conditions of which the Commission, according to its usual practice, has hitherto taken account, namely the existence in the country concerned of a like product of like volume and production methods, of conditions of access to raw materials comparable to those of the exporting country concerned and of prices resulting from the operation of the rules of the market economy.

- 15 In this respect Nölle claims first that China produces round, flat and radiator paint brushes, whereas Sri Lanka produces only flat brushes as well as other brushes not affected by the anti-dumping duty at issue.
- 16 The Commission thinks, however, that the Sri Lankan brushes are similar to the Chinese brushes because they are essentially manufactured from animal hair and have wooden handles of similar thickness, a ferrule and a quantity and weight of hair and bristle similar to those of the Chinese brushes. It is therefore in the Commission's view irrelevant that Sri Lanka produces only flat brushes.
- 17 It should be noted that neither the documents sent by the national court nor the documents and explanations produced during the hearing before the Court show conclusively whether or not the products in question are similar. It is therefore not established that in this respect the institutions made a manifestly incorrect appraisal.
- 18 Nölle claims in the second place that production volumes are not comparable, because in Sri Lanka there are only two major producers, one of whom manufactures practically none of the products in question, whereas in China there are at least 150 small and medium-sized businesses and the production volume there is accordingly at least 200 times as great as that in Sri Lanka.
- 19 According to the Commission the fact that production volume in the People's Republic of China is higher than in Sri Lanka is not relevant since the decisive criterion for calculating the normal value is the production costs of individual firms. In both these countries the firms are small or medium-sized with labour-intensive production in small-scale units with low wage rates.

---

NÖLLE

- 20 It should be recalled that according in particular to paragraph 31 of the judgment in Joined Cases C-305/86 and C-160/87 *Neotype*, cited above, the size of the domestic market is not in principle a factor capable of being taken into consideration in the choice of a reference country under Article 2(5) of the basic regulation in so far as, during the period of the investigation, there is a sufficient number of transactions to ensure the representative nature of the market in relation to the exports in question. In this respect it should be borne in mind that in paragraphs 12 and 13 of the judgment in Case 250/85 *Brother Industries v Council* [1988] ECR 5683, the Court rejected a challenge to the institutions' practice of fixing the minimum level of representativity of the domestic market, for the purpose of calculating the normal value, at 5% of the exports in question.
- 21 At the hearing Nölle and the Commission agreed that the volume of exports of Chinese paint brushes to the Community was some 60 million brushes, whereas Sri Lanka's total production was of the order of 750 000 brushes a year, representing 1.25% of the volume of the exports in question.
- 22 It should be emphasized that although the sole fact that the production volume of the reference country is below the minimum level of 5% does not necessarily signify that the choice of that country cannot be regarded as appropriate and not unreasonable, a figure of 1.25% nevertheless amounts to an indication that the market considered is not very representative.
- 23 It must also be noted that the Commission and the Council did not produce during either the written or the oral procedure any figures or details capable of showing that, as they stated, production methods in Sri Lanka consisted in labour-intensive production in small-scale units with low wage rates, so that they were comparable to production methods in China.

- 24 Nölle states in the third place that the Sri Lankan industry is obliged to import pig bristle, wood for the handles, and the ferrules, whilst China has practically 85% of the world market in pig bristle.
- 25 The Commission contends that the alleged advantage resulting from access to raw materials cannot be satisfactorily quantified in a non-market-economy country and that in any event such an advantage may be offset by other competitive advantages existing in a market-economy country. Moreover it claims that, as regards the raw materials imported for paint-brush manufacture, adjustments were made (see recital 20 in the preamble to the contested regulation) and that the Commission deducted 25% of the already adjusted price to take account of quality differences.
- 26 This argument put forward by the Commission cannot be accepted. In the first place it follows from the Community institutions' established practice that the comparability of access to raw materials must be taken into consideration for the choice of reference country (see, for example Council Regulation (EEC) No 407/80 of 18 February 1980 imposing a definitive anti-dumping duty on certain sodium carbonate originating in the Soviet Union, Official Journal 1980 L 48, p. 1). Secondly the advantages resulting from access to raw materials cannot be excluded simply because there is no market economy in the exporting country. Since Article 2(5) of the basic regulation is actually applied only in the case of imports from non-market-economy countries, that argument would be tantamount to making impossible any comparison between the production costs of countries with different market conditions.
- 27 Nölle claims finally that the prices charged in Sri Lanka are not the result of the rules of a market economy since there is no natural competition there. It stresses in this respect that the two producers share roughly 90% of the domestic market and that the one of them who manufactures products comparable to those imported from China is a subsidiary of a Community producer who took a leading part in the anti-dumping proceeding set in motion by the European producers.



- 28 The Commission contends that that does not imply the existence of an agreement, decision or concerted practice on prices or the absence of sufficient competition.
- 29 In this respect it must be emphasized that, although the sole fact that there are only two producers in the reference country does not, of itself, prevent prices from being the result of real competition, Nölle, without any objection from the Commission, drew price comparisons during the written procedure and at the hearing from which it is clear that the Sri Lankan producers charged prices higher than those of two representative Community producers. In addition, Nölle produced two documents from the Sri Lankan firms in question, showing that they could supply the Community only to a very limited extent as the production of brushes is adapted to the needs of the domestic market and that there is no price advantage in comparison with the prices which the parent company is able to offer in Europe.
- 30 It appears from the foregoing that Nölle has produced sufficient factors, already known to the Commission and the Council during the anti-dumping proceeding, to raise doubts as to whether the choice of Sri Lanka as a reference country was appropriate and not unreasonable.
- 31 However, the institutions came to the conclusion that Sri Lanka represented an appropriate and not unreasonable choice and did not therefore consider Taiwan, which had been suggested by the plaintiff.
- 32 It should be pointed out in this connection that although the institutions are not required to consider every reference country suggested by the parties during an anti-dumping proceeding, the doubts which arose in this case with regard to the choice of Sri Lanka ought to have led the Commission to examine the proposal made by the plaintiff in greater depth.

- 33 It may be seen from the preamble to the contested regulation that Taiwan was considered as a possible reference country but that the institutions did not pursue that possibility on the ground that the physical characteristics and the production costs of the products were different and that the Taiwanese producers who were approached refused to cooperate (recitals 16 and 17 in the preamble to the contested regulation).
- 34 These statements were not supported by any details and no facts were produced. As regards, in particular, the Taiwanese producers' alleged refusal to cooperate, it should be noted that the letter addressed to the two main producers in Taiwan, produced by the Commission during the hearing, cannot be regarded as a sufficient attempt to obtain information, regard being had to its wording and the extremely short period allowed for reply, which made it practically impossible for the producers in question to cooperate.
- 35 In view of all the circumstances set out above it appears, on the one hand, that various factors known to the institutions were in any event such as to raise doubts as to the appropriateness of Sri Lanka as a reference country and, on the other hand, that the institutions did not make a serious or sufficient attempt to determine whether Taiwan could be considered as an appropriate reference country.
- 36 In these circumstances it must be considered that the normal value was not determined 'in an appropriate and not unreasonable manner' within the meaning of Article 2(5)(a) of the basic regulation.
- 37 As the anti-dumping duty was therefore imposed in contravention of that provision, the contested regulation must be declared invalid and there is no need to consider the other grounds for invalidity put forward by the national court.

---

NÖLLE

- 38 The answer to the question raised must therefore be that Regulation No 725/89 is invalid.

**Costs**

- 39 The costs incurred by the Commission and the Council of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the question submitted to it by the Finanzgericht Bremen (Second Chamber), by order of 12 December 1989, hereby rules:

**Council Regulation (EEC) No 725/89 of the Council of 20 March 1989 imposing a definitive anti-dumping duty on imports of paint, distemper, varnish and similar brushes originating in the People's Republic of China and definitively collecting the provisional anti-dumping duty in such imports is invalid.**

Slynn

Grévisse

Moitinho de Almeida

Rodríguez Iglesias

Zuleeg

I - 5209

Delivered in open court in Luxembourg on 22 October 1991.

J.-G. Giraud

Registrar

Gordon Slynn

President of Chamber acting as  
President of the Fifth Chamber

**CLA-023**

**Draft articles on  
Prevention of Transboundary Harm from Hazardous Activities,  
with commentaries**

2001

Text adopted by the International Law Commission at its fifty-third session, in 2001, and submitted to the General Assembly as a part of the Commission's report covering the work of that session (A/56/10). The report, which also contains commentaries on the draft articles, appears in the *Yearbook of the International Law Commission, 2001*, vol. II, Part Two.



dispute shall, at the request of any of them, have recourse to the establishment of an impartial fact-finding commission.

3. The Fact-finding Commission shall be composed of one member nominated by each party to the dispute and in addition a member not having the nationality of any of the parties to the dispute chosen by the nominated members who shall serve as Chairperson.

4. If more than one State is involved on one side of the dispute and those States do not agree on a common member of the Commission and each of them nominates a member, the other party to the dispute has the right to nominate an equal number of members of the Commission.

5. If the members nominated by the parties to the dispute are unable to agree on a Chairperson within three months of the request for the establishment of the Commission, any party to the dispute may request the Secretary-General of the United Nations to appoint the Chairperson who shall not have the nationality of any of the parties to the dispute. If one of the parties to the dispute fails to nominate a member within three months of the initial request pursuant to paragraph 2, any other party to the dispute may request the Secretary-General of the United Nations to appoint a person who shall not have the nationality of any of the parties to the dispute. The person so appointed shall constitute a single-member Commission.

6. The Commission shall adopt its report by a majority vote, unless it is a single-member Commission, and shall submit that report to the parties to the dispute setting forth its findings and recommendations, which the parties to the dispute shall consider in good faith.

## 2. TEXT OF THE DRAFT ARTICLES WITH COMMENTARIES THERETO

98. The text of the draft articles adopted by the Commission at its fifty-third session with commentaries thereto is reproduced below.

### PREVENTION OF TRANSBOUNDARY HARM FROM HAZARDOUS ACTIVITIES

#### *General commentary*

(1) The articles deal with the concept of prevention in the context of authorization and regulation of hazardous activities which pose a significant risk of transboundary harm. Prevention in this sense, as a procedure or as a duty, deals with the phase prior to the situation where significant harm or damage might actually occur, requiring States concerned to invoke remedial or compensatory measures, which often involve issues concerning liability.

(2) The concept of prevention has assumed great significance and topicality. The emphasis upon the duty to prevent as opposed to the obligation to repair, remedy or compensate has several important aspects. Prevention should be a preferred policy because compensation in case of harm often cannot restore the situation prevailing prior to the event or accident. Discharge of the duty of prevention or due diligence is all the more required as knowledge regarding the operation of hazardous activities, materials used and the process of managing them and the risks involved is steadily growing. From a legal point of view, the enhanced ability to trace the chain of causation, i.e. the physical link between the cause (activity) and the effect (harm), and even the several intermediate links

in such a chain of causation, makes it also imperative for operators of hazardous activities to take all steps necessary to prevent harm. In any event, prevention as a policy is better than cure.

(3) Prevention of transboundary harm arising from hazardous activities is an objective well emphasized by principle 2 of the Rio Declaration on Environment and Development (Rio Declaration)<sup>857</sup> and confirmed by ICJ in its advisory opinion on the *Legality of the Threat or Use of Nuclear Weapons*<sup>858</sup> as now forming part of the corpus of international law.

(4) The issue of prevention, therefore, has rightly been stressed by the Experts Group on Environmental Law of the World Commission on Environment and Development (Brundtland Commission). Article 10 recommended by the Group in respect of transboundary natural resources and environmental interferences thus reads: "States shall, without prejudice to the principles laid down in articles 11 and 12, prevent or abate any transboundary environmental interference or a significant risk thereof which causes substantial harm—i.e. harm which is not minor or insignificant."<sup>859</sup> It must be further noted that the well-established principle of prevention was highlighted in the arbitral award in the *Trail Smelter case*<sup>860</sup> and was reiterated not only in principle 21 of the Declaration of the United Nations Conference on the Human Environment (Stockholm Declaration)<sup>861</sup> and principle 2 of the Rio Declaration, but also in General Assembly resolution 2995 (XXVII) of 15 December 1972 on cooperation between States in the field of the environment. This principle is also reflected in principle 3 of the Principles of conduct in the field of the environment for the guidance of States in the conservation and harmonious utilization of natural resources shared by two or more States, adopted by the Governing Council of UNEP in 1978, which provided that States must:

avoid to the maximum extent possible and ... reduce to the minimum extent possible the adverse environmental effects beyond its jurisdiction of the utilization of a shared natural resource so as to protect the environment, in particular when such utilization might:

- (a) cause damage to the environment which could have repercussions on the utilization of the resource by another sharing State;
- (b) threaten the conservation of a shared renewable resource;
- (c) endanger the health of the population of another State.<sup>862</sup>

<sup>857</sup> *Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3–14 June 1992* (United Nations publication, Sales No. E.93.I.8 and corrigenda), vol. I: *Resolutions adopted by the Conference*, resolution 1, annex I.

<sup>858</sup> *Legality of the Threat or Use of Nuclear Weapons* (see footnote 54 above), pp. 241–242, para. 29; see also A/51/218, annex.

<sup>859</sup> *Environmental Protection and Sustainable Development: Legal Principles and Recommendations* (London, Graham and Trotman/Martinus Nijhoff, 1987), p. 75, adopted by the Experts Group. It was also noted that the duty not to cause substantial harm could be deduced from the non-treaty-based practice of States, and from the statements made by States individually and/or collectively. See J. G. Lammers, *Pollution of International Watercourses* (The Hague, Martinus Nijhoff, 1984), pp. 346–347 and 374–376.

<sup>860</sup> *Trail Smelter* (see footnote 253 above), pp. 1905 et seq.

<sup>861</sup> *Report of the United Nations Conference on the Human Environment, Stockholm, 5–16 June 1972* (United Nations publication, Sales No. E.73.II.A.14 and corrigendum), part one, chap. I.

<sup>862</sup> UNEP, *Environmental Law: Guidelines and Principles*, No. 2, *Shared Natural Resources* (Nairobi, 1978), p. 2. The principles are re-

(5) Prevention of transboundary harm to the environment, persons and property has been accepted as an important principle in many multilateral treaties concerning protection of the environment, nuclear accidents, space objects, international watercourses, management of hazardous wastes and prevention of marine pollution.<sup>863</sup>

### *Preamble*

#### *The States Parties,*

**Having in mind Article 13, paragraph 1 (a), of the Charter of the United Nations, which provides that the General Assembly shall initiate studies and make recommendations for the purpose of encouraging the progressive development of international law and its codification,**

**Bearing in mind the principle of permanent sovereignty of States over the natural resources within their territory or otherwise under their jurisdiction or control,**

**Bearing also in mind that the freedom of States to carry on or permit activities in their territory or otherwise under their jurisdiction or control is not unlimited,**

**Recalling the Rio Declaration on Environment and Development of 13 June 1992,**

**Recognizing the importance of promoting international cooperation,**

**Have agreed as follows:**

### *Commentary*

(1) The preamble sets out the general context in which the topic of prevention is elaborated, keeping in view the mandate given to the Commission to codify and develop international law. Activities covered under the present topic of prevention require States to engage in cooperation and accommodation in their mutual interest. States

produced in ILM, vol. 17, No. 5 (September 1978), p. 1098. See also decision 6/14 of 19 May 1978 of the Governing Council of UNEP, *Official Records of the General Assembly, Thirty-third Session, Supplement No. 25 (A/33/25)*, annex I. For a mention of other sources where the principle of prevention is reflected, see *Environmental Protection and Sustainable Development ...* (footnote 859 above), pp. 75–80.

<sup>863</sup> For a collection of treaties arranged according to the area or sector of the environment covered and protection offered against particular threats, see E. Brown Weiss, D. B. Magraw and P. C. Szasz, *International Environmental Law: Basic Instruments and References* (Dobbs Ferry, N.Y., Transnational, 1992); P. Sands, *Principles of International Environmental Law*, vol. 1: *Frameworks, Standards and Implementation* (Manchester University Press, 1995); L. Boisson de Chazournes, R. Desgagné and C. Romano, *Protection internationale de l'environnement: recueil d'instruments juridiques* (Paris, Pedone, 1998); C. Dommen and P. Cullet, eds., *Droit international de l'environnement. Textes de base et références* (London, Kluwer, 1998); M. Prieur and S. Doumbé-Billé, eds., *Recueil francophone des textes internationaux en droit de l'environnement* (Brussels, Bruylant, 1998); A. E. Boyle and D. Freestone, eds., *International Law and Sustainable Development: Past Achievements and Future Challenges* (Oxford University Press, 1999); F. L. Morrison and R. Wolfrum, eds., *International, Regional and National Environmental Law* (The Hague, Kluwer, 2000); and P. W. Birnie and A. E. Boyle, *International Law and the Environment*, 2nd ed. (Oxford University Press, 2002) (forthcoming).

are free to formulate necessary policies to develop their natural resources and to carry out or authorize activities in response to the needs of their populations. In so doing, however, States have to ensure that such activities are carried out taking into account the interests of other States and therefore the freedom they have within their own jurisdiction is not unlimited.

(2) The prevention of transboundary harm from hazardous activities should also be seen in the context of the general principles incorporated in the Rio Declaration and other considerations that emphasize the close interrelationship between issues of environment and development. A general reference in the fourth preambular paragraph to the Rio Declaration indicates the importance of the interactive nature of all the principles contained therein. This is without prejudice to highlighting specific principles of the Rio Declaration, as appropriate, in the commentaries to follow on particular articles.

### *Article 1. Scope*

**The present articles apply to activities not prohibited by international law which involve a risk of causing significant transboundary harm through their physical consequences.**

### *Commentary*

(1) Article 1 limits the scope of the articles to activities not prohibited by international law and which involve a risk of causing significant transboundary harm through their physical consequences. Subparagraph (d) of article 2 further limits the scope of the articles to those activities carried out in the territory or otherwise under the jurisdiction or control of a State.

(2) Any activity which involves the risk of causing significant transboundary harm through the physical consequences is within the scope of the articles. Different types of activities could be envisaged under this category. As the title of the proposed articles indicates, any hazardous and by inference any ultrahazardous activity which involves a risk of significant transboundary harm is covered. An ultrahazardous activity is perceived to be an activity with a danger that is rarely expected to materialize but might assume, on that rare occasion, grave (more than significant, serious or substantial) proportions.

(3) Suggestions have been made at different stages of the evolution of the present articles to specify a list of activities in an annex to the present articles with an option to make additions or deletions to such a list in the future as appropriate. States could also be given the option to add to or delete from the list items which they may include in any national legislation aimed at implementing the obligations of prevention.

(4) It is, however, felt that specification of a list of activities in an annex to the articles is not without problems and functionally not essential. Any such list of activities is likely to be under inclusion and could become quickly



dated from time to time in the light of fast evolving technology. Further, except for certain ultrahazardous activities which are mostly the subject of special regulation, e.g. in the nuclear field or in the context of activities in outer space, the risk that flows from an activity is primarily a function of the particular application, the specific context and the manner of operation. It is felt that a generic list could not capture these elements.

(5) It may be further noted that it is always open to States to specify activities coming within the scope of the articles in any regional or bilateral agreements or to do so in their national legislation regulating such activities and implementing obligations of prevention.<sup>864</sup> In any case, the scope of the articles is clarified by the four different criteria noted in the article.

(6) The *first criterion* to define the scope of the articles refers to “activities not prohibited by international law”. This approach has been adopted in order to separate the topic of international liability from the topic of State responsibility.<sup>865</sup> The employment of this criterion is also intended to allow a State likely to be affected by an activity involving the risk of causing significant transboundary harm to demand from the State of origin compliance with obligations of prevention although the activity itself is not prohibited. In addition, an invocation of these articles by a State likely to be affected is not a bar to a later claim by that State that the activity in question is a prohibited activity. Equally, it is to be understood that non-fulfilment of the duty of prevention at any event of the minimization of risk under the articles would not give rise to the implication that the activity itself is prohibited.<sup>866</sup> However, in such a case State responsibility could be engaged to implement the obligations, including any civil responsi-

<sup>864</sup> For example, various conventions deal with the type of activities which come under their scope: the Convention for the Prevention of Marine Pollution from Land-based Sources; the Protocol for the Protection of the Mediterranean Sea against Pollution from Land-based Sources; the Agreement for the Protection of the Rhine against Chemical Pollution; appendix I to the Convention on Environmental Impact Assessment in a Transboundary Context, where a number of activities such as the crude oil refineries, thermal power stations, installations to produce enriched nuclear fuels, etc., are identified as possibly dangerous to the environment and requiring environmental impact assessment under the Convention; the Convention on the Protection of the Marine Environment of the Baltic Sea Area; the Convention on the Transboundary Effects of Industrial Accidents; annex II to the Convention on Civil Liability for Damage Resulting from Activities Dangerous to the Environment, where activities such as the installations or sites for the partial or complete disposal of solid, liquid or gaseous wastes by incineration on land or at sea, installations or sites for thermal degradation of solid, gaseous or liquid wastes under reduced oxygen supply, etc., have been identified as dangerous activities; this Convention also has a list of dangerous substances in annex I.

<sup>865</sup> *Yearbook ... 1977*, vol. II (Part Two), p. 6, para. 17.

<sup>866</sup> See M. B. Akehurst “International liability for injurious consequences arising out of acts not prohibited by international law”, *NYIL*, 1985, vol. 16, pp. 3–16; A. E. Boyle, “State responsibility and international liability for injurious consequences of acts not prohibited by international law: a necessary distinction?”, *International and Comparative Law Quarterly*, vol. 39 (1990), pp. 1–26; K. Zemanek, “State responsibility and liability”, *Environmental Protection and International Law*; W. Lang, H. Neuhold and K. Zemanek, eds. (London, Graham and Trotman/Martinus Nijhoff, 1991), p. 197; and the second report on international liability for injurious consequences arising out of acts not prohibited by international law (prevention of transboundary damage from hazardous activities), by the Special Rapporteur, Pemmaraju Sreenivasa Rao, *Yearbook ... 1999*, vol. II (Part One), document A/CN.4/501, paras. 35–37.

ity or duty of the operator.<sup>867</sup> The articles are primarily concerned with the management of risk and emphasize the duty of cooperation and consultation among all States concerned. States likely to be affected are given the right of engagement with the State of origin in designing and, where appropriate, in the implementation of a system of management of risk commonly shared between or among them. The right thus envisaged in favour of the States likely to be affected however does not give them the right to veto the activity or project itself.<sup>868</sup>

(7) The *second criterion*, found in the definition of the State of origin in article 2, subparagraph (d), is that the activities to which preventive measures are applicable “are planned or are carried out” in the territory or otherwise under the jurisdiction or control of a State. Three concepts are used in this criterion: “territory”, “jurisdiction” and “control”. Even though the expression “jurisdiction or control of a State” is a more commonly used formula in some instruments,<sup>869</sup> the Commission finds it useful to mention also the concept of “territory” in order to emphasize the importance of the territorial link, when such a link exists, between activities under these articles and a State.

(8) For the purposes of these articles, *territorial jurisdiction* is the dominant criterion. Consequently, when an activity covered by the present articles occurs within the *territory* of a State, that State must comply with the *obligations of prevention*. “Territory” is, therefore, taken as conclusive evidence of jurisdiction. Consequently, in cases of competing jurisdictions over an activity covered by these articles, the territorially based jurisdiction prevails. The Commission, however, is mindful of situations where a State, under international law, has to accept limits to its territorial jurisdiction in favour of another State. The prime example of such a situation is innocent passage of a foreign ship through the territorial sea. In such situations, if the activity leading to significant transboundary harm

<sup>867</sup> See P.-M. Dupuy, *La responsabilité internationale des États pour les dommages d'origine technologique et industrielle* (Paris, Pedone, 1976); Brownlie, *System of the Law of Nations ...* (footnote 92 above); A. Rosas, “State responsibility and liability under civil liability regimes”, *Current International Law Issues: Nordic Perspectives (Essays in honour of Jerzy Sztucki)*, O. Bring and S. Mahmoudi, eds. (Dordrecht, Martinus Nijhoff, 1994), p. 161; and F. Bitar, *Les mouvements transfrontières de déchets dangereux selon la Convention de Bâle: Étude des régimes de responsabilité* (Paris, Pedone, 1997), pp. 79–138. However, different standards of liability, burden of proof and remedies apply to State responsibility and liability. See also P.-M. Dupuy, “Où en est le droit international de l'environnement à la fin du siècle?”, *RGDIP*, vol. 101, No. 4 (1997), pp. 873–903; T. A. Berwick, “Responsibility and liability for environmental damage: a roadmap for international environmental regimes”, *Georgetown International Environmental Law Review*, vol. 10, No. 2 (1998), pp. 257–267; and P.-M. Dupuy, “À propos des mésaventures de la responsabilité internationale des États dans ses rapports avec la protection internationale de l'environnement”, *Les hommes et l'environnement: quels droits pour le vingt-et-unième siècle? Études en hommage à Alexandre Kiss*, M. Prieur and C. Lambrechts, eds. (Paris, Frison-Roche, 1998), pp. 269–282.

<sup>868</sup> On the nature of the duty of engagement and the attainment of a balance of interests involved, see the first report on prevention of transboundary damage from hazardous activities, by the Special Rapporteur, Pemmaraju Sreenivasa Rao, *Yearbook ... 1998*, vol. II (Part One), document A/CN.4/487 and Add.1, paras. 43, 44, 54 and 55 (d).

<sup>869</sup> See, for example, principle 21 of the Stockholm Declaration (footnote 861 above); article 194, paragraph 2, of the United Nations Convention on the Law of the Sea; principle 2 of the Rio Declaration (footnote 857 above); and article 3 of the Convention on Biological Diversity.

emanates from the foreign ship, the flag State, and not the territorial State, must comply with the provisions of the present articles.

(9) The concept of “territory” for the purposes of these articles does not cover all cases where a State exercises “jurisdiction” or “control”. The expression “jurisdiction” of a State is intended to cover, in addition to the activities being undertaken within the territory of a State, activities over which, under international law, a State is authorized to exercise its competence and authority. The Commission is aware that questions involving the determination of jurisdiction are complex and sometimes constitute the core of a dispute. This article certainly does not presume to resolve all the questions of conflicts of jurisdiction.

(10) Sometimes, because of the location of the activity, there is no territorial link between a State and the activity such as, for example, activities taking place in outer space or on the high seas. The most common example is the jurisdiction of the flag State over a ship. The Geneva Conventions on the Law of the Sea and the United Nations Convention on the Law of the Sea have covered many jurisdictional capacities of the flag State.

(11) In cases of concurrent jurisdiction by more than one State over the activities covered by these articles, States shall individually and, when appropriate, jointly comply with the provisions of these articles.

(12) The function of the concept of “control” in international law is to attach certain legal consequences to a State whose jurisdiction over certain activities or events is not recognized by international law; it covers situations in which a State is exercising *de facto* jurisdiction, even though it lacks jurisdiction *de jure*, such as in cases of unlawful intervention, occupation and unlawful annexation. Reference may be made, in this respect, to the advisory opinion by ICJ in the *Namibia* case. In that advisory opinion, the Court, after holding South Africa responsible for having created and maintained a situation which the Court declared illegal and finding South Africa under an obligation to withdraw its administration from Namibia, nevertheless attached certain legal consequences to the *de facto* control of South Africa over Namibia. The Court held:

The fact that South Africa no longer has any title to administer the Territory does not release it from its obligations and responsibilities under international law towards other States in respect of the exercise of its powers in relation to this Territory. Physical control of a territory, and not sovereignty or legitimacy of title, is the basis of State liability for acts affecting other States.<sup>870</sup>

(13) The *third criterion* is that activities covered in these articles must involve a “risk of causing significant transboundary harm”. The term is defined in article 2 (see the commentary to article 2). The words “transboundary harm” are intended to exclude activities which cause harm only in the territory of the State within which the activity is undertaken without the possibility of any harm to any other State. For discussion of the term “significant”, see the commentary to article 2.

(14) As to the element of “risk”, this is by definition concerned with future possibilities, and thus implies some element of assessment or appreciation of risk. The mere fact that harm eventually results from an activity does not mean that the activity involved a risk, if no properly informed observer was or could have been aware of that risk at the time the activity was carried out. On the other hand, an activity may involve a risk of causing significant transboundary harm even though those responsible for carrying out the activity underestimated the risk or were even unaware of it. The notion of risk is thus to be taken objectively, as denoting an appreciation of possible harm resulting from an activity which a properly informed observer had or ought to have had.

(15) In this context, it should be stressed that these articles as a whole have a continuing operation and effect, i.e. unless otherwise stated, they apply to activities as carried out from time to time. Thus, it is possible that an activity which in its inception did not involve any risk (in the sense explained in paragraph (14)), might come to do so as a result of some event or development. For example, a perfectly safe reservoir may become dangerous as a result of an earthquake, in which case the continued operation of the reservoir would be an activity involving risk. Or developments in scientific knowledge might reveal an inherent weakness in a structure or materials which carry a risk of failure or collapse, in which case again the present articles might come to apply to the activity concerned in accordance with their terms.

(16) The *fourth criterion* is that the significant transboundary harm must have been caused by the “physical consequences” of such activities. It was agreed by the Commission that in order to bring this topic within a manageable scope, it should exclude transboundary harm which may be caused by State policies in monetary, socio-economic or similar fields. The Commission feels that the most effective way of limiting the scope of these articles is by requiring that these activities should have transboundary physical consequences which, in turn, result in significant harm.

(17) The physical link must connect the activity with its transboundary effects. This implies a connection of a very specific type—a consequence which does or may arise out of the very nature of the activity or situation in question. That implies that the activities covered in these articles must themselves have a physical quality, and the consequences must flow from that quality. Thus, the stockpiling of weapons does not entail the consequence that the weapons stockpiled will be put to a belligerent use. Yet, this stockpiling may be characterized as an activity which, because of the explosive or incendiary properties of the materials stored, entails an inherent risk of disastrous misadventure.

### *Article 2. Use of terms*

**For the purposes of the present articles:**

**(a) “Risk of causing significant transboundary harm” includes risks taking the form of a high probability of causing significant transboundary harm and**

<sup>870</sup> See footnote 176 above.

a low probability of causing disastrous transboundary harm;

(b) “Harm” means harm caused to persons, property or the environment;

(c) “Transboundary harm” means harm caused in the territory of or in other places under the jurisdiction or control of a State other than the State of origin, whether or not the States concerned share a common border;

(d) “State of origin” means the State in the territory or otherwise under the jurisdiction or control of which the activities referred to in article 1 are planned or are carried out;

(e) “State likely to be affected” means the State or States in the territory of which there is the risk of significant transboundary harm or which have jurisdiction or control over any other place where there is such a risk;

(f) “States concerned” means the State of origin and the State likely to be affected.

#### Commentary

(1) *Subparagraph* (a) defines the concept of “risk of causing significant transboundary harm” as encompassing a low probability of causing disastrous transboundary harm or a high probability of causing significant transboundary harm. The Commission feels that instead of defining separately the concept of “risk” and then “harm”, it is more appropriate to define the expression of “risk of causing significant transboundary harm” because of the interrelationship between “risk” and “harm” and the relationship between them and the adjective “significant”.

(2) For the purposes of these articles, “risk of causing significant transboundary harm” refers to the combined effect of the probability of occurrence of an accident and the magnitude of its injurious impact. It is, therefore, the combined effect of “risk” and “harm” which sets the threshold. In this respect inspiration is drawn from the Code of Conduct on Accidental Pollution of Transboundary Inland Waters,<sup>871</sup> adopted by ECE in 1990. Under section I, subparagraph (f), of the Code of Conduct, “‘risk’ means the combined effect of the probability of occurrence of an undesirable event and its magnitude”. A definition based on the combined effect of “risk” and “harm” is more appropriate for these articles, and *the combined effect should reach a level that is deemed significant*. The obligations of prevention imposed on States are thus not only reasonable but also sufficiently limited so as not to impose such obligations in respect of virtually any activity. The purpose is to strike a balance between the interests of the States concerned.

(3) The definition in the preceding paragraph allows for a spectrum of relationships between “risk” and “harm”, all of which would reach the level of “significant”.

<sup>871</sup> United Nations publication, Sales No. E.90.II.E.28. See also G. Handl, *Grenzüberschreitendes nukleares Risiko und völkerrechtlicher Schutzanspruch* (Berlin, Duncker und Humblot, 1992), pp. 15–20.

The definition refers to two types of activities under these articles. One is where there is a low probability of causing disastrous harm. This is normally the characteristic of ultrahazardous activities. The other one is where there is a high probability of causing significant harm. This includes activities which have a high probability of causing harm which, while not disastrous, is still significant. But it would exclude activities where there is a very low probability of causing significant transboundary harm. The word “includes” is intended to highlight the intention that the definition is providing a spectrum within which the activities under these articles will fall.

(4) The term “significant” is not without ambiguity and a determination has to be made in each specific case. It involves more factual considerations than legal determination. It is to be understood that “*significant*” is *something more than “detectable” but need not be at the level of “serious” or “substantial”*. The harm must lead to a real detrimental effect on matters such as, for example, human health, industry, property, environment or agriculture in other States. Such detrimental effects must be susceptible of being measured by factual and objective standards.

(5) The ecological unity of the planet does not correspond to political boundaries. In carrying out lawful activities within their own territories, States have impacts on each other. These mutual impacts, so long as they have not reached the level of “significant”, are considered tolerable.

(6) The idea of a threshold is reflected in the *Trail Smelter* award, which used the words “serious consequence[s]”,<sup>872</sup> as well as in the *Lake Lanoux* award, which relied on the concept “seriously” (*gravement*).<sup>873</sup> A number of conventions have also used “significant”, “serious” or “substantial” as the threshold.<sup>874</sup> “Significant” has also been used in other legal instruments and domestic law.<sup>875</sup>

<sup>872</sup> See footnote 253 above.

<sup>873</sup> *Lake Lanoux* case, UNRIAA, vol. XII (Sales No. 63.V.3), p. 281.

<sup>874</sup> See, for example, article 4, paragraph 2, of the Convention on the Regulation of Antarctic Mineral Resource Activities; articles 2, paragraphs 1 and 2, of the Convention on Environmental Impact Assessment in a Transboundary Context; section I, subparagraph (b), of the Code of Conduct on Accidental Pollution of Transboundary Inland Waters (footnote 871 above); and article 7 of the Convention on the Law of the Non-navigational Uses of International Watercourses.

<sup>875</sup> See, for example, article 5 of the draft convention on industrial and agricultural uses of international rivers and lakes, prepared by the Inter-American Juridical Committee in 1965 (OAS, *Ríos y lagos internacionales (utilización para fines agrícolas e industriales)*, 4th ed. rev. (OEA/Ser.I/VI, CIJ-75 Rev.2) (Washington, D.C., 1971), p. 132); article X of the Helsinki Rules on the Uses of the Waters of International Rivers (International Law Association, *Report of the Fifty-second Conference, Helsinki, 1966* (London, 1967), p. 496); paragraphs 1 and 2 of General Assembly resolution 2995 (XXVII) of 15 December 1972 concerning cooperation between States in the field of the environment; paragraph 6 of the annex to OECD Council recommendation C(74)224 of 14 November 1974 on Principles concerning transfrontier pollution (OECD, *OECD and the Environment* (Paris, 1986), p. 142, reprinted in ILM, vol. 14, No. 1 (January 1975), p. 246); the Memorandum of Intent Concerning Transboundary Air Pollution, between the Government of the United States and the Government of Canada, of 5 August 1980 (United Nations, *Treaty Series*, vol. 1274, No. 21009, p. 235) and article 7 of the Agreement between the United States of America and the United Mexican States on Cooperation for the Protection and

(7) The term “significant”, while determined by factual and objective criteria, also involves a value determination which depends on the circumstances of a particular case and the period in which such determination is made. For instance, a particular deprivation at a particular time might not be considered “significant” because at that specific time scientific knowledge or human appreciation for a particular resource had not reached a point at which much value was ascribed to that particular resource. But some time later that view might change and the same harm might then be considered “significant”.

(8) *Subparagraph* (b) is self-explanatory in that “harm” for the purpose of the present articles would cover harm caused to persons, property or the environment.

(9) *Subparagraph* (c) defines “transboundary harm” as meaning harm caused in the territory of or in other places under the jurisdiction or control of a State other than the State of origin, whether or not the States concerned share a common border. This definition includes, in addition to a typical scenario of an activity within a State with injurious effects on another State, activities conducted under the jurisdiction or control of a State, for example, on the high seas, with effects on the territory of another State or in places under its jurisdiction or control. It includes, for example, injurious impacts on ships or platforms of other States on the high seas as well. It will also include activities conducted in the territory of a State with injurious consequences on, for example, the ships or platforms of another State on the high seas. The Commission cannot forecast all the possible future forms of “transboundary harm”. However, it makes clear that the intention is to be able to draw a line and clearly distinguish a State under whose jurisdiction and control an activity covered by these articles is conducted from a State which has suffered the injurious impact.

(10) In *subparagraph* (d), the term “State of origin” is introduced to refer to the State in the territory or otherwise under the jurisdiction or control of which the activities referred to in article 1 are carried out.<sup>876</sup>

(11) In *subparagraph* (e), the term “State likely to be affected” is defined to mean the State on whose territory or in other places under whose jurisdiction or control there is the risk of significant transboundary harm. There may be more than one such State likely to be affected in relation to any given activity.

(12) In *subparagraph* (f), the term “States concerned” refers to both the State of origin and the State likely to be affected to which some of the articles refer together.

Improvement of the Environment in the Border Area, of 14 August 1983 (reprinted in ILM, vol. 22, No. 5 (September 1983), p. 1025). The United States has also used the word “significant” in its domestic law dealing with environmental issues; see *Restatement of the Law Third, Restatement of the Law, The Foreign Relations Law of the United States* (St. Paul, Minn., American Law Institute Publishers, 1987), vol. 2, pp. 111–112.

<sup>876</sup> See paragraphs (7) to (12) of the commentary to article 1.

### Article 3. Prevention

**The State of origin shall take all appropriate measures to prevent significant transboundary harm or at any event to minimize the risk thereof.**

#### Commentary

(1) Article 3 is based on the fundamental principle *sic utere tuo ut alienum non laedas*, which is reflected in principle 21 of the Stockholm Declaration,<sup>877</sup> reading:

States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own natural resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.

(2) However, the limitations on the freedom of States reflected in principle 21 are made more specific in article 3 and subsequent articles.

(3) This article, together with article 4, provides the basic foundation for the articles on prevention. The articles set out the more specific obligations of States to prevent significant transboundary harm or at any event to minimize the risk thereof. The article thus emphasizes the primary duty of the State of origin to prevent significant transboundary harm; and only in case this is not fully possible it should exert its best efforts to minimize the risk thereof. The phrase “at any event” is intended to express priority in favour of the duty of prevention. The word “minimize” should be understood in this context as meaning to pursue the aim of reducing to the lowest point the possibility of harm.

(4) The present article is in the nature of a statement of principle. It provides that States shall take all appropriate measures to prevent significant transboundary harm or at any event minimize the risk thereof. The phrase “all appropriate measures” refers to all those specific actions and steps that are specified in the articles on prevention and minimization of transboundary harm. Article 3 is complementary to articles 9 and 10 and together they constitute a harmonious ensemble. In addition, it imposes an obligation on the State of origin to adopt and implement national legislation incorporating accepted international standards. These standards would constitute a necessary reference point to determine whether measures adopted are suitable.

(5) As a general principle, the obligation in article 3 to prevent significant transboundary harm or minimize the risk thereof applies only to activities which involve a risk of causing significant transboundary harm, as those terms are defined in article 2. In general, in the context of prevention, a State of origin does not bear the risk of unforeseeable consequences to States likely to be affected by activities within the scope of these articles. On the other hand, the obligation to “take all appropriate measures” to prevent harm, or to minimize the risk thereof, cannot be

<sup>877</sup> See footnote 861 above. See also the Rio Declaration (footnote 857 above).

confined to activities which are already properly appreciated as involving such a risk. The obligation extends to taking appropriate measures to identify activities which involve such a risk, and this obligation is of a continuing character.

(6) This article, then, sets up the principle of prevention that concerns every State in relation to activities covered by article 1. The *modalities* whereby the State of origin may discharge the obligations of prevention which have been established include, for example, legislative, administrative or other action necessary for enforcing the laws, administrative decisions and policies which the State of origin has adopted.<sup>878</sup>

(7) The obligation of the State of origin to take preventive or minimization measures is one of due diligence. It is the conduct of the State of origin that will determine whether the State has complied with its obligation under the present articles. The duty of due diligence involved, however, is not intended to guarantee that significant harm be totally prevented, if it is not possible to do so. In that eventuality, the State of origin is required, as noted above, to exert its best possible efforts to minimize the risk. In this sense, it does not guarantee that the harm would not occur.<sup>879</sup>

(8) An obligation of due diligence as the standard basis for the protection of the environment from harm can be deduced from a number of international conventions<sup>880</sup> as well as from the resolutions and reports of international conferences and organizations.<sup>881</sup> The obligation of due diligence was discussed in a dispute which arose in 1986 between Germany and Switzerland relating to the pollution of the Rhine by Sandoz. The Swiss Government acknowledged responsibility for lack of due diligence in preventing the accident through adequate regulation of its pharmaceutical industries.<sup>882</sup>

<sup>878</sup> See article 5 and commentary.

<sup>879</sup> For a similar observation, see paragraph (4) of the commentary to article 7 of the draft articles on the law of the non-navigational uses of international watercourses adopted by the Commission on second reading, *Yearbook ... 1994*, vol. II (Part Two), p. 103. As to the lack of scientific information, see A. Epiney and M. Scheyli, *Strukturprinzipien des Umweltvölkerrechts* (Baden-Baden, Nomos-Verlagsgesellschaft, 1998), pp. 126–140.

<sup>880</sup> See, for example, article 194, paragraph 1, of the United Nations Convention on the Law of the Sea; articles I and II and article VII, paragraph 2, of the Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter; article 2 of the Vienna Convention for the Protection of the Ozone Layer; article 7, paragraph 5, of the Convention on the Regulation of Antarctic Mineral Resource Activities; article 2, paragraph 1, of the Convention on Environmental Impact Assessment in a Transboundary Context; and article 2, paragraph 1, of the Convention on the Protection and Use of Transboundary Watercourses and International Lakes.

<sup>881</sup> See principle 21 of the World Charter for Nature (General Assembly resolution 37/7 of 28 October 1982, annex); and principle VI of the draft principles of conduct for the guidance of States concerning weather modification, prepared by WMO and UNEP (M. L. Nash, *Digest of United States Practice in International Law* (Washington, D.C., United States Government Printing Office, 1978), p. 1205).

<sup>882</sup> See *The New York Times*, 11, 12 and 13 November 1986, pp. A1, A8 and A3, respectively. See also A. C. Kiss, “‘Tchernobâle’ ou la pollution accidentelle du Rhin par les produits chimiques”, *Annuaire français de droit international*, vol. 33 (1987), pp. 719–727.

(9) In the “*Alabama*” case, the tribunal examined two different definitions of due diligence submitted by the parties. The United States defined due diligence as:

[A] diligence proportioned to the magnitude of the subject and to the dignity and strength of the power which is to exercise it; a diligence which shall, by the use of active vigilance, and of all the other means in the power of the neutral, through all stages of the transaction, prevent its soil from being violated; a diligence that shall in like manner deter designing men from committing acts of war upon the soil of the neutral against its will.<sup>883</sup>

The United Kingdom defined due diligence as “such care as Governments ordinarily employ in their domestic concerns”.<sup>884</sup> The tribunal seemed to have been persuaded by the broader definition of the standard of due diligence presented by the United States and expressed concern about the “national standard” of due diligence presented by the United Kingdom. The tribunal stated that:

[the] British case seemed also to narrow the international duties of a Government to the exercise of the restraining powers conferred upon it by municipal law, and to overlook the obligation of the neutral to amend its laws when they were insufficient.<sup>885</sup>

(10) In the context of the present articles, due diligence is manifested in reasonable efforts by a State to inform itself of factual and legal components that relate foreseeably to a contemplated procedure and to take appropriate measures, in timely fashion, to address them. Thus, States are under an obligation to take unilateral measures to prevent significant transboundary harm or at any event to minimize the risk thereof arising out of activities within the scope of article 1. Such measures include, first, formulating policies designed to prevent significant transboundary harm or to minimize the risk thereof and, secondly, implementing those policies. Such policies are expressed in legislation and administrative regulations and implemented through various enforcement mechanisms.

(11) The standard of due diligence against which the conduct of the State of origin should be examined is that which is generally considered to be appropriate and proportional to the degree of risk of transboundary harm in the particular instance. For example, activities which may be considered ultrahazardous require a much higher standard of care in designing policies and a much higher degree of vigour on the part of the State to enforce them. Issues such as the size of the operation; its location, special climate conditions, materials used in the activity, and whether the conclusions drawn from the application of these factors in a specific case are reasonable, are among the factors to be considered in determining the due diligence requirement in each instance. What would be considered a reasonable standard of care or due diligence may change with time; what might be considered an appropriate and reasonable procedure, standard or rule at one point in time may not be considered as such at some point in the future. Hence, due diligence in ensuring safety requires a State to keep abreast of technological changes and scientific developments.

(12) It is also necessary in this connection to note principle 11 of the Rio Declaration, which states:

<sup>883</sup> “*Alabama*” (see footnote 87 above), pp. 572–573.

<sup>884</sup> *Ibid.*, p. 612.

<sup>885</sup> *Ibid.*, p. 613.

States shall enact effective environmental legislation. Environmental standards, management objectives and priorities should reflect the environmental and developmental context to which they apply. Standards applied by some countries may be inappropriate and of unwarranted economic and social cost to other countries, in particular developing countries.<sup>886</sup>

(13) Similar language is found in principle 23 of the Stockholm Declaration. That principle, however, specifies that such domestic standards are “[w]ithout prejudice to such criteria as may be agreed upon by the international community”.<sup>887</sup> The economic level of States is one of the factors to be taken into account in determining whether a State has complied with its obligation of due diligence. But a State’s economic level cannot be used to dispense the State from its obligation under the present articles.

(14) Article 3 imposes on the State a duty to take all necessary measures to prevent significant transboundary harm or at any event to minimize the risk thereof. This could involve, *inter alia*, taking such measures as are appropriate by way of abundant caution, even if full scientific certainty does not exist, to avoid or prevent serious or irreversible damage. This is well articulated in principle 15 of the Rio Declaration and is subject to the capacity of States concerned (see paragraphs (5) to (8) of the commentary to article 10). An efficient implementation of the duty of prevention may well require upgrading the input of technology in the activity as well as the allocation of adequate financial and manpower resources with necessary training for the management and monitoring of the activity.

(15) The operator of the activity is expected to bear the costs of prevention to the extent that he is responsible for the operation. The State of origin is also expected to undertake the necessary expenditure to put in place the administrative, financial and monitoring mechanisms referred to in article 5.

(16) States are engaged in continuously evolving mutually beneficial schemes in the areas of capacity-building, transfer of technology and financial resources. Such efforts are recognized to be in the common interest of all States in developing uniform international standards regulating and implementing the duty of prevention.

(17) The main elements of the obligation of due diligence involved in the duty of prevention could be thus stated: the degree of care in question is that expected of a good Government. It should possess a legal system and sufficient resources to maintain an adequate administrative apparatus to control and monitor the activities. It is, however, understood that the degree of care expected of a State with a well-developed economy and human and material resources and with highly evolved systems and structures of governance is different from States which are not so well placed.<sup>888</sup> Even in the latter case, vigi-

lance, employment of infrastructure and monitoring of hazardous activities in the territory of the State, which is a natural attribute of any Government, are expected.<sup>889</sup>

(18) The required degree of care is proportional to the degree of hazard involved. The degree of harm itself should be foreseeable and the State must know or should have known that the given activity has the risk of significant harm. The higher the degree of inadmissible harm, the greater would be the duty of care required to prevent it.

#### Article 4. Cooperation

**States concerned shall cooperate in good faith and, as necessary, seek the assistance of one or more competent international organizations in preventing significant transboundary harm or at any event in minimizing the risk thereof.**

#### Commentary

(1) The principle of cooperation between States is essential in designing and implementing effective policies to prevent significant transboundary harm or at any event to minimize the risk thereof. The requirement of cooperation of States extends to all phases of planning and of implementation. Principle 24 of the Stockholm Declaration and principle 7 of the Rio Declaration recognize cooperation as an essential element in any effective planning for the protection of the environment. More specific forms of cooperation are stipulated in subsequent articles. They envisage the participation of the State likely to be affected in any preventive action, which is indispensable to enhance the effectiveness of any such action. The latter State may know better than anybody else, for instance, which features of the activity in question may be more damaging to it, or which zones of its territory close to the border may be more affected by the transboundary effects of the activity, such as a specially vulnerable ecosystem.

(2) The article requires States concerned to cooperate in *good faith*. Paragraph 2 of Article 2 of the Charter of the United Nations provides that all Members “shall fulfil in good faith the obligations assumed by them in accordance with the present Charter”. The 1969 and 1978 Vienna Conventions declare in their preambles that the principle of good faith is universally recognized. In addition, article 26 and article 31, paragraph 1, of the 1969 Vienna Convention acknowledge the essential place of this principle in the law of treaties. The decision of ICJ in the *Nuclear Tests* case touches upon the scope of the application of good faith. In that case, the Court proclaimed that “[o]ne of the basic principles governing the creation and performance of legal obligations, whatever their source, is the principle of good faith”.<sup>890</sup> This dictum of the Court implies that good faith applies also to unilateral

<sup>886</sup> See footnote 857 above.

<sup>887</sup> See footnote 861 above.

<sup>888</sup> See A. C. Kiss and S. Doumbé-Billé, “La Conférence des Nations Unies sur l’environnement et le développement (Rio de Janeiro, 3–14 June 1992)”, *Annuaire français de droit international*, vol. 38 (1992), pp. 823–843; M. Kamto, “Les nouveaux principes du droit international de l’environnement”, *Revue juridique de l’environnement*, vol. 1 (1993),

pp. 11–21; and R. Lefeber, *Transboundary Environmental Interference and the Origin of State Liability* (The Hague, Kluwer, 1996), p. 65.

<sup>889</sup> See the observation of Max Huber in the *British Claims in the Spanish Zone of Morocco* case (footnote 44 above), p. 644.

<sup>890</sup> See footnote 196 above.

acts.<sup>891</sup> Indeed, the principle of good faith covers “the entire structure of international relations”.<sup>892</sup>

(3) The arbitration tribunal, established in 1985 between Canada and France in the *La Bretagne* case, held that the principle of good faith was among the elements that afforded a sufficient guarantee against any risk of a party exercising its rights abusively.<sup>893</sup>

(4) The words “States concerned” refer to the State of origin and the State or States likely to be affected. While other States in a position to contribute to the goals of these articles are encouraged to cooperate, no legal obligations are imposed upon them to do so.

(5) The article provides that States shall “as necessary” seek the assistance of one or more international organizations in performing their preventive obligations as set out in these articles. States shall do so only when it is deemed necessary. The words “as necessary” are intended to take account of a number of possibilities: First, assistance from international organizations may not be necessary in every case. For example, the State of origin or the States likely to be affected may, themselves, be technologically advanced and have the necessary technical capability. Secondly, the term “international organization” is intended to refer to organizations that are competent and in a position to assist in such matters. Thirdly, even if there are competent international organizations, they could extend necessary assistance only in accordance with their constitutions. In any case, the article does not purport to create any obligation for international organizations to respond to requests for assistance independent of its own constitutional requirements.

(6) Requests for assistance from international organizations may be made by one or more States concerned. The principle of cooperation means that it is preferable that such requests be made by all States concerned. The fact, however, that all States concerned do not seek necessary assistance does not free individual States from the obligation to seek assistance. Of course, the response and type of involvement of an international organization in cases in which the request has been lodged by only one State will depend, for instance, on the nature of the request, the type of assistance involved and the place where the international organization would have to perform such assistance.

### Article 5. Implementation

**States concerned shall take the necessary legislative, administrative or other action including the establishment of suitable monitoring mechanisms to implement the provisions of the present articles.**

<sup>891</sup> M. Virally, “Review essay: good faith in public international law”, *AJIL*, vol. 77, No. 1 (1983), p. 130.

<sup>892</sup> See R. Rosenstock, “The declaration of principles of international law concerning friendly relations: a survey”, *AJIL*, vol. 65 (1971), p. 734; see, more generally, R. Kolb, *La bonne foi en droit international public: contribution à l'étude des principes généraux de droit* (Paris, Presses Universitaires de France, 2000).

<sup>893</sup> *ILR*, vol. 82 (1990), p. 614.

### Commentary

(1) This article states what might be thought to be the obvious, viz. that under the present articles, States are required to take the necessary measures of implementation, whether of a legislative, administrative or other character. Implementation, going beyond formal application, involves the adoption of specific measures to ensure the effectiveness of the provisions of the present articles. Article 5 has been included here to emphasize the continuing character of the obligations, which require action to be taken from time to time to prevent transboundary harm or at any event to minimize the risk thereof arising from activities to which the articles apply.<sup>894</sup>

(2) The measures referred to in this article include, for example, the opportunity available to persons concerned to make representations and the establishment of quasi-judicial procedures. The use of the term “other action” is intended to cover the variety of ways and means by which States could implement the present articles. Article 5 mentions some measures expressly only in order to give guidance to States; it is left up to them to decide upon necessary and appropriate measures. Reference is made to “suitable monitoring mechanisms” in order to highlight the measures of inspection which States generally adopt in respect of hazardous activities.

(3) To say that States must take the necessary measures does not mean that they must themselves get involved in operational issues relating to the activities to which article 1 applies. Where these activities are conducted by private persons or enterprises, the obligation of the State is limited to establishing the appropriate regulatory framework and applying it in accordance with these articles. The application of that regulatory framework in the given case will then be a matter of ordinary administration or, in the case of disputes, for the relevant courts or tribunals, aided by the principle of non-discrimination contained in article 15.

(4) The action referred to in article 5 may appropriately be taken in advance. Thus, States may establish a suitable monitoring mechanism before the activity in question is approved or instituted.

### Article 6. Authorization

**1. The State of origin shall require its prior authorization for:**

**(a) any activity within the scope of the present articles carried out in its territory or otherwise under its jurisdiction or control;**

<sup>894</sup> This article is similar to article 2, paragraph 2, of the Convention on Environmental Impact Assessment in a Transboundary Context, which reads: “Each Party shall take the necessary legal, administrative or other measures to implement the provisions of this Convention, including, with respect to proposed activities listed in appendix I that are likely to cause significant adverse transboundary impact, the establishment of an environmental impact assessment procedure that permits public participation and preparation of the environmental impact assessment documentation described in appendix II.”

(b) any major change in an activity referred to in subparagraph (a);

(c) any plan to change an activity which may transform it into one falling within the scope of the present articles.

2. The requirement of authorization established by a State shall be made applicable in respect of all pre-existing activities within the scope of the present articles. Authorizations already issued by the State for pre-existing activities shall be reviewed in order to comply with the present articles.

3. In case of a failure to conform to the terms of the authorization, the State of origin shall take such actions as appropriate, including where necessary terminating the authorization.

#### Commentary

(1) This article sets forth the fundamental principle that the prior authorization of a State is required for activities which involve a risk of causing significant transboundary harm undertaken in its territory or otherwise under its jurisdiction or control. The word “authorization” means granting permission by governmental authorities to conduct an activity covered by these articles. States are free to choose the form of such authorization.

(2) The requirement of authorization noted in article 6, *paragraph 1* (a), obliges a State to ascertain whether activities with a possible risk of significant transboundary harm are taking place in its territory or otherwise under its jurisdiction or control and implies that the State should take the measures indicated in these articles. It also requires the State to take a responsible and active role in regulating such activities. The tribunal in the *Trail Smelter* arbitration held that Canada had “the duty ... to see to it that this conduct should be in conformity with the obligation of the Dominion under international law as herein determined”. The tribunal held that, in particular, “the Trail Smelter shall be required to refrain from causing any damage through fumes in the State of Washington”.<sup>895</sup> Article 6, *paragraph 1* (a), is compatible with this requirement.

(3) ICJ in the *Corfu Channel* case held that a State has an obligation “not to allow knowingly its territory to be used for acts contrary to the rights of other States”.<sup>896</sup>

(4) The words “in its territory or otherwise under its jurisdiction or control” are taken from article 2. The expression “any activity within the scope of the present articles” introduces all the requirements specified in article 1 for an activity to fall within the scope of these articles.

(5) Article 6, *paragraph 1* (b), makes the requirement of prior authorization applicable also for a major change planned in an activity already within the scope of article 1 where that change may increase the risk or alter the nature or the scope of the risk. Some examples of major changes are: building of additional production capacities, large-scale employment of new technology in an existing activ-

ity, re-routing of motorways, express roads or re-routing airport runways. Changing investment and production (volume and type), physical structure or emissions and changes bringing existing activities to levels higher than the allowed threshold could also be considered as part of a major change.<sup>897</sup> Similarly, article 6, *paragraph 1* (c), contemplates a situation where a change is proposed in the conduct of an activity that is otherwise innocuous, where the change would transform that activity into one which involves a risk of causing significant transboundary harm. The implementation of such a change would also require State authorization.

(6) *Paragraph 2* of article 6 emphasizes that the requirement of authorization should be made applicable to all the pre-existing activities falling within the scope of the present articles, once a State adopts these articles. It might be unreasonable to require States when they assume the obligations under these articles to apply them immediately in respect of existing activities. A suitable period of time might be needed in that case for the operator of the activity to comply with the authorization requirements. The decision as to whether the activity should be stopped pending authorization or should continue while the operator goes through the process of obtaining authorization is left to the State of origin. In case the authorization is denied by the State of origin, it is assumed that the State of origin will stop the activity.

(7) The adjustment envisaged in *paragraph 2* generally occurs whenever new legislative and administrative terms are put in place because of safety standards or new international standards or obligations which the State has accepted and needed to enforce.

(8) *Paragraph 3* of article 6 notes the consequences of the failure of an operator to comply with the requirement of authorization. The State of origin, which has the main responsibility to monitor these activities, is given the necessary flexibility to ensure that the operator complies with the requirements involved. As appropriate, the State of origin shall terminate the authorization and, where appropriate, prohibit the activity from taking place altogether.

#### Article 7. Assessment of risk

**Any decision in respect of the authorization of an activity within the scope of the present articles shall, in particular, be based on an assessment of the possible transboundary harm caused by that activity, including any environmental impact assessment.**

#### Commentary

(1) Under article 7, a State of origin, before granting authorization to operators to undertake activities referred to in article 1, should ensure that an assessment is undertaken of the risk of the activity causing significant transboundary harm. This assessment enables the State to determine the extent and the nature of the risk involved in an

<sup>895</sup> *Trail Smelter* (see footnote 253 above), pp. 1965–1966.

<sup>896</sup> *Corfu Channel* (see footnote 35 above), p. 22.

<sup>897</sup> See ECE, *Current Policies, Strategies and Aspects of Environmental Impact Assessment in a Transboundary Context* (United Nations publication, Sales No. E.96.II.E.11), p. 48.



activity and consequently the type of preventive measures it should take.

(2) Although the assessment of risk in the *Trail Smelter* case may not directly relate to liability for risk, it nevertheless emphasized the importance of an assessment of the consequences of an activity causing significant risk. The tribunal in that case indicated that the study undertaken by well-established and known scientists was “probably the most thorough [one] ever made of any area subject to atmospheric pollution by industrial smoke”.<sup>898</sup>

(3) The requirement of article 7 is fully consonant with principle 17 of the Rio Declaration, which provides also for assessment of risk of activities that are likely to have a significant adverse impact on the environment:

Environmental impact assessment, as a national instrument, shall be undertaken for proposed activities that are likely to have a significant adverse impact on the environment and are subject to a decision of a competent national authority.<sup>899</sup>

The requirement of assessment of adverse effects of activities has been incorporated in various forms in many international agreements.<sup>900</sup> The most notable is the Convention on Environmental Impact Assessment in a Transboundary Context.

(4) The practice of requiring an environmental impact assessment has become very prevalent in order to assess whether a particular activity has the potential of causing significant transboundary harm. The legal obligation to conduct an environmental impact assessment under national law was first developed in the United States of America in the 1970s. Later, Canada and Europe adopted the same approach and essentially regulated it by guidelines. In 1985, a European Community directive required member States to conform to a minimum requirement of environmental impact assessment. Since then, many other countries have also made environmental impact assessment a necessary condition under their national law for authorization to be granted for developmental but hazardous industrial activities.<sup>901</sup> According to one United

Nations study, the environmental impact assessment has already shown its value for implementing and strengthening sustainable development, as it combines the precautionary principle with the principle of preventing environmental damage and also allows for public participation.<sup>902</sup>

(5) The question of who should conduct the assessment is left to States. Such assessment is normally conducted by operators observing certain guidelines set by the States. These matters would have to be resolved by the States themselves through their domestic laws or as parties to international instruments. However, it is presumed that a State of origin will designate an authority, whether or not governmental, to evaluate the assessment on behalf of the Government and will accept responsibility for the conclusions reached by that authority.

(6) The article does not specify what the content of the risk assessment should be. Obviously, the assessment of risk of an activity can only be meaningfully prepared if it relates the risk to the possible harm to which the risk could lead. This corresponds to the basic duty contained in article 3. Most existing international conventions and legal instruments do not specify the content of assessment. There are exceptions, such as the Convention on Environmental Impact Assessment in a Transboundary Context, which provides in detail the content of such assessment.<sup>903</sup> The 1981 study of the legal aspects concerning the environment related to offshore mining and drilling within the limits of national jurisdiction, prepared by the Working Group of Experts on Environmental Law of UNEP,<sup>904</sup> also provides, in its conclusion No. 8, in detail the content of assessment for offshore mining and drilling.

(7) The specifics of what ought to be the content of assessment is left to the domestic laws of the State

1995), p. 259; and G. J. Martin “Le concept de risque et la protection de l’environnement: évolution parallèle ou fertilisation croisée?”, *Les hommes et l’environnement ...* (footnote 867 above), pp. 451–460.

<sup>902</sup> See footnote 897 above.

<sup>903</sup> Article 4 of the Convention provides that the environmental impact assessment of a State party should contain, as a minimum, the information described in appendix II to the Convention. Appendix II (Content of the environmental impact assessment documentation) lists nine items as follows:

“(a) A description of the proposed activity and its purpose;

“(b) A description, where appropriate, of reasonable alternatives (for example, location or technological) to the proposed activity and also the no-action alternative;

“(c) A description of the environment likely to be significantly affected by the proposed activity and its alternatives;

“(d) A description of the potential environmental impact of the proposed activity and its alternatives and an estimation of its significance;

“(e) A description of mitigation measures to keep adverse environmental impact to a minimum;

“(f) An explicit indication of predictive methods and underlying assumptions as well as the relevant environmental data used;

“(g) An identification of gaps in knowledge and uncertainties encountered in compiling the required information;

“(h) Where appropriate, an outline for monitoring and management programmes and any plans for post-project analysis; and

“(i) A non-technical summary including a visual presentation as appropriate (maps, graphs, etc.).”

<sup>904</sup> See UNEP/GC.9/5/Add.5, annex III.

<sup>898</sup> *Trail Smelter* (see footnote 253 above), pp. 1973–1974.

<sup>899</sup> See footnote 857 above.

<sup>900</sup> See, for example, article XI of the Kuwait Regional Convention for Cooperation on the Protection of the Marine Environment from Pollution; articles 205 and 206 of the United Nations Convention on the Law of the Sea; the Regional Convention for the Conservation of the Environment of the Red Sea and Gulf of Aden; article 14 of the ASEAN Agreement on the Conservation of Nature and Natural Resources; Convention for the Protection of the Natural Resources and Environment of the South Pacific Region; article 4 of the Convention on the Regulation of Antarctic Mineral Resource Activities; article 8 of the Protocol on Environmental Protection to the Antarctic Treaty; article 14, paragraphs 1 (a) and (b), of the Convention on Biological Diversity; and article 4 of the Convention on the Transboundary Effects of Industrial Accidents.

<sup>901</sup> For a survey of various North American and European legal and administrative systems of environmental impact assessment policies, plans and programmes, see ECE, *Application of Environmental Impact Assessment Principles to Policies, Plans and Programmes* (United Nations publication, Sales No. E.92.II.E.28), pp. 43 et seq.; approximately 70 developing countries have environmental impact assessment legislation of some kind. Other countries either are in the process of drafting new and additional environmental impact assessment legislation or are planning to do so; see M. Yeater and L. Kurukulasuriya, “Environmental impact assessment legislation in developing countries”, *UNEP’s New Way Forward: Environmental Law and Sustainable Development*, Sun Lin and L. Kurukulasuriya, eds. (UNEP,

conducting such assessment.<sup>905</sup> For the purposes of article 7, however, such an assessment should contain an evaluation of the possible transboundary harmful impact of the activity. In order for the States likely to be affected to evaluate the risk to which they might be exposed, they need to know what possible harmful effects that activity might have on them.

(8) The assessment should include the effects of the activity not only on persons and property, but also on the environment of other States. The importance of the protection of the environment, independently of any harm to individual human beings or property, is clearly recognized.

(9) This article does not oblige the State of origin to require risk assessment for any activity being undertaken within their territory or otherwise under their jurisdiction or control. Activities involving a risk of causing significant transboundary harm have some general characteristics which are identifiable and could provide some indication to States as to which activities might fall within the terms of these articles. For example, the type of the source of energy used in manufacturing, the location of the activity and its proximity to the border area, etc. could all give an indication of whether the activity might fall within the scope of these articles. There are certain substances that are listed in some conventions as dangerous or hazardous and their use in any activity may in itself be an indication that those activities might involve a risk of significant transboundary harm.<sup>906</sup> There are also certain conventions that list the activities that are presumed to be harmful and that might signal that those activities might fall within the scope of these articles.<sup>907</sup>

#### *Article 8. Notification and information*

**1. If the assessment referred to in article 7 indicates a risk of causing significant transboundary harm, the State of origin shall provide the State likely to be affected with timely notification of the risk and the assessment and shall transmit to it the available technical and all other relevant information on which the assessment is based.**

**2. The State of origin shall not take any decision on authorization of the activity pending the receipt, within a period not exceeding six months, of the response from the State likely to be affected.**

<sup>905</sup> For the format of environmental impact assessment adopted in most legislations, see M. Yeater and L. Kurukulasuriya, *loc. cit.* (footnote 901 above), p. 260.

<sup>906</sup> For example, the Convention for the Prevention of Marine Pollution from Land-based Sources provides in article 4 an obligation for the parties to eliminate or restrict the pollution of the environment by certain substances, and the list of those substances is annexed to the Convention. Similarly, the Convention on the Protection of the Marine Environment of the Baltic Sea Area provides a list of hazardous substances in annex I and of noxious substances and materials in annex II, deposits of which are either prohibited or strictly limited; see also the Protocol for the Protection of the Mediterranean Sea against Pollution from Land-based Sources; and the Agreement for the Protection of the Rhine against Chemical Pollution.

<sup>907</sup> See footnote 864 above.

#### *Commentary*

(1) Article 8 deals with a situation in which the assessment undertaken by a State of origin, in accordance with article 7, indicates that the activity planned does indeed pose a risk of causing significant transboundary harm. This article, together with articles 9, 11, 12 and 13, provides for a set of procedures essential to balancing the interests of all the States concerned by giving them a reasonable opportunity to find a way to undertake the activity with satisfactory and reasonable measures designed to prevent or minimize transboundary harm.

(2) Article 8 calls on the State of origin to notify States likely to be affected by the planned activity. The activities here include both those that are planned by the State itself and those planned by private entities. The requirement of notification is an indispensable part of any system designed to prevent transboundary harm or at any event to minimize the risk thereof.

(3) The obligation to notify other States of the risk of significant harm to which they are exposed is reflected in the *Corfu Channel* case, where ICJ characterized the duty to warn as based on "elementary considerations of humanity".<sup>908</sup> This principle is recognized in the context of the use of international watercourses and in that context is embodied in a number of international agreements, decisions of international courts and tribunals, declarations and resolutions adopted by intergovernmental organizations, conferences and meetings, and studies by intergovernmental and international non-governmental organizations.<sup>909</sup>

(4) In addition to the utilization of international watercourses, the principle of notification has also been recognized in respect of other activities with transboundary effects, for example, article 3 of the Convention on Environmental Impact Assessment in a Transboundary Context<sup>910</sup> and articles 3 and 10 of the Convention on the Transboundary Effects of Industrial Accidents. Principle 19 of the Rio Declaration speaks of timely notification:

States shall provide prior and timely notification and relevant information to potentially affected States on activities that may have a significant adverse transboundary environmental effect and shall consult with those States at an early stage and in good faith.<sup>911</sup>

<sup>908</sup> *Corfu Channel* (see footnote 35 above), p. 22.

<sup>909</sup> For treaties dealing with prior notification and exchange of information in respect of watercourses, see paragraph (6) of the commentary to article 12 (Notification concerning planned measures with possible adverse effects), of the draft articles on the law of the non-navigational uses of international watercourses (*Yearbook ... 1994*, vol. II (Part Two), pp. 119–120).

<sup>910</sup> Article 3, paragraph 2, of the Convention provides for a system of notification which reads:

"This notification shall contain, *inter alia*:

"(a) Information on the proposed activity, including any available information on its possible transboundary impact;

"(b) The nature of the possible decision; and

"(c) An indication of a reasonable time within which a response under paragraph 3 of this Article is required, taking into account the nature of the proposed activity;

"and may include the information set out in paragraph 5 of this Article."

<sup>911</sup> See footnote 857 above.

(5) The procedure for notification has been established by a number of OECD resolutions. For example, in respect of certain chemical substances, the annex to OECD resolution C(71)73 of 18 May 1971 stipulates that each member State is to receive notification prior to the proposed measures in each other member State regarding substances which have an adverse impact on man or the environment where such measures could have significant effects on the economies and trade of the other States.<sup>912</sup> The annex to OECD Council recommendation C(74)224 of 14 November 1974 on "Some principles concerning transfrontier pollution" in its "Principle of information and consultation" requires notification and consultation prior to undertaking an activity which may create a risk of significant transboundary pollution.<sup>913</sup> The principle of notification is well established in the case of environmental emergencies.<sup>914</sup>

(6) Where assessment reveals the risk of causing significant transboundary harm, in accordance with *paragraph 1*, the State which plans to undertake such activity has the obligation to notify the States which may be affected. The notification shall be accompanied by available technical information on which the assessment is based. The reference to "available" technical and other relevant information is intended to indicate that the obligation of the State of origin is limited to transmitting the technical and other information which was developed in relation to the activity. This information is generally revealed during the assessment of the activity in accordance with article 7. Paragraph 1 assumes that technical information resulting from the assessment includes not only what might be called raw data, namely fact sheets, statistics, etc., but also the analysis of the information which was used by the State of origin itself to make the determination regarding the risk of transboundary harm. The reference to the available data includes also other data which might become available later after transmitting the data which was initially available to the States likely to be affected.

(7) States are free to decide how they wish to inform the States that are likely to be affected. As a general rule, it is assumed that States will directly contact the other States through diplomatic channels.

(8) Paragraph 1 also addresses the situation where the State of origin, despite all its efforts and diligence, is unable to identify *all* the States which may be affected prior to authorizing the activity and gains that knowledge only after the activity is undertaken. In accordance with this paragraph, the State of origin, in such cases, is under an obligation to notify the other States likely to be affected as soon as the information comes to its knowledge and it has had an opportunity, within a reasonable time, to determine the States concerned.

(9) *Paragraph 2* addresses the need for the States likely to be affected to respond within a period not exceeding six months. It is generally a period of time that should

allow these States to evaluate the data involved and arrive at their own conclusion. This is a requirement that is conditioned by cooperation and good faith.

#### *Article 9. Consultations on preventive measures*

**1. The States concerned shall enter into consultations, at the request of any of them, with a view to achieving acceptable solutions regarding measures to be adopted in order to prevent significant transboundary harm or at any event to minimize the risk thereof. The States concerned shall agree, at the commencement of such consultations, on a reasonable time frame for the consultations.**

**2. The States concerned shall seek solutions based on an equitable balance of interests in the light of article 10.**

**3. If the consultations referred to in paragraph 1 fail to produce an agreed solution, the State of origin shall nevertheless take into account the interests of the State likely to be affected in case it decides to authorize the activity to be pursued, without prejudice to the rights of any State likely to be affected.**

#### *Commentary*

(1) Article 9 requires the States concerned, that is, the State of origin and the States that are likely to be affected, to enter into consultations in order to agree on the measures to prevent significant transboundary harm, or at any event to minimize the risk thereof. Depending upon the time at which article 9 is invoked, consultations may be prior to authorization and commencement of an activity or during its performance.

(2) There is a need to maintain a balance between two equally important considerations in this article. First, the article deals with activities that are not prohibited by international law and that, normally, are important to the economic development of the State of origin. Secondly, it would be unfair to other States to allow those activities to be conducted without consulting them and taking appropriate preventive measures. Therefore, the article does not provide a mere formality which the State of origin has to go through with no real intention of reaching a solution acceptable to the other States, nor does it provide a right of veto for the States that are likely to be affected. To maintain a balance, the article relies on the manner in which, and purpose for which, the parties enter into consultations. The parties must enter into consultations in good faith and must take into account each other's legitimate interests. The parties should consult each other with a view to arriving at an acceptable solution regarding the measures to be adopted to prevent significant transboundary harm, or at any event to minimize the risk thereof.

(3) The principle of good faith is an integral part of any requirement of consultations and negotiations. The obligation to consult and negotiate genuinely and in good faith was recognized in the *Lake Lanoux* award where the tribunal stated that:

<sup>912</sup> OECD, *OECD and the Environment* (see footnote 875 above), annex, p. 91, para. 1.

<sup>913</sup> *Ibid.*, p. 142.

<sup>914</sup> See paragraph (1) of the commentary to article 17.

Consultations and negotiations between the two States must be genuine, must comply with the rules of good faith and must not be mere formalities. The rules of reason and good faith are applicable to procedural rights and duties relative to the sharing of the use of international rivers.<sup>915</sup>

(4) With regard to this particular point about good faith, the judgment of ICJ in the *Fisheries Jurisdiction* case is also relevant. There the Court stated that “[t]he task [of the parties] will be to conduct their negotiations on the basis that each must in good faith pay reasonable regard to the legal rights of the other”.<sup>916</sup> In the *North Sea Continental Shelf* cases the Court held that:

(a) [T]he parties are under an obligation to enter into negotiations with a view to arriving at an agreement, and not merely to go through a formal process of negotiation as a sort of prior condition for the automatic application of a certain method of delimitation in the absence of agreement; they are under an obligation so to conduct themselves that the negotiations are meaningful, which will not be the case when either of them insists upon its own position without contemplating any modification of it.<sup>917</sup>

Even though the Court in this judgment speaks of “negotiations”, it is believed that the good-faith requirement in the conduct of the parties during the course of consultation or negotiations is the same.

(5) The purpose of consultations is for the parties to find acceptable solutions regarding measures to be adopted in order to prevent significant transboundary harm, or at any event to minimize the risk thereof. The words “acceptable solutions”, regarding the adoption of preventive measures, refer to those measures that are accepted by the parties within the guidelines specified in paragraph 2. Generally, the consent of the parties on measures of prevention will be expressed by means of some form of agreement.

(6) The parties should obviously aim, first, at selecting those measures which may avoid any risk of causing significant transboundary harm or, if that is not possible, which minimize the risk of such harm. Under the terms of article 4, the parties are required, moreover, to cooperate in the implementation of such measures. This requirement, again, stems from the assumption that the obligation of due diligence, the core base of the provisions intended to prevent significant transboundary harm, or at any event to minimize the risk thereof, is of a continuous nature affecting every stage related to the conduct of the activity.

(7) Article 9 may be invoked whenever there is a question about the need to take preventive measures. Such questions obviously may arise as a result of article 8, because a notification to other States has been made by the State of origin that an activity it intends to undertake may pose a risk of causing significant transboundary harm, or in the course of the exchange of information under article 12 or in the context of article 11 on procedures in the absence of notification.

(8) Article 9 has a broad scope of application. It is to apply to all issues related to preventive measures. For ex-

ample, when parties notify under article 8 or exchange information under article 12 and there are ambiguities in those communications, a request for consultations may be made simply in order to clarify those ambiguities.

(9) *Paragraph 2* provides guidance for States when consulting each other on preventive measures. The parties shall seek solutions based on an equitable balance of interests in the light of article 10. Neither paragraph 2 of this article nor article 10 precludes the parties from taking account of other factors which they perceive as relevant in achieving an equitable balance of interests.

(10) *Paragraph 3* deals with the possibility that, despite all efforts by the parties, they cannot reach an agreement on acceptable preventive measures. As explained in paragraph (3) above, the article maintains a balance between the two considerations, one of which is to deny the States likely to be affected a right of veto. In this context, the *Lake Lanoux* award may be recalled where the tribunal noted that, in certain situations, the party that was likely to be affected might, in violation of good faith, paralyse genuine negotiation efforts.<sup>918</sup> To take account of this possibility, the article provides that the State of origin is permitted to go ahead with the activity, for the absence of such an alternative would, in effect, create a right of veto for the States likely to be affected. The State of origin, while permitted to go ahead with the activity, is still obligated, as measure of self-regulation, to take into account the interests of the States likely to be affected. As a result of consultations, the State of origin is aware of the concerns of the States likely to be affected and is in a better position to seriously take them into account in carrying out the activity. The last part of paragraph 3 preserves the rights of States likely to be affected.

#### *Article 10. Factors involved in an equitable balance of interests*

**In order to achieve an equitable balance of interests as referred to in paragraph 2 of article 9, the States concerned shall take into account all relevant factors and circumstances, including:**

**(a) the degree of risk of significant transboundary harm and of the availability of means of preventing such harm, or minimizing the risk thereof or repairing the harm;**

**(b) the importance of the activity, taking into account its overall advantages of a social, economic and technical character for the State of origin in relation to the potential harm for the State likely to be affected;**

**(c) the risk of significant harm to the environment and the availability of means of preventing such harm, or minimizing the risk thereof or restoring the environment;**

**(d) the degree to which the State of origin and, as appropriate, the State likely to be affected are prepared to contribute to the costs of prevention;**

<sup>915</sup> See footnote 873 above.

<sup>916</sup> *Fisheries Jurisdiction (United Kingdom v. Iceland)*, Merits, Judgment, I.C.J. Reports 1974, p. 33, para. 78.

<sup>917</sup> *North Sea Continental Shelf* (see footnote 197 above), para. 85. See also paragraph 87.

<sup>918</sup> See footnote 873 above.

(e) the economic viability of the activity in relation to the costs of prevention and to the possibility of carrying out the activity elsewhere or by other means or replacing it with an alternative activity;

(f) the standards of prevention which the State likely to be affected applies to the same or comparable activities and the standards applied in comparable regional or international practice.

### Commentary

(1) The purpose of this article is to provide some guidance for States which are engaged in consultations seeking to achieve an equitable balance of interests. In reaching an equitable balance of interests, the facts have to be established and all the relevant factors and circumstances weighed. This article draws its inspiration from article 6 of the Convention on the Law of the Non-navigational Uses of International Watercourses.

(2) The main clause of the article provides that in order “to achieve an equitable balance of interests as referred to in paragraph 2 of article 9, the States concerned shall take into account all relevant factors and circumstances”. The article proceeds to set forth a non-exhaustive list of such factors and circumstances. The wide diversity of types of activities which is covered by these articles, and the different situations and circumstances in which they will be conducted, make it impossible to compile an exhaustive list of factors relevant to all individual cases. No priority or weight is assigned to the factors and circumstances listed, since some of them may be more important in certain cases while others may deserve to be accorded greater weight in other cases. In general, the factors and circumstances indicated will allow the parties to compare the costs and benefits which may be involved in a particular case.

(3) *Subparagraph (a)* compares the degree of risk of significant transboundary harm to the availability of means of preventing such harm or minimizing the risk thereof and the possibility of repairing the harm. For example, the degree of risk of harm may be high, but there may be measures that can prevent the harm or reduce that risk, or there may be possibilities for repairing the harm. The comparisons here are both quantitative and qualitative.

(4) *Subparagraph (b)* compares the importance of the activity in terms of its social, economic and technical advantages for the State of origin and the potential harm to the States likely to be affected. The Commission in this context recalls the decision in the *Donauversinkung* case where the court stated that:

The interests of the States in question must be weighed in an equitable manner one against another. One must consider not only the absolute injury caused to the neighbouring State, but also the relation of the advantage gained by the one to the injury caused to the other.<sup>919</sup>

<sup>919</sup> *Streitsache des Landes Württemberg und des Landes Preussen gegen das Land Baden (Württemberg and Prussia v. Baden), betreffend die Donauversinkung*, German Staatsgerichtshof, 18 June 1927, *Entscheidungen des Reichsgerichts in Zivilsachen* (Berlin), vol. 116, appendix, pp. 18 et seq.; see also A. McNair and H. Lauterpacht, eds., *Annual Digest of Public International Law Cases, 1927 and 1928* (London,

In more recent times, States have negotiated what might be seen as equitable solutions to transboundary disputes; agreements concerning French potassium emissions into the Rhine, pollution of United States–Mexican boundary waters, and North American and European acid rain all display elements of this kind.<sup>920</sup>

(5) *Subparagraph (c)* compares, in the same fashion as subparagraph (a), the risk of significant harm to the environment and the availability of means of preventing such harm, or minimizing the risk thereof and the possibility of restoring the environment. It is necessary to emphasize the particular importance of protection of the environment. Principle 15 of the Rio Declaration is relevant to this subparagraph. Requiring that the precautionary approach be widely applied to States according to their capabilities, principle 15 states:

Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.<sup>921</sup>

(6) The precautionary principle was affirmed in the “pan-European” Bergen Ministerial Declaration on Sustainable Development in the ECE Region, adopted in May 1990 by the ECE member States. It stated that: “Environmental measures must anticipate, prevent and attack the causes of environmental degradation. Where there are threats of serious or irreversible damage, lack of full scientific certainty should not be used as a reason for postponing measures to prevent environmental degradation.”<sup>922</sup> The precautionary principle was recommended by the UNEP Governing Council in order to promote the prevention and elimination of marine pollution, which is increasingly becoming a threat to the marine environment and a cause of human suffering.<sup>923</sup> The precautionary principle has also been referred to or incorporated without any explicit reference in various other conventions.<sup>924</sup>

Longmans, 1931), vol. 4, p. 131; *Kansas v. Colorado, United States Reports*, vol. 206 (1921), p. 100 (1907); and *Washington v. Oregon, ibid.*, vol. 297 (1936), p. 517 (1936).

<sup>920</sup> See the Convention on the Protection of the Rhine against Pollution from Chlorides, with the Additional Protocol to the Convention on the Protection of the Rhine against Pollution from Chlorides; the Agreement on the Permanent and Definitive Solution to the International Problem of the Salinity of the Colorado River, ILM, vol. 12, No. 5 (September 1973), p. 1105; the Convention on Long-Range Transboundary Air Pollution; and the Agreement between the United States and Canada on Air Quality of 1991 (United Nations, *Treaty Series*, vol. 1852, No. 31532, p. 79, reprinted in ILM, vol. 30 (1991), p. 678). See also A. E. Boyle and D. Freestone, *op. cit.* (footnote 863 above), p. 80; and I. Romy, *Les pollutions transfrontières des eaux: l'exemple du Rhin* (Lausanne, Payot, 1990).

<sup>921</sup> See footnote 857 above.

<sup>922</sup> Report of the Economic Commission for Europe on the Bergen Conference (8–16 May 1990), A/CONF.151/PC/10, annex I, para. 7.

<sup>923</sup> Governing Council decision 15/27 (1989); see *Official Records of the General Assembly, Forty-fourth Session, Supplement No. 25 (A/44/25)*, annex I. See also P. Sands, *op. cit.* (footnote 863 above), p. 210.

<sup>924</sup> See article 4, paragraph 3, of the Bamako Convention on the Ban of the Import into Africa and the Control of Transboundary Movement and Management of Hazardous Wastes within Africa; article 3, paragraph 3, of the United Nations Framework Convention on Climate Change; article 174 (ex-article 130r) of the Treaty establishing the European Community as amended by the Treaty of Amsterdam; and article 2 of the Vienna Convention for the Protection of the Ozone Layer. It may be noted that previous treaties apply the precautionary principle in a very general sense without making any explicit reference to it.

(7) According to the Rio Declaration, the precautionary principle constitutes a very general rule of conduct of prudence. It implies the need for States to review their obligations of prevention in a continuous manner to keep abreast of the advances in scientific knowledge.<sup>925</sup> ICJ in its judgment in the *Gabčíkovo-Nagymaros Project* case invited the parties to “look afresh at the effects on the environment of the operation of the Gabčíkovo power plant”, built on the Danube pursuant to the Treaty on the Construction and Operation of the Gabčíkovo-Nagymaros Barrage System of 1977, in the light of the new requirements of environmental protection.<sup>926</sup>

(8) States should consider suitable means to restore, as far as possible, the situation existing prior to the occurrence of harm. It is considered that this should be highlighted as a factor to be taken into account by States concerned which should adopt environmentally friendly measures.

(9) *Subparagraph* (d) provides that one of the elements determining the choice of preventive measures is the willingness of the State of origin and States likely to be affected to contribute to the cost of prevention. For example, if the States likely to be affected are prepared to contribute to the expense of preventive measures, it may be reasonable, taking into account other factors, to expect the State of origin to take more costly but more effective preventive measures. This, however, should not underplay the measures the State of origin is obliged to take under these articles.

(10) These considerations are in line with the basic policy of the so-called polluter-pays principle. This principle was initiated first by the Council of OECD in 1972.<sup>927</sup> The polluter-pays principle was given cognizance at the global level when it was adopted as principle 16 of the Rio Declaration. It noted:

<sup>925</sup> On the principle of precaution generally, see H. Hohmann, *Präventive Rechtspflichten und -prinzipien des modernen Umweltvölkerrechts: Zum Stand des Umweltvölkerrechts zwischen Umweltnutzung und Umweltschutz* (Berlin, Duncker and Humblot, 1992), pp. 406–411; J. Cameron, “The status of the precautionary principle in international law”, *Interpreting the Precautionary Principle*, T. O’Riordan and J. Cameron, eds. (London, Earthscan, 1994), pp. 262–289; H. Hohmann, *Precautionary Legal Duties and Principles of Modern International Environmental Law: The Precautionary Principle — International Environmental Law between Exploitation and Protection* (London, Graham and Trotman/Martinus Nijhoff, 1994); D. Freestone and E. Hey, eds., *The Precautionary Principle and International Law: The Challenge of Implementation* (The Hague, Kluwer, 1996); A. Epiney and M. Scheyli, *op. cit.* (footnote 879 above), pp. 103–125; P. Martin-Bidou, “Le principe de précaution en droit international de l’environnement”, *RGDIP*, vol. 103, No. 3 (1999), pp. 631–666; and N. de Sadeleer, “Réflexions sur le statut juridique du principe de précaution”, *Le principe de précaution: significations et conséquences*, E. Zaccai and J.-N. Missa, eds. (Éditions de l’Université de Bruxelles, 2000), pp. 117–142.

<sup>926</sup> *Gabčíkovo-Nagymaros Project* (see footnote 27 above), pp. 77–78, para. 140. However, in this case the Court did not accept Hungary’s claim that it was entitled to terminate the Treaty on the grounds of “ecological state of necessity” arising from risks to the environment that had not been detected at the time of its conclusion. It stated that other means could be used to remedy the vague “peril”; see paragraphs 49 to 58 of the judgment, pp. 39–46.

<sup>927</sup> See OECD Council recommendation C(72)128 on Principles relative to transfrontier pollution (OECD, *Guiding Principles concerning International Economic Aspects of Environmental Policies*) and OECD environment directive on equal right of access and non-discrimination in relation to transfrontier pollution, mentioned in the “Survey of liability regimes ...” (footnote 846 above), paras. 102–130.

National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.<sup>928</sup>

This is conceived as the most efficient means of allocating the cost of pollution prevention and control measures so as to encourage the rational use of scarce resources. It also encourages internalization of the cost of publicly mandated technical measures in preference to inefficiencies and competitive distortions in governmental subsidies.<sup>929</sup> This principle is specifically referred to in article 174 (ex-article 130r) of the Treaty establishing the European Community as amended by the Treaty of Amsterdam.

(11) The expression “as appropriate” indicates that the State of origin and the States likely to be affected are not put on the same level as regards the contribution to the costs of prevention. States concerned frequently embark on negotiations concerning the distribution of costs for preventive measures. In so doing, they proceed from the basic principle derived from article 3 according to which these costs are to be assumed by the operator or the State of origin. These negotiations mostly occur in cases where there is no agreement on the amount of the preventive measures and where the affected State contributes to the costs of preventive measures in order to ensure a higher degree of protection that it desires over and above what is essential for the State of origin to ensure. This link between the distribution of costs and the amount of preventive measures is in particular reflected in *subparagraph* (d).

(12) *Subparagraph* (e) introduces a number of factors that must be compared and taken into account. The economic viability of the activity must be compared to the costs of prevention. The cost of the preventive measures should not be so high as to make the activity economically non-viable. The economic viability of the activity should also be assessed in terms of the possibility of changing the location, or conducting it by other means, or replacing it with an alternative activity. The words “carrying out the activity ... by other means” intend to take into account, for example, a situation in which one type of chemical substance used in the activity, which might be the source of transboundary harm, could be replaced by another chemical substance; or mechanical equipment in the plant or the factory could be replaced by different equipment. The words “replacing [the activity] with an alternative activity” are intended to take account of the possibility that the same or comparable results may be reached by another activity with no risk, or lower risk, of significant transboundary harm.

<sup>928</sup> See footnote 857 above.

<sup>929</sup> See G. Hafner, “Das Verursacherprinzip”, *Economy-Fachmagazin* No. 4/90 (1990), pp. F23–F29; S. E. Gaines, “The polluter-pays principle: from economic equity to environmental ethos”, *Texas International Law Journal*, vol. 26 (1991), p. 470; H. Smets, “The polluter-pays principle in the early 1990s”, *The Environment after Rio: International Law and Economics*, L. Campiglio et al., eds. (London, Graham and Trotman/Martinus Nijhoff, 1994), p. 134; “Survey of liability regimes ...” (footnote 846 above), para. 113; Rio Declaration on Environment and Development—application and implementation: report of the Secretary-General (E/CN.17/1997/8, paras. 87–90); and A. Epiney and M. Scheyli, *op. cit.* (see footnote 879 above), p. 152.

(13) According to *subparagraph* (f), States should also take into account the standards of prevention applied to the same or comparable activities in the State likely to be affected, other regions or, if they exist, the international standards of prevention applicable for similar activities. This is particularly relevant when, for example, the States concerned do not have any standard of prevention for such activities, or they wish to improve their existing standards.

#### *Article 11. Procedures in the absence of notification*

**1. If a State has reasonable grounds to believe that an activity planned or carried out in the State of origin may involve a risk of causing significant transboundary harm to it, it may request the State of origin to apply the provision of article 8. The request shall be accompanied by a documented explanation setting forth its grounds.**

**2. In the event that the State of origin nevertheless finds that it is not under an obligation to provide a notification under article 8, it shall so inform the requesting State within a reasonable time, providing a documented explanation setting forth the reasons for such finding. If this finding does not satisfy that State, at its request, the two States shall promptly enter into consultations in the manner indicated in article 9.**

**3. During the course of the consultations, the State of origin shall, if so requested by the other State, arrange to introduce appropriate and feasible measures to minimize the risk and, where appropriate, to suspend the activity in question for a reasonable period.**

#### *Commentary*

(1) Article 11 addresses the situation in which a State, although it has received no notification about an activity in accordance with article 8, becomes aware that an activity is being carried out in the State of origin, either by the State itself or by a private operator, and believes, on reasonable grounds, that the activity carries a risk of causing it significant harm.

(2) The expression “a State” is not intended to exclude the possibility that more than one State could entertain the belief that a planned activity could adversely affect them in a significant way. The words “apply the provision of article 8” should not be taken as suggesting that the State which intends to authorize or has authorized an activity has necessarily failed to comply with its obligations under article 8. In other words, the State of origin may have made an assessment of the potential of the planned activity for causing significant transboundary harm and concluded in good faith that no such effects would result therefrom. *Paragraph 1* allows a State to request that the State of origin take a “second look” at its assessment and conclusion, and does not prejudge the question whether the State of origin initially complied with its obligations under article 8.

(3) The State likely to be affected could make such a request, however, only upon satisfaction of two conditions. The first is that the requesting State must have “reasonable grounds to believe” that the activity in question may involve a risk of causing significant transboundary harm. The second is that the requesting State must provide a “documented explanation setting forth its grounds”. These conditions are intended to require that the requesting State have more than a vague and unsubstantiated apprehension. A serious and substantiated belief is necessary, particularly in view of the possibility that the State of origin may be required to suspend implementation of its plans under paragraph 3 of article 11.

(4) The first sentence of *paragraph 2* deals with the case in which the planning State concludes, after taking a “second look” as described in paragraph (2) of the present commentary, that it is not under an obligation to provide a notification under article 8. In such a situation, paragraph 2 seeks to maintain a fair balance between the interests of the States concerned by requiring the State of origin to provide the same kind of justification for its finding as was required of the requesting State under paragraph 1. The second sentence of paragraph 2 deals with the case in which the finding of the State of origin does not satisfy the requesting State. It requires that, in such a situation, the State of origin promptly enter into consultations with the other State (or States), at the request of the latter. The consultations are to be conducted in the manner indicated in paragraphs 1 and 2 of article 9. In other words, their purpose is to achieve “acceptable solutions” regarding measures to be adopted in order to prevent significant transboundary harm or at any event to minimize the risk thereof, and that the solutions to be sought should be “based on an equitable balance of interests”. These phrases are discussed in the commentary to article 9.

(5) *Paragraph 3* requires the State of origin to introduce appropriate and feasible measures to minimize the risk and, where appropriate, to suspend the activity in question for a reasonable period, if it is requested to do so by the other State during the course of consultations. States concerned could also agree otherwise.

(6) Similar provisions have been provided for in other legal instruments. Article 18 of the Convention on the Law of the Non-navigational Uses of International Watercourses, and article 3, paragraph 7, of the Convention on Environmental Impact Assessment in a Transboundary Context also contemplate a procedure whereby a State likely to be affected by an activity can initiate consultations with the State of origin.

#### *Article 12. Exchange of information*

**While the activity is being carried out, the States concerned shall exchange in a timely manner all available information concerning that activity relevant to preventing significant transboundary harm or at any event minimizing the risk thereof. Such an exchange of information shall continue until such time as the States concerned consider it appropriate even after the activity is terminated.**

*Commentary*

(1) Article 12 deals with steps to be taken after an activity has been undertaken. The purpose of all these steps is the same as previous articles, viz. to prevent significant transboundary harm or at any event to minimize the risk thereof.

(2) Article 12 requires the State of origin and the States likely to be affected to exchange information regarding the activity after it has been undertaken. The phrase “concerning that activity” after the words “all available information” is intended to emphasize the link between the information and the activity and not any information. The duty of prevention based on the concept of due diligence is not a one-time effort but requires continuous effort. This means that due diligence is not terminated after granting authorization for the activity and undertaking the activity; it continues in respect of monitoring the implementation of the activity as long as the activity continues.

(3) The information that is required to be exchanged, under article 12, is whatever would be useful, in the particular instance, for the purpose of prevention of risk of significant harm. Normally, such information comes to the knowledge of the State of origin. However, when the State that is likely to be affected has any information which might be useful for prevention purposes, it should make it available to the State of origin.

(4) The requirement of exchange of information is fairly common in conventions designed to prevent or reduce environmental and transboundary harm. These conventions provide for various ways of gathering and exchanging information, either between the parties or through providing the information to an international organization which makes it available to other States.<sup>930</sup> In the context of these articles, where the activities are most likely to involve a few States, the exchange of information is effected between the States directly concerned. Where the information might affect a large number of States, relevant information may be exchanged through other avenues, such as, for example, competent international organizations.

(5) Article 12 requires that such information should be exchanged in a *timely manner*. This means that when the State becomes aware of such information, it should inform the other States quickly so that there will be enough time for the States concerned to consult on appropriate preventive measures or the States likely to be affected will have sufficient time to take proper actions.

<sup>930</sup> For example, article 10 of the Convention for the Prevention of Marine Pollution from Land-based Sources, article 200 of the United Nations Convention on the Law of the Sea and article 4 of the Vienna Convention for the Protection of the Ozone Layer speak of individual or joint research by the States parties on prevention or reduction of pollution and of transmitting to each other directly or through a competent international organization the information so obtained. The Convention on Long-Range Transboundary Air Pollution provides for research and exchange of information regarding the impact of activities undertaken by the States parties. Examples are found in other instruments such as section VI, para. 1 (b) (iii), of the Code of Conduct on Accidental Pollution of Transboundary Inland Waters (see footnote 871 above), article 17 of the Convention on Biological Diversity and article 13 of the Convention on the Protection and Use of Transboundary Watercourses and International Lakes.

(6) There is no requirement in the article as to the frequency of exchange of information. The requirement of article 12 comes into operation only when States have any information which is relevant to preventing transboundary harm or at any rate to minimizing the risk thereof.

(7) The second sentence of article 12 is designed to ensure exchange of information under this provision not only while an activity is “carried out”, but even after it ceases to exist, if the activity leaves behind by-products or materials associated with the activity which require monitoring to avoid the risk of significant transboundary harm. An example in this regard is nuclear activity which leaves behind nuclear waste even after the activity is terminated. But it is a recognition of the fact that the consequences of certain activities even after they are terminated continue to pose a significant risk of transboundary harm. Under these circumstances, the obligations of the State of origin do not end with the termination of the activity.

*Article 13. Information to the public*

**States concerned shall, by such means as are appropriate, provide the public likely to be affected by an activity within the scope of the present articles with relevant information relating to that activity, the risk involved and the harm which might result and ascertain their views.**

*Commentary*

(1) Article 13 requires States, whenever possible and by such means as are appropriate, to provide the public likely to be affected, whether their own or that of other States, with information relating to the risk and harm that might result from an activity to ascertain their views thereon. The article therefore requires States (a) to provide information to the public regarding the activity and the risk and the harm it involves; and (b) to ascertain the views of the public. It is, of course, clear that the purpose of providing information to the public is to allow its members to inform themselves and then to ascertain their views. Without that second step, the purpose of the article would be defeated.

(2) The content of the information to be provided to the public includes information about the activity itself as well as the nature and the scope of risk and harm that it entails. Such information is contained in the documents accompanying the notification which is effected in accordance with article 8 or in the assessment which may be carried out by the requesting State under article 11.

(3) This article is inspired by new trends in international law, in general, and environmental law, in particular, of seeking to involve, in the decision-making processes, individuals whose lives, health, property and environment might be affected by providing them with a chance to present their views and be heard by those responsible for making the ultimate decisions.



(4) Principle 10 of the Rio Declaration provides for public involvement in decision-making processes as follows:

Environmental issues are best handled with the participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to information concerning the environment that is held by public authorities, including information on hazardous materials and activities in their communities, and the opportunity to participate in decision-making processes. States shall facilitate and encourage public awareness and participation by making information widely available. Effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.<sup>931</sup>

(5) A number of other recent international instruments dealing with environmental issues have required States to provide the public with information and to give it an opportunity to participate in decision-making processes. Section VII, paragraphs 1 and 2, of the Code of Conduct on Accidental Pollution of Transboundary Inland Waters is relevant in that context:

1. In order to promote informed decision-making by central, regional or local authorities in proceedings concerning accidental pollution of transboundary inland waters, countries should facilitate participation of the public likely to be affected in hearings and preliminary inquiries and the making of objections in respect of proposed decisions, as well as recourse to and standing in administrative and judicial proceedings.

2. Countries of incident should take all appropriate measures to provide physical and legal persons exposed to a significant risk of accidental pollution of transboundary inland waters with sufficient information to enable them to exercise the rights accorded to them by national law in accordance with the objectives of this Code.<sup>932</sup>

Article 3, paragraph 8, of the Convention on Environmental Impact Assessment in a Transboundary Context; article 17 of the Convention on the Protection of the Marine Environment of the Baltic Sea Area; article 6 of the United Nations Framework Convention on Climate Change; the Convention on the Protection and Use of Transboundary Watercourses and International Lakes (art. 16); the Convention on the Transboundary Effects of Industrial Accidents (art. 9 and annex VIII); article 12 of the Convention on the Law of the Non-navigational Uses of International Watercourses; the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters; the European Council directives 90/313/EEC on the freedom of access to information on the environment<sup>933</sup> and 96/82/EC on the control of major-accident hazards involving dangerous substances;<sup>934</sup> and OECD Council recommendation C(74)224 on Principles concerning transfrontier pollution<sup>935</sup> all provide for information to the public.

(6) There are many modalities for participation in decision-making processes. Reviewing data and information on the basis of which decisions will be based and having an opportunity to confirm or challenge the accuracy of the facts, the analysis and the policy considerations either through administrative tribunals, courts, or groups of concerned citizens is one way of participation in decision-

making. This form of public involvement enhances the efforts to prevent transboundary and environmental harm.

(7) The obligation contained in article 13 is circumscribed by the phrase “by such means as are appropriate”, which is intended to leave the ways in which such information could be provided to the States, their domestic law requirements and the State policy as to, for example, whether such information should be provided through media, non-governmental organizations, public agencies and local authorities. In the case of the public beyond a State’s borders, information may be provided, as appropriate, through the good offices of the State concerned, if direct communication is not feasible or practical.

(8) Further, the State that might be affected, after receiving notification and information from the State of origin and before responding to the notification shall, by such means as are appropriate, inform those parts of its own public likely to be affected.

(9) “Public” includes individuals, interest groups (non-governmental organizations) and independent experts. General “public”, however, refers to individuals who are not organized into groups or affiliated to specific groups. Public participation could be encouraged by holding public meetings or hearings. The public should be given the opportunity for consultation and their participation should be facilitated by providing them with necessary information on the proposed policy, plan or programme under consideration. It must, however, be understood that requirements of confidentiality may affect the extent of public participation in the assessment process. It is also common that the public is not involved, or only minimally involved, in efforts to determine the scope of a policy, plan or programme. Public participation in the review of a draft document or environmental impact assessment would be useful in obtaining information regarding concerns related to the proposed action, additional alternatives and potential environmental impact.<sup>936</sup>

(10) Apart from the desirability of encouraging public participation in national decision-making on vital issues regarding development and the tolerance levels of harm in order to enhance the legitimacy of and compliance with the decisions taken, it is suggested that, given the development of human rights law, public participation could also be viewed as a growing right under national law as well as international law.<sup>937</sup>

#### *Article 14. National security and industrial secrets*

**Data and information vital to the national security of the State of origin or to the protection of industrial secrets or concerning intellectual property may**

<sup>936</sup> See ECE, *Application of Environmental Impact Assessment Principles ...* (footnote 901 above), pp. 4 and 8.

<sup>937</sup> See T. M. Franck, “Fairness in the international legal and institutional system: general course on public international law”, *Recueil des cours...*, 1993–III (Dordrecht, Martinus Nijhoff, 1994), vol. 240, p. 110. See also D. Craig and D. Ponce Nava, “Indigenous peoples’ rights and environmental law”, *UNEP’s New Way Forward ...* (footnote 901 above), pp. 115–146.

<sup>931</sup> See footnote 857 above.

<sup>932</sup> See footnote 871 above.

<sup>933</sup> *Official Journal of the European Communities*, No. L 158 of 23 June 1990, p. 56.

<sup>934</sup> *Ibid.*, No. L 10 of 14 January 1997, p. 13.

<sup>935</sup> See footnote 875 above.

**be withheld, but the State of origin shall cooperate in good faith with the State likely to be affected in providing as much information as possible under the circumstances.**

#### *Commentary*

(1) Article 14 is intended to create a narrow exception to the obligation of States to provide information in accordance with articles 8, 12 and 13. States are not obligated to disclose information that is vital to their national security. This type of clause is not unusual in treaties which require exchange of information. Article 31 of the Convention on the Law of the Non-navigational Uses of International Watercourses also provides for a similar exception to the requirement of disclosure of information vital to national defence or security.

(2) Article 14 includes industrial secrets and information protected by intellectual property in addition to national security. Although industrial secrets are a part of the intellectual property rights, both terms are used to give sufficient coverage to protected rights. In the context of these articles, it is highly probable that some of the activities which come within the scope of article 1 might involve the use of sophisticated technology involving certain types of information which are protected under the domestic law. Normally, domestic laws of States determine the information that is considered an industrial secret and provide protection for them. This type of safeguard clause is not unusual in legal instruments dealing with exchange of information relating to industrial activities. For example, article 8 of the Convention on the Protection and Use of Transboundary Watercourses and International Lakes and article 2, paragraph 8, of the Convention on Environmental Impact Assessment in a Transboundary Context provide for similar protection of industrial and commercial secrecy.

(3) Article 14 recognizes the need for balance between the legitimate interests of the State of origin and the States that are likely to be affected. It therefore requires the State of origin that is withholding information on the grounds of security or industrial secrecy to cooperate in good faith with the other States in providing as much information as possible under the circumstances. The words "as much information as possible" include, for example, the general description of the risk and the type and the extent of harm to which a State may be exposed. The words "under the circumstances" refer to the conditions invoked for withholding the information. Article 14 essentially encourages and relies on the good-faith cooperation of the parties.

#### *Article 15. Non-discrimination*

**Unless the States concerned have agreed otherwise for the protection of the interests of persons, natural or juridical, who may be or are exposed to the risk of significant transboundary harm as a result of an activity within the scope of the present articles, a State shall not discriminate on the basis of nationality or residence or place where the injury might occur, in**

**granting to such persons, in accordance with its legal system, access to judicial or other procedures to seek protection or other appropriate redress.**

#### *Commentary*

(1) This article sets out the basic principle that the State of origin is to grant access to its judicial and other procedures without discrimination on the basis of nationality, residence or the place where the injury might occur. The content of this article is based on article 32 of the Convention on the Law of the Non-navigational Uses of International Watercourses.

(2) Article 15 contains two basic elements, namely, non-discrimination on the basis of nationality or residence and non-discrimination on the basis of where the injury might occur. The rule set forth obliges States to ensure that any person, whatever his nationality or place of residence, who might suffer significant transboundary harm as a result of activities referred to in article 1 should, regardless of where the harm might occur, receive the same treatment as that afforded by the State of origin to its nationals in case of possible domestic harm. It is not intended that this obligation should affect the existing practice in some States of requiring that non-residents or aliens post a bond, as a condition of utilizing the court system, to cover court costs or other fees. Such a practice is not "discriminatory" under the article, and is taken into account by the phrase "in accordance with its legal system".

(3) Article 15 also provides that the State of origin may not discriminate on the basis of the place where the damage might occur. In other words, if significant harm may be caused in State A as a result of an activity referred to in article 1 in State B, State B may not bar an action on the grounds that the harm would occur outside its jurisdiction.

(4) This rule is residual, as indicated by the phrase "unless the States concerned have agreed otherwise". Accordingly, States concerned may agree on the best means of providing protection or redress to persons who may suffer a significant harm, for example through a bilateral agreement. States concerned are encouraged under the present articles to agree on a special regime dealing with activities with the risk of significant transboundary harm. In such arrangements, States may also provide for ways and means of protecting the interests of the persons concerned in case of significant transboundary harm. The phrase "for the protection of the interests of persons" has been used to make it clear that the article is not intended to suggest that States can decide by mutual agreement to discriminate in granting access to their judicial or other procedures or a right to compensation. The purpose of the inter-State agreement should always be the protection of the interests of the victims of the harm.

(5) Precedents for the obligation contained in this article may be found in international agreements and in recommendations of international organizations. For example, the Convention on the Protection of the Environment between Denmark, Finland, Norway and Sweden in its article 3 provides as follows:

Any person who is affected or may be affected by a nuisance caused by environmentally harmful activities in another contracting State shall have the right to bring before the appropriate Court or Administrative Authority of that State the question of the permissibility of such activities, including the question of measures to prevent damage, and to appeal against the decision of the Court or the Administrative Authority to the same extent and on the same terms as a legal entity of the State in which the activities are being carried out.

The provisions of the first paragraph of this article shall be equally applicable in the case of proceedings concerning compensation for damage caused by environmentally harmful activities. The question of compensation shall not be judged by rules which are less favourable to the injured Party than the rules of compensation of the State in which the activities are being carried out.<sup>938</sup>

(6) The OECD Council has adopted recommendation C(77)28(Final) on implementation of a regime of equal right of access and non-discrimination in relation to trans-frontier pollution. Paragraph 4, subparagraph (a), of the annex to that recommendation provides as follows:

Countries of origin should ensure that any person who has suffered transfrontier pollution damage or is exposed to a significant risk of transfrontier pollution shall at least receive equivalent treatment to that afforded in the Country of origin in cases of domestic pollution and in comparable circumstances, to persons of equivalent condition or status ...<sup>939</sup>

#### Article 16. Emergency preparedness

**The State of origin shall develop contingency plans for responding to emergencies, in cooperation, where appropriate, with the State likely to be affected and competent international organizations.**

#### Commentary

(1) This article contains an obligation that calls for anticipatory rather than responsive action. The text of article 16 is based on article 28, paragraph 4, of the Convention on the Law of the Non-navigational Uses of International Watercourses which reads:

When necessary, watercourse States shall jointly develop contingency plans for responding to emergencies, in cooperation, where appropriate, with other potentially affected States and competent international organizations.

The need for the development of contingency plans for responding to possible emergencies is well recognized.<sup>940</sup>

<sup>938</sup> Similar provisions may be found in article 2, paragraph 6, of the Convention on Environmental Impact Assessment in a Transboundary Context; the Guidelines on responsibility and liability regarding transboundary water pollution, part II.E.8, prepared by the ECE Task Force on responsibility and liability regarding transboundary water pollution (document ENVWA/R.45, annex); and paragraph 6 of the Draft ECE Charter on environmental rights and obligations, prepared at a meeting of experts on environmental law, 25 February to 1 March 1991 (document ENVWA/R.38, annex I).

<sup>939</sup> OECD, *OECD and the Environment* (see footnote 875 above), p. 150. This is also the main thrust of principle 14 of the Principles of conduct in the field of the environment for the guidance of States in the conservation and harmonious utilization of natural resources shared by two or more States (see footnote 862 above). A discussion of the principle of equal access may be found in S. van Hoogstraten, P.-M. Dupuy and H. Smets, "L'égalité d'accès: pollution transfrontière", *Environmental Policy and Law*, vol. 2, No. 2 (June 1976), p. 77.

<sup>940</sup> See E. Brown Weiss, "Environmental disasters in international law", *Anuario Jurídico Interamericano*, 1986 (OAS, Washington, D.C., 1987), pp. 141-169. Resolution No. 13 of 17 December 1983

It is suggested that the duty to prevent environmental disasters obligates States to enact safety measures and procedures to minimize the likelihood of major environmental accidents, such as nuclear reactor accidents, toxic chemical spills, oil spills or forest fires. Where necessary, specific safety or contingency measures are open to States to negotiate and agree in matters concerning management of risk of significant transboundary harm, such safety measures could include: (a) adoption of safety standards for the location and operation of industrial and nuclear plants and vehicles; (b) maintenance of equipment and facilities to ensure ongoing compliance with safety measures; (c) monitoring of facilities, vehicles or conditions to detect dangers; and (d) training of workers and monitoring of their performance to ensure compliance with safety standards. Such contingency plans should include establishment of early warning systems.

(2) While States of origin bear the primary responsibility for developing contingency plans, in many cases it will be appropriate to prepare them in cooperation with other States likely to be affected and competent international organizations. For example, the contingency plans may necessitate the involvement of other States likely to be affected, as well as international organizations with competence in the particular field.<sup>941</sup> In addition, the coordination of response efforts might be most effectively handled by a competent international organization of which the States concerned are members.

(3) Development of contingency plans are also better achieved through establishment of common or joint commissions composed of members representing all States concerned. National points of contact would also have to be established to review matters and employ the latest means of communication to suit early warnings.<sup>942</sup> Contingency plans to respond to marine pollution disasters are well known. Article 199 of the United Nations Convention on the Law of the Sea requires States to develop such plans. The obligation to develop contingency plans is also found in certain bilateral and multilateral agreements concerned with forest fires, nuclear accidents and other environmental catastrophes.<sup>943</sup> The Convention for the Protection of the Natural Resources and Environment of the South Pacific Region provides in article 15 that the "Parties shall develop and promote individual

of the European Council of Environmental Law concerning "Principles concerning international cooperation in environmental emergencies linked to technological development" expressly calls for limits on siting of all hazardous installations, for the adoption of safety standards to reduce risk of emergencies, and for monitoring and emergency planning; see *Environmental Policy and Law*, vol. 12, No. 3 (April 1984), p. 68. See also G. Handl, *op. cit.* (footnote 871 above), pp. 62-65.

<sup>941</sup> For a review of various contingency plans established by several international organizations and bodies such as UNEP, FAO, the United Nations Disaster Relief Coordinator, UNHCR, UNICEF, WHO, IAEA and ICRC, see B. G. Ramcharan, *The International Law and Practice of Early-Warning and Preventive Diplomacy: The Emerging Global Watch* (Dordrecht, Kluwer, 1991), chapter 7 (The Practice of Early-Warning: Environment, Basic Needs and Disaster-Preparedness), pp. 143-168.

<sup>942</sup> For establishment of joint commissions, see, for example, the Indus Waters Treaty, 1960 and the Agreement for the Protection of the Rhine against Chemical Pollution.

<sup>943</sup> For a mention of these agreements, see E. Brown Weiss, *loc. cit.* (see footnote 940 above), p. 148.

contingency plans and joint contingency plans for responding to incidents”.

### *Article 17. Notification of an emergency*

**The State of origin shall, without delay and by the most expeditious means, at its disposal, notify the State likely to be affected of an emergency concerning an activity within the scope of the present articles and provide it with all relevant and available information.**

#### *Commentary*

(1) This article deals with the obligations of States of origin in responding to an actual emergency situation. The provision is based on article 28, paragraph 2, of the Convention on the Law of the Non-navigational Uses of International Watercourses which reads:

A watercourse State shall, without delay and by the most expeditious means available notify other potentially affected States and competent international organizations of any emergency originating within its territory.

Similar obligations are also contained, for example, in Principle 18 of the Rio Declaration;<sup>944</sup> the Convention on Early Notification of a Nuclear Accident;<sup>945</sup> article 198 of the United Nations Convention on the Law of the Sea; article 14, paragraph 1 (d) of the Convention on Biological Diversity; article 5, paragraph 1 (c), of the International Convention on Oil Pollution Preparedness, Response and Cooperation, 1990 and a number of other agreements concerning international watercourses.<sup>946</sup>

(2) According to this article, the seriousness of the harm involved together with the suddenness of the emergency's occurrence justifies the measures required. However, suddenness does not denote that the situation

<sup>944</sup> See footnote 857 above.

<sup>945</sup> Article 5 of this Convention provides for detailed data to be notified to the States likely to be affected: “(a) the time, exact location where appropriate, and the nature of the nuclear accident; (b) the facility or activity involved; (c) the assumed or established cause and the foreseeable development of the nuclear accident relevant to the transboundary release of the radioactive materials; (d) the general characteristics of the radioactive release, including, as far as is practicable and appropriate, the nature, probable physical and chemical form and the quantity, composition and effective height of the radioactive release; (e) information on current and forecast meteorological and hydrological conditions, necessary for forecasting the transboundary release of the radioactive materials; (f) the results of environmental monitoring relevant to the transboundary release of the radioactive materials; (g) the off-site protective measures taken or planned; (h) the predicted behaviour over time of the radioactive release.”

<sup>946</sup> See, e.g., article 11 of the Agreement for the Protection of the Rhine against Chemical Pollution; the Agreement concerning the Activities of Agencies for the Control of Accidental Water Pollution by Hydrocarbons or Other Substances capable of Contaminating Water and Recognized as such under the Convention of 16 November 1962 between France and Switzerland concerning Protection of the Waters of Lake Geneva against Pollution (1977 Official Collection of Swiss Laws, p. 2204), reproduced in B. Ruester, B. Simma and M. Bock, *International Protection of the Environment*, vol. XXV (Dobbs Ferry, N.Y., Oceana, 1981), p. 285; and the Agreement on Great Lakes Water Quality, concluded between Canada and the United States (*United States Treaties and Other International Agreements, 1978-79*, vol. 30, part 2 (Washington, D.C., United States Government Printing Office, 1980), No. 9257).

needs to be wholly unexpected. Early warning systems established or forecasting of severe weather disturbances could indicate that the emergency is imminent. This may give the States concerned some time to react and take reasonable, feasible and practical measures to avoid or at any event mitigate ill effects of such emergencies. The words “without delay” mean immediately upon learning of the emergency and the phrase “by the most expeditious means, at its disposal” indicates that the most rapid means of communication to which a State may have recourse is to be utilized.

(3) Emergencies could result from natural causes or human conduct. Measures to be taken in this regard are without prejudice to any claims of liability whose examination is outside the scope of the present articles.

### *Article 18. Relationship to other rules of international law*

**The present articles are without prejudice to any obligation incurred by States under relevant treaties or rules of customary international law.**

#### *Commentary*

(1) Article 18 intends to make it clear that the present articles are without prejudice to the existence, operation or effect of any obligation of States under international law relating to an act or omission to which these articles apply. It follows that no inference is to be drawn from the fact that an activity falls within the scope of these articles, as to the existence or non-existence of any other rule of international law as to the activity in question or its actual or potential transboundary effects.

(2) The reference in article 18 to any obligation of States covers both treaty obligations and obligations under customary international law. It is equally intended to extend both to rules having a particular application, whether to a given region or a specified activity, and to rules which are universal or general in scope. This article does not purport to resolve all questions of future conflict of overlap between obligations under treaties and customary international law and obligations under the present articles.

### *Article 19. Settlement of disputes*

**1. Any dispute concerning the interpretation or application of the present articles shall be settled expeditiously through peaceful means of settlement chosen by mutual agreement of the parties to the dispute, including negotiations, mediation, conciliation, arbitration or judicial settlement.**

**2. Failing an agreement on the means for the peaceful settlement of the dispute within a period of six months, the parties to the dispute shall, at the request of any of them, have recourse to the establishment of an impartial fact-finding commission.**

**3. The Fact-finding Commission shall be composed of one member nominated by each party to the dispute and in addition a member not having the nationality of any of the parties to the dispute chosen by the nominated members who shall serve as Chairperson.**

**4. If more than one State is involved on one side of the dispute and those States do not agree on a common member of the Commission and each of them nominates a member, the other party to the dispute has the right to nominate an equal number of members of the Commission.**

**5. If the members nominated by the parties to the dispute are unable to agree on a Chairperson within three months of the request for the establishment of the Commission, any party to the dispute may request the Secretary-General of the United Nations to appoint the Chairperson who shall not have the nationality of any of the parties to the dispute. If one of the parties to the dispute fails to nominate a member within three months of the initial request pursuant to paragraph 2, any other party to the dispute may request the Secretary-General of the United Nations to appoint a person who shall not have the nationality of any of the parties to the dispute. The person so appointed shall constitute a single-member Commission.**

**6. The Commission shall adopt its report by a majority vote, unless it is a single-member Commission, and shall submit that report to the parties to the dispute setting forth its findings and recommendations, which the parties to the dispute shall consider in good faith.**

#### *Commentary*

(1) Article 19 provides a basic rule for the settlement of disputes arising from the interpretation or application of the regime of prevention set out in the present articles. The rule is residual in nature and applies where the States concerned do not have an applicable agreement for the settlement of such disputes.

(2) It is assumed that the application of this article would come into play only after States concerned have exhausted all the means of persuasion at their disposal through appropriate consultation and negotiations. These could take place as a result of the obligations imposed by the present articles or otherwise in the normal course of inter-State relations.

(3) Failing any agreement through consultation and negotiation, the States concerned are urged to continue to exert efforts to settle their dispute, through other peaceful means of settlement to which they may resort by mutual agreement, including mediation, conciliation, arbitration or judicial settlement. These are means of peaceful settlement of disputes set forth in Article 33 of the Charter of the United Nations, in the second paragraph

of the relevant section of the Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States in accordance with the Charter of the United Nations<sup>947</sup> and in paragraph 5 of section I of the Manila Declaration on the Peaceful Settlement of International Disputes,<sup>948</sup> which are open to States as free choices to be mutually agreed upon.<sup>949</sup>

(4) If the States concerned are unable to reach an agreement on any of the means of peaceful settlement of disputes within a period of six months, paragraph 2 of article 19 obliges States, at the request of one of them, to have recourse to the appointment of an impartial fact-finding commission. Paragraphs 3, 4, and 5 of article 19 elaborate the compulsory procedure for the appointment of the fact-finding commission.<sup>950</sup> This compulsory procedure is useful and necessary to help States to resolve their disputes expeditiously on the basis of an objective identification and evaluation of facts. Lack of proper appreciation of the correct and relevant facts is often at the root of differences or disputes among States.

(5) Resort to impartial fact-finding commissions is a well-known method incorporated in a number of bilateral or multilateral treaties, including the Covenant of the League of Nations, the Charter of the United Nations and the constituent instruments of certain specialized agencies and other international organizations within the United Nations system. Its potential to contribute to the settlement of international disputes is recognized by General Assembly resolution 1967 (XVIII) of 16 December 1963 on the "Question of methods of fact-finding" and the Declaration on Fact-Finding by the United Nations in the Field of the Maintenance of International Peace and Security adopted by the General Assembly in its resolution 46/59 of 9 December 1991, annex.

(6) By virtue of the mandate to investigate the facts and to clarify the questions in dispute, such commissions usually have the competence to arrange for hearings of the parties, the examination of witnesses or on-site visits.

(7) The report of the Commission usually should identify or clarify "facts". Insofar as they involve no assessment or evaluation, they are generally beyond further contention. States concerned are still free to give such weight as they deem appropriate to these "facts" in arriving at a resolution of the dispute. However, article 19 requires the States concerned to give the report of the fact-finding commission a good-faith consideration at the least.<sup>951</sup>

<sup>947</sup> See footnote 273 above.

<sup>948</sup> General Assembly resolution 37/10 of 15 November 1982, annex.

<sup>949</sup> For an analysis of the various means of peaceful settlement of disputes and references to relevant international instruments, see *Handbook on the Peaceful Settlement of Disputes between States* (United Nations publication, Sales No. E.92.V.7).

<sup>950</sup> See article 33 of the Convention on the Law of the Non-navigational Uses of International Watercourses.

<sup>951</sup> The criteria of good faith are described in the commentary to article 9.

**CLA-024**

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

**INVESMART, B.V.**

**CLAIMANT**

**v**

**CZECH REPUBLIC**

**RESPONDENT**

---

**AWARD**

---

**TRIBUNAL**

Dr Michael Pryles

Mr Christopher Thomas Q.C.

Professor Piero Bernardini

Secretary of the Tribunal

Ms Leah Ratcliff

## Contents

<b>Award of the Tribunal .....</b>	<b>5</b>
<b>The Parties, Representation and Tribunal.....</b>	<b>5</b>
<b>Procedural Background.....</b>	<b>6</b>
Discovery/document production.....	9
Security for Costs .....	10
Procedural steps as requested by the Chairman to the Tribunal.....	10
Case Management Conference .....	11
Claimant's extraordinary submission dated 4 November 2008.....	11
The hearing .....	11
<b>Factual Background.....</b>	<b>12</b>
The expansion of Union Banka.....	13
Union Banka's accumulation of related party loans.....	15
State aid discussions between Union Banka and CF in 2001.....	15
Invesmart retained by Union Banka .....	16
Invesmart's decision to acquire Union Banka.....	17
Invesmart's contractual arrangements to acquire Union Banka.....	18
Invesmart's applications to the CNB for regulatory approval to acquire Union Banka.....	20
Union Banka's growing financial problems throughout 2002 .....	23
Negotiations for state aid between Invesmart and Czech Government agencies.....	25
Invesmart's takeover of Union Banka and Union Group.....	28
Continued negotiations regarding State Aid.....	29
Union Banka's liquidity crisis and the denial of state aid .....	31
Union Banka's attempts to renew its operation .....	34
The fraudulent bankruptcy proceedings of Union Banka.....	35
The revocation of Union Banka's banking licence and the liquidation of Union Banka.....	36
Invesmart's refusal to pay for shares it acquired in Union Banka .....	37
<b>Jurisdiction.....</b>	<b>38</b>
Introduction.....	38
Nationality.....	38
Investment.....	39
Preclusion.....	41
<b>Applicable Law .....</b>	<b>42</b>
<b>Fair and equitable treatment .....</b>	<b>44</b>
General standard .....	44
<b>Legitimate Expectations .....</b>	<b>45</b>
The Claimant .....	45
Correspondence between Invesmart and the CNB and MOF .....	46
Meeting of 24 September 2002.....	48
Meeting of 24 October 2002 .....	49
Claimant's characterisation of negotiations following CNB approval .....	51
Amount of state aid.....	53
The Respondent.....	54
The Tribunal's analysis - General Approach .....	57
Detailed analysis.....	59
The law on state aid.....	62



Due diligence.....	62
Invesmart's contractual relations with Union Banka and the selling shareholders .....	65
The Claimant's general awareness of the domestic competition law regime prior to 24 October 2002.....	68
The issue of "old" versus "new" aid .....	69
The Czech Republic's commitment to the European Union .....	72
What did the Ministry of Finance commit to do?.....	75
Conclusion on legitimate expectations .....	80
<b>Inconsistency and ambiguity .....</b>	<b>81</b>
The Claimant .....	81
The Respondent .....	83
Tribunal's analysis .....	84
Inconsistency - OPC approval.....	84
The run on Union Banka .....	84
The CKA's proposal to settle the BDS arbitration claim.....	86
The MOF's failure to submit the Third Restructuring Plan to the OPC.....	87
The MOF's "undertaking" to issue a resolution in support of Union Banka .....	87
The Czech Republic's renewed commitment to the EC.....	88
<b>Discrimination .....</b>	<b>89</b>
The Claimant .....	89
The Respondent .....	91
The Tribunal's analysis .....	94
Were the other recipients of state aid similarly situated to Union Banka? .....	94
<b>Bad faith.....</b>	<b>97</b>
The Claimant .....	97
The Respondent .....	98
The Tribunal's analysis .....	98
Inducement to assume the RPLs .....	99
Failure to choose the least cost option.....	99
The proceedings in Ústí nad Labem and the allegation of deliberate conspiracy.....	100
<b>Impairment clause.....</b>	<b>100</b>
Applicable legal standard.....	100
Unreasonableness.....	102
The Claimant .....	102
The Respondent .....	104
The Tribunal's analysis .....	105
The reasonableness of the CNB's approval .....	105
<b>Expropriation.....</b>	<b>107</b>
The Claimant .....	108
The Respondent .....	110
The Tribunal's Analysis.....	111
The Minister's decision to deny state aid .....	111
The revocation of Union Banka's licence .....	114
<b>Umbrella clause.....</b>	<b>120</b>
<b>Concluding comments.....</b>	<b>121</b>
Invesmart's financial capacity .....	121
Invesmart did not pay off the RPLs it assumed .....	121
The shifting sources of the funds .....	123

Invesmart did not comply with the Receivables Assignment Agreement .....	124
A number of wealthy shareholders withdrew from Invesmart .....	125
capacity to raise the majority of the €90 million capital increase was doubtful.....	128
<b>Tribunal's determination on costs .....</b>	<b>130</b>
Costs of arbitration.....	130
Allocation of costs.....	130
Parties' submissions .....	130
Determination .....	131
<b>AWARD AND ORDER.....</b>	<b>133</b>

## Award of the Tribunal

### The Parties, Representation and Tribunal

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

Via Manzoni 46, 20122  
Milan, Italy

("Claimant")

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

Leetenská 15  
118 10 Prague 1  
Czech Republic

("Respondent")

3. In this arbitration the Claimant is represented by:

King and Spalding LLP

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

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

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

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

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

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

Weil, Gotshal & Manges

Ms Karolina Horakova  
Partner  
Krizovnicke nam. 1  
11000 Prague 1

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

## **Procedural Background**

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

### Article 8

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

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

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

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

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

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

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

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

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

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

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

Statement of Claim dated 12 December 2007

Statement of Defence dated 27 March 2008

Reply Memorial dated 18 July 2008

Statement of Rejoinder dated 6 October 2008

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

Mr Paul de Sury

Mr Radovan Vávra

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

Professor Hyun Song Shin

Associate Professor Raj Desai

PricewaterhouseCoopers

17. The Claimant's Reply Memorial was accompanied by Second Witness Statements from each of the Claimant's fact witnesses and supplementary expert reports from each expert.
18. The Respondent provided witness statements from the following:
  - Mr Pavel Racoča
  - Mr Pavel Řežábek
  - Mr Bohuslav Sobotka
  - Mr Zdeněk Tůma
19. The Respondent provided expert reports from the following:
  - Dr Milan Hulmák
  - Dr Petr Kotáb
  - Professor Claus-Dieter Ehlermann
  - Professor Anthony Saunders
  - Mr Pavel Závitkovský (KPMG)
  - Mr Jean Luc Guitera (KPMG)
20. The Respondent's Reply Memorial was accompanied by Second Witness Statements from each of the Respondent's witnesses of fact and Second Expert Reports from Professor Saunders, Professor Elhermann and KPMG (prepared by Mr Pavel Závitkovský).

**Discovery/document production**

21. On 4 April 2008, both parties requested that the other produce certain categories of documents pursuant to section 6(a) of Procedural Order No 1 dated 30 August 2007.
22. Both parties responded to these requests on 18 April 2008, largely without objection. The Claimant, whilst stating that the "categories of documents requested by the Czech Republic appear overly broad, and the relevance of a number of the categories is neither apparent nor adequately explained", confirmed by letter dated 23 April 2004 that it had produced all of the documents in its possession that were covered by the categories identified by the Respondent. Similarly, by letter dated 18 April 2004 the Respondent produced all documents in its possession that were responsive to the categories, except for documents held by the Czech Office of the Protection of Competition or UOHS to use the Czech acronym ("OPC"), which were subject to formal administrative procedures to facilitate their release. These documents were provided to the Claimant on 16 June 2008.

### **Security for Costs**

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

### **Procedural steps as requested by the Chairman to the Tribunal**

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



### **Case Management Conference**

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

### **Claimant's extraordinary submission dated 4 November 2008**

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

### **The hearing**

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

Mr Reginald Smith (King & Spalding)

Mr Ken Fleuriet (King & Spalding)

Mr Tom Childs (King & Spalding)

Mr Craig Miles (King & Spalding)

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

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

Ms Karolina Horakova (Weil, Gotshal & Manges)

Ms Barbora Balaptikova (Weil, Gotshal & Manges)

Professor James Crawford

Mr Zachary Douglas

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

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

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

## **Factual Background**

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

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

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

### **The expansion of Union Banka**

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

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

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

---

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

### **Union Banka's accumulation of related party loans**

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

### **State aid discussions between Union Banka and CF in 2001**

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

---

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

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

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

<sup>5</sup> Exhibit R-25, decision of the CNB, dated 31 May 2001.

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

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

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

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

#### **Invesmart retained by Union Banka**

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

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

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

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

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

---

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

<sup>9</sup> First Witness Statement of Radovan Vávra, paragraph 10.

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

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

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

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

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

#### **Invesmart's decision to acquire Union Banka**

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

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

78. These are:

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

---

<sup>11</sup> First Witness Statement of [redacted], para 17.

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

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

The material facts are considered in turn below.

### **Invesmart's contractual arrangements to acquire Union Banka**

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

---

<sup>13</sup> Statement of Claim, para 72.

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

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

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



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

82. Completion of the transaction was conditional on the provision of state aid by 2 December 2002.<sup>17</sup> Relevantly, the agreement contained the following provision:

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

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

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

83. Together SPA A and SPA B constituted an agreement to acquire 70 percent of Union Group for CZK 2.833 billion.
84. In the following months SPA A and SPA B were amended.
85. In particular, on 27 May 2002 the SPAs were amended such that a cash payment, instead of the letter of credit, was to be deposited in escrow under SPA B on 17 June 2002 and the closing date under SPA A was postponed to 30 September 2002.
86. On 14 August 2002, Invesmart and Union Group's selling shareholders entered into Addendum No 4 to the SPAs. Instead of making payment to the shareholders in exchange for their shares, Invesmart would assume the shareholders' debts under the RPLs "as soon as the CNB gives the approval with the taking over of debts by [Invesmart]". The Addendum was to become effective upon approval by the shareholders of Invesmart. Thus, SPA A had also become conditional.<sup>18</sup>
87. On 14 October 2002, Invesmart and the selling shareholders entered into Addendum No 5 to the SPAs. Invesmart was to assume the debts of the selling shareholders to Union Banka without undue delay. Addendum No 5 was to become effective upon (1) the CNB's approval of Invesmart's acquisition of control over Union Banka and assumption for selling shareholders' debts and (2) approval of Invesmart's shareholders.<sup>19</sup>

---

<sup>17</sup> *Id.*, Clause 3.3.

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

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

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

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

---

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

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

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

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

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

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

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

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

---

<sup>22</sup> Exhibit R-61, minutes of meeting held on 12 September 2002.

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

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

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

<sup>26</sup> Statement of Claim, para 94.

96. On 22 October 2002, Invesmart submitted its third application for approval by CNB for it to acquire a controlling interest in Union Banka.<sup>27</sup> The application included Minutes of an Extraordinary General Meeting of Shareholders that was convened by Invesmart on 16 October 2002.<sup>28</sup> The application stipulated that the meeting was duly held and a resolution was validly approved for a capital increase of "EUR 90 million by way of share premium upon sole request of the Board of Managing Directors of the Company". [redacted] further signed and contemporaneously submitted to the CNB a declaration by Invesmart that:

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

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

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

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

---

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

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

<sup>29</sup> Exhibit R-436, Declaration of Invesmart B.V., signed by [redacted], dated 16 October 2002.

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

<sup>31</sup> Transcript, Day 4, p. 191, lines 6-14.

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

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

### **Union Banka's growing financial problems throughout 2002**

103. The October 2002 run occurred at the end of a period of declining financial fortunes for Union Banka. In June 2002 it became apparent, as a result of Invesmart's due diligence, that its financial situation remained impaired by RPLs to the value of CZK 2.5 billion.<sup>33</sup>
104. On 6 June 2002, CNB delivered a report to Union Banka indicating that Union Banka had extended new RPLs to certain of its shareholders and that, as a consequence, significant additional funds (between CZK 160 billion and 1.878 billion) needed to be created by the bank.
105. Invesmart responded by requesting replacement of Union Banka's board of directors. The CNB was informed of this request<sup>34</sup> and by letter dated 4 July 2002 informed Union Banka that it too required that it replace all of the members of its Board of Directors.<sup>35</sup>
106. Union Banka's financial situation continued to deteriorate as Deloitte & Touche sought to finalise its Union Banka's 2001 auditor's report. In the end an acceptable auditor's report for the bank was only secured as a result of two transactions that Invesmart entered to support the balance sheet of Union Banka.
107. First, on 13 August 2002, Invesmart entered into the Receivables Assignment Agreement with Union Banka (the "**Receivables Assignment Agreement**") under which Invesmart unconditionally agreed to purchase the portfolio of loans earmarked for assignment to CF for a cash payment of CZK 1.2 billion, if by 1 December 2002 CF did not take assignment of these loans. As security for its promise to pay, Invesmart agreed to post a CZK 300 million bank guarantee on the date of signing the Receivables Assignment Agreement. Invesmart's commitment under the Receivables Assignment Agreement, combined with the bank guarantee, thus 'replaced' provisions on the loan portfolio earmarked for transfer to CF for the

---

<sup>32</sup> Exhibit R-38, CNB Decision, dated 24 October 2002.

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

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

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

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

108. Secondly, on 14 August 2002, and as is discussed at paragraph 86 above, Invesmart and Union Group's selling shareholders entered into Addendum No 4 of the SPAs. Instead of making payment to the shareholders in exchange for their shares, Invesmart would assume the shareholders' debts under the RPLs "as soon as the Czech National Bank gives the approval with the taking over of debts by [Invesmart]". The effect of this agreement, having been entered into simultaneously with the Receivables Assignment Agreement, was to remove the CF Transaction as a condition precedent to the acquisition of Union Group share by Invesmart.
109. The 2001 audit of Union Banka, dated 16 August 2002, was issued in explicit reliance on the Receivables Assignment Agreement and Addendum No 4.<sup>36</sup> Specifically, the report was qualified by a statement that in Deloitte & Touche's opinion Union Banka might not be able to continue as a going concern absent Invesmart's capital entry into the bank.<sup>37</sup> However, Invesmart did not issue the bank guarantee required under the RAA on 13 August 2002 or at any time thereafter.<sup>38</sup> Moreover, when the 1 December 2002 deadline for the contemplated assignment of the loan portfolio to CF passed and Invesmart became liable under the Receivables Assignment Agreement to pay the CZK 1.2 billion it had agreed to pay, it failed to do so.
110. Union Banka's balance sheets were further supported by the entry of the "CNB Receivable" on its books on 23 September 2002. This "receivable" was based on an amount sought by Union Banka from the CNB which, having been rejected by the latter, resulted in an arbitration claim quantified by Union Banka at CZK 1.762 billion against it.<sup>39</sup> (Union Banka ultimately lost the arbitration in April 2003.) On 22 October 2002, the same day that Invesmart submitted its third application to the CNB and the day before the run on Union Banka took place, the CNB requested that Union Banka de-recognise the CNB receivable in its accounts by 25 October 2002.<sup>40</sup> Union Banka never took this action, even though the recording of a contingent asset such as the CNB receivable was contrary to IFRS Standards.<sup>41</sup>

---

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

<sup>37</sup> *Id.*

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

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

<sup>40</sup> *Id.*

<sup>41</sup> See First KPMG Expert Report, pp. 10-11.

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

### **Negotiations for state aid between Invesmart and Czech Government agencies**

113. The documentary record clearly shows that throughout 2002 the MOF was favourably disposed to consider making a grant of state aid to Union Banka. In particular, on 12 April 2002, based on assessments of Union Banka's 2001 proposals, the MOF prepared a draft proposal to Cabinet for the solution of the relationship between Union Banka and CF. This proposal was based on the proposed CF Transaction.<sup>43</sup> The MOF decided not to submit this proposal to Cabinet. Union Banka was informed of this decision in May 2002.<sup>44</sup>
114. Parliamentary elections took place in the Czech Republic on 14 and 15 June 2002.
115. Notwithstanding the parliamentary elections, [redacted] wrote to Minister of Finance Rusnok on 28 June 2002. In this letter [redacted] reiterated Invesmart's intention to proceed with its investment in Union Banka and asked Minister Rusnok to reconsider if the relationship between Union Banka and CF relating to the Fores Deposit could be resolved.<sup>45</sup>
116. Following the elections, with effect from 15 July 2002 a new Minister of Finance, Mr Bohuslav Sobotka, took office. After the change in leadership in July 2002, the MOF was favourably disposed to considering a grant of state aid to Union Banka. On 25 July 2002 First Deputy Minister of Finance, Eduard Janota, wrote to Invesmart stating that:

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

---

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

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

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

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

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

117. In August 2001, Invesmart initiated more regular contact with Czech Government agencies and negotiations with the newly elected Czech Government for the provision of state aid to Union Banka commenced in earnest.
118. Invesmart submitted a three part proposal to the Czech Government on 20 August 2002 (the "20 August Proposal"). The key parts of this proposal were as follows:
- (i) settle Union Bank's obligations under the Fores Deposit immediately by payment of CZK 1,134 million (as opposed to the CZK 1,591 million which Union Banka was obligated to pay on 31 December 2004 under the existing contract);
  - (ii) sell problem loans taken over from the 4 small banks in aggregate nominal value of CZK 1.6 billion (purchase price was not specified); and
  - (iii) invest the amount freed by the early termination of the Fores Deposit (i.e., CZK 1,134 million) into subordinated debt of Union Banka of unspecified maturity and bearing an 8 percent rate of interest, to be modified on an annual basis.<sup>47</sup>
119. This proposal was rejected by the MOF on 24 September 2002 at a meeting between the MOF, CKA and CNB. At that meeting Minister Sobotka informed the officials of the CKA and CNB that the MOF would not accept the 20 August Proposal, but that it would be willing to submit an alternatively structured state aid proposal to the Czech Cabinet. Specifically:
- ...the lowering of prospective interest to market rate was proposed for discussion. The MOF was also willing to discuss a reduction in the principal amount of the Fores Deposit by some CZK 400 million through a transfer of problem assets of that amount.<sup>48</sup>
120. Minister Sobotka also indicated that any grant of state aid would be subject to OPC approval.<sup>49</sup>
121. Invesmart was informed of the outcome of the 24 September meeting by letter from the CNB dated 25 September 2002.<sup>50</sup>

---

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

<sup>48</sup> Statement of Defence, para 88.

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

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



122. On 25 October 2002, the day after CNB issued its regulatory approval, discussions resumed between the MOF and Invesmart about the provision of state aid to Union Banka. A meeting took place between Euro-Trend, the consulting group hired by Union Banka on 16 October 2002 to conduct the state aid negotiations,<sup>51</sup> and First Deputy Minister of Finance Dr Doruška.<sup>52</sup> At this meeting Dr Doruška suggested possible forms of state aid. Specifically, a combination of:
- (a) lowering the interest rate on the Fores deposit; and
  - (b) the acquisition by CKA of a portfolio of non-performing loans at a value to be determined by an independent expert plus a mark-up of CZK 650 million, less cost of administration of the portfolio.<sup>53</sup>
123. On 1 November 2002, Union Banka submitted a state aid proposal to the MOF which totalled CZK 1.2 billion (the "**First Euro-Trend Proposal**").<sup>54</sup> The proposal envisaged:
- (a) lowering the interest rate on the Fores Deposit of 11.5 percent to a rate between PRIBOR and a standard commercial rate;
  - (b) acquisition by CKA of a portfolio of non-performing assets at a price determined by independent experts plus an additional amount of state aid; and
  - (c) withdrawal of the arbitration claim which Union Banka filed against the CNB on 25 October 2002 in connection with Union Banka's takeover of the BDS ( the "**BDS Arbitration Claim**") discussed above at paragraph 110.<sup>55</sup>
124. On 5 November 2002, a meeting took place between Union Banka, the MOF and the CKA which was attended by Messrs Vávra (CEO of Union Banka), Nekovar (Euro-Trend), Oklestek (Eurotrend), Janota (First Deputy Minister of Finance, Doruška (MOF), Majer (MOF), Řežábek (CKA) and Svoboda (CKA). At this meeting the parties mooted the possibility of a commercial settlement of the BDS Arbitration Claim as an alternative to the First Euro-Trend Proposal.<sup>56</sup> The parties also discussed the regulatory requirement that any grant of state aid

---

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

<sup>52</sup> Statement of Claim, paras 90 and 104; Statement of Defence, para 120.

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

<sup>54</sup> Exhibit R-13, First Plan submitted by Euro-Trend.

<sup>55</sup> Exhibit R-80, Claim by Union Banka against the CNB.

<sup>56</sup> Statement of Claim, para 107.

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

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

#### **Invesmart's takeover of Union Banka and Union Group**

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

---

<sup>57</sup> *Id.*, para 110.

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

<sup>59</sup> Exhibit R-14, Second Euro-Trend Proposal.

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

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

#### **Continued negotiations regarding State Aid**

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

---

<sup>61</sup> Witness Statement of Radovan Vávra, paras 47–48.

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

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

<sup>64</sup> Statement of Claim, para 123; Witness Statement of Radovan Vávra, para 70.

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

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

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

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

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

138. The MOF provided comments on both the First and Second Restructuring Plans at a meeting held on 28 January 2003.<sup>68</sup>

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

---

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

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

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

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

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

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

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

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

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

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

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

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

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

---

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

<sup>70</sup> Exhibit R-18, Third Restructuring Plan.

<sup>71</sup> *Id.*, p. 5.

<sup>72</sup> *Id.*, p. 31.

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

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

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

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

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

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

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

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

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

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

---

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

<sup>75</sup> *Id.*, p. 2.

<sup>76</sup> Exhibit R-154, minutes of a meeting held on 20 February 2003 between \_\_\_\_\_ and de Sury and Governor Tůma, Mr. Štěpánek, Mr. Krejča and Mr. Jíříček of the CNB.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>78</sup> *Id.*

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

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

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

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

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

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

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

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

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

---

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

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

<sup>81</sup> *Id.*

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

#### **Union Banka's attempts to renew its operation**

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

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

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

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

<sup>85</sup> Exhibit R-445, *Týden*, dated 10 March 2003.

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

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



154. First, on 3 March 2003, Union Banka filed the plan with the CNB and commented on the CNB's notice of the commencement of administrative proceedings to revoke Union Banka's licence.<sup>88</sup> This plan was based on unverified data. It included a statement that the plan was subject to change pending an external audit to verify the correctness of assumptions and information presented therein.
155. Secondly, on 10 March 2003, Union Banka submitted a supplement to its plan to the CNB.<sup>89</sup> This proposal envisaged Union Banka continuing to operate on a limited licence whereby it would be prohibited from taking further deposits. It would pay out 100 percent of claims by depositors itself and would finance payment of claims by depositors in excess of CZK 5 million per client under a five year loan agreement with the Bank Deposit Insurance Fund ("FPV"). The Czech Government was not satisfied that Union Banka had funds to implement this plan. Further, the proposal was inconsistent with provisions of the Czech *Banking Act* and the law establishing the FPV.<sup>90</sup>
156. Thirdly, on 18 March 2003, [redacted] informed the CNB that Invesmart had entered into a memorandum of understanding with MTGLQ investors, L.P., a wholly owned subsidiary of Goldman Sachs, to cooperate on a new plan.<sup>91</sup> The CNB was informed of this plan once it had already made its decision to proceed with the revocation of Union Banka's banking license, which occurred on that same day.
157. On 27 March 2003, the FMV applied for Union Banka's bankruptcy before the Regional Court in Ostrava. On 31 March 2003, Union Banka created provisions for debts assumed by Invesmart as requested by CNB, resulting in negative capital of CZK1.29 billion.<sup>92</sup>

### **The fraudulent bankruptcy proceedings of Union Banka**

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

---

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

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

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

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

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

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

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

163. On 30 April 2003, the CNB Board rejected Union Banka's appeal of the CNB's decision of 18 March 2003 to revoke its banking licence. The revocation of Union Banka's licence became effective on 2 May 2003.<sup>97</sup>
164. On 9 May 2003, the CNB filed a petition with the Regional Court in Ostrava to dissolve Union Banka and appoint a liquidator.<sup>98</sup> On the same day, the Regional Court in Ostrava declared Union Banka to have entered liquidation and appointed Value Added S.R.O. as liquidator.<sup>99</sup> The decision came into effect on 19 May 2003. Union Banka did not appeal the decision.
165. On 17 May 2003, the FTV began making payments to Union Banka's depositors.<sup>100</sup>

---

<sup>93</sup> Statement of Claim, para 188.

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

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

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

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

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

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

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

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

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

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

---

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

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

<sup>103</sup> Statement of Claim, para 207.

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

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

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

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

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

## **Jurisdiction**

### **Introduction**

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

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

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

### **Nationality**

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

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

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

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

### **Investment**

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

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

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

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

---

<sup>108</sup> ICSID Case No. ARB/02/18.

<sup>109</sup> Statement of Defence, paras 276 and 277.

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

183. The second aspect of the Respondent's argument focuses on the substance of the investment. The Respondent refers to the preamble to the BIT which states that the Treaty's object is to "stimulate the flow of capital and technology and the economic development of the Contracting Parties". The Respondent maintains that merely acquiring legal title over any kind of asset is not sufficient to bring that asset under the protection of the BIT. The Respondent contends that there must be a commitment of money to earn a financial return. The Respondent states that the Claimant has not paid for the shares and that throughout the lifetime of its activities in the Czech Republic, the Claimant has outlayed no expenditure for the benefit of Union Banka. Indeed the Claimant has instead been reimbursed for its due diligence work and for the living expenses of its representatives operating in the Czech Republic.
184. In support of its argument the Respondent refers to a number of cases including *Salini Costruttori S.p.A and Italstrade S.p.A v Kingdom of Morocco*,<sup>110</sup> *Joy Mining Machinery Limited v Arab Republic of Egypt*,<sup>111</sup> amongst others.
185. The Claimant contends that the cases cited by the Respondent are ICSID cases that examine the meaning of the term "investment" in Article 25 of the ICSID Convention, which was purposely left undefined by the drafters. However, the Claimant argues that the definition of investment for the purposes of the BIT is defined and is exclusive.
186. Article 1(a) of the BIT defines "investments" as follows:
- (a) the term 'investments' shall comprise every kind of asset invested either directly or through an investor of a third State and more particularly, though not exclusively:
    - i. movable and immovable property and all related property rights;
    - ii. shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom;
    - iii. title to money and other assets and to any performance having an economic value;
    - iv. rights in the field of intellectual property, also including technical processes, goodwill and know-how;
    - v. concessions conferred by law or under contract, including concessions to prospect, explore, extract and win natural resources.

---

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

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

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

### **Preclusion**

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

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

### **Applicable Law**

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

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

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

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

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

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



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

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

---

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

<sup>113</sup> Reply Memorial, para 278.

<sup>114</sup> Statement of Claim, paras 227, 231 and 233.

<sup>115</sup> Statement of Rejoinder, paras 40–48

## Fair and equitable treatment

### General standard

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

---

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

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

304. This Tribunal would observe, however, that while it subscribes to the general thrust of these and similar statements, it may be that, if the terms were taken too literally, they would impose upon host States’ obligations which would be inappropriate and unrealistic. Moreover, the scope of the Treaty’s protection of foreign investment against unfair and unequitable treatment cannot exclusively be determined by foreign investors’ subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness *in light of the circumstances*.

305. No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor’s expectations was justified and reasonable, the host State’s legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. As the *S.D. Myers* tribunal has stated, the determination of a breach of “fair and equitable treatment” by the host State must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.<sup>117</sup>

## **Legitimate Expectations**

### **The Claimant**

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

---

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

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

#### **Correspondence between Invesmart and the CNB and MOF**

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

---

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

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

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

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

212. Three letters to similar effect followed during the course of the spring and summer of 2002.<sup>121</sup>

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

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

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

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

---

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

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

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

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

## Meeting of 24 September 2002

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

---

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

<sup>125</sup> *Id.*

<sup>126</sup> Transcript, Day 1, Smith, p. 25, lines 13–25, p. 26; Transcript, Day 1, ( ), p. 159, lines 3–18.

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

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

220. Following the 24 September 2002 meeting, there were a number of communications on the Invesmart proposal between senior Czech officials. These documents were disclosed to the Claimant in response to its request for production of documents. For example, by letter dated 7 October 2002, Minister Sobotka wrote to the CNB Governor adverting to Invesmart's earlier proposal and noting that the conditions of the entry of the investor to the bank had since been "mutually defined". He referred to the CF matter and noted that on 25 September 2002, a meeting was held at the office of the First Deputy Minister of Finance's office at which representatives of Invesmart gave a binding promise to provide the documents that had been missing in Invesmart's first application for acquisition of control of Union Banka.<sup>130</sup>
221. A reply to Minister Sobotka's letter, dated 11 October 2002, was sent by Oldřich Dědek of the CNB. Referring to the CNB's rejection on 4 October 2002 of Invesmart's second application to acquire the bank due to the missing documents, Mr Dědek noted that while Invesmart had stated that it would supply the requested documents and it had also confirmed that its entry into the bank was "still subject to the state aid in resolving the problem of the receivable of Česká Finanční, s.r.o. due from this bank". Mr. Dědek continued: "Given the above, we may state that, if the state aid is refused, Invesmart B.V. will most probably cease its effort to enter into Union banka, a.s." He thus requested the Ministry of Finance to communicate "its clear standpoint to the representatives of Invesmart B.V."<sup>131</sup> The Claimant construed these letters as confirming its view that the CNB would not have later approved its share acquisition without the Ministry of Finance's having first agreed to provide state aid.

#### **Meeting of 24 October 2002**

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

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

---

<sup>128</sup> Transcript, Day 1, p. 159, lines 3–14.

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

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

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

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

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

---

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

<sup>133</sup> Transcript, Day 4, Sobotka, p. 31, lines 815.

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

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

<sup>136</sup> Transcript, Day 1, Smith, p. 33, lines 6–22.



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

### **Claimant's characterisation of negotiations following CNB approval**

227. During the hearing, the Claimant developed the point that after the CNB's approval was granted, the Czech authorities changed the rules of engagement and began to impose new conditions on the granting of state aid. This culminated in the denial of state aid to Invesmart, contrary to its expectation. The Claimant argued that it was only after the CNB acted and Invesmart had bound itself to acquire the shares in Union Banka and Union Group that these conditions were brought to its attention. Invesmart argued that at this point the structure of what was acceptable to the government changed and hurdles began to be raised that were inconsistent with its expectation that the CNB's prior approval of 24 October had resolved the issue of state aid in its favour.

228. This argument relates both to the legitimate expectations claim and to the separate alleged violation of Article 3, namely, the claimed inconsistent treatment of Invesmart's investment by the Czech authorities. Insofar as the legitimate expectation argument is concerned, the Claimant referred principally to two events.

229. First, it noted that unbeknownst to Invesmart, the Deputy Prime Minister of the Czech Republic had represented to the European Union that the Republic would not grant any new state aid to the banking sector.<sup>139</sup>

230. Secondly, Invesmart adverted to the meeting between the Ministry of Finance, CKA and Invesmart representatives on 5 November 2002 at which the bank's First Plan was reviewed and Invesmart was informed of the internal discussions that had been held with the OPC. It was advised that any aid had to be "targeted, limited and pre-approved by the OPC" and had to be approved by the government. In addition, it was told that if the solution proposed in the material presented was chosen, the material required further work.<sup>140</sup> Invesmart asserted that this marked the beginning of a series of demands for more detail and shifting mechanisms of delivering state aid, the effect of which was inconsistent with what it had been led to believe

---

<sup>137</sup> *Id.*, p. 12, lines 18–21.

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

<sup>139</sup> *Id.*, p. 49, lines 3–25.

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

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

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

---

<sup>141</sup> Transcript, Day 7, Smith, p. 58, lines 9–22.

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

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

<sup>144</sup> *Id.*

<sup>145</sup> Transcript, Day 7, Smith p. 52, lines 16–22.

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

#### **Amount of state aid**

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

---

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

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

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

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

### The Respondent

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

---

<sup>149</sup> Transcript, Day 1, Crawford, p. 120, lines 12–22.

<sup>150</sup> *Id.*, p. 120, lines 12–15.

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

<sup>152</sup> Transcript, Day 1, Crawford, p. 126, lines 15–18.

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

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

---

<sup>153</sup> *Id.*, p. 125, lines 21–25.

<sup>154</sup> *Id.*, p. 125, lines 9–13.

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

<sup>156</sup> *Id.*, p. 160, lines 10–15.

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

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

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

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

---

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

<sup>160</sup> Transcript, Day 1, Crawford, p. 126, lines 24–25, p. 127, lines 1–8.

<sup>161</sup> *Id.*, p. 128, lines 10–24.

<sup>162</sup> *Id.*, p. 129, lines 5–24.

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

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

247. The Respondent also noted that the legitimate expectation claim had to be evaluated having regard to the state's "margin of appreciation" recognised by international law. This margin is particularly wide, it was argued, when it comes to state aid and there was no case where a breach of fair and equitable treatment had been found as a result of a regular exercise of inherently discretionary governmental powers such as a refusal of state aid.<sup>166</sup>
248. Finally, insofar as the Basel Committee's Guidelines had been relied upon in support of the legitimate expectations claim, the Respondent did not see such standards as being relevant to determining a breach of the fair and equitable treatment standard. The Guidelines addressed "best practices" and were by their own terms non-binding. They could not be equated with an international legal obligation, breach of which gave rise to a breach of Article 3 of the Treaty.

<sup>167</sup>

### **The Tribunal's analysis - General Approach**

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

---

<sup>164</sup> *Id.*, p. 196, lines 23–25, p. 197, lines 1–25.

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

<sup>166</sup> Transcript, Day 7, Crawford, p. 168, lines 14–21.

<sup>167</sup> *Id.*, p. 192, lines 22–25, p. 193, lines 1–16.

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

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

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

---

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



must rise to the level of legitimacy and reasonableness in light of the circumstances.<sup>169</sup>

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

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

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

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

### Detailed analysis

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

---

<sup>169</sup> Saluka Partial Award of 17 March 2006, para 304.

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

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

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

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

262. He testified further that:

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

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

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

---

<sup>171</sup> Transcript, Day 1, [redacted], p. 166, lines 10–19.

<sup>172</sup> *Id.*, p. 165, line 10.

<sup>173</sup> *Id.*, p. 165, lines 12–13.

<sup>174</sup> *Id.*, p. 165, lines 15–20.

<sup>175</sup> *Id.*, p. 167, lines 10–12.

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

265. This means, in the Tribunal’s view, that the CNB’s approval in itself cannot be taken to have amounted to an implicit commitment because Invesmart understood that it had no role in the decision whether to grant state aid. This in turn narrows the inquiry to the Claimant’s contention that the CNB would only have approved its application if it had had a concrete statement from the Minister of Finance that state aid was going to be granted. The Tribunal will revert to this below.

266. As for the role of the OPC : [redacted] acknowledged that when Invesmart was debriefed about the 24 September 2002 inter-agency meeting, he was told that the advice of the OPC was being sought “in order to get their advice on the viability as far as the EU issues were concerned”.<sup>179</sup> He agreed that the OPC was the entity of the Czech Republic that was to decide whether the reduction of the interest rate on the Fores deposit would constitute state aid.<sup>180</sup> He also acknowledged that he was told by Union Banka’s consultants, Euro-Trend, on 25 October 2002 (one day after the CNB had approved Invesmart’s acquisition of indirect control of the bank) of the commitment made in writing to the EU by Deputy Prime Minister Rychetský that the Respondent did not anticipate providing any further state aid to the Czech banking sector.<sup>181</sup>

267. [redacted]’s testimony that he was made aware of the OPC’s role as a result of the 24 September 2002 meeting, that it would determine whether lowering the Fores interest rate constituted state aid, and that Euro-Trend was informed of the Rychetský letter to the EU on 25 October 2002 – eleven days before Invesmart’s shareholders ratified their earlier approval of the €90 million capital increase – is also relevant to the Tribunal’s consideration of the legitimate expectation claim.

---

<sup>176</sup> *Id.*, p. 165, line 25, p. 166, line 1.

<sup>177</sup> *Id.*, p. 169, lines 23–25, p. 170, line 1.

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

<sup>179</sup> *Id.*, p. 174, lines 23–25, p. 175, line 1.

<sup>180</sup> *Id.*, p. 176, lines 4–8.

<sup>181</sup> *Id.*, p. 176, lines 14–25, p. 177, lines 1–8.

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

### **The law on state aid**

269. There is no legal entitlement to state aid at international law. As an exercise of its sovereignty, leaving aside any treaty obligations it may have, a State has the discretion to decide whether or not to grant aid. On the facts of this case, there was nothing in Czech law which affirmatively stated that state aid would be granted upon request and a properly advised investor would understand that to be the case.
270. In fact, rather than obliging signatory states to grant aid, the member States of the EU have to the contrary undertaken *not* to grant it within the common market. That is, they have agreed to constrain their previously unfettered right to grant aid in order to achieve the goal of free competition. As an aspiring member of the EU, the Czech Republic was one such state at the material time in this case.
271. Under Article 8(6) of the BIT, the Tribunal must have regard both to Czech law and the provisions of "other relevant Agreements between the Contracting Parties". The relevant EU instruments and the Czech law implementing them fall within these categories. Under those regimes (the national and the supranational, which were consistent with each other in 2002 as the Czech Republic moved towards full accession to the Treaty of Rome), there could be no *prima facie* legal right to the granting of state aid. To the contrary, Section 2 of the Law on state aid affirms that aid is forbidden if the OPC does not authorise an exemption from the prohibition.<sup>182</sup>

### **Due diligence**

272. One element relevant to judging a legitimate expectation claim is whether the investor could have made itself aware of the regulatory issues that faced its investment. Some tribunals have characterised this as an issue of transparency. International agreements that have contained express transparency obligations have cast them in terms of a duty imposed on the state to publish its laws and regulations so as to allow a private party to familiarise itself with them and be able to conduct its business affairs accordingly.<sup>183</sup>
273. Czech law and the relevant international agreements between the two Contracting States to the Treaty were both readily discoverable by the Claimant in 2001-2002. The regulatory practice

---

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

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

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

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

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

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

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

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

---

<sup>184</sup> First Expert Report of Claus-Dieter Ehlermann, paras 28–41.

<sup>185</sup> Transcript, Day 1, \_\_\_\_\_ p. 154, lines 21–22, p. 156, lines 1–3, p. 158, lines 20–24.

<sup>186</sup> Exhibit R-32, letter dated 28 June 2002 from \_\_\_\_\_ to Minister Rusnok.

278. \_\_\_\_\_ conceded that “looking back, we should have” obtained legal advice on the state aid issue.<sup>187</sup> His explanation was that Invesmart did not do so because it found an existing transaction on the table and it took it from there and that “my understanding, my shareholders’ understanding throughout the whole process, has been that it was in the primary interest of the Czech Government and the Czech Republic to rescue and save Union Banka”.<sup>188</sup> This does not assist the Claimant because, while the Claimant did indeed receive positive signals from the Respondent, the record shows that they were not all in that direction. There had been attempts by the bank’s existing management to resolve the problem, but those had been unsuccessful.
279. Indeed, when \_\_\_\_\_ approached the newly-appointed Minister of Finance in July 2002 after the parliamentary elections there was no “existing transaction” on the table because Minister Sobotka’s predecessor had *rejected* Invesmart’s approach in May 2002. This is what had led \_\_\_\_\_ to send his letter of 28 June 2002 to Minister Rusnok asking him to reconsider. His reference in that letter to Invesmart’s seeking an expert opinion so that the OPC would not block the project shows an understanding that state aid was not automatic even if the Minister of Finance were inclined to recommend its granting. Likewise, after the Ministry of Finance indicated that it was willing to look at the issue of state aid, as \_\_\_\_\_ 16 September 2002 letter shows, Invesmart’s 12 September 2002 meeting with the CNB was not entirely positive from the investor’s perspective. \_\_\_\_\_ recorded the CNB’s Mr Jiríček as stating that “he sees no or very little chances for the transaction to be completed”.<sup>189</sup> The CNB’s reply to \_\_\_\_\_ while not prejudging the outcome of the state aid issue, emphasised the MOF’s and OPC’s roles in approving the aid and pointed out that determining whether to grant aid was not the CNB’s responsibility.<sup>190</sup> The information conveyed to Invesmart after the 24 September 2002 intra-governmental meeting highlighted the OPC’s role. In short, even the positive statements made by government officials during the material period did not in any way purport to vary the legal regime applicable to state aid.
280. \_\_\_\_\_ position, though not entirely unreasonable, did not show the prudence that could be expected of an investor whose investment was being conditioned upon the government’s financial support.
281. The Tribunal considers that Czech counsel would have been aware of the tightening of the Czech rules on state aid and the increasing oversight of the EC. Not surprisingly, as the state aid regime became more stringent for the Czech Republic, the onus upon a party seeking such

---

<sup>187</sup> Transcript, Day 1, \_\_\_\_\_, p. 156, line 3.

<sup>188</sup> *Id.*, p. 156, lines 3–10.

<sup>189</sup> Exhibit R-64, letter dated 16 September 2002 from \_\_\_\_\_ to the CNB.

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

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

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

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

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

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

---

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

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

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

\*\*\*

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

287. Although Mr Rienmüller's letter referred to a CZK 300 million guarantee being issued by Invesmart, that was only one aspect of the transaction. In the Receivables Assignment Agreement, Invesmart and Union Banka recognised that the bank was attempting to sell the loan portfolio to CF.<sup>194</sup> Invesmart agreed to an irrevocable assumption and purchase of that portfolio if it was not transferred to CF, subject to the proviso that Union Banka would only be able to require such assumption if and after it had failed to, for any reason whatsoever, assign the receivables to CF by 1 December 2002.<sup>195</sup> In that event, Invesmart agreed to pay CZK 1.2 billion for the portfolio and the CZK 300 million guarantee to which Mr Rienmüller referred was to secure that obligation. In the event that it failed to take over the loan portfolio, the guarantee, valid until 15 December 2002, was enforceable by the bank after its having given notice to Invesmart.<sup>196</sup>
288. The Receivables Assignment Agreement appears to have had at least two effects.
289. First, as Mr Rienmüller anticipated in his 12 August 2002 letter to the CNB, it permitted the bank to secure the issuance of the auditor's report for the year ending 31 December 2001.<sup>197</sup> On 16 August 2002, Deloitte & Touche issued its audit report on the bank's 2001 financial statements. Without such an audit report, the evidence showed, the bank's situation would have been extremely tenuous.

---

<sup>193</sup> *Id.*

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

<sup>195</sup> *Id.*, Clause II.1.

<sup>196</sup> *Id.*, Clause II.5.

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



290. Secondly, the Receivables Assignment Agreement evidently led to an amendment of the SPAs because on 14 August 2002, the day after its execution, Invesmart entered into Addendum No 4 to the two SPAs. In the Tribunal's view, the importance of these contractual developments is this: Invesmart assumed the obligation to pay for the CF loan portfolio – a key element of the state aid that it was seeking – 7 days *before* submitting its proposal on the settlement of the bank's relationship with CF to the MOF. That is, Invesmart's first proposal to the MOF was made on 20 August 2002, seven days *after* it executed the Receivables Assignment Agreement.<sup>198</sup>
291. In the Tribunal's view the Receivable Assignment Agreement and Addendum No 4 tend to undermine the Claimant's contention that it made its participation in Union Banka conditional upon the grant of state aid. In mid-August 2002, it bound itself to having to deliver the substantial part of what it later proposed the state should grant. Moreover, although Addendum No 4 still reserved the power to approve the share purchase to Invesmart's shareholders, its conditions for completing the transaction did not reflect the position that Invesmart was consistently articulating to different government agencies. When asked by the Chairman as to whether Invesmart sought legal advice on the amendments to the SPAs, I answered:
- I believe it was not very much a legal issue at the time, it was very much contained in a business decision at the time.<sup>199</sup>
292. The Tribunal recognises that it is not privy to the negotiating history of the entire transaction and it is loath to impose legal perfection on an evolving situation after the fact. However, it considers that the Claimant exposed itself in a sense in the way in which it structured the conditions for the acquisition of the shares and the assumption of the related-party loans and when it assumed the CF loan portfolio.
293. If the grant of state aid was the *sine qua non* of Invesmart's acquisition of control of Union Banka, it might have been expected that it would have either: (i) completed its acquisition of control of the bank only upon receipt of a written undertaking from the Minister of Finance that the requested state aid would be provided; or (ii) to be even more certain, have completed the acquisition simultaneously with the aid being granted. Invesmart did not follow either course of action.

---

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

<sup>199</sup> Transcript, Day 2, Pryles-( ), p. 104, lines 2–4.

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

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

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

---

<sup>200</sup> Transcript, Day 1, [redacted] p. 166, lines 13–16.

<sup>201</sup> Transcript, Day 7, [redacted] 156, lines 19–25, pp. 156–157.

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

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

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

### **The issue of "old" versus "new" aid**

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

---

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

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

<sup>205</sup> *Id.*, p. 157, lines 6–12.

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

---

<sup>206</sup> Exhibit R-66, letter dated 16 September 2002 from [redacted] to Zdeněk Tůma, Pavel Racocho, Vladimír Krejča, Petr Jiríček, and Renate Vernerova, p. 2.

[redacted] to Zdeněk Tůma, Pavel Racocho, Vladimír

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

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

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

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

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

---

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

<sup>208</sup> Transcript, Day 2, p. 206, lines 21–25.

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

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

### **The Czech Republic's commitment to the European Union**

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

---

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

<sup>211</sup> Transcript, Day 7, Smith, p. 48, lines 12–25, p. 49, lines 1–7.

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

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

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

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

---

<sup>214</sup> Transcript, Day 7, Smith, p. 49, lines 8–14, p. 51, lines 7–14.

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

<sup>216</sup> *Id.*, proposal 5.

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

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

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

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

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

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

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

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

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

324. The Tribunal has already adverted to [redacted] 28 June 2002 letter which recognised that the OPC could block the transaction.
325. Thus, although there is no direct evidence of precisely what was communicated to Invesmart by the Respondent after the inter-agency meeting of 16 May 2002, it can be inferred from [redacted] contemporaneous letters that Invesmart was informed of issues relating to competition law as it affected the granting of state aid to Union Banka. There would have been

---

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

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



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

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

#### **What did the Ministry of Finance commit to do?**

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

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

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

---

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

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

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

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

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

---

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

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

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

<sup>227</sup> *Id.*

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

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

337. The timing and content of this agreement indicates that having received a debriefing of the 24 September 2002 inter-agency meeting and having appointed Mr Vávra as its new CEO, Union Banka then retained professional advisors to negotiate on its behalf.<sup>230</sup> The retention of advisors to assist in negotiations is indicative that a state aid package had not been agreed, even in Union Banka's view. Moreover, with the contract's heavy weighting of compensation towards a success fee, both parties explicitly recognised that the substantial part of Euro-Trend's fee would be paid only upon the attainment of the objective, i.e., the grant of the aid being sought.
338. This contract, executed on the same day as the shareholders of Invesmart initially voted on the capital increase, supports the finding that all parties, including Union Banka and Invesmart, considered that they were about to engage in a process of negotiation, the outcome of which was plainly hoped-for by the bank and the Claimant, but which could not be guaranteed.
339. Although it does not place great weight upon it, the Tribunal notes that an interview given by [redacted] on 24 February 2003, after the aid was refused, was consistent with its finding. The interview quoted [redacted] as stating that:

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

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

---

<sup>229</sup> *Id.*

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

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

<sup>232</sup> Transcript, Day 2, [redacted] pp. 65-66.

341. Fourthly, the Tribunal notes that Euro-Trend's First Proposal for Union Banka, dated 4 November 2002, was submitted to the Ministry of Finance 11 days after the Claimant says that its expectation crystallised. The Plan set out the proposed CF Transaction (lowering of the interest rate and the sale of the loan portfolio to CF) but also noted that there was a potential connection between this aid (which Euro-Trend argued could not be characterised as a grant of new state aid as suggested by what it called a "potential opinion" of the OPC<sup>233</sup>) and the resolution of Union Banka's arbitration claim against the CNB:

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

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

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

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

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

---

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

<sup>234</sup> *Id.*, Part I, p. 2.

<sup>235</sup> *Id.*

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

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

### **Conclusion on legitimate expectations**

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

---

<sup>236</sup> Exhibit R-14, Second Euro-Trend Proposal.

<sup>237</sup> Transcript, Day 7, Smith, p. 7, lines 20–25.

<sup>238</sup> *Id.*, p. 7, lines 11–15.

<sup>239</sup> Transcript, Day 1, Smith, p. 32, lines 21–25, p. 33, line 1.

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

## **Inconsistency and ambiguity**

### **The Claimant**

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

---

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

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

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

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

---

<sup>242</sup> Statement of Claim, para 303.

<sup>243</sup> *Id.*

<sup>244</sup> Statement of Claim, para 303.

<sup>245</sup> Exhibit R-81, Minutes of Meeting held on 5 November 2002.

<sup>246</sup> first witness statement of Governor Tůma, para 39; first witness statement of Mr. Vávra, para 63.

<sup>247</sup> *Id.*

<sup>248</sup> Claimant's Opening Statement, p. 36.



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

### The Respondent

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

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

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

---

<sup>249</sup> *Id.*, para 304.

<sup>250</sup> Statement of Reply, para 365.

<sup>251</sup> Statement of Defence, paras 393–394.

<sup>252</sup> *Id.*, paras 396–399.

<sup>253</sup> *Id.*, paras 403–404.

<sup>254</sup> *Id.*, para 405.

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

### **Tribunal's analysis**

#### **Inconsistency - OPC approval**

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

#### **The run on Union Banka**

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

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

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

---

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

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

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

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

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

---

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

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

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

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

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

#### **The CKA's proposal to settle the BDS arbitration claim**

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

---

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

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

<sup>263</sup> *Id.*, conclusion.

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

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

371. The reasons for the MOF's rejection of the Third Restructuring Plan were given by Minister Sobotka in his letter to Union Banka dated 20 February 2003.<sup>265</sup> The application for state aid having been rejected, there was no reason for the MOF to submit Union Banka's application to the OPC for an exemption from state aid prohibition, as mentioned by Minister Sobotka in the same letter. The MOF's prior approval was in fact a necessary pre-condition of the OPC's review of state aid proposals. Further, the MOF, after the many months spent in an attempt to find a solution to the state aid issue, had no obligation to meet again with Union Banka to explore alternative solutions. Union Banka's financial situation at that point in time, as confirmed by its CEO, Mr Vávra, on 19 February 2003, was so critical ("catastrophical", regarding the liquidity situation) as to suggest that no time was left for further discussions.<sup>266</sup>

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

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

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

373. The somewhat confused record of this part of the minutes prompted a clarification by the First Deputy Finance Minister (present at the meeting), who suggested that the exemption by the MOF was not meant to refer to the ban on state aid but rather "to the comments procedure".<sup>269</sup>

374. Following that meeting, based on its understanding that the Government had accepted to issue a resolution allowing an exemption on the ban on state aid, Union Banka circulated a draft of

---

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

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

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

<sup>268</sup> *Id.*

<sup>269</sup> *Id.*

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

### **The Czech Republic's renewed commitment to the EC**

375. As already mentioned, the Czech Republic cannot be reproached for its alleged failure to alert Invesmart about the need of the OPC's approval of the state aid. The Claimant contends that the Respondent should have informed Invesmart in a timely manner that obtaining such approval had become more difficult following the Deputy Prime Minister's commitment to the EC that the Czech Republic would not provide any new aid to banks. Due to the terms of the commitment so made (as reflected in the minutes of 29 November 2002 meeting),<sup>273</sup> the prospects of obtaining the EC's approval of new state aid by the Czech Republic were reduced.
376. The minutes mention that "possible further aid to UB would mean a violation of the commitment made by Deputy Prime Minister Pavel Rychetsky that the Czech Republic would not provide any new aid to banks".<sup>274</sup> In the Claimant's view, this wording underlines the fact that a serious additional obstacle existed to the granting of state aid to Union Banka, although the OPC's representatives indicated at the meeting that "they would not rule out the provision of aid to the bank on principle".<sup>275</sup>
377. According to the Claimant, the significance of the Czech Republic's failure to inform Union Banka and Invesmart in a timely manner is made manifest by the fact that by 29 November 2002 Invesmart had already completed its acquisition of Union Banka and Union Group. The Debt Assumption Agreements signed by Invesmart on 17 November 2002 had in fact become effective upon the transfer of shares in Union Banka and Union Group to Invesmart on 18 November 2002.<sup>276</sup>
378. The Claimant's complaint is misplaced in more than one respect. As already indicated at paragraph 319 above, the Deputy Prime Minister's commitment to the EC that there would be

---

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

<sup>271</sup> *Id.*, Point II, front page.

<sup>272</sup> *Id.*, Point III, front page.

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

<sup>274</sup> *Id.*,

<sup>276</sup> Exhibits R-83 and R-102 and Statement of Defence, para 132.

no more public subsidisation to the banks had been disclosed to Union Banka's advisors, Euro-Trend, at a meeting held on 25 October 2002.<sup>277</sup>

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

## **Discrimination**

### **The Claimant**

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

---

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

<sup>278</sup> *Saluka*, Partial Award, dated 17 March 2006, para 419.

<sup>279</sup> Statement of Claim, para 346.

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

385. Invesmart went on to refer the Tribunal to its own analysis of state aid provided by the Czech Republic, and its predecessor state, to banks between 1990 and 2004.<sup>280</sup> This analysis was largely derived from information provided to the EC by the Czech Republic.<sup>281</sup> The Claimant's submissions on discrimination were also supplemented by Appendix A of the Statement of Claim which summarised the main forms of state aid that the Czech Republic provided to banks between 1990 and 2004. This evidence was summarised in the following way by the Claimant in opening submissions:

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

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

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

---

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

<sup>281</sup> Transcript, Day 1, Fleuriet, p. 63, lines 13–14.

<sup>282</sup> Claimant's opening statement, pp. 43–44.

<sup>283</sup> Report of Associate Professor Raj Desai, dated 6 December 2007, p. 3.

<sup>284</sup> Report of Associate Professor Raj Desai, dated 11 July 2008, para 1.



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

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

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

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

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

### **The Respondent**

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

---

<sup>285</sup> Report of Associate Professor Raj Desai, dated 6 December 2007, p. 20.

<sup>286</sup> *Id.*, pp. 20-29.

<sup>287</sup> *Id.*, pp. 30-34.

<sup>288</sup> Report of Associate Professor Raj Desai, dated 11 July 2008, para 8.

<sup>289</sup> *Id.*, para 13.

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

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

393. The Respondent went on to argue that no Czech banks operated under conditions similar to those of Union Banka. It submitted that:
- (a) Union Banka was one of a more diverse group of small privately owned banks, some of which had been allowed to fail without the provision of state aid or following the provision of state aid;<sup>292</sup>
  - (b) Union Banka's balance sheet problems were the unique consequence of its acquisition of the four smaller banks in the 1990s;<sup>293</sup> and
  - (c) No similarly situated Czech bank was granted state aid in 2002 or 2003.<sup>294</sup>
394. The Respondent's submissions were supported by two expert opinions prepared by Professor Dr Dr h.c. Claus-Dieter Ehlermann dated 25 March 2008 and 2 October 2008, respectively.
395. In particular, Professor Elhermann's analysis introduced a temporal aspect to the discrimination case. Professor Ehlermann opined that "the situation in February 2003 was different from and not comparable to the situation in which earlier privatisations and takeover operations had taken place".
396. Professor Elhermann advanced two main arguments in support of this position.
397. First, the Czech Act on state aid, which was enacted on 1 April 2000 and entered into force on 1 January 2001, restricted the Czech Republic's legal right to grant state aid unless the OPC approved the grant.<sup>295</sup> The implementation of the new law had a significant impact on the preparedness of the Czech Government to make grants of state aid. Professor Elhermann acknowledged that the Czech Republic made grants of state aid after the implementation of the Act between January and June 2001. However, he suggested that these grants of state aid related to 'older' negotiations that pre-dated the Act.<sup>296</sup>
398. Secondly, state aid controls were imposed on the Czech Republic as part of its accession to the EU. Large sections of Professor Elhermann's first report were dedicated to describing how the

---

<sup>291</sup> *Id.*, para 418.

<sup>292</sup> *Id.*, para 419

<sup>293</sup> *Id.*,

<sup>294</sup> *Id.*, para 420.

<sup>295</sup> First Report of Professor Elhermann, para 285.

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

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

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

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

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

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

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

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

402. In closing submissions the Respondent also tendered, without objection from the Claimant, a table listing 21 examples where OPC denied requests for state aid between 2001 and 2004.<sup>301</sup> Similarly, in the Statement of Defence the Respondent listed four small and medium sized banks that had been allowed to fail without the provision of state assistance.<sup>302</sup>

---

<sup>296</sup> First Report of Professor Elhermann, para 286.

<sup>297</sup> *Id.*, paras 288–289.

<sup>298</sup> Second Report of Professor Elhermann, para 11.

<sup>299</sup> Transcript, Day 7, Professor Crawford, p. 237, lines 11–21.

<sup>300</sup> Transcript, Day 7, Professor Crawford, p. 237, lines 6–7.

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

<sup>302</sup> Statement of Defence, para 418: the banks are listed in fnns 608 and 609.

### **The Tribunal's analysis**

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

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

404. The Tribunal is not satisfied that Union Banka was similarly situated to other Czech Banks who received state aid at the time Union Banka sought it.

405. In its submissions the Claimant referred the Tribunal to numerous banks that received state aid following the State's transition from a communism, many as part of the Consolidation and Stabilisation Programs during the 1990s. The Tribunal notes that the parties agreed that throughout the 1990s the Czech banking system was in crisis and that as a result the Czech Republic, and its predecessor state, implemented three state aid programs to restructure and stabilise the banking system.<sup>303</sup> The parties also agreed that following the end of the Stabilisation Program in 1998 aid was provided to Czech banks in order to avert the failure of banks and to facilitate the sale of banks to foreign "strategic" investors.<sup>304</sup>

406. The Claimant placed significant emphasis on the state aid provided to Czech Banks during the Second Consolidation Program in 1995-1996 and the Stabilisation Program between 1996 and 1998. For example, in its opening submissions Invesmart referred the Tribunal to 12 mid-sized and small Czech banks that received state aid from 1996 to 2001. However, based on the evidence contained in the first report of Professor Desai it is apparent that the arrangements for the provision of this state aid were made between 1996 and 1998.

407. The Claimant said that Union Banka's problems were similar to those experienced by these other Banks because they were typical of systemic problems that plagued the Czech banking system throughout the 1990s. To wit, the key element of the Claimant's discrimination case was that the Czech Republic, in denying state aid, including emergency liquidity loans, had treated Union Banka differently to other banks that had similar problems.

408. In the Tribunal's opinion there are four key factors that arise from the Respondent's rebuttal of the discrimination claim which contradict this analysis.

---

<sup>303</sup> Agreed Statement of Facts, paras 2, 4 and 5.

<sup>304</sup> Agreed Statement of Facts, para 6.

409. First, the Respondent's claim that the policy of the Czech Republic towards the granting of state aid changed as a consequence of its accession to the EU significantly. The entry into force of the Czech Act on State Aid on January 2001 was a critical step in this process and it was clear that after this time there was a marked reluctance by the Czech Republic to grant state aid. This is supported by the fact that only two grants of state aid were made to banks between 2001 and 2003. It is also supported by the numerous denials of requests for state aid made by the OPC between 2001 and 2004. Further, it seems logical that the onus would be on the Czech Republic to strictly observe its commitments to the EU in the pre-accession period, particularly in respect of state aid control. No evidence was advanced by the Claimant that contradicted this claim.
410. Secondly, the Respondent was correct to draw a distinction between the granting and the paying of state aid. It is necessary for the Tribunal to compare the Government's decision to deny state aid with other instances where the state aid was granted. The point at which the decision was made and the Czech Republic assumed an obligation to pay state aid is the relevant factor in the Tribunal's inquiry in respect of discrimination.
411. The Tribunal notes that questions regarding the relevance of the distinction between granting and paying aid were put to Professor Desai in cross-examination. However, it is apparent from the following exchange that Professor Desai did not incorporate this distinction or specifically compare Union Banka's circumstances with those of banks who were granted state aid in 2002 and 2003.

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

Professor Desai: I understand.

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

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

Professor Crawford: I said after the end of 2000

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

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

412. Thirdly, the circumstances of the two banks that received state aid in 2002-2003 can be readily distinguished from the circumstances of Union Banka. In this regard, the distinction drawn by the Respondent in closing submissions seems sound. The Claimant did not seek to contradict this analysis, despite having been given the opportunity to do so.
413. Fourthly, it is highly relevant that there were other banks that were denied state aid and allowed to fail between 2000 and 2004. There can be no finding of discrimination if banks similarly situated to Union Banka are found to have been treated similarly to Union Banka. The fact that other banks were denied aid suggests this may be the case. Neither party made detailed submissions on the similarities between the small and medium banks that were denied aid, other than by reference to their size and the widespread problems affecting numerous Czech banks. The Claimant did not seek to distinguish Union Banka's circumstances from the banks that failed.
414. Finally, it is necessary for the Tribunal to refer to the analogy drawn by the Claimant between the facts in *Saluka* and the facts at hand. The Tribunal is of the opinion that the discrimination against IBP in *Saluka* was fundamentally different to that to the Czech Republic's treatment of Union Banka. This is because of the close comparison that the *Saluka* tribunal was able to draw between IBP and the three other major Czech banks. In its award, the *Saluka* tribunal noted that:

... irrespective of whether the bad debt problem with which the Big Four banks were face from 1998 to 2000 may properly be characterised as "systemic" or not, these banks were in a sufficiently comparable situation: All of them had large non-performing loan portfolios resulting in increase provisions and consequently insufficient regulatory capital. None of them was able to absorb the losses by calling on shareholder equity. The survival of all of them was sooner or later seriously threatened unless the Czech State was willing to provide financial assistance. On the other hand, due to the macroeconomic significance of the Big Four banks, the Czech State apparently could not afford to let any one of these banks fail.<sup>306</sup>

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

---

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

<sup>306</sup> *Saluka* Prtial Award, 17 March 2006, para 322.

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

## **Bad faith**

### **The Claimant**

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

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

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

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

---

<sup>307</sup> Statement of Claim, paras 335-336.

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

### **The Respondent**

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

### **The Tribunal's analysis**

419. In making its allegation of bad faith the Claimant correctly pointed out that while acts of bad faith violate the fair and equitable treatment standard, bad faith is not required to make out a violation of the standard.

420. This was noted by the tribunal in *Mondev International Ltd. v United States of America* when it stated that:

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

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

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

422. In the Tribunal's opinion these statements notably draw an appropriate distinction between other forms of unfair and inequitable conduct, such as manifest unreasonableness, inconsistency and arbitrariness, and bad faith conduct, which has malicious or egregious intent, such as deliberate conspiracy, as an essential ingredient.

423. The Tribunal was unable to identify this essential ingredient in the Respondent's conduct on the evidence presented to it.

---

<sup>308</sup> Claimant's Opening Statement, pp. 47-51.

<sup>309</sup> Statement of Defence, paras 429-431.

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

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



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

#### **Inducement to assume the RPLs**

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

#### **Failure to choose the least cost option**

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

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

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

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

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

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

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

### **Impairment clause**

#### **Applicable legal standard**

435. Article 3(1) provides that with reference to the investments of investors of the other Contracting Party

Each Contracting Party ... shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.

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

---

<sup>312</sup> Transcript, Day 1, p. 70, lines 9-21.

437. The Tribunal notes that the parties disagree on this question.
438. In its Statement of Defence the Respondent contended that the impairment standard in Article 3(1) of the BIT "is not, in fact, a separate, free-standing standard that can add anything" to Invesmart's claims under the fair and equitable treatment and expropriation standards.<sup>313</sup>
439. The Respondent based this analysis on comments made in *Saluka* that
- [in] so far as the standard of conduct is concerned a violation of the non-impairment requirement does not therefore differ substantially from a violation of the "fair and equitable treatment" standard. The non-impairment requirements merely identifies more specific effects of any such violations.<sup>314</sup>
440. By contrast the Claimant described the relationship between the standards of protection described in Article 3(1) in the following terms:
- The Czech Republic is required to treat the investments of Dutch investors fairly and equitably, and it is additionally prohibited from impairing such investments by unreasonable or discriminatory measures ... Furthermore, since the phrase "unreasonable or discriminatory measures" in Article 3(1) uses the disjunctive "or" instead of the conjunctive "and", it is clear that either "unreasonable" or "discriminatory" measures will violate the impairment clause.<sup>315</sup>
441. In the Tribunal's opinion the Claimant's characterisation of Article 3(1) as comprising two separate standards is correct. It is not for the Tribunal to speculate about the circumstances in which a factual allegation may be held to constitute a breach of the impairment clause but not fair and equitable treatment. However, the Claimant is entitled to invoke the protections afforded by both clauses.
442. The *Saluka* tribunal acknowledged that the standards of "reasonableness" and "discrimination" contained in the impairment clause have no different meaning than in fair and equitable treatment. However, it also recognised that it offered a separate standard of protection. This is borne out by the tribunal's separate analysis of *Saluka*'s claims under the impairment clause.
443. In the Tribunal's opinion the Claimant was thus correct when it stated:
- The plain wording of Article 3(1) demonstrates that it contains two distinct legal standards. Additionally, under cardinal principles of treaty interpretation, the impairment clause must be interpreted in a manner that gives it substance and meaning, rather than as mere surplusage that adds nothing to the fair and equitable treatment clause.<sup>316</sup>

---

<sup>313</sup> Statement of Defence, p. 434.

<sup>314</sup> *Saluka* Partial Award, paras 460–461.

<sup>315</sup> Reply Memorial, para 374.

<sup>316</sup> Reply Memorial, para 377.

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

"Impairment" means, according to its ordinary meaning (Article 31 of the Vienna Convention on the Law of Treaties), any negative impact or effect caused by "measures" taken by the Czech Republic.

The term "measures" covers any action or omission of the Czech Republic. As the ICJ has stated in the *Fisheries Jurisdiction Case (Spain v Canada)*...

[I]n its ordinary sense the word is wide enough to cover any act, step or proceeding, and imposes no particular limit on their material content or on the aim pursued thereby ...

The standard of "reasonableness" therefore requires, in this context as well, a showing that the State's conduct bears a reasonable relationship to some rational policy, whereas the standard of "non-discrimination" requires a rational justification of any differential treatment of a foreign investor.

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

## **Unreasonableness**

### **The Claimant**

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

447. These actions included:

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

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

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

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

---

<sup>317</sup> Statement of Claim, para 342.

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

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

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

### **The Respondent**

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

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

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

---

<sup>318</sup> Reply Memorial, paras 384–388.

<sup>319</sup> Statement of Rejoinder, paras 94–97.

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

### The Tribunal's analysis

#### The reasonableness of the CNB's approval

452. The question of what the parties understood to be the significance of the CNB's approval is considered in the Tribunal's discussion of legitimate expectations at paragraphs 264-265 above. The Tribunal has concluded that the evidence does not demonstrate that any of the parties, including Invesmart, understood that approval by the CNB constituted a commitment that the Foresbank settlement or any other form of state aid would be provided.
453. The remaining question is therefore whether it was unreasonable for the CNB to approve Invesmart's application to acquire Union Banka and for the MOF to deny its request for state aid.
454. The standard to apply in assessing this question is whether the conduct of the Czech Republic bore a reasonable relationship to some rational policy. This question is to be distinguished from any consideration of the merits of the policy adopted by the Czech Republic.
455. The Tribunal notes that Professor Shin, in his first expert report, suggested that on any view the conduct of the CNB and the MOF fell short of international regulatory best practice.
456. For example, in his first expert report Professor Shin stated:

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

- a. **Either** the CNB did not consult the Ministry of Finance before giving approval of the acquisition;
- b. **Or** the CNB consulted the Ministry of Finance, but the CNB approved the acquisition without receiving formal approval from the public funding support by the MOF.
- c. **Or** the CNB consulted the MOF and the CNB received formal approval of public funding support from the MOF before granting approval of the acquisition.

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

---

<sup>320</sup> Statement of Defence, para 411.

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

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

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

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

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

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

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

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

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

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

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

---

<sup>321</sup> First report of Shin, paras 76–77. [Emphasis added.]

<sup>322</sup> Report of Saunders, paras 11–13.

<sup>323</sup> *Id.*, para 20.



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

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

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

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

## Expropriation

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

465. Article 5 of the Treaty provides:

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

- (a) the measures are taken in the public interest and under due process of law;
- (b) the measures are not discriminatory;
- (c) the measures are accompanied by provision for the payment of just compensation. Such compensation shall represent the genuine value of the investments affected...

---

<sup>324</sup> Transcript, Day 4, pp. 186–187, lines 1–4 and 13–25.

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

### **The Claimant**

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

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

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

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

---

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

<sup>326</sup> Statement of Claim, paras 241 and 249.

<sup>327</sup> *Id.*, para 241.

<sup>328</sup> *Id.*, para 257.

<sup>329</sup> *Id.*, paras 258–265.

<sup>330</sup> *Id.*, para 259.

<sup>331</sup> *Id.*, para 267.

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

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

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

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

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

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

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

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

---

<sup>332</sup> *Id.*, para 268.

<sup>333</sup> *Id.*, para 269.

<sup>334</sup> Reply Memorial, para 288.

<sup>335</sup> *Id.*, para 292.

<sup>336</sup> Transcript, Day 7, Smith, p. 72, lines 1–25.

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

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

### **The Respondent**

477. The Respondent's submissions on the Minister's decision for denying state aid have already been recorded in the Tribunal's discussion of the legitimate expectations claim. They need not be repeated here.
478. Insofar as the licence revocation and the ensuing measures are concerned, the Respondent denied that anything approaching a direct expropriation had occurred. It observed that the revocation of the licence and the bank's subsequent liquidation left intact Invesmart's shareholding in Union Group and Union Banka and did not affect its shareholding as such. This meant that the Claimant was left to argue that the State's actions constituted an indirect expropriation insofar as they deprived it of any value that it might have had.<sup>339</sup>
479. The Respondent also took issue with the Claimant's characterisation of the measures as expropriatory. The Respondent submitted that the CNB's administrative proceeding was a lawful regulatory measure within the state's police powers, for which no compensation was

---

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

<sup>338</sup> *Id.*, paras 294–297.

<sup>339</sup> Statement of Defence, para 301.

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

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

### **The Tribunal's Analysis**

#### **The Minister's decision to deny state aid**

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

---

<sup>340</sup> *Id.*, paras 302–303.

<sup>341</sup> *Id.*, para 306.

<sup>342</sup> *Id.*, paras 310–324.

<sup>343</sup> *Id.*, paras 313–316.

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

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

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

It is also very doubtful whether a Government can be said to be under an international legal obligation always to choose the least cost alternative and not to waste taxpayers' money.<sup>346</sup>

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

---

<sup>345</sup> Statement of Claim, paras 258–262.

<sup>346</sup> *Saluka* Partial Award, para 411.

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

<sup>348</sup> *Id.*, p. 5.

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

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

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

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

---

<sup>349</sup> *Id.*, p. 35.

<sup>350</sup> *Id.*, p. 27.

<sup>351</sup> Transcript, Day 3, Sobotka, pp. 79–83.

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

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

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

495. Accordingly, that part of the expropriation claim which relies upon the denial of state aid is rejected.

#### **The revocation of Union Banka’s licence**

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

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

\*\*\*

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

497. There is no doubt that Section 26(b) is a *bona fide* non-discriminatory regulation aimed at the general welfare. All states with modern banking regulatory regimes vest a licensing power in their regulators. Inherent in such regimes is the power not only to grant but to revoke the licence.

498. International investment treaties were never intended to do away with their signatories’ right to regulate. As found in *Saluka*, where the instant Treaty was being applied, notwithstanding the breadth of its prohibition against expropriation and the absence of an express regulatory power exception, Article 5 imports into the Treaty the customary international law notion that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the

---

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



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

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

It is now well established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.<sup>354</sup>

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

It thus inevitably falls to the *adjudicator* to determine whether particular conduct by a state "crosses the line" that separates valid regulatory activity from expropriation. Faced with the question of *when, how and at what point an otherwise valid regulation becomes, in fact and effect, an unlawful expropriation*, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.<sup>355</sup> [Italics in original.]

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

... Even though Article 3 obviously leaves room for judgment and appreciation by the Tribunal, it does not set out totally subjective standards which would allow the Tribunal to substitute, with regard to the Czech Republic's conduct to be assessed

---

<sup>353</sup> *Saluka*, para 254.

<sup>354</sup> *Id.*, para 255.

<sup>355</sup> *Id.*, para 264.

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

in the present case, its judgment on the choice of solutions for the Czech Republic's  
...<sup>357</sup>

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

The Czech State, in the person of its banking regulator, the CNB, had the responsibility to take a decision on 16 June 2000. It enjoyed a margin of discretion in the exercise of that responsibility.<sup>358</sup> [Emphasis added.]

503. The Tribunal agrees.

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

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

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

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

---

<sup>357</sup> *Saluka* Partial Award, para 284.

<sup>358</sup> *Saluka*, Partial Award, para 272.

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

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

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

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

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

A. That is what I say here.

Q. So the bank was not insolvent.

A. The bank was not technically insolvent.

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

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

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

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

---

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

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

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

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

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

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

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

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

A. Correct.

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

\*\*\*

A. Sorry. Yes, the answer is yes.<sup>363</sup>

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

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

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

---

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

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

<sup>364</sup> Exhibit R-18, Third Restructuring Plan, p. 5.

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

\*\*\*

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

\*\*\*

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

516. The BDS Receivable was thus critical to propping up Union Banka. In the event, on 24 April 2003, an arbitral tribunal rejected the bank's claim.<sup>366</sup>
517. The Respondent adduced the expert evidence of Dr Milan Hulmák who opined that the BDS Receivable claim was without merit in light of the previous settlement agreement between the parties.<sup>367</sup> The Tribunal examined the settlement agreement concluded by the parties and considers that the CNB took a defensible position in rejecting the bank's claim. Reference to the agreement shows that in Clause 3.5 it is stated:

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

---

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

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

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

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

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

### **Umbrella clause**

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

---

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

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

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

## **Concluding comments**

### **Invesmart's financial capacity**

527. A factor of some significance, in the Tribunal's estimation, is the Claimant's capacity to effect the transaction which it claims to have been denied the opportunity to consummate. This was not a case where the investor was fully funded and ready to complete the transaction (even according to the "three step plan" that Invesmart contended governed the acquisition<sup>371</sup>).

### **Invesmart did not pay off the RPLs it assumed**

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

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

---

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

<sup>372</sup> Exhibits R-83–R-100, 18 agreements on debt assumption entered into on 17 November 2002.

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

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

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

A. Correct.

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

A. Absolutely.

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

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

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

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

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

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

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

---

<sup>374</sup> Transcript, Day 2, Douglas, p. 192, lines 10–12.

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

<sup>376</sup> Transcript, Day 2, Vávra, p. 192, lines 2–25.



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

### **The shifting sources of the funds**

532. As has already been seen, Invesmart was obliged to include in its application to acquire control of Union Banka information as to the provenance of the funds it would use to effect the acquisition. Invesmart did not have such funds at its disposal during the period leading up to the CNB's approval on 24 October 2002. There is some evidence that it initially intended to borrow the money.<sup>378</sup> It then informed the CNB that it would raise the funds by means of a shareholders' capital contribution.<sup>379</sup>
533. Invesmart's first formal application for the approval of its indirect acquisition of a controlling interest in Union Banka, filed on 4 April 2002, did not include the required information and the application was discontinued on 3 July 2002.<sup>380</sup> Evidently as a means of providing some assurance on the matter, by letter dated 25 June 2002, Mr Gert H Rienmüller of Invesmart wrote to Vladimir Krejča, manager of the CNB's Bank Supervision Section, referring to previous correspondence and discussing the supplementation of the Invesmart's application concerning the origin of funds. Mr Rienmüller informed the CNB that Fortis, a large Benelux international financial group, "has issued a guarantee for the payment of the price in accordance with a contract which matures in September and December 2002".<sup>381</sup>
534. This appears to be the first and last reference in the record of this proceeding to any role that Fortis might play in financing the transaction, including its having issued a guarantee. The representation evidently did not satisfy the CNB which, on 3 July 2002, discontinued the administrative approval proceeding after the expiry of the statutory three month deadline for its decision on the application.<sup>382</sup>
535. Invesmart re-applied for CNB approval on 4 July 2002. Throughout the time that its second application was under consideration, the CNB requested further information on the source of the funds to be used to purchase the shareholding interest.<sup>383</sup> The second application was also

---

<sup>377</sup> Reply Memorial, para 35: "Invesmart did not make the capital contribution of €90 million for the RPLs – the third step in the agreed restructuring plan – because the Czech Republic did not honor its commitment to provide state aid – the second step in the restructuring plan."

<sup>378</sup> Exhibit R-66, letter dated 16 September 2002 from Invesmart to the CNB.

<sup>379</sup> *Id.*

<sup>380</sup> Exhibit C-43, letter dated 3 July 2002 from the CNB to Invesmart.

<sup>381</sup> Exhibit R-62, letter dated 25 June 2002 from Gert H. Rienmüller to Vladimir Krejča.

<sup>382</sup> Exhibit C-43, letter dated 3 July 2002 from the CNB to Invesmart.

<sup>383</sup> Exhibit C-52, minutes of a meeting held on 12 September 2002 between the CNB and Invesmart representatives; Exhibit R-66, letter dated 16 September 2002 from Invesmart to the CNB; Exhibit C-52, letter dated 19 September

rejected for lack of information on the source of the funds.<sup>384</sup> The Tribunal will revert to this below.

### **Invesmart did not comply with the Receivables Assignment Agreement**

536. It will be recalled from the Tribunal's discussion of the legitimate expectations claim that in mid-August 2002, Union Banka's auditors were balking at issuing their report for the bank's financial statements for the year ending 31 December 2001. To resolve the auditors' need for adequate provisioning of loans in light of concerns expressed by the CNB, Invesmart concluded the Receivables Assignment Agreement pursuant to which it assumed the troubled loan portfolio that Union Banka (and Invesmart) hoped to transfer to CF as part of the Fores transaction.<sup>385</sup> This relieved Union Banka from having to record a provision of CZK 300 million against the loans which it hoped to transfer to CF.
537. Under Clause 11.5 of the Agreement, Invesmart agreed, as of the Agreement's execution, to deliver to Union Banka an irrevocable first demand Bank Guarantee issued by a reputable bank for the amount of CZK 300 million valid through 15 December 2002. This was to secure payment of a penalty in the event that Invesmart did not take over the CF loan portfolio after being so requested by the bank.
538. Invesmart did not issue the bank guarantee on 13 August 2002 or at any time thereafter. Mr Catalfamo conceded that although the Agreement required Invesmart to issue the guarantee, it did not so do:

A. Yes, this is very much connected to the Česká Finanční transactions, and actually the value of 1.2 billion was exactly the same value that had been negotiated at the time with CF. And we decided to take this major step because we wanted to show the commitment of Invesmart to the auditors that we really believed that the Česká Finanční will be concluded and the bank will continue as a going concern.

Q. Paragraph 5, you were supposed to deliver as of this day an irrevocable first demand bank guarantee issued by reputable bank for the amount of 300 million Czech crowns, valid through 15th December. That is right, isn't it?

A. Yes.

Q. You didn't do that, did you?

A. No, we didn't.<sup>386</sup>

---

2002 from the CNB to Invesmart; Exhibit R-72, letter dated 7 October 2002 from Minister Sobotka to the CNB; Exhibit R-74, letter dated 11 October 2002 from the CNB to Minister Sobotka.

<sup>384</sup> Exhibit R-71, CNB decision, dated 4 October 2002.

<sup>385</sup> Exhibit R-52, letter dated 12 August 2002 from Invesmart to the CNB; Exhibit R-49, Receivables Assignment Agreement entered into between Union Banka and Invesmart, dated 13 August 2002.

<sup>386</sup> Transcript, Day 2, , p. 40, lines 8-22.

539. Thus, although the Receivables Assignment Agreement cleaned up the bank's finances enough to secure the issuance of the auditor's report, a key obligation undertaken by Invesmart in mid-August 2002 was not performed.<sup>387</sup>

540. Moreover, when the 1 December 2002 deadline for the contemplated assignment of the loan portfolio to CF passed and Invesmart became liable under the Receivables Assignment Agreement to pay the CZK 1.2 billion it had agreed to pay, it did not do so.

541. was also cross examined on this point:

Q. Why didn't you pay in December?

A. As I said, because we believed that a conclusion of what was the Česká Finanční transaction then – the government changing into another restructuring plan, was very, very close, and there was no need.

Q. This was a private law obligation to Union banka, which was in serious trouble in December. Why didn't you pay?

A. Because we felt it wasn't needed, because without the State support there would be --

Q. No UB?

A. There would be no UB, as we said.<sup>388</sup>

#### **A number of wealthy shareholders withdrew from Invesmart**

542. From the outset, Invesmart was held out as an investment company whose shareholders comprised a number of wealthy and prominent Italian individuals and families. Invesmart repeatedly adverted to the shareholders' substantial financial capacity in its dealings with the Czech authorities.<sup>389</sup>

543. One of the representatives of those families, a Mr Ajello (an Invesmart shareholder through C.G.I., S.r.l and also a representative of the interests of the Barilla and Ricci families<sup>390</sup>) joined and Mr Rienmüller in meeting with CNB representatives on 12 September 2002. At this meeting, CNB officials continued to press for further details on the documentation for proof of the source of the funds that was to be submitted with the second application. They noted that the end of the three month approval period was nearing and if the

---

<sup>387</sup> Exhibit C-31, audit report for Union banka issued by Deloitte & Touche on 16 August 2002 which noted, at p.2, that Union Banka might not be able to continue as a going concern absent Invesmart's capital entry into the bank.

<sup>388</sup> Transcript, Day 2, Catalfamo, p. 41, lines 19–25, p. 42, lines 1–4.

<sup>389</sup> Exhibit R-66, letter dated 16 September 2002 from to the CNB; Exhibit R-18, Third Restructuring Plan submitted by Union Banka to the Ministry of Finance on 12 February 2003, p. 4. Mr. Vávra agreed that when was negotiating the CNB's approval he represented that there were serious companies supporting Invesmart as shareholders: Transcript, Day 2, Vávra, p. 210, lines 24–25, p. 211, lines 1–3.

documents were not provided, the administrative proceeding would likely be terminated with a negative decision. The minutes record the CNB observing that:

... proving financial capacity of Invesmart B.V. to realize the transaction and to remove problems of Union banka (particularly paying loans granted to shareholders and persons related to Union Group) is a key feature for CNB to assess the application.<sup>391</sup>

544. The minutes further record Invesmart's position that it did not expect that "the investors would deposit funds with a foreign bank and prove thereby the origin of funds and their actual amount until the final decision is made with respect to the transaction realization". Invesmart's priority was to decide whether to continue with the transaction, but it would "assess another possible method to prove the financial capacity".<sup>392</sup>

545. testified that:

[t]he reason why Mr. Ajello was there and participated in the meeting was for them to understand better what was the status of the Union banka transactions ... [and] we met some of the representatives of the supervisory departments. The reception was not very good, and Mr. Ajello was a little bit surprised that -- not to find the same kind of attitude that I had represented, which was that we were working entirely with the governments.<sup>393</sup>

546. The meeting's significance lies in the fact that the shareholders represented by Mr Ajello decided not to participate further in Invesmart. Indeed, at the very meeting at which Invesmart's shareholders approved the capital increase, some of its shareholders (such as the Barilla family) either abstained from voting on the increase or were unrepresented at the meeting and moreover had decided to sell their shares to \_\_\_\_\_ and thus withdraw from the company.<sup>394</sup>

547. The 12 September 2002 meeting led to an exchange of letters between \_\_\_\_\_ and the CNB. By letter dated 16 September 2002, \_\_\_\_\_ informed the CNB that Invesmart had

---

<sup>390</sup> Transcript, Day 2, \_\_\_\_\_, p. 16, lines 22–24.

<sup>391</sup> Exhibit R-61, minutes of a meeting held on 12 September 2002 between the CNB and Invesmart.

<sup>392</sup> *Id.*, pp. 1–2.

<sup>393</sup> Transcript, Day 2, \_\_\_\_\_, p. 17, lines 4–14.

<sup>394</sup> Exhibit R-469, minutes of a meeting held on 4 November 2002 of shareholders of Invesmart B.V.. At this meeting, in addition to ratifying the capital contribution approved at the 16 October 2002 shareholders meeting (which decision had been taken at a meeting that had not been convened in accordance with the company's bylaws and therefore had to be ratified at a duly convened meeting), the shareholders approved the sale of shares from Sabina International S.A. to \_\_\_\_\_ and authorised the sale of shares from Fin.Ba, S.p.A., C.G.I., S.r.l, Selfid S.p.A. and Cititrust S.p.A. to \_\_\_\_\_

decided to complete the acquisition of up to 95 percent of Union Group subject to the resolution of certain matters such as the conclusion of a satisfactory transaction with CF.<sup>395</sup>

548. He noted further that the complexity and “inreliability” (sic) of the project made it impossible for Invesmart to obtain third party financing and that therefore the Union Group acquisition “will be therefore entirely covered by Invesmart with its own asset.” Board and shareholders’ meetings had been called (he attached the notices convening the two meetings on Invesmart letterhead) for 24 September 2002 and 16 October 2002, respectively, “to increase the capital of the company of additional €90 million”.<sup>396</sup>
549. The letter went on to describe some of Invesmart’s shareholders, which described as having “a strong and solid financial weight and reputation”. They included the previously mentioned Barilla and Ricci families and others.<sup>397</sup>
550. Invesmart’s 16 September 2002 letter evidently did not provide sufficient comfort to the CNB as to the source of the funds and consequently on 4 October 2002, for the second time, the CNB denied Invesmart’s application to acquire control of Union Banka.<sup>398</sup> This set the stage for Invesmart’s third application, filed on 22 October 2002 and leading up to that, the holding of the shareholders meeting on 16 October 2002 at which the €90 million capital increase was approved.
551. At the 16 October 2002 shareholders’ meeting administered by Meespierson in Rotterdam, the only shareholders voting in favour of the resolution to increase the share capital of the company by €90 million by way of share premium were \_\_\_\_\_ and de Sury (the holder of a very small interest). Apparently unbeknownst to the CNB (which had been advised in a previous communication that he owned 21 percent of Invesmart’s shares<sup>399</sup>) \_\_\_\_\_ now owned 56 percent of Invesmart’s shares after some shareholders, such as the Barilla family, had decided to exit the company. At Invesmart’s 4 November 2002 extraordinary general meeting convened to ratify the 16 October 2002 resolution and to take certain other decisions, resolutions were passed to either approve the sale or permit the sale of their shares to \_\_\_\_\_.<sup>400</sup>

---

<sup>395</sup> Exhibit R-66, letter dated 16 September 2002 from \_\_\_\_\_ to Zdeněk Tůma, Pavel Racoča, Vladimír Krejča, Petr Jířicek, and Renate Vernerova, p. 2.

<sup>396</sup> *Id.*

<sup>397</sup> *Id.*

<sup>398</sup> Exhibit R-71, CNB Decision, dated 4 October 2002.

<sup>399</sup> Exhibit R-469, minutes of a meeting held on 4 November 2002 of shareholders of Invesmart B.V., proposals 3 and 4.

<sup>400</sup> Exhibit R-469, minutes of the meeting held on 4 November 2002 of shareholders of Invesmart B.V.

**capacity to raise the majority of the €90 million capital increase was doubtful**

552. The exit of wealthy investors who decided not to participate in Invesmart suggests that experienced investors did not see the upside potential of the Union Banka deal being pursued by . The timing of their decision also warrants note: global financial markets declined after the events of 11 September 2001 and Invesmart's other investment funds were destined to be wound up. In fact, the decision to do so was also taken at the 4 November 2002 shareholders' meeting.<sup>401</sup>
553. There is no documentary evidence to show how the remaining investors, in particular , could have paid for their shares of the €90 million capital increase. testified that he had his own means to make a contribution, but that he was also counting on his family to come up with the necessary funds.<sup>402</sup> Other than testimony there is no record evidence that shows that his family was prepared to contribute the significant funds owed to Union Banka pursuant to the debt assumption and share purchase agreements.
554. While there is no doubt as to enthusiasm for the acquisition and profitable onward sale of Union Banka, having regard to all of the circumstances (particularly Invesmart's failure to issue the CZK 300 million bank guarantee on 13 August 2002 which had led the bank's auditors to issue the audited financial statements for the year ending 31 December 2001), the Tribunal does not consider his hope of familial financial support to be sufficient proof of his ability to finance his majority share of the €90 million needed to complete the deal. There is no indication that at any time after 4 November 2002 any shareholder made its respective contributions so as to enable the company to pay off the RPLs.
555. It also warrants noting that no claim for costs thrown away in the pursuit of the Union Banka acquisition was advanced in this proceeding. Indeed, such evidence as has been adduced shows that Invesmart used its control of the bank to authorise payment to it of the costs of its due diligence in acquiring control of the bank and that at least CZK 35 million of the CZK 65 million authorised by Union Banka's shareholders after Invesmart acquired control was paid out to it.<sup>403</sup> No evidence was adduced of the costs incurred in pursuing the investment,

---

<sup>401</sup> *Id.*, proposals 7 and 8. The shareholders resolved *inter alia* to liquidate the Pleiades I-fund, Zodiac Hedge Fund Ltd. and Investar S.A.

<sup>402</sup> Transcript, Day 2, , p. 90, lines 10–25, p. 91, lines 1–13.

<sup>403</sup> Exhibit R-125, letter dated 2 June 2003 submitted by Union banka "in liquidation" to Silvie Goldscheirová and Jiří Majer of the CNB. At a meeting between : and the CNB held on 22 January 2003 the latter advised that the CZK 65 million payment could be a "possible contradiction" of the Banking Act (Exhibit R-137, minutes of a meeting held on 22 January 2003 between and Messrs Racoča, Štěpánek, and Krejča). A legal opinion rendered on 30 April 2003 stated that the payment was unlawful and the liquidator sought its repayment from Invesmart. No repayment was made.

although in closing submissions, counsel for the Claimant noted that Invesmart had spent close to two years trying to effect the transaction.<sup>404</sup>

556. The Tribunal views from Invesmart's: (i) lax due diligence; (ii) uncertain financial means; (iii) reliance upon the means of wealthy Italian shareholders who were about to sell their shares to<sup>405</sup>; (iv) failure to ensure that the various legal agreements it signed accorded with the conditions that it says governed its acquisition of control of the bank; and (v) failure to either issue the bank guarantee on 13 August 2002 or to pay the consideration for the Receivables Assignment Agreement when it came due in December 2002, collectively to be indicative of the Claimant's approach to the investment opportunity. This was, in the Tribunal's view, to take a "flyer" at gaining ownership of the bank with the assistance of state aid and then sell it at a quick profit.

557. It likewise appears to the Tribunal that recognising that Union Banka was in serious peril, the CNB erred in agreeing to treat with Invesmart. The CNB knew that Invesmart was a new company with no experience in running a bank. In response to the Chairman's question as to why the CNB approved the acquisition in such circumstances, Governor Tůma testified that:

... in the end we believed they would be able to deliver that money. They committed themselves. It means -- generally speaking, it's not an easy decision to close the bank. So that you look for chances how to avoid that. You look for potential mergers and so on.<sup>406</sup>

558. The evidence is that no Western bank would touch Union Banka in its current condition and the testimony was that Invesmart was the bank's only chance. Governor Tůma testified that "in the end we decided to try it. So it was a chance and we didn't want to kill it". He stated further that this was a mistake.<sup>407</sup> The Tribunal agrees.

559. The CNB's willingness to treat with Invesmart goes however to the issue of an award of costs. It is the Tribunal's view that although the claims have been rejected, the CNB bears some responsibility for the bringing of this international proceeding.

---

<sup>404</sup> Transcript, Day 7, Smith, p. 122, lines 24–25, p. 123, lines 1–8.

<sup>405</sup> Even after the Barilla family sold their interests to (effective December 2002) their involvement in Invesmart was being represented to the Czech Ministry of Finance. The Third Restructuring Plan, submitted on 12 February 2003, continued to emphasise the wealth of various families that were no longer involved in Invesmart. acknowledged this to be a mistake (Transcript, Day 2, , p. 24, line 23). Other investors were still involved but were withdrawing.

<sup>406</sup> Transcript, Day 4, Tůma, p. 186, lines 14–18.

<sup>407</sup> *Id.*, p. 186, line 21.

## **Tribunal's determination on costs**

### **Costs of arbitration**

560. Article 38 of the UNCITRAL Arbitration Rules requires the Arbitral Tribunal to fix the costs of the arbitration in the award. The Claimant's costs (which include its share of the Tribunal's fees and disbursements) amount to €5,899,846. The Respondent's costs (including its share of the Tribunal's fees and disbursements) total €4,116,712.
561. Accordingly the costs of the arbitration amount to €10,016,558.

### **Allocation of costs**

562. Article 40(1) of the UNCITRAL Arbitration Rules provides, subject to paragraph 2, that the costs of arbitration shall in principle be borne by the unsuccessful party. However the Arbitral Tribunal may apportion such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.
563. With respect to the costs of legal representation and assistance, Article 40(2) provides that the Arbitral Tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable.
564. Thus the general rule under the UNCITRAL Rules that the unsuccessful party shall bear the costs of arbitration does not apply with respect to that portion of the costs of arbitration which comprise the costs of legal representation and assistance. In both instances, however, the Tribunal possesses a discretion. With respect to the costs of arbitration (excluding costs of legal representation and assistance) the unsuccessful party bears the costs but subject to the Tribunal's discretion to apportion such costs taking into account the circumstances of the case. With respect to the costs of legal representation and assistance the Tribunal decides which party shall bear such costs or whether the costs should be apportioned.

### **Parties' submissions**

565. The Respondent submits that the general rule as to the costs of arbitration (excluding costs of legal representation and assistance) referred to in Article 40(1) should apply. Hence it says that the prevailing party should be reimbursed for all non-legal costs. The Respondent further states that this rule has been widely followed by arbitral tribunals in recent investment arbitrations conducted under the UNCITRAL Arbitration Rules and is consistent with Czech practice.



566. As to the costs of legal representation and assistance, the Respondent says that the success of a party in the dispute is a determining factor as recent decisions in investment treaty arbitrations have confirmed.
567. The Claimant also submits that the successful party should be awarded costs including costs of legal representation and assistance.

### **Determination**

568. The Tribunal has already referred to Article 40(1) and (2) of the UNCITRAL Arbitration Rules. The general rule as to the costs of arbitration (excluding costs of legal representation and assistance) is that they shall be borne by the unsuccessful party. While no general rule is stated with respect to the costs of legal representation and assistance the Tribunal agrees with the parties' submissions that such costs are also often awarded to the successful party and are therefore borne by the unsuccessful party.
569. However it is abundantly clear that under Article 40 the Tribunal possesses a discretion as to the awarding of costs and their allocation. The concluding words of Article 40(1) require the Tribunal to take into account "the circumstances of the case". Thus decisions of other tribunals in previous cases concerning the awarding of costs are not determinative and do not establish a precedent. They are merely illustrative of the application of Article 40 to the case at hand. In this case the successful party is the Respondent. However upon careful reflection, the Tribunal has concluded that there are special circumstances which make it inappropriate to award the Respondent costs.
570. In the first place the Respondent applied for an order for security for costs which was unsuccessful. This is a relevant factor although the Tribunal acknowledges that the costs incurred in connection with the application comprise only a small percentage of the total costs of arbitration.
571. A much more significant factor concerns the facts established by the Tribunal.
572. The Claimant is a company with extremely limited financial resources and little or no experience or expertise in banking. It was a most unlikely and perhaps inappropriate entity to acquire and manage what had been, at one time, a significant bank within the Czech Republic. And yet it received permission from the CNB to acquire the shares in Union Banka. It is true that the Claimant intended to on-sell Union Banka, after restructuring it, but even an acquisition for a limited time or purpose appears inappropriate, having regard to the financial resources and expertise of the Claimant.
573. At the hearing Mr Tůma, who was the Chairman of the CNB at the time the share acquisition was approved, was called to give evidence. Claimant's counsel asked Mr Tůma what he meant

when he said in his witness statement that Invesmart was not a substantial company. Mr Tůma answered:

I think that I already mentioned that today. It means Invesmart was not any Deutsche Bank of Société Générale or other well-known bank, so it was, let's say, no name in the banking sector, having no expertise in running the bank, and no experience in that respect. That is why, as I explained already, the procedure and the procedure for providing licence is -- would differ probably from looking at Deutsche or some other bank. So it is not -- that is one point.

Secondly, it wasn't a wealthy investor. So that I can imagine there are financial investors, so this was some kind of a financial investor, but it wasn't -- we didn't see at that time, at the beginning, enough money behind it. So that is why it was very -- it was one of the crucial issues during that licence procedure.<sup>408</sup>

574. The Chairman of the Tribunal then asked Mr Tůma why he had approved the acquisition to which he responded:

Because in the end we believed they would be able to deliver that money. They committed themselves. It means -- generally speaking, it's not an easy decision to close the bank. So that you look for chances how to avoid that. You look for potential mergers and so on. So there was an investor, and I believed at that time, I trust, that [redacted] was a fair and honest person. Unfortunately it was my biggest mistake, probably and -- but in the end we believed that that commitment by the shareholders meeting was fair and that Invesmart would be able to deliver the money. So -- but we are speaking about that wasn't a substantial company, so explaining that at the time this was -- I am just saying this was a crucial issue, but in the end we decided to try it. So it was a chance and we didn't want to kill it.<sup>409</sup>

575. Having acquired Union Banka, the Claimant pressed its application for state assistance and argued in this arbitration that the CNB's approval of the share acquisition led it to believe that state aid would be granted.

576. Although this Tribunal has held that there was no breach of the BIT, the actions of the Czech authorities, and in particular the CNB in approving the share acquisition, were perhaps unfortunate or unwise.

577. In these circumstances the Tribunal, although unable to find that there was a breach of the BIT, considers that the Respondent should not recover any of the costs of arbitration which it has incurred and that the costs of arbitration should be allocated between the parties in accordance with the amounts they have paid or the costs incurred.

578. Accordingly the Tribunal makes no order concerning the costs of arbitration.

---

<sup>408</sup> Transcript, Day 4, Tůma, p. 185, lines 23-25 and p. 186, lines 1-12.

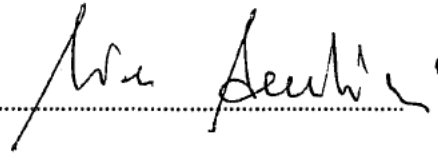
<sup>409</sup> Transcript, Day 4, Tůma, p. 186, lines 14-24.

**AWARD AND ORDER**

- 1. The Tribunal finds that the Respondent did not breach its obligations to the Claimant under the BIT.
  
- 2. The Claims of the Claimant are dismissed.
  
- 3. Each party is to bear its own costs.

This award is made this        26        day of        June        2009

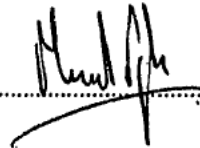
Signed by co-arbitrator  
PIERO BERNARDINI

)  
)   
.....

Signed by co-arbitrator  
CHRISTOPHER THOMAS QC

)  
)   
.....

Signed by chairman  
MICHAEL PRYLES

)  
)   
.....

**CLA-025**

Date of dispatch to the parties: October 2, 2006

**INTERNATIONAL CENTRE FOR  
SETTLEMENT OF INVESTMENT DISPUTES**

**ICSID Case No. ARB/03/16**

---

ADC Affiliate Limited

- and -

ADC & ADMC Management Limited

Claimants

- v. -

The Republic of Hungary

Respondent

---

**Award of the Tribunal**

---

TRIBUNAL

The Hon. Charles Brower

Professor Albert Jan van den Berg

Neil Kaplan CBE QC (President)

Secretary of the Tribunal  
Ucheora Onwuamaegbu

## Table of Content

<b>I. THE PARTIES</b> .....	<b>3</b>
A. The Claimants .....	3
B. The Respondent.....	3
<b>II. PROCEDURAL HISTORY</b> .....	<b>4</b>
A. Arbitration Agreement and Constitution of Arbitration Tribunal.....	4
B. Proceedings.....	5
C. The Hearing.....	10
<b>III. FACTS</b> .....	<b>14</b>
A. THE PARTIES.....	14
B. THE AIRPORT.....	15
C. THE TENDER PROCESS.....	16
1. First Phase .....	16
2. Second Phase .....	16
3. Third Phase.....	17
D. NEGOTIATION OF THE AGREEMENTS .....	17
2. The Project Agreements .....	19
3. Credit Agreement.....	21
E. THE CLAIMANTS' INVESTMENTS .....	22
1. ADC Affiliate's Investment.....	22
2. ADC & ADMC Management's Investment.....	26
F. Construction of Terminal 2/B.....	27
G. Business Planning Process for the Project Company .....	27
H. Project Company's Financial Results .....	29
I. Project Company's Operations from 1999 through 2001 .....	30
J. Transformation of the ATAA, Legislative Amendments and the Decree.....	31
K. Developments after the Decree .....	35
1. Separation of the Functions of the ATAA .....	35
2. Passenger Traffic .....	36
3. Parking Facility .....	36
4. Terminal Expansion and Reconstruction .....	36
L. The Privatization of Budapest Airport .....	36
M. Arbitration Proceedings Brought by the Project Company .....	38
<b>IV. CONTENTIONS OF THE PARTIES</b> .....	<b>38</b>
A. Contentions of the Claimants.....	38
B. Contentions of the Respondent.....	40
<b>V. RELIEF SOUGHT BY THE PARTIES</b> .....	<b>41</b>
A. Relief Sought by the Claimants .....	41
B. Relief Sought by the Respondent.....	42
<b>VI. FINDINGS OF FACT</b> .....	<b>43</b>
A. Credibility of Witnesses.....	43
B. The Nature of the Claimants' Investment .....	44
C. Complaints about the construction of the Terminal.....	44
D. Attempted Reasons for and Justification of the Decree .....	45

<b>VII. ISSUES TO BE CONSIDERED IN THIS ARBITRATION .....</b>	<b>48</b>
<b>A. Applicable Law.....</b>	<b>49</b>
<b>B. Jurisdiction .....</b>	<b>51</b>
1. Is the Nature of the Dispute Governed by the BIT or Contractual in Nature?.....	55
2. Did the Claimants Make Any Investment in Hungary within the Definition of the BIT and the ICSID Convention? .....	58
3. Does the Dispute Arise “Directly” out of An Investment as Required by the ICSID Convention? .....	61
4. Does the dispute involve “investors” under the BIT who are nationals of a Contracting State to the ICSID Convention?.....	63
5. Does the dispute fall within the scope of Art. 7 of the BIT?.....	69
6. Conclusion on Jurisdiction.....	69
<b>C. Expropriation .....</b>	<b>69</b>
<b>D. Miscellaneous Points Raised by the Respondent.....</b>	<b>81</b>
1. Is the Operating Period Lease Invalid “Due to the Inappropriate Legal Form of the Project Company”? .....	81
2. Are the Project Agreements Invalid “Due to the Missing Approval” of a Quotaholders’ Meeting of the Project Company?.....	84
3. Is There “a Grossly Unfair Difference in Value” Regarding the Service Rendered and Consideration for That Service? .....	85
4. Did the Conclusion of the Terminal Management Agreement Violate the Public Procurement Act and Therefore Became “Unlawful”? .....	87
<b>E. Conclusion on Matters Other Than Quantum.....</b>	<b>88</b>
<b>F. Quantum .....</b>	<b>88</b>
1. The Applicable Standard for Damages Assessment .....	89
2. Discounted Cash Flow (DCF) Method v. Balancing Payment Method .....	95
3. The Respondent’s Other Attacks on the LECG Reports .....	96
4. Conclusion on Quantification .....	97
5. The Amount of Compensation Payable to the Claimants .....	98
<b>G. Return of the Shares and Promissory Notes.....</b>	<b>99</b>
<b>H. Costs .....</b>	<b>99</b>
1. Principle.....	100
2. Quantum .....	101
<b>THE AWARD.....</b>	<b>103</b>

## Award of the Tribunal

### I. THE PARTIES

#### A. The Claimants

1. The Claimants (“*Claimants*”) are ADC Affiliate Ltd. (“*ADC Affiliate*”) and ADC & ADMC Management Ltd. (“*ADC & ADMC Management*”). Both are companies incorporated under the laws of the Republic of Cyprus.

2. In this arbitration, the Claimants are represented by:

Mr. Pierre Bienvenu  
Mr. Martin Valasek  
Mr. Jacques Demers  
Ogilvy Renault SENC in Montréal;

Mr. René Cadieux  
Mr. Daniel Picotte  
Fasken Martineau DuMoulin LLP in Montréal;

Prof. Dr. Iván Szász  
Squire Sanders & Dempsey LLP in Budapest; and

Prof. Dr. James R. Crawford SC  
University of Cambridge and Matrix Chambers.

#### B. The Respondent

4. The Respondent (“*Respondent*”) is the Republic of Hungary and is a sovereign State.

5. In this arbitration, the Respondent was originally represented by:

Mr. John Beechey  
Mr. Audley Sheppard  
Clifford Chance LLP, London; and

Mr. Peter Köves  
Köves & Társai Ügyvédi Iroda, Clifford Chance LLP, Budapest.

6. By letter dated 12 August, 2005, Clifford Chance LLP informed the Tribunal and ICSID that they no longer served as legal counsel for the Respondent in this arbitration.



7. By letter dated 29 September, 2005, the Respondent advised ICSID that it had appointed Prof. Dr. László Bodnár of the Bodnár Ügyvédi Iroda Law Firm (“*Bodnár Law Firm*”) as its replacement legal counsel in this arbitration.

8. Subsequently, the Respondent informed ICSID that Mr. Jan Burmeister and Dr. Szabo Levente Antal of BNT Budapest and Dr. Inka Handefeld of New York and Hamburg were retained as Co-Counsel for the Respondent.

9. Hence throughout the hearing on the merits the Respondent has been represented by Bodnár Law Firm and the Co-Counsel referred to above.

10. The Claimants and the Respondent are referred to hereinafter together as the “*Parties*”.

## **II. PROCEDURAL HISTORY**

### **A. Arbitration Agreement and Constitution of Arbitration Tribunal**

11. This arbitration arises from an alleged unlawful expropriation by the Respondent of the investment of the Claimants in and related to the Budapest-Ferihegy International Airport (“*Airport*”) which expropriation, as alleged by the Claimant, constituted a breach of the *Agreement between the Government of the Hungarian People’s Republic and the Government of the Republic of Cyprus on Mutual Promotion and Protection of Investment (“BIT”)*, which entered into force on May 24, 1989.

12. Article 7 of the BIT provides:

*“1. Any dispute between either Contracting Party and the investor of the other Contracting Party concerning expropriation of an investment shall, as far as possible, be settled by the disputing parties in an amicable way.*

*2. If such disputes cannot be settled within six months from the date either party requested amicable settlement, it shall, upon request of the investor, be submitted to one of the following:*

*(a) the Arbitration Institution of the Arbitral Tribunal of the Chamber of Commerce in Stockholm;*

*(b) the Arbitral Tribunal of the International Chamber of Commerce in Paris;*

*(c) the International Centre for the Settlement of Investment Disputes in case both Contracting Parties have become members of the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States.”*

13. The Claimants have invoked the ICSID arbitration provisions in the BIT.

14. On May 7, 2003, the Claimants submitted their *Request for Arbitration* against the Respondent in which they invoked the ICSID arbitration provisions in the BIT.
15. On July 17, 2003, the Acting Secretary-General of ICSID registered the *Request for Arbitration* pursuant to Article 36(3) of the ICSID Convention and ICSID Institution Rule(6)(1)(a).
16. Shortly thereafter, the Parties agreed that there should be three arbitrators in this case and also agreed on the method of their appointment.
17. Further to that agreement, the Claimants appointed the Honorable Charles N. Brower, a national of the United States of America, as arbitrator and the Respondent appointed Professor Albert Jan van den Berg, a national of The Netherlands. The two party-appointed arbitrators appointed Mr. Allan Philip, a national of Denmark, to serve as President of the Tribunal.
18. By letter of January 26, 2004, the Acting Secretary-General of ICSID notified the Parties and the above-appointed arbitrators that the Tribunal had been constituted and the proceeding deemed to have begun on that day in accordance with ICSID Arbitration Rule 6(1).
19. On September 3, 2004, due to ill health, Mr. Allan Philip resigned from the Tribunal.
20. Immediately after Mr. Philip's resignation, the two party-appointed arbitrators appointed Mr. Neil T. Kaplan CBE, QC, a national of the United Kingdom, as President of the Tribunal to fill the vacancy created.
21. On September 28, 2004, with Mr. Kaplan's acceptance of the appointment, the Tribunal was reconstituted and the proceedings continued in accordance with ICSID Arbitration Rule 12.

## **B. Proceedings**

22. On March 8, 2004, the Tribunal, as originally constituted, held its first session in The Hague. Present at the session were the full Tribunal, the ICSID Secretary of the Tribunal, Mr. Ucheora Onwuamaegbu ("*Secretary*"), and the legal counsel of the Claimants and the Respondent and/or their representatives.
23. At this first session, the Tribunal considered a series of procedural matters together with several other non-procedural matters as listed in the provisional Agenda circulated by the Secretary prior to the session and adopted at the start of the session.
24. Specifically, the matters considered at the first session were, *inter alia*, the following:
  - (a) applicable arbitration rules;

- (b) apportionment of costs and advance payments to the Centre;
- (c) quorum;
- (d) decisions of the Tribunal by correspondence or telephone conference;
- (e) place of arbitration;
- (f) procedural language;
- (g) pleadings: number, sequence, time limits; and
- (h) production of evidence and examination of witnesses and experts.

25. On May 11, 2004, the amended *Minutes of the First Session*, dated March 8, 2004 as signed by the President on behalf of the Tribunal and by the Secretary, were dispatched to the Parties by the Secretary.

26. Paragraph 15.3 of the *Minutes of the First Session* set out a procedural timetable for pleadings agreed by the Parties.

27. On July 30, 2004, in accordance with the agreed timetable, the Claimants submitted to ICSID the following:

- 1) Memorial of the Claimants, dated July 30, 2004;
- 2) Witness Statement of Mr. Michael Huang, dated July 29, 2004;
- 3) Exhibits referred to in Witness Statement of Mr. Michael Huang Vol.1;
- 4) Exhibits referred to in Witness Statement of Mr. Michael Huang Vol.2;
- 5) Exhibits referred to in Witness Statement of Mr. Michael Huang Vol.3;
- 6) Exhibits referred to in Witness Statement of Mr. Michael Huang Vol.4;
- 7) Witness Statement of Mr. Tamás Tahy, dated July 25, 2004 but signed on 28 July, 2004;
- 8) Witness Statement of Mr. György Onozó, dated July 28, 2004, and English translation thereof;
- 9) Expert Report by Manuel A. Abdala, Andres Ricover and Pablo T. Spiller of LECG LLC, dated July 29, 2004, entitled Damage Valuation of Claimants' Investment in the Airport ("*LECG Report*");
- 10) Annexes to LECG Report Vol.1;
- 11) Annexes to LECG Report Vol.2;
- 12) Annexes to LECG Report Vol.3;
- 13) Annexes to LECG Report Vol.4;
- 14) Annexes to LECG Report Vol.5;
- 15) Annexes to LECG Report Vol.6;
- 16) Annexes to LECG Report Vol.7;
- 17) Authorities Vol. I;
- 18) Authorities Vol. II; and
- 19) Authorities Vol. III.

28. On August 19, 2004, the Secretary confirmed with the Parties an agreed adjusted timetable for meetings and hearings which replaced the original timetable set forth in the *Minutes of the First Session*.

29. On January 17, 2005, in accordance with the pleading timetable agreed, the Respondent submitted to ICSID the following:

- 1) *Counter-Memorial of the Respondent*, dated January 17, 2005;
- 2) Expert quantum report by NERA Consulting ("*NERA Report*");
- 3) Witness Statement of Dr. László Kiss;
- 4) Witness Statement of Mr Gyula Gansperger;
- 5) Witness Statement of Mr. Gabor Somogyi-Tóth;
- 6) Exhibits of the Respondent's Counter Memorial; and
- 7) Authorities.

30. On February 7, 2005, and in accordance with the agreed timetable, both Parties served their *Requests for Production of Documents* on the other party.

31. As agreed at the First Session of the Tribunal, on February 14, 2005, a telephone conference was held between the Parties and the Tribunal to assess the status of the proceeding. At that telephone conference, the Respondent submitted to the Tribunal its *Application for Bifurcation of Jurisdiction from the Merits*.

32. On February 15, 2005, the Tribunal issued its *Decision on the Respondent's Application for Bifurcation of Jurisdiction from the Merits* in which it rejected the Respondent's application for bifurcation.

33. On February 22, 2005, in accordance with the agreed procedural timetable, the Parties submitted to the Tribunal their respective objections to the request by the other side for production of documents. Replies to the objections were filed on March 7, 2005.

34. On March 10, 2005, a hearing was held by the Tribunal in London on the requests for production of documents. At the hearing, the Tribunal granted certain of the Claimants' requests, and with respect to the Respondent's requests, it was agreed that the Respondent would file a revised request by March 21, 2005; the Claimants would file their response thereto by April 1, 2005; and the Tribunal would thereafter issue its decision on the revised requests.

35. On March 22, 2005, the Respondent filed its amended request for production of documents ("*Amended Request*").

36. On April 5, 2005, as agreed by the Parties, the Claimants made their submission in response to the Respondent's *Amended Request*. In this submission, the Claimants agreed to produce a number of documents requested by the Respondent but rejected the remaining requests. The Claimants' objections were mainly based on the argument that the remaining requests still violated specific instructions and observations made by the Tribunal at the hearing on March 10, 2005.

37. On April 15, 2005, having considered the *Amended Request* by the Respondent and the Claimants' submission in response, the Tribunal, in its decision of that date, granted several requests in the *Amended Request* and refused others.

38. On June 2, 2005, following correspondence between the Parties in regard to the adjustment of the procedural timetable, the Tribunal agreed and confirmed a revised schedule for the remaining written submissions, organizational meeting and main hearing.

39. On July 22, 2005, in accordance with the revised timetable, the Claimants submitted to the Tribunal and the Respondent the following documents:

- 1) Claimants' *Reply*, dated July 22, 2005;
- 2) Reply Witness Statement of Mr. Michael Huang, dated July 21, 2005;
- 3) Reply Witness Statement of Mr. Tamás Tahy, dated July 14, 2005;
- 4) Reply Witness Statement of Mr. György Onozó, dated July 20, 2005, and English translation thereof;
- 5) Supplemental Expert Report by Manuel A. Adbala, Andres Ricover and Pablo T. Spiller of LECG LLC, dated July 22, 2005, entitled Damage Valuation for the Investment of ADC Affiliate Limited and ADC & ADMC Management Limited in the Budapest-Ferihegy International Airport ("*Supplemental LECG Report*").

40. As stated above, on August 12, 2005, the Tribunal was notified by Clifford Chance LLP that the Respondent had terminated its engagement of the firm in this arbitration.

41. On September 15, 2005, in response to the Tribunal's inquiries as to whether it intended to appoint replacement legal counsel and to follow the fixed deadlines, the Minister of Finance of the Republic of Hungary sent a letter to ICSID in which it was stated that the Respondent was in the process of appointing new legal counsel. Further, the Respondent requested that the Tribunal re-schedule the deadline for filing the Respondent's *Rejoinder* to January 2006 and adjust the ensuing deadlines accordingly.

42. On September 21, 2005, the Tribunal informed the Parties that it was not satisfied with the grounds given by the Respondent for the postponement of the deadlines and that the schedule of this arbitration would remain unchanged. It also confirmed its decision that the organizational meeting, for which December 15, 2005 had been set aside, would be held in London at a venue to be determined.

43. On September 29, 2005, the Respondent notified ICSID via fax that it had appointed the Bodnár Law Firm as its counsel of record in this arbitration in replacement of Clifford Chance LLP. A copy of the Power of Attorney was attached to the fax.

44. On October 4, 2005, Prof. Dr. László Bodnár of Bodnár Law Firm, as legal counsel of the Respondent, sent a letter to the Tribunal requesting the deadline for service of Respondent's *Rejoinder*, Claimants' *Sur-Rejoinder on Jurisdiction* and the date of the Organizational Meeting be postponed while the date for final hearing should remain unchanged.

45. On October 6, 2005, the Tribunal informed the Parties that it had decided to amend the schedule in this arbitration as follows:

November 4, 2005	Deadline for filing the Respondent's <i>Rejoinder</i> ;
December 9, 2005	Deadline for filing the Claimants' <i>Sur-Rejoinder on Jurisdiction</i> ;
December 19, 2005	Organizational meeting in London, at 10a.m.;
January 17 to 27, 2006	Hearing on jurisdiction and merits in London or The Hague.

46. On November 4, 2005, the Respondent's counsel served its *Rejoinder* on the Tribunal and the Claimants.

47. On December 11, 2005, the Claimants' counsel served on the Tribunal and the Respondent the following:

- 1) *Sur-Rejoinder on Jurisdiction*; and
- 2) Supplemental Reply Witness Statement of Mr. Michael Huang.

48. On December 19, 2005, a second organizational meeting was held in London. Mr. Pierre Bienvenu, Mr. Martin Valasek, Mr. René Cadieux and Prof. Dr. Iván Szász appeared on behalf of the Claimants. Prof. Dr. Lazlo Bodnár, Mr. Jan Burmeister, Dr. Inka Hanefeld and Dr. Janka Ban appeared on behalf of the Respondent. Present at the meeting were the full Tribunal and the Secretary of the Tribunal.

49. At this meeting, the Parties agreed to and confirmed a series of administrative matters in regard to the conduct of the main hearing.

50. Also at the meeting, the Respondent informed the Tribunal and the Claimants that Mr. Matthew, author of the *NERA Report* and key expert witness for the Respondent, would be unavailable for cross-examination at the main hearing; instead, two new expert witnesses recently appointed by the Respondent would be produced at the hearing for cross-examination in regard to the *NERA Report*.

51. The Claimants' counsel opposed such arrangement and requested that Mr. Matthew be produced for cross-examination.

52. The Claimants also requested that the Respondent produce the transactional documents entered into by British Airports Authority ("BAA") a week previously in its acquisition of the majority shares of the company owning Budapest Airport.

53. Having heard the Parties at the meeting, the Tribunal issued its Procedural Order dated December 19, 2005, in which it was ordered, *inter alia*, that:

- 1) the Respondent shall use its best endeavours to procure Mr. Matthew to testify at the hearing in January; if this proves impossible, the Respondent shall serve on the Claimants and the Tribunal, before December 29, 2005, statements of the two new expert witnesses who will state that they entirely agree with and adopt the *NERA Report*;
- 2) the Respondent shall supply to the Claimants before December 23, 2005 various versions of the bid requirements and tender documents together with the agreement entered into by BAA in relation to BAA's acquisition of the shares in Budapest Airport; such production shall be subject to a Confidentiality Agreement annexed to the Procedural Order.

54. In accordance with the above Procedural Order, on December 31, 2005, counsel for the Respondent filed a *CRAI Rebuttal Report* issued and signed by its new expert witness, Dr. Alister L. Hunt ("*Hunt Report*").

55. In his Report, Dr. Hunt declared that he had "*read, understood, analyzed*" and, subject to one exception, "*agree(s) with the NERA Report.*" However, in paragraph 10 of this Report, Dr. Hunt made the important point that he concluded that the definition of the financial contribution made by Airport Development Corporation ("ADC") for the purposes of calculating compensation was US\$16.765 million and the Internal Rate of Return ("IRR") computations were to incorporate this initial cash infusion. This point deviated from the *NERA Report* and as Dr. Hunt noted, "*this deviation is in favour of the Claimants' position*".

56. On the same date, the Respondent's counsel in its covering letter attached to the *Hunt Report* informed the Tribunal and the Claimants that Dr. Kothari, its other proposed new expert, would not be produced at the January hearing and therefore was withdrawn.

### **C. The Hearing**

57. The hearing took place at the International Dispute Resolution Centre in Fleet Street, London. It commenced on Tuesday January 17, 2006 and concluded on Wednesday January 25, 2006. Audio recording of the hearing was made and verbatim transcripts were also produced, the latter being concurrently available with the aid of LiveNote computer software.

58. At the hearing, the following appeared as legal counsel for the Claimants: Messrs. Pierre Bienvenu, Martin Valasek, Jacques Demers and Azim Hussein of Ogilvy Renault, Mr. René Cadieux of Fasken Martineau Dumoulin, Prof. Dr. Iván Szász and Miss Judith Kelman of Squire Sanders & Dempsey and Prof. Dr. James Crawford SC.

59. The following appeared as legal counsel for the Respondent: Prof. Dr. Bodnár of the Bodnár Law Offices, Messrs. Jan Burmeister and Dr. Levente Szabo of B&T law firm of Budapest and Dr. Inka Hanefeld, Dr. Ulf Renzenbrink and Mr. Daniele Ferretti of RRKH law firm of Hamburg. Ms. Bernadette Marton also appeared at the hearing as a representative of the Hungarian Ministry of Finance.

60. Both sides made an oral presentation at the opening of the hearing. With regard to post-hearing submissions, the Tribunal confirmed the dates set forth in its December 19, 2005 Procedural Order, namely, written closing submissions to be served on March 7, 2006 and the written rebuttals to be served by March 21, 2006.

61. At the hearing, the following witnesses gave evidence, in sequence, for the Claimants and were cross-examined by the Respondent's counsel:

Mr. Michael Huang  
Mr. György Onozó  
Mr. Tamás Tahy  
Mr. Manuel A. Abdala, Mr. Andres Ricover and Mr. Pablo T. Spiller of LECG LLC

62. The following witnesses gave evidence for the Respondent and were cross-examined by the Claimants' counsel:

Dr. László Kiss  
Mr. Gyula Gansperger  
Mr. Gabor Somogyi-Tóth  
Dr. Alister L. Hunt of CRA International

63. At the conclusion of his evidence, Mr. Gansperger asked the Tribunal for a copy of the transcript of the proceedings and a copy of Mr. Tahy's witness statement.

64. The Tribunal heard oral arguments on the issue of confidentiality and made its decision on this issue in a letter to the Parties dated January 31, 2006. In this letter, the Tribunal referred to ICSID Arbitration Rule 19 and Articles 44 and 48(5) of the Convention.

65. Arbitration Rule 19 provides:

*"The Tribunal shall make the orders required for the conduct of the proceeding."*

66. Article 44 of the Convention provides:

*"Any arbitration proceeding shall be conducted in accordance with the provisions of this Section and, except as the parties otherwise agree, in accordance with the Arbitration Rules in effect on the date on which the parties consented to arbitration. If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question."*



67. Article 48 (5) of the Convention provides:

*“The Centre shall not publish the award without the consent of the parties.”*

68. Bearing in mind of these provisions, the Tribunal ruled in the above letter as follows:

“ ...

*14. Having considered all the submissions on this matter, the Tribunal is satisfied that confidentiality does attach to all the documents produced in this ICSID arbitration. Confidentiality is important because parties to ICSID arbitrations may not want the details of the dispute made public and furthermore witnesses who come forward to assist the Tribunal in their difficult task should do so with the knowledge that what they say is confidential and cannot be released without an order of the Tribunal. Such a rule is necessary to preserve the integrity of the arbitral process.*

*15. That confidentiality is desirable is made evident by the frank statement of Mr. Gansperger that he wanted these documents for the purposes of ‘obtaining satisfaction’ against the statement made by Mr. Tahy.*

*16. Mr. Burmeister suggested that it was only fair to let a witness, who gave evidence in his native language and was translated into English for the benefit of the Tribunal, have the right to check the English translation of what he said and how that was recorded in the transcript. It is clear that Mr. Gansperger does speak English and therefore would be able to check the accuracy of his words.*

*17. The Tribunal accepts that it is only fair that Mr. Gansperger should be able to have access to the transcript to check the authenticity of the translation.*

*18. However, for that purpose, he does not require to be given a copy of the transcript of his evidence. What the Tribunal is prepared to allow is that Mr. Gansperger may, only at the offices of the Bodnár law firm, be shown a copy of the transcript of his evidence and be allowed to read it through and check it for accuracy. On no account is he to be given a copy to be taken away from the Bodnár law firm offices.*

*19. As to the request that Mr. Gansperger be given a copy of the statement or extract of the statement of Mr. Tahy, this application is refused. This refusal is based upon the importance of maintaining the confidentiality of ICSID arbitrations which involves protecting witnesses who come forward to assist the Tribunal. The Tribunal accepts that in ICSID arbitrations it is difficult for some witnesses to give evidence against their own State and when this is coupled with a request for “satisfaction” from a co-national*

*who is clearly a powerful figure in that country, the importance of confidentiality looms large.”*

This confidentiality issue was then closed.

69. On March 6, 2006, the Respondent’s counsel informed the Tribunal by email that by mutual agreement, the Parties agreed to postpone the dates for post-hearing submissions to March 10, 2006 and March 24, 2006 respectively.

70. On March 10, 2006, the Claimants served on the Tribunal their *Post-Hearing Brief* together with an *LECG Post-Hearing Report*. On the same date, the Respondent served on the Tribunal its *Closing Submissions*.

71. On March 16, 2006, Prof. Bodnár, on behalf of the co-counsel for the Respondent, by a letter to the Tribunal, objected to the newly submitted *LECG Post-Hearing Report* and claimed that said report and an updated electronic model therewith “*constitute new evidence*”.

72. On March 24, 2006, the Respondent served on the Tribunal the Respondent’s *Closing Reply*. On the same date, the Claimants served on the Tribunal Claimants’ *Post-Hearing Rebuttal*.

73. On March 30, 2006, the Claimants’ counsel, by a letter to the Tribunal, denied that the disputed report and model constituted new evidence.

74. In a letter to the Tribunal dated April 3, 2006, the Respondent reiterated its position concerning the report and the model in question and further claimed that the report also contained new factual allegations. The Respondent therefore requested the Tribunal to disregard the *LECG Post-Hearing Report* as well as the electronic model submitted with it.

75. On April 7, 2006, after reviewing the relevant correspondence and careful consideration of the issue, the Tribunal, through the Secretary, sent a letter to the Parties in regard to the “*new evidence*” matter and directed the Respondent to specify its allegation that “*new evidence*” was contained in the *LECG Post-Hearing Report* by May 1, 2006.

76. On May 1, 2006, in accordance with the Tribunal’s direction, the Respondent served on the Tribunal a *Supplemental Expert Report* prepared by Dr. Hunt which addressed the defects as the Respondent sees them in the *LECG Post-Hearing Report*.

77. On May 12, 2006, the Claimants’ co-counsel wrote a letter to the Tribunal in response to the *Supplemental Expert Report*. In this letter, the Claimants acknowledged certain minor calculation errors in the *LECG Post-Hearing Report* but maintained its position that no new evidence was introduced therein and argued that Dr. Hunt’s criticism on LECG’s methodology was unfounded.

78. On May 19, 2006, the Tribunal, through its Secretary, wrote to the Parties with the following ruling:

*“After careful reading of the LECG Post-Hearing Report as well as Dr. Hunt’s Supplemental Expert Report and thorough consideration of the issue, the Tribunal is now satisfied that it can conclude that no new evidence was introduced in the LECG Post-Hearing Report. Therefore, the objection raised by the Respondent in this regard is rejected. The issue of new evidence is closed.”*

### **III. FACTS**

79. At a fairly early stage in these proceedings, the Tribunal requested the Parties to agree a non-contentious narrative statement of the background facts of this case. The Tribunal’s intention was to incorporate such agreed text in this Award. After much delay, doubtless caused by the change of counsel and through no fault of the Respondent’s able and new legal team, all that was provided was the Claimants’ version. The Respondent’s legal team had, by the end of the hearing, not been able to agree this text although they were not in a position to state with what they disagreed. The Tribunal gave the Respondent a period of two weeks following the conclusion of the hearing to either agree the Claimants’ text or to make suggested amendments. The text contained in paragraph 80 to 213 represents the Claimants’ version with some textual change made by the Tribunal. The Tribunal has also taken into account the Respondent’s version which was finally received on March 10, 2006.

#### **A. THE PARTIES**

80. The Claimants are companies incorporated under the laws of the Republic of Cyprus.

81. The Claimants were established on February 25, 1997 for the sole purpose of the Airport Project as defined in paragraph 94 below.

82. ADC Affiliate’s shareholders are:

Class A Voting Shares:	51% ADC, incorporated in Canada
Class A Voting Shares:	49% Aeroports de Montreal Capital Inc (“ADMC”), incorporated in Canada
Class B Participating Non-Voting Shares:	100% ADC Financial Ltd, incorporated in the British Virgin Islands
Class C Participating Non-Voting Shares:	100% ADMC

83. ADC & ADMC Management's shareholders are:

Class A Voting Shares:	50% ADMC
Class A Voting Shares:	50% ADC Management Ltd, incorporated in the British Virgin Islands
Class B Participating Non-Voting Shares:	100% ADC Management Ltd, incorporated in the British Virgin Islands
Class C Participating Non-Voting Shares:	100% ADMC

84. The controlling shareholders, directors and ultimate beneficiaries of ADC were two Canadians, Mr. Huang and Mr. Danczkay. ADC was a fully owned subsidiary of Huang & Danczkay Properties, a general partnership of Huang & Danczkay Limited and Huang & Danczkay Development Inc. organised under the laws of Ontario, Canada. The British Virgin Islands companies were also ultimately owned by Mr. Huang and Mr. Danczkay (and their relatives).

85. The directors of the Claimants are Cypriot lawyers and Canadian lawyers.

## **B. THE AIRPORT**

86. The Airport is located approximately 18 km south-east of Budapest, the capital of the Republic of Hungary.

87. The Airport is the principal airport in Hungary for both domestic and international scheduled passenger flights.

88. The Airport also plays a military role, and, for example, was used during the Balkans War by NATO Member States for transporting military personnel, supplies and equipment.

89. In 1992, the Airport comprised of two passenger terminals. Terminal 1 had been built in 1950, and had a capacity of two million passengers a year, but it no longer met the then current commercial and security standards. Terminal 2/A, which had an additional capacity of two million passengers a year, had been built in 1985.

90. The Airport is an exclusive and non-negotiable asset of the State, as stated in Section 36/A of the Air Traffic Act (Act XCVII of 1995) and the Hungarian Civil Code. However, pursuant to Decree No. 12/1993 of the Minister of Transport and Water Management ("*Ministry of Transport*"), the Air Traffic and Airport Administration ("*ATAA*") had the authority to transfer revenue generating usage and revenue collection rights relating to the operation of certain facilities at the airport.

91. The Airport was held, managed and operated by ATAA, a Hungarian state entity, which was under the auspices of the Ministry of Transport. As from 1 January 1988, the Director of the ATAA had been Mr. Tamás Erdei. Before that he had been the Technical Deputy Director.

92. In 1992, United States and Hungarian advisors concluded that to accommodate future passenger requirements, the Airport would need to be expanded. It was also considered that the Airport had the potential to be developed into a hub with a much higher passenger turnover.

93. It was further concluded that it would be preferable financially to construct a new terminal, rather than renovate Terminal 1. Accordingly, the ATAA initiated a tender process for expansion of the Airport.

### **C. THE TENDER PROCESS**

94. In September 1992, ATAA initiated a three-phase process to select a partner to renovate Terminal 2/A and to design a new Terminal 2/B at the Airport. The invitation to tender also involved the design of the adjoining public road and traffic entrance areas and related infrastructure, as well as the financing, construction, leasing and operation of Airport facilities (“*Airport Project*” or “*Project*”).

95. The ATAA was, at the time, an agency of the Hungarian Ministry of Transport and wholly under the control of the Respondent.

96. The first phase of the tender process involved the ATAA’s selection of qualified bidders. Only qualified bidders were allowed to participate in the second phase, which involved the ATAA’s selection of two “*Preferred Tenderers*”. The third and final phase involved the ATAA’s selection of the “*Selected Tenderer*”.

#### **1. First Phase**

97. The first phase began in September 1992 with the issuance by the ATAA of an “*International Prequalification*” document containing information relating to the Airport Project and an “*Application*”, including an Invitation to Prequalification, a description of the prequalification procedure and the Applicant’s Questionnaire, or “*Request for Qualification*” (“*RFQ*”).

98. ATAA received a total of 17 RFQs. On November 23, 1992, ADC submitted a RFQ to the ATAA.

99. The ATAA brought the first phase of the tender process to a close by announcing its short list of qualified tenderers. The ATAA’s short list of qualified tenderers included ADC and five other bidders.

#### **2. Second Phase**

100. In the second phase of the tender process, each qualified bidder was invited to submit a tender to the ATAA for the Airport Project. The invitation also included a tender on the construction of a covered and open air parking facility, a hotel and a business centre.

101. The ATAA's tender documentation, which was issued between December 13, 1993 and January 17, 1994, consisted of two parts in eleven volumes ("*Tender Documentation*"). Part A contained, *inter alia*, the Invitation to Tender and Instructions to Tenderers, as well as the Project Conditions and Requirements. Part B contained technical documents such as drawings, technical specifications, Bills of Quantities and Technical Descriptions.

102. The Tender Documentation required bidders to include in their tenders a "*Basic Tender*" conforming strictly to the conditions set forth by the ATAA. Bidders were also invited, but not obligated, to submit an "*Alternative Tender*", which did not need to conform to all of the conditions set out in the Tender Documentation.

103. On April 29, 1994, ADC, acting as an individual corporation, not as a consortium, submitted its tender ("*ADC's Tender*") to ATAA. ADC's Tender included both a Basic Tender, submitted in compliance with the Tender Documentation, and an Alternative Tender. ADC's Alternative Tender proposed an alternative concept for Terminal 2/B based on the same footprint as the Basic Tender building, but with more cost-effective and efficient design, reduced capital costs and lower operating expenses. It also increased the maximum passenger handling capacity of the terminals by one million passengers per year over the Basic Tender.

104. As part of its tender, ADC agreed to procure that the Canadian Commercial Corporation ("*CCC*"), a Canadian Crown corporation and agent of the Government of Canada, would enter into a turnkey fixed price contract for the construction of Terminal 2/B and the renovation of Terminal 2/A.

105. The ATAA received proposals from at least three other qualified bidding teams or consortia, led respectively by Siemens, Schiphol (Amsterdam) Airport and Lockheed.

106. The second phase of the tender process ended when ATAA selected ADC and Lockheed as Preferred Tenderers.

### **3. Third Phase**

107. The third and final phase of the tender process went from May 1994 to August 1994, culminating in August 1994 with the selection of ADC as the Selected Tenderer.

108. ADC was selected as the Selected Tenderer on the basis of a unanimous recommendation from a selection jury of eleven persons. It is ADC's Alternative Tender that was chosen by the ATAA.

109. In specific, ADC was awarded contracts by the ATAA to (a) renovate Terminal 2/A, (b) construct Terminal 2/B, and (c) participate in the operation of Terminals 2/A and 2/B.

## **D. NEGOTIATION OF THE AGREEMENTS**

110. Following ADC's selection as the Selected Tenderer, negotiations with the ATAA with respect to the legal documentation were officially launched. ATAA had reserved the right to enter into negotiations with the second Preferred Tenderer (*i.e.*, Lockheed).

111. ADC's negotiating team consisted of Mr. Huang and Mr. Béla Danczkay. ADC's legal advisers were Meighen Demers, since merged with Ogilvy Renault, and local Hungarian counsel. For its part, the ATAA was represented in the negotiations by a team led by Mr. Tamás Erdei, its General Director, and they were assisted by the global law firm Debevoise & Plimpton LLP, by local Hungarian counsel and by Lehman Brothers, as financial adviser.

112. The parties proceeded by first negotiating a "*Master Agreement*", which set out the fundamental terms and conditions of the transaction and provided the framework under which all the other agreements would be negotiated and ultimately executed.

### **1. The Master Agreement and the Incorporation of the Project Company**

113. The negotiations of the Master Agreement began in August 1994 and it was executed on March 31, 1995. Parties to the Master Agreement are ADC and the ATAA. On the same day a Guarantee Agreement between Huang & Danczkay Properties and the ATAA was executed ("*Huang & Danczkay Guarantee*"). The Master Agreement is a legal instrument that laid down the fundamental structures of the whole Project. As stated in Article 2 of the Master Agreement, the purpose of the Master Agreement

*"is to set forth the agreements among the parties as to the terms and conditions with respect to the following subjects:*

- 2.1 the obligations and the satisfaction of the obligations of ADC and the ATAA in connection with the Project prior to the Construction Commencement Date;*
- 2.2 the obligations of ADC, the Project Company and the ATAA in connection with the Project after the Construction Commencement Date;*
- 2.3 the Operating Rights of the Project Company following the Operations Commencement Date;*
- 2.4 the rights and obligations of the Project Company and the ATAA during the Operating Period;*
- 2.5 the participation by ADC and the ATAA, provided that the necessary approvals are obtained, in the equity capital of the Project Company;*
- 2.6 the management of the Project Company; and*
- 2.7 the nature of other agreements to be entered into in connection with the Project."*

114. In particular, the Master Agreement provided, *inter alia*, for the formation under Hungarian law of a wholly-owned subsidiary of ADC (“*Project Company*” or “*FUF*”) for the sole purpose of:

- “(a) *incurring the Project Debt and funding the Construction work following the Initial Drawdown.*
- “(b) *preparing operation and asset management plans and engaging in other preparatory work for the Terminal Operations prior to completion of the Construction work; and*
- “(c) *conducting the Terminal Operation on and after the Operations Commencement Date and servicing the Project Debt until expiration of the Term.[...]*”

115. The Master Agreement also provided that the ATAA and the Project Company would enter into an operating period agreement, which would grant to the Project Company, subject to certain conditions, the right to conduct the terminal operations and to collect the terminal revenues. It was also intended that the initial term (“*Initial Term*”) of the Master Agreement would be twelve years from the operations commencement date (“*Operations Commencement Date*”), which would be extended under certain conditions up to six additional years.

116. The Master Agreement also provided that the Project Company could establish the fees and charges to be levied at the terminals, but only in accordance with the regulatory framework (“*Regulatory Framework*”). That framework set forth the policies and procedures for preparing the Annual Business Plan, and became Schedule C to the Operating Period Lease.

117. The Master Agreement and the Regulatory Framework also refer to the concept of ADC’s “IRR”. The parties agreed on a target IRR on ADC’s initial equity investment of 15.4% (“*Target IRR*”), and an absolute ceiling of 17.5%.

118. Concurrently with the execution of the Master Agreement on March 31, 1995, ADC formed the Project Company, which was registered as a one-member limited liability company on June 15, 1995, with legal effect as of March 31, 1995. The Project Company was established by ADC for the limited purposes of the Project. Its objects included incurring and servicing Airport Project debt, funding construction of the Airport Project, preparing operation and asset management plans prior to completion of construction, and operating the terminals following construction. Under the terms of its Charter, the Project Company was established for an initial term of fourteen years. This term could be extended, on one occasion, by no more than four years.

## **2. The Project Agreements**

119. The “*Project Agreements*”, as defined by the Master Agreement, means all those legal instruments as required in order to implement the contractual structure of the Project and to



set out the terms and conditions of all parties' participation in, and involvement with, the Project Company.

120. The Master Agreement set a target date for the execution of the Project Agreements as of six months after execution of the Master Agreement. The complexities of the Project did not permit the completion of the Project Agreements and the commencement of the Project by the initial target date. The parties mutually agreed to extend the target date with the final target date being set at March 31, 1997.

121. In its tender, ADC had proposed that the ATAA would receive its share in the Project Company in return for providing the Project Company with an in-kind contribution consisting of its rights to operate the airport terminals. This concept was accepted by the ATAA in the Master Agreement, but conditional on the ATAA receiving Government authorization, as required by Hungarian law, to acquire its quota in the Project Company.

122. Subsequently, ADC was advised that the Government had come to the conclusion that, for legal reasons, ATAA needed to make a cash contribution to the Project Company to receive its quota and that the proposed in-kind contribution by the ATAA would not entitle it to receive its 66% quota of the Project Company. In order to address this problem to the satisfaction of the ATAA, the parties agreed to the terms ultimately set out in the Project Agreements, namely that of the US\$16.765 million contributed by ADC to the equity of the Project Company, 66% or US\$11.065 million would be contributed by ADC to the Project Company on behalf of the ATAA in return for equivalent value from the ATAA, in the form of rental payments from the Project Company that would otherwise be due to ATAA under the Operating Period Lease. These rental payments were in turn converted into a stream of payments under a promissory note ("*Promissory Note*").

123. Among all the Project Agreements concluded, those executed in February 1997 (concurrently with the execution of the Credit Agreements described in the section below) included the following:

- (1) Quotaholders Agreement among ADC, the ATAA and the Project Company, executed on February 17, 1997;
- (2) Quota Transfer Agreement between ADC and the ATAA, executed on February 18, 1997;
- (3) Association Agreement between ADC and the ATAA, executed on February 18, 1997;
- (4) Subscription Agreement among ADC, the ATAA and the Project Company, executed on February 27, 1997;
- (5) Receipt and Acknowledgment among ADC, the ATAA and the Project Company, executed on February 27, 1997;
- (6) Release and Note Agreement between ADC and the Project Company, executed on February 27, 1997;

- (7) Assignment and Assumption Agreement between ATAA, ADC and ADC Affiliate, executed on February 27, 1997;
- (8) Operating Period Lease between the ATAA and the Project Company, executed on February 27, 1997;
- (9) Terminal Management Agreement for entrepreneurial operations among the ATAA, the Project Company and ADC & ADMC Management Limited, executed on February 27, 1997; and
- (10) ATAA Services Agreement between the ATAA and the Project Company, executed on February 27, 1997.

124. The Claimants contend that, at the end of the day (*i.e.*, referred to in the Subscription Agreement as the Equity Closing Date), through the simultaneous execution and operation of the Operating Period Lease, the Receipt and Acknowledgment and the Release and Note Agreement, ADC held a 34% quota in the Project Company and the Promissory Note from the Project Company, representing collectively a single investment in, and capital contribution to, the Project Company, in the amount of US\$16.765 million. The Respondent originally contested this but abandoned the point at the hearing in the light of Dr. Hunt's inability to support it.

### **3. Credit Agreement**

125. From the outset of the tender process, the ATAA made it clear that the Project should be financed on a non-recourse project basis, and that all tenders should assume that neither the ATAA nor any other entity of the Government of Hungary would guarantee any debt incurred in connection with the Airport Project. These conditions were listed as the first "*fundamental objective*" and the first "*financial assumption*" in the Tender Documentation.

126. As part of its tender, ADC had secured letters of interest from the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD), each of which was prepared to lead a syndicate of lenders to finance the debt portion of the Airport Project. During the negotiations of the Credit Agreements, EBRD emerged as the front-runner to lead the lending syndicate. EBRD offered to provide the A-loan portion of the financing at an interest rate of LIBOR plus 2.5%. The negotiations proceeded on this basis through 1995 and through the better part of 1996.

127. In the course of 1996, Mr. Péter Medgyessy, who at the time was Hungary's Finance Minister, involved himself personally in the negotiations of the credit facility. Mr. Medgyessy wanted the Airport Project debt to be financed by a syndicate of commercial banks only and he thus rejected the EBRD loan offer. To this end, the Government was willing to provide a guarantee of the Airport Project debt in order to secure a precedent in the international commercial banking community for a long term Hungarian Government guaranteed debt of ten years at a favourable interest rate.

128. This was a significant departure from the financing conditions that the Government of Hungary had earlier set out in the Tender Documentation, where it was specified that there

would be no sovereign guarantee of debt. In connection with the higher profile and greater risk the Government of Hungary was now taking in the Airport Project, the ATAA took the position that its share of the voting capital in the Project Company should be increased from 49% to 66%, matching the ATAA's share capital, and the Project Agreements were amended accordingly.

129. The Credit Agreement (the “*Facility Agreement*” as the document was titled) was executed on February 27, 1997 in Budapest. Mr. Medgyessy himself signed the guarantee (“*Guarantee*”), on behalf of the Government, on the very same day. The syndicate of lending banks had agreed to provide US\$103 million of financing to the Project Company to realize the Project at an interest rate of LIBOR plus 0.95% to be paid over a period of ten years.

## **F. THE CLAIMANTS’ INVESTMENTS**

130. The Claimants’ investments in the Project Company are set out below.

### **1. ADC Affiliate’s Investment**

131. From the very beginning of this transaction, the parties shared the assumption that ADC's capital contribution to the Project Company would be made through an affiliate, so as to allow the investment to benefit from the tax treaty regime between Hungary and the jurisdiction of the affiliate's incorporation. Accordingly, Section 3.2(a) of the Master Agreement, for example, provided that the cash equity contribution would be made by ADC or by an “Affiliate” of ADC.

132. Having chosen Cyprus for its advantageous tax regime (among other reasons), ADC incorporated ADC Affiliate in Cyprus on February 25, 1997 in advance of the execution of the Subscription Agreement and the closing of the equity contribution. (ADC & ADMC Management was incorporated at the same time.)

133. Pursuant to a Shareholders' Agreement dated February 21, 1997 between ADC Financial Ltd., ADC and ADMC, ADC Financial Ltd. contributed US\$6.765 million and ADMC contributed US\$10 million to the equity capital of ADC Affiliate. These funds, totalling US\$16.765 million, were intended by ADC Affiliate and its shareholders to be used to fund the capital increase of the Project Company through a direct contribution of cash. This was reflected in Section 2.1(a)(ii) of the ADC Affiliate Shareholders' Agreement:

*“[ADC Affiliate's] principal activities will be (i) to purchase and hold 100% of the Quotas currently owned by ADC in the Project Company; (ii) to subscribe for and purchase additional Quotas in the Project Company such that [ADC Affiliate's] holding of registered capital in the Project Company shall be 34%; and (iii) in accordance with Article 4.4(ii) of the Quotaholders' Agreement, to be jointly and severally bound with ADC towards ATAA for the performance of the obligations of ADC and the Project Company as contemplated in the Project Agreement.”*

134. As the Parties approached the closing date, there were two options available to complete the transaction:

- i. the relevant Project Agreements could all be amended to refer to ADC Affiliate, and ADC Affiliate could participate directly in the closing by making the US\$16.765 million capital contribution itself, in exchange for the Quota and Note; or
- ii. the transactions could be completed through ADC (without needing to amend the relevant Project Agreements), followed by an assignment of the Quota and Note to ADC Affiliate.

135. It was decided to pursue the second option. In order to do so, ADC needed (i) to borrow the US\$16.765 million from ADC Affiliate, (ii) to agree to subscribe for the capital increase in the Project Company with those funds and, finally, (iii) to agree to transfer and assign all rights and interests associated with the quota and the Promissory Note to ADC Affiliate. This was accomplished through a Loan and Transfer Agreement dated 27 February 1997 between ADC Affiliate and ADC ("*Loan and Transfer Agreement*") and a Quota Purchase Agreement dated February 28, 1997 between ADC and ADC Affiliate ("*Quota Purchase Agreement*").

136. Pursuant to the Loan and Transfer Agreement:

- ADC acknowledged receipt of a loan in the principal sum of US\$16.765 million from ADC Affiliate;
- ADC agreed to assign, transfer and convey to ADC Affiliate all of its rights, title and interest in and to the ADC quotas and the Promissory Note as soon as practical following the giving by ATAA of the ATAA's consent; and
- ADC Affiliate agreed to accept such assignment, transfer and conveyance.

137. Furthermore, ADC and ADC Affiliate agreed in Section 1 of the Quota Purchase Agreement as follows:

*"Upon the terms and subject to the conditions contained herein, the Parties agree that in consideration of the loan which ADC Affiliate provided to ADC in the amount of US\$ 16,765,000 (the "Loan Amount") pursuant to the Loan and Transfer Agreement referred to above:*

- (a) *ADC hereby sells and delivers to ADC Affiliate, and ADC Affiliate hereby purchases the Sale Quotas together with all rights and interest in the Sale Quotas; and*
- (b) *ADC hereby assigns, transfers and conveys to ADC Affiliate, all of its rights, title and interest in the Fixed Rate Promissory Note issued by the Project Company to ADC pursuant to the Release and Note Agreement dated February 27, 1997 entered into between the Project*

*Company and ADC, which assignment is accepted by ADC Affiliate hereby.”*

138. The assignment was completed for all purposes when ADC assigned to ADC Affiliate, and ADC Affiliate assumed, the rights and obligations of ADC under the Quotaholders' Agreement pursuant to the Assignment and Assumption Agreement dated February 27, 1997 between the ATAA, ADC and ADC Affiliate.

139. Each of ATAA and the Project Company consented in writing to the assignment by ADC to ADC Affiliate of the quota, the note and the Quotaholders' Agreement and all associated rights, titles and interests. Such written consent was granted in Section 4.2 of the Receipt and Acknowledgement dated February 27, 1997:

*“4.2 Assignment. Except as otherwise expressly provided herein, neither this Agreement nor any right or obligation arising hereunder or by reasons hereof shall be assignable by any party hereto without the prior written consent of the other parties hereto. Notwithstanding the foregoing, (a) the ATAA may assign its rights and obligations under this Agreement to any successor entity entrusted with the operation of the Airport that is a legal successor to the ATAA and assumes such rights and obligations in writing and (b) each of the ATAA and the Project Company hereby consent to the proposed assignment by ADC to ADC Affiliate Ltd. of all of the Quotas owned by ADC in the Project Company, all of ADC's rights under the Quotaholders' Agreement and all of ADC's right, title and interest in and to the Note [emphasis added], provided that ADC guarantees the obligations of ADC Affiliate Ltd. under the Quotaholders' Agreement by instruments reasonably satisfactory to the ATAA.”*

140. ADC guaranteed the obligations of ADC Affiliate under the Quotaholders' Agreement in Section 2 of the Assignment and Assumption Agreement. Finally, ADC Affiliate's status as Quotaholder in the Project Company since 28 February 1997 is confirmed by Hungary's Company Register.

141. As a quotaholder of the Project Company, ADC Affiliate's return on its investment was governed by the Regulatory Framework adopted by ATAA and the Project Company as Schedule C to the Operating Period Lease. Section 4.1 of the Regulatory Framework defines the IRR as follows:

*“4.1 Definition*

*The Internal Rate of Return (“IRR”) is defined as the discount rate that equates the discounted value of a stream of cash flows to the cost of the investment that produced the cash flows, calculated over the entire life of the investment.*

*Calculations of IRR shall be made by reference to each Quotaholders' initial equity investments (US\$ 16,765,000 in the case of the ADC Parties), with any dividend, interest or other distribution or payment*

*(including return of capital, redemption of note or repayment of principal on the note) or rentals payable pursuant to the Operating Period Lease being treated as part of such Quotaholders' return and not as reducing the base reference amount on which the return is to be calculated. [...]"*

142. Section 4.1 of the Regulatory Framework thus provided that “[c]alculations of the IRR shall be made by reference to each Quotaholders’ initial equity investments (US\$16,765,000 in the case of the ADC Parties) ...”, with payments under the Promissory Note being treated as part of ADC Affiliate’s return. The Claimants contend that, at the time, the Parties considered the Promissory Note as part of one single equity investment in the Project Company, and that this equity investment was in the amount of US\$16.765 million. The Respondent originally disputed this contention but following Dr. Hunt’s Report (see below), this is no longer disputed.

143. In addition, the Regulatory Framework established a Target IRR of 15.4% (in Section 4.2) with an upper limit of 17.5% (Section 7.0). It also set out a procedure for devising the Business Plan for the Project Company so that the Target IRR would be met through the adjustments of Regulated Rates and Charges (Section 5.0), and committed the ATAA to implement such adjustments (Section 6.0).

144. The Regulatory Framework further provided that the Annual Business Plan for the first year of operation would set the initial Regulated Rates and Charges to yield an IRR of 15.4%. In subsequent years, if the IRR turned out to be higher than 15.4% but not exceeding 17.5%, the initial Regulated Rates and Charges would remain unchanged.

145. Finally, the Quotaholders' Agreement, like the Regulatory Framework, considered the payment of dividends, rental payments and payments under the Promissory Note as equivalent for purposes of calculating the IRR:

*“7.2 Limitation on Dividends, Rental Payments and ADC Notes*

*(a) The Quotaholders in the Project Company shall be entitled to receive dividends in proportion to their Quotas from the after-tax profits of the Project Company determined by the Quotaholders' Meeting, provided that when the actual receipts by the Quotaholders which are ADC Parties, collectively, of dividends after any required withholding or other applicable tax (Net Dividends), any refund of withholding tax or other distributions and loan payments (including distributions of capital and payments of the principal of or interest (after withholding tax) on any ADC notes) and payments of rentals, if any, reach an amount representing an IRR (as defined in the Regulatory Framework) of 17.5% on their collective initial equity investment (i.e., initially US\$16,765,000), calculated as described in the Regulatory Framework, all additional future distributions that would otherwise accrue to the ADC Parties and their Affiliates or their transferees shall be waived by them and shall be retained by the Project Company and set aside as an asset reserve fund to be used for the improvement or renovation of the Terminals. [...][emphasis added]”*

## 2. ADC & ADMC Management's Investment

146. ADC's Tender provided for management fees payable to ADC (in the event, ADC & ADMC Management), calculated as 3% of Airport Project revenues (net of interest income). These fees were designed to compensate ADC (ADC & ADMC Management) for the provision of management expertise to the Airport Project. The Project Company entered into the Terminal Management Agreement with ADC & ADMC Management as part of the Project Agreements executed in February 1997. It is pursuant to this agreement that ADC & ADMC Management provided Management Services (as defined in the Terminal Management Agreement) to the Project Company.

147. The Terminal Manager was obligated to provide Management Services both before and after the Operations Commencement Date. The term of this agreement commenced on the date of execution and not on the Operation Commencement Date. This distinction is important:

- The Management Services that the Terminal Manager was obligated to provide before the Operations Commencement Date were performed on its behalf by Mr. Huang and his associates, between February 1997 and December 1998.
- The Management Services that the Terminal Manager was obligated to provide after the Operations Commencement Date were performed on its behalf by the employees of the wholly-owned Hungarian subsidiary of ADC & ADMC Management, an entity named ADC & ADMC Management Hungary Ltd.

148. The management fee of 3% payable in each calendar year commencing on and after the Operations Commencement Date (pursuant to Section 4.1(a) of the Terminal Management Agreement) was designed in large part to compensate the Claimants for the services that had been rendered by the Terminal Manager (by Mr. Huang and his associates on its behalf) before the Operations Commencement Date, and otherwise served as an incentive payment linked to the performance (*i.e.*, the revenues) of the Project Company.

149. With respect to the Management Services provided after the Operations Commencement Date, the Terminal Manager incurred only minimal overhead costs and expenses associated with the on-going supervision and knowledge transfer it provided, inasmuch as the salaries and benefits of the employees in Hungary who provided the on-site Management Services during the Operating Period were paid by the Project Company, pursuant to Section 4.1(b) of the Terminal Management Agreement.

150. The management team employed by the Terminal Manager was composed of 10 individuals, namely:

- A. Mr. Mihaly Farkas, who replaced Mr. Tamás Tahy as Managing Director of the Terminal Manager beginning in September 1999;
- B. Ms. Krisztina Meggyes, chief accountant;

- C. Ms. Edina Tiszai and Ms. Krisztina Törteli, accountants;
- D. Mr. György Onozó, technical manager;
- E. Ms. Orsolya Bárány, commercial and technical assistant;
- F. Ms. Noémi Devecseri and Mr. Levente Tordai, commercial assistants;
- G. Ms. Mariann Bördös, who served as Mr. Huang's assistant; and
- H. Dr. Béla Keszei, financial and administration manager.

151. Dr. Keszei is an economist who served in a role equivalent to the company's controller. Dr. Keszei, together with Ms. Meggyes and the two accountants, were responsible for all financial accounting, reporting and taxation matters (billing, accounts receivable, accounts payable, etc.). They and the other members of the staff were under the supervision and direction of Mr. Tahy.

152. Mr. Onozó and Ms. Bárány were in charge of managing the relationship with Airport tenants as well as the various departments of the ATAA on all technical aspects of the operation of the Terminals. Mr. Tordai and Ms. Devecseri used data received from the airport to develop the statistics that served as the basis for billing and certain commercial arrangements at the airport, such as number of passengers on each flight and the time each airplane spent on the tarmac.

## **F. Construction of Terminal 2/B**

153. The Project Company and the ATAA entered into a turnkey contract with CCC for the construction of Terminal 2/B on December 19, 1996. When the credit facility transaction closed in February 1997, monies were disbursed to the Project Company in order to fund the construction. CCC broke ground in March 1997 and construction proceeded through 1997 and 1998.

154. Terminal 2/B was commissioned and transferred to the Government of Hungary on or about December 25, 1998. Both the ATAA and the Project Company signed the Taking-Over Certificate dated November 25, 1998. The completed Terminal 2/B was opened to the public on or about 19 December 1998.

## **G. Business Planning Process for the Project Company**

155. The original business plan for the Airport Project was contained in ADC's Tender dated April 29, 1994. This business plan was developed by ADC in cooperation with KPMG. In order to carry out the financial analysis of the project, KPMG developed a computerized financial model which generated projections for the duration of the Project. The original and subsequent business plans projected the Project Company's financial results for the entire twelve year operating period (1997-2009), subject to further extension.



156. An updated version of the business plan was prepared by KPMG in December 1996. The parties referred to this updated business plan as the “*feasibility study*,” and it was defined in the Master Agreement as the “*KPMG Feasibility Study*”.

157. Pursuant to Section 2.0 of Schedule C to the Operating Period Lease, the KPMG Feasibility Study served as the basis for the Project Company’s initial “Annual Business Plan,” as defined in Section 4.1 of the Operating Period Lease. Section 2.0 of Schedule C to the Operating Period Lease defines the procedure to be followed in order to develop subsequent Annual Business Plans for the Project Company. The highlights of that procedure are as follows:

- Prior to each operational year of the Project Company, the Terminal Manager was to prepare and submit to the ATAA a new draft Annual Business Plan covering each financial year, or portion thereof, for the remainder of the Term;
- The ATAA had twenty days, following submission of such first draft, to comment in writing on the draft;
- If no comments were made, such draft Annual Business Plan was to be submitted to the Quotaholders’ meeting for approval;
- If comments were made, a second (or third) draft would be produced by the Terminal Manager following consultations between the ATAA, the Terminal Manager and the Project Company; and
- The agreed draft of the Annual Business Plan would be submitted to the Quotaholders’ meeting for approval.

158. In keeping with the procedure set out in Schedule C of the Operating Period Lease, the Annual Business Plans for the years 1999 through 2002 were each approved by the Quotaholders as follows:

- The Quotaholders approved the Annual Business Plan for the year 1999 on October 9, 1998;
- The Quotaholders approved the Annual Business Plan for the year 2000 on September 13, 1999; and
- The Quotaholders approved the Annual Business Plan for the year 2001 on October 2, 2000.

159. Regarding the Annual Business Plan for the year 2002, the first paragraph of the 2002 Business Plan describes the drafting and review process for the document as follows:

*“Pursuant to the Regulatory Framework, the Terminal Manager is required to prepare and submit to the ATAA a new draft Annual Business Plan by May 31 of each year. Accordingly, ADC & ADMC Management Ltd. (the “Terminal Manager”) submitted the first draft of the Annual Business Plan*

*dated May 29, 2001. The ATAA provided its comments on the first draft by letter dated June 20, 2001. The Terminal Manager submitted the second draft on June 30, 2001. Based on the request by the ATAA, the Terminal Manager submitted the third draft on August 23, 2001. On September 21, 2001, the ATAA requested further modifications to the third draft. The Terminal Manager submitted the Fourth Draft on October 12, 2001. Upon receipt of comments on November 15, 2001, the terminal manager submits this Fifth Draft for approval of the Quotaholders.”*

160. The Claimants contend that the Quotaholders approved the Annual Business Plan for the year 2002 on December 11, 2001. The Respondent disputes this contention. By letter dated December 11, 2001 from Mr. Somogyi-Tóth, Acting Director of ATAA, addressed to Mr. Tamás Tahy, the Commercial Director of Ferihegy ADC Limited, it was stated as follows:

*“We have received the 5<sup>th</sup> version of the Business Plan for 2002. Thank you very much for your taking into consideration our comments when revising it. We inform you that we accept the 5<sup>th</sup> version of the Business Plan and we ask you to do your best to perform all the tasks defined in the plan.*

*At the same time we ask you again to consult with MALÉV regarding the planned parking (bridge) fee structure and please to inform us about the results of this discussion at your earliest convenience. In addition we ask you to update the exchange rate forecast for the whole project period when preparing the next year plan.”*

In the light of this letter, the Tribunal fails to see how it could be contended that the Annual Business Plan for the year 2002 was not approved. The Tribunal is satisfied that it was.

## **H. Project Company’s Financial Results**

161. The Project Company began reporting its financial results as of its establishment in 1995. The Project Company’s results from 1995 through 2001 were presented in audited financial statements as follows:

- Independent auditors’ report on Project Company’s 1995 Annual Report dated May 30, 1996;
- Independent auditors’ report on Project Company’s 1996 Annual Report dated February 4, 1997;
- Independent auditors’ report on Project Company’s 1997 Simplified Annual Report dated May 4, 1998;
- Independent auditors’ report on Project Company’s 1998 Simplified Annual Report dated May 31, 1999;

- Independent auditors' report on Project Company's 1999 Annual Report dated March 31, 2000;
- Independent auditors' report on Project Company's Financial Statements for 2000, dated March 14, 2001; and
- Independent auditors' report on Project Company's 2001 Annual Report dated August 27, 2002.

162. Two types of distributions were made by the Project Company to ADC Affiliate. The first consisted of payments on the Promissory Note. These payments were made semi-annually. The second consisted of dividends from the profit of the Project Company, which were paid around March of each year (based on the profit of the previous year). The management fees payable to ADC & ADMC Management were paid semi-annually, after the semi-annual payments of debt service.

163. The Claimants contend that the financial results of the Project Company generally show that it was performing over and above the projections in the Business Plans. The Tribunal accepts that this was so.

## **I. Project Company's Operations from 1999 through 2001**

164. The primary objective of the Project Company, after completion of the construction of Terminal 2/B and modifications of Terminal 2/A, was to perform or arrange for the performance of what the Operating Period Lease defined as Entrepreneurial Operations, and it was entitled to collect the revenues accruing from these Entrepreneurial Operations (defined in the Operating Period Lease as Terminal Revenues). These included passenger terminal usage fees, passenger handling activity fees, aircraft parking fees, ground handling fees, space rentals within the Terminals, retail activity fees, including duty-free outlets, revenues from advertising, within and on the exterior walls of the Terminals, revenues from business centre and VIP lounges, *etc.*

165. Section 4 of the Operating Period Lease set out the covenants of the Project Company, which included:

- (a) submitting annual business plans (prepared by the Terminal Manager in consultation with the Project Company) to the Quotaholders of the Project Company for their final approval;
- (b) conducting the Entrepreneurial Operations and the design, financing and construction of any Terminal improvement authorized in any Annual Business Plan or otherwise undertaken by it in a diligent workmanlike and commercially reasonable manner in accordance with Hungarian law;
- (c) using its best efforts to promote and optimize commercial revenues at the Terminals;

- (d) promoting the airport internationally so as to maximize potential air traffic and in connection therewith using its best efforts to create overseas hub operations at the airport; and
- (e) after soliciting bids, awarding retail franchises and entering into contracts for goods and services on a prudent and businesslike basis with the view to the profitable operation of the Terminals.

166. Project Company staff consisted of the two Managing Directors appointed by the Quotaholders, the Commercial Managing Director appointed by ADC Affiliate, and the Operations Managing Director appointed by the ATAA.

167. The Project Agreements gave the Terminal Manager (*i.e.*, ADC & ADMC Management) primary day-to-day responsibility for managing, administering, coordinating and ensuring the proper and efficient performance, on behalf of the Project Company, of most of the Entrepreneurial Operations, and for collecting the Terminal Revenues.

168. ADC & ADMC Management Hungary Kft. had a staff of ten individuals as of December 31, 2001. All of these individuals were Hungarian nationals.

169. In keeping with industry practice, the Project Company's operations and performance were closely monitored, notably by the syndicate of banks lending to the Project, the Project Company's auditors, and the Ministry of Finance in its capacity as the guarantor of the project loan. Pursuant to the Credit Agreement, the Ministry of Finance appointed CIB Bank as its "*financial adviser*" to review and monitor the financial performance of the Project Company during the term of the Facility.

170. There were at least three audits or inspections of the Project Company:

- In 1998, the Government Control Office investigated the Project's contractual system to determine whether it was lawful, and concluded that it was.
- In 2000, Ernst & Young was retained by the ATAA to perform a financial and business audit of the Project Company, and concluded that the Project was "*particularly favourable*" for the ATAA.
- In March 2001, the Supervisory Board of the Project Company retained its own outside expert to conduct "*a comprehensive review*" of the Project Company.

171. In 2001, the ATAA launched an investigation whose objective was to gather detailed information concerning many aspects of the Project Company.

## **J. Transformation of the ATAA, Legislative Amendments and the Decree**

172. In 1999, the Ministry of Transport prepared a Proposal for the Government's Air Transportation Strategy, which requested that plans be drawn up to transform the ATAA. The ATAA was a State budgetary organ. The ATAA had two principal tasks: air traffic

control and the operation of the Airport. There had been concern that these two functions should be separated to prevent possible conflicts in decision-making and to ensure transparency in financial matters. It was also necessary to separate these two functions to comply with international and regional requirements and standards.

173. On November 25, 1999, a Ministerial Commissioner was appointed by the Ministry of Transport to prepare a plan for transformation of the ATAA.

174. The Government developed a national aviation strategy, embracing the entire aviation sector, of which part of its programme was to align with and implement EU law within the aviation sector in preparation for accession to the EU.

175. This national aviation strategy was adopted on April 14, 2000, when the Government passed Resolution No. 2078/2000 on The Strategic Tasks of the Development of Air Transport. The Resolution was published in the official Gazette “Collection of Resolutions”. This set out a 9-point programme to implement the national aviation strategy and harmonise the aviation sector with EU law. The plan included transformation of the ATAA. The Minister of Transport was in charge of the transformation. The Government Resolution required transformation to be complete by January 31, 2002.

176. The Ministry of Transport appointed a Management Committee to prepare, discuss, and implement proposals for transformation of the ATAA.

177. From autumn 2001, a change took place in the management of the ATAA in order to prepare for its transformation: Mr. Somogyi-Tóth remained Acting Director in charge of the day-to-day operations; Mr. Gansperger became responsible for starting up Budapest Airport Rt (the new company) (“*BA Rt*”) and the commencement of its operations; and Mr. Istvan Mudra became responsible for starting up HungaroControl (Mr. Mudra had been the Deputy Director of Air Traffic Control).

178. On September 20, 2001, BA Rt was established. On October 25, 2001, BA Rt was registered in the Court of Registration in Budapest.

179. Decree No. 45/2001 (XII.20) KöViM (“*Decree*”) was issued on December 20, 2001, by the Minister of Transport (“*KöViM Minister*”). It was issued with the agreement of the Minister of Finance, the Minister of the Prime Minister’s Office, the Minister of the Interior, the Minister of Health, the Minister of Defence and the Minister of Environment Protection.

180. The Decree was adopted under the authority of the Act No. XCVII of 1995 on Air Traffic (“*Air Traffic Act*”), following amendments made to the Air Traffic Act by Act No. CIX of 2001 on the Amendment of Various Traffic-Related Laws (“*Amending Act*”).

181. The Amending Act was introduced in Parliament in the form of a Government Bill in September 2001, and, following a series of amendments to the Bill, it was adopted on 18 December 2001. Section 19 of the Amending Act introduced an amendment to Section 45 of the Air Traffic Act by adding thereto, among others, Section 45(5). Section 45(5) of the Air Traffic Act contains the prohibition, repeated in Section 1(5) of the Decree, against

the transfer by ATAA (or its successor) of the activities of the type previously performed by the Project Company and the Terminal Manager (“*Project Company Activities*”) to any third party, *e.g.*, the Claimants.

182. Section 45(5) of the Air Traffic Act found its way into the Bill due to a subsequent Amendment Motion introduced by a Government MP, Dr. Dénes Kosztolányi. The Amendment Motion, introduced on November 8, 2001, advanced as justification, the following reasoning:

*“Reasoning*

*The activities listed in Section (1) have substantial influence on the operation and development of Budapest-Ferihegy International Airport, and thus the State has such strategic interest connected to these activities that the law itself specifies that the operator performing such activities may only be an organization in which the State is the majority owner, or if it is a minor shareholder then it owns preference shares, or the organization is a concession company. If any of the activities specified in Section (1) may be transferred to a third party under a contract it may not be ensured that the strategic requirements of the State are fulfilled, in other words, the limitations and restrictions established under Section (1) may be circumvented pursuant to a contract concluded with a third party.”*

183. On November 28, 2001, the same MP who had submitted the Amendment Motion submitted a “*Supplementary Amendment Motion*” in which he recommended that Section 45 of the Air Traffic Act be amended by the addition of two more paragraphs, paragraphs (6) and (7), in addition to paragraph (5). The reasoning for this Supplementary Amendment Motion reads as follows:

*“Reasoning*

*The aim of the amendment motion is to implement the Community liberalization of air transport with respect to the ground service market when our country joins the European Union.*

*The amendment establishes the obligation for service providers with significant market power to enter into a contract. Pursuant to the Civil Code conclusion of a contract can be rendered obligatory by a legal regulation.”*

184. The plenary session of the Hungarian Parliament considered the Amendment Motions on December 11, 2001. There were a total of seventeen Amendment Motions relating to the Bill. Parliament accepted the Motion of Dr. Kosztolányi as contained in the Supplementary Amendment Motion. On December 18, 2001, two days before the issuance of the Decree, the Hungarian Parliament voted in favour of the consolidated text of the Bill.

185. On December 21, 2001, the Project Company was informed of the Decree upon reception of a copy of same by Mr. Tahy. On Saturday, December 22, 2001, the Project Company received a letter from Mr. Gansperger and Mr. Gábor Somogyi-Tóth further

notifying it of the Decree. Mr. Gansperger signed the letter in his capacity as representative of the new Budapest Ferihegy International Airport Management Ltd. (“Joint Stock Co.”) and statutory successor of ATAA, and Mr. Somogyi-Tóth signed as representative of ATAA.

186. The letter stated that all operations and related activities of the Airport would be taken over effective January 1, 2002, by the Joint Stock Co. The translated text of this letter reads as follows:

*“Dear Mr. Tahy,*

*As you probably know, issued No.149 of the Hungarian Official Gazette, 2001, published Transport and Water Management Ministry Order No.45/2001 (XII.20) of the Minister of Transport and Water Management on the abolition of the Air Traffic and Airport Directorate and on the creation of HungaroControl Hungarian Air Traffic Service. Said ministerial order designates the Budapest Ferihegy International Airport Management Joint-Stock Co. (hereinafter referred to as “JS Co.”) and HungaroControl Hungarian Air Traffic Service as the legal successors to the Air Traffic and Airport Directorate as regards all operations and management activities and all related rights and obligations, as well as all contracts made with the State Treasury Asset Management Directorate. Furthermore, paragraph (5) of Article 1 of the order unequivocally states that as of January 1, 2002, the JS Co. may not cede or transfer to any third parties any of the operations or activities performed up till now by the Ferihegy Passenger Development Ltd. Co. pursuant to the lease agreement concluded on February 27, 1997 between the Air Traffic and Airport Directorate and the Ferihegy Passenger Development Ltd. Co (“FUF”).*

*The effect of said ministerial order naturally also extends to the Terminal Management Agreement signed on February 27, 1997 by the ATAD, the FPD Ltd. Co., and the ADC&ADC Management Ltd. Co., as well as to the contracts held by the FPD Ltd. Co. concerning the operations and leasing of Terminal II/A and II/B.*

*In view of the above, therefore, we hereby notify you pursuant to the provisions of paragraph (1) of Article 312 of the Civil Code that the further performance of the above contracts have been rendered impossible, and thus the leasehold deed, the Terminal Management Agreement, the ATAD Service Agreement concluded between the FPD Ltd. Co. and the ATAD, and the lease agreements – including all Appendices and Supplements – shall lapse and become void as of January 1, 2002.*

*The activities covered by the leasehold deed, the Terminal Management Agreement and the Service Agreement will be wholly taken over as of January 1, 2002 by the JS Co. with full competence. We respectfully suggest that the appropriate executive officers of the JS Co. and the FPD Ltd. Co. should meet*

*in view of carrying out the appropriate consultations in the matter for the purpose of closing off business in progress and for the settlement of accounts.*

*Please be further informed of the fact that in the interest of carrying on with normal business operations, we are also sending notice to all contractual partners of the FPD Ltd. Co. concerning the developments and the resulting impossibilities to continue with the performance of said contracts so as to facilitate a smooth and speedy changeover.”*

187. Also on December 22, 2001, ADC & ADMC Management received a similar letter from the Joint Stock Co. notifying it of the Decree and its principal provisions, including Article 1(5). The letter concluded that the Terminal Management Agreement between the Project Company, ATAA and ADC & ADMC Management:

*“... shall similarly lapse and become void, and the activities performed by your company will be taken over and performed by the JS Co. as of January 1, 2002, with full competence. In order to facilitate the maintenance of normal business operations, it is respectfully suggested that we should begin consultations on the transfer without delay.”*

188. On December 27, 2001 (the first business day following Christmas), Mr. Tahy was informed that the Project Company’s offices in Terminal 2/B had to be vacated within three business days, namely by 2 January 2002.

189. As a result of the Amending Act, the Decree and the actions taken in reliance thereon, the Project Company was no longer able to operate the Terminals and collect the associated revenues.

190. Since the Decree, ADC Affiliate has received no dividends on its Quota and no payments on the Promissory Note from the Project Company (including dividends due from the Project Company’s 2001 profit), and ADC & ADMC Management has received no management fees from the Project Company (including management fees due for the second part of 2001).

## **K. Developments after the Decree**

### **1. Separation of the Functions of the ATAA**

191. On January 1, 2002, ATAA’s functions were separated and allocated to BA Rt and HungaroControl as a result of the Amendment to the Air Traffic Act and the subsequent Decree. HungaroControl, according to the Decree, became “*the legal successor with respect to the management of air traffic, the performance of other aviation services and related activities*”. BA Rt, on the other hand, became “*the legal successor with respect to the operation of the Budapest Ferihegy International Airport and related activities*”.

192. The separation of the ATAA’s functions and the establishment of HungaroControl were deemed to be necessary to modernize Hungary’s aviation industry and to harmonize the aviation sector with EU law.



## 2. Passenger Traffic

193. Since 2001, passenger traffic at the Airport has increased substantially year over year, and is projected to continue to grow:

Period	Total Passengers (million)
2002	4.5
2003	5.0
2004	6.5
2005	7.5
2008	10
2010	Above 11

194. Data for the first quarter of 2005 show an increase in passenger traffic of 35.6% over the same period in 2004. This is triple the average growth in passenger traffic in Europe.

195. According to IATA, Hungary will be the world's third-fastest growing market during the period 2004 through 2008, behind only China and Poland, with a projected annual growth rate of 9.6%.

## 3. Parking Facility

196. Prior to the Decree, the Government hired a consultant to develop plans for a parking garage. A request for proposals for architectural services in connection with a parking facility dated April 23, 2004 was followed by a feasibility study for a parking facility prepared by PricewaterhouseCoopers dated September 2004.

## 4. Terminal Expansion and Reconstruction

197. Reconstruction of Terminal 1 started in October 2004 and was completed on July 15, 2005. According to a press release from Budapest Airport, this is the "*first stage*" in the "*long-term development*" of the Airport.

198. According to statements reported in the March 30, 2005 issue of the *Budapest Business Journal*, the deputy CEO of Budapest Airport, Mr. Balazs Bella, acknowledged that the Airport will soon be facing terminal capacity problems. He noted that "*further extension [of Terminal 1] is hindered by the fact that [Terminal 1] is listed as a building under national monument protection.*" He confirmed that the Airport plans to "inaugurate" a new Terminal 2/C in 2009. Mr. Bella also indicated that plans were under way to improve public transit and road accessibility to the Airport.

## L. The Privatization of Budapest Airport

199. In anticipation of privatization, on June 1, 2005, Hungary amended Section 45(1) of the Air Traffic Act so that the majority shares in the Joint Stock Co. could be owned by a

foreign entity. On June 6, 2005, the Government of Hungary issued an invitation to tender for Budapest Airport Rt. The subject of the tender was the sale of shares representing 75% minus one vote of the registered capital of Budapest Airport Rt., which is currently wholly-owned by the Hungarian Privatization and State Holding Company Ltd. (“ÁPV Rt.”).

200. Pursuant to Article 5.2 of the invitation to tender, eleven interested parties submitted written non-binding expressions of interest to ÁPV Rt. by the deadline of June 28, 2005.

201. On July 12, 2005, ÁPV Rt. announced that all but one of these parties were invited to participate in the first round of the tender, namely the submission of non-binding bids by August 9, 2005. On August 26, 2005, ÁPV Rt. invited five bidders from among those who had submitted timely non-binding bids to participate in the second round of the tender, namely the submission of legally binding bids by November 2, 2005.

202. In the first round, the financial bids of the bidders were between HUF 202 billion (US\$1.01 billion) and HUF 390 billion (US\$1.96 billion).

203. On September 29, 2005, the Budapest Metropolitan Court invalidated the tender process on the grounds that the workers at Budapest Airport Rt. were not given a sufficient opportunity for input into the process. On October 20, 2005, ÁPV Rt. recalled the call for final binding bids from the five bidders it had invited into the second round of the invalidated process.

204. On October 28, 2005, ÁPV Rt. announced a closed, single-round tender for the sale of Budapest Airport Rt. (75% minus one vote) to replace the cancelled process. The bidders invited to participate in the restricted tender were those that had been selected for the second round of the previous tender, namely:

- Fraport AG Frankfurt Airport Worldwide (Germany) – operator of the Frankfurt and Frankfurt-Hahn airports, among others;
- BAA international Ltd. (United Kingdom) – operator of Heathrow, Gatwick and Stansted airports in London, among others;
- Hochtief Airport GmbH and Hochtief AirPort Capital (Germany) – operators of the Düsseldorf, Hamburg and Athens airports, among others;
- Macquarie Airports (Australia) – operator of the Rome, Brussels, Birmingham and Sydney airports, among others; and
- Copenhagen Airports (Denmark) – operator of Copenhagen airport, among others.

205. The five bidders were invited to make their bids by November 14, 2005. Three bidders submitted binding bids by the deadline: BAA, Hochtief and Fraport. The highest bid was submitted by BAA, which offered more than HUF 400 billion (US\$1.86 billion). On 8 December 2005, ÁPV Rt. announced its ranking of the bids based on technical and financial criteria. BAA was ranked first.

206. On December 18, 2005, ÁPV Rt. announced that it had signed a privatization contract for Budapest Airport Rt. with BAA (International Holdings) Ltd., for US\$ 2.23 billion (£ 1.26 billion).

207. On December 22, 2005, BAA (International Holdings) Ltd. closed the deal with BA Rt. Under the terms of the deal, BAA acquired a 75% minus one share stake in the Airport as well as moveable assets and agreed on a 75-year asset management contract with Hungary.

208. The press in Hungary has reported that Hungary's opposition Fidesz party has said that it would renationalize the Airport if it wins power in the elections to be held in the spring of 2006.

209. An illustration of the relevant contracts was set out in Claimants' Chart 3 which was submitted at the hearing and helpfully agreed by the Respondent. For ease of understanding the complex structure relevant to this case, the Tribunal sets this out as Appendix 1 to this Award.

## **M. Arbitration Proceedings Brought by the Project Company**

210. In November and December 2005, the Project Company commenced four arbitration proceedings against the Joint Stock Co., which is the legal successor of the ATAA.

211. In the arbitration proceedings initiated on November 29, 2005, the Project Company seeks additional relief amounting to approximately US\$ 19.3 million in compensation for advance lease payments under the Operating Period Lease allegedly paid by the Project Company to the ATAA in excess of the actual utilization period of the Terminals.

212. In the arbitration proceedings initiated on December 15, 2005, the Project Company claims compensation for certain development and repair works under the Operating Period Lease in an amount of approximately US\$ 145,000.

213. The other two arbitration proceedings were both initiated on December 21, 2005. In one of these two proceedings, the Project Company claims damages in a preliminary amount of approximately US\$ 101.5 million on the grounds of an alleged breach of the Operating Period Lease by the Joint Stock Co. and consequential losses of income emanating from rights under the Operating Period Lease. In the other, the Project Company demands refund of VAT allegedly charged erroneously by the ATAA in an amount to be determined following submission of an itemised accounting.

## **IV. CONTENTIONS OF THE PARTIES**

### **A. Contentions of the Claimants**

214. The Claimants contend that the construction phase of the Project was completed without any significant problems or delays. The Project Company operated Terminal 2/A and 2/B efficiently, effectively and profitably.

215. The Claimants claim that under the business structure set forth in the Project Agreements, they constructed and operated Terminals of world class standards.

216. The Claimants claim that the parties put in place a business planning process that was rational, consensual and conservative. The annual business plans for the Project Company were subject to discussion and revision before, in each case, being expressly approved by the ATAA and ADC Affiliate, the Project Company's two quotaholders.

217. The Claimants contend that the distributions to ADC Affiliate and the management fees paid to ADC & ADMC Management were strictly in accordance with the agreements in place between the parties and were reasonable in light of the risks assumed by the Claimants and the value of the know-how transferred to the Airport and the Government partners.

218. The Claimants contend that the Respondent's issuance of the Decree and the following taking-over of all activities of the Project Company in the airport by BA Rt constitute an expropriation of the Claimants' investments in Hungary.

219. The Claimants contend that the Respondent's expropriation of the Claimants' investments, in December 2001, was unexpected, unjustified and uncompensated. As a result of the expropriation, the Project Company has been unable to pursue the sole purpose for which it has been established, namely the operation of the Terminals.

220. The Claimants contend that by reason of such expropriation, ADC Affiliate has been deprived of the stream of dividends on its quota and the payments due on the Promissory Note from the Project Company, and ADC & ADMC Management has been deprived of the management fees payable to it by the Project Company.

221. The Claimants also contend that had the expropriation not occurred, the Project Company would have benefited from the improvements in the market for commercial air travel, and the Project Company would have had the opportunity to participate in the financing, building and operation of the proposed new Terminal 2/C or in the renovation and reopening of Terminal 1, as well as in the construction and operation of a new parking facility.

222. The Claimants contend that the expropriation of the Claimants' interest constituted a depriving measure under Article 4 of the BIT and was unlawful as: (a) the taking was not in the public interest; (b) it did not comply with due process, in particular, the Claimants were denied of "*fair and equitable treatment*" specified in Article 3(1) of the BIT and the Respondent failed to provide "*full security and protection*" to the Claimants' investment under Article 3(2) of the BIT; (c) the taking was discriminatory and (d) the taking was not accompanied by the payment of just compensation to the expropriated parties.

## **B. Contentions of the Respondent**

223. The Respondent denies the Claimants' claims and contentions in their entirety.

224. The Respondent claims that the Airport is an exclusive and non-negotiable asset of the State, as stated in Section 36/A of the Air Traffic Act (Act XCVII of 1995) and the Civil Code.

225. According to the Respondent, the Airport was managed by the ATAA, which was under the administration of the Ministry of Transport, Communications and Water Management.

226. The Respondent claims that ADC and the Claimants have not established a Terminal of "*world class standards*". They have not made it a hub airport, or attracted new carriers. They have not provided management services. They have made minimal investment and have taken on minimal risk.

227. The Respondent claims that neither ADC nor the Claimants took on any risk during the construction phase.

228. The Respondent claims that the Claimants and ADC have received back to date amounts in the order of US\$20 million.

229. The Respondent claims that ADC recovered its bidding and preparation costs during the construction phase.

230. The Respondent contends that the construction of Terminal 2/B was not completed on schedule nor on budget and there were also problems with the renovation of Terminal 2/A.

231. The Respondent claims that ADC & ADMC Management did not fulfil its obligations as the Terminal Manager. Rather, it was the ATAA that in reality managed and operated the Airport.

232. The Respondent contends that following the legislative changes, especially the issuance of the Decree, BA Rt has managed and operated the Airport.

233. The Respondent claims that BA Rt has offered to settle the accounts of the Project Company, but ADC and the Claimants have failed to cooperate.

234. The Respondent claims that the Claimants mischaracterized the dispute between the parties. Specifically the Respondent claims that the Claimants' claims are claims for damages for breach of contract and should be pursued against the Project Company, through the dispute resolution procedures prescribed in the applicable agreements.

235. The Respondent contends that the Claimants have not been deprived of their rights in the Project Company or under the Project Agreements. Nor have the Claimants been deprived of their rights to seek redress from the Project Company.

236. Without prejudice to its contention that this Tribunal lacks jurisdiction, the Respondent denies that it has violated the BIT.

237. In particular, the Respondent claims that it has not taken a measure that deprives the Claimants of their investments.

238. In the alternative, the Respondent claims that even if the Respondent's measure deprived the Claimants of their investments, any such measure was lawful, in that it was in the public interest, under due process of law, not discriminatory, and accompanied by provision for the payment of just compensation.

239. In any event, the Respondent claims that it has not violated any other standards of protection in the BIT, namely fair and equitable treatment, reasonable or non-discriminatory measure, and full security and protection (Article 3(1) and (2)).

240. The Respondent therefore claims that the Claimants are not entitled to the damages claimed.

## **V. RELIEF SOUGHT BY THE PARTIES**

### **A. Relief Sought by the Claimants**

241. The Claimants claim that they are entitled to damages measured under the international law standard of compensation for an unlawful taking.

242. The Claimants contend that due to the fact that actual restitution of the contractual rights confiscated by the Respondent is impractical and considering Article 4 of the BIT in the context of the relevant rules of international customary law, the Claimants are entitled to (a) the consequential damages of the taking, plus (b) the greater of:

- a. the market value of the expropriated investment at the moment of expropriation; and
- b. the sum of (x) the market value of the expropriated investment at the date of the award, calculated with the benefit of post-taking information and (y) the value of the income that the Claimant would have earned from the expropriated investments between the date of the taking and the date of the award.

243. Based on the *LECG Report*, the *LECG Supplemental Report* and the *LECG Post-Hearing Report*, all produced by Messrs. Abdala, Ricover and Spiller of LECG LLP, the Claimants submit that the damages to which they are entitled under each calculation approach as of 30 September, 2006 (including interest) as follows:

damages under the Time of Expropriation Approach	US\$ 68,423,638
damages under the Restitution Approach	US\$ 76,227,279
damages under the Unjust Enrichment Approach	US\$ 99,722,430

plus further interest as of October 1, 2006 until the date of payment.

244. The Tribunal notes that while the Claimants have continued to reserve their right to claim consequential damages caused by the expropriation, which include, as submitted by the Claimants, administrative and overhead costs and damages to the Claimants' reputation, such claims were never substantiated and pursued in the course of these proceedings. The Tribunal therefore deems it appropriate to treat these claims as being effectively withdrawn by the Claimants.

## **B. Relief Sought by the Respondent**

245. The Respondent's requests to the Tribunal are threefold.

246. First, the Respondent requests the Tribunal to dismiss the Claimants' claims in their entirety on grounds of lack of jurisdiction and/or inadmissibility and/or their lack of merit.

247. Second and alternatively, the Respondent requests a stay of the arbitration to allow the Claimants to pursue their contractual remedies.

248. Third, in the event that the Tribunal should award compensation to the Claimants, the Respondent requests as a condition of any payment to the Claimants and ADC, on its behalf and on behalf of any companies controlled by ADC, that they first waive in writing any and all rights they may have under the Project Agreement (including Promissory Note) and transfer the 34% Quota in the Project Company to the Respondent (including any rights to unpaid dividends, and any rights to share in the assets of the Project Company). In a letter dated January 13, 2006 from Ogilvy Renault to the Bodnár Law Firm copied to the Tribunal, Ogilvy Renault stated in response to the argument that the FUF arbitration proceedings could lead to a double recovery:

*"...this Tribunal has the discretion to fashion a remedy that would avoid any risk of double recovery. For example, as was done in other ICSID cases, the Tribunals award can provide that upon payment of the sum awarded by the Tribunal to the Claimants in this case, ADC Affiliate must surrender its quota in the Project Company to the Respondent. Indeed, paragraph 488 of the Respondent's Rejoinder contemplates precisely such an approach."*

249. On Day 1 of the Oral Hearing, at the end of his helpful opening submission, Mr. Burmeister stated as follows:

*"I may conclude with our prayers for relief, but only very briefly addressed. They have been set out in the submissions and briefs."*

*I only want to stress one point, again, and this is basically the last one. In the event that any award would be granted to the Claimants, this may only be conditional upon the transferring back the share in the Project Company to the Respondent, giving back the Promissory Notes they have received and waiving any future rights in relation to the Project Agreements.”*

Judge Brower then said he “*expected those conditions would be agreeable to the Claimants*”.

Mr. Bienvenu then stated:

*“You have seen the statement in our letter of January 13, 2006 subject to payment.”*

## **VI. FINDINGS OF FACT**

### **A. Credibility of Witnesses**

250. The Tribunal has no difficulty in accepting the evidence of the Claimants’ witnesses of fact, Messrs Huang, Tahy and Onozó. They gave their evidence in such a way as to give the Tribunal confidence that they could be relied upon. They all had intimate knowledge with this matter - in Mr. Huang’s case, from inception of the Project to this arbitration. Their oral evidence was consistent with their written statements and, to be fair, their evidence was not seriously challenged in cross-examination.

251. The Respondent called three witnesses. Unfortunately for the Respondent, one of these witnesses, Mr. Somogyi-Tóth, cast considerable doubt on the testimony of Messrs. Gansperger and Kiss.

252. Dr. Kiss was asked when he first heard that the Project Company would be displaced and its operations taken over. Given his then position as the General Director of the General Directorate of Civil Aviation, which was at the time part of the Ministry of Transport, he gave the surprising answer that it was not until January 2002.

253. Mr. Gansperger also denied that he had any prior knowledge of the takeover. He maintained that the first he learned of the decision was when the legislation was adopted on December 18, 2001. He was asked specifically whether he knew that the legislation was contemplated prior to that date. He denied any such knowledge.

254. Mr. Somogyi-Tóth, on the other hand, told the Tribunal that all through the autumn and early winter months of 2001 talk was in the air about the impending changes. He confirmed that this possibility was being discussed between, *inter alia*, Messrs. Gansperger and Kiss from the Transport Department. He further confirmed that both these gentlemen were advocating in favour of the takeover.



255. It is the clear view of the Tribunal that Mr. Somogyi-Tóth's evidence is obviously correct and the Tribunal accordingly accepts it.

256. Even without his testimony, it would seem most unlikely that figures so involved as Messrs. Gansperger and Kiss were not aware of such major impending changes. With the evidence of Somogyi-Tóth, the Tribunal can be convinced that Messrs. Gansperger and Kiss were well aware of what was being planned.

257. Having considered the evidence of Messrs. Gansperger and Kiss in the light of the testimony not only of the witnesses of the Claimants but also that of Mr. Somogyi-Tóth, the Tribunal has no doubt that the evidence of the Claimants' witnesses is to be preferred when there is any conflict with the Respondent's witnesses. The Tribunal will deal with the expert witnesses under the quantum section of this award.

## **B. The Nature of the Claimants' Investment**

258. The Tribunal is satisfied that Mr. Huang was the most competent witness to explain the tender process and the negotiation of the Project Agreements. The Tribunal accepts his evidence. The Tribunal is satisfied that the essence of this transaction never changed. The deal discussed and agreed in 1995 was the same deal as executed in the suite of agreements in 1997. The Tribunal accepts that the 1997 agreements involved a more complex structure. However, it was proposed by the Hungarian side for reasons which they thought necessary.

259. The Tribunal accepts that the return on equity contribution and management fees were part of one package deal. The Tribunal accepts the evidence of Messrs Huang and Ricover that this approach is prevalent in the airport industry.

260. It is worth noting that the competing Lockheed bid also contained such features. The Claimants' bid was the lowest and it is not now open to the Respondent to challenge these matters which were voluntarily agreed at that time.

261. The Tribunal accepts that it was understood and agreed that expenses would be incurred and work executed prior to the Operation Commencement Date because without it the Project would have been delayed. The annual management fee was an integral part of the return which the Hungarian party agreed to return to the Claimants. The Tribunal is satisfied that a management contribution was made by ADC & ADMC Management. If the management fee represented in part deferred compensation the Tribunal can see nothing wrong with this. It seems clear from the management agreement that this would be the case.

## **C. Complaints about the construction of the Terminal**

262. Poor performance in the construction of Terminal 2B and the renovation of Terminal 2A has been hinted at as a possible reason why the agreements were terminated. It is clear to the Tribunal that this was not the reason. The contemporary documents do not support

such a conclusion and the Respondent's witnesses got no where near to establishing this as a justification. At the best, it was a half-hearted *ex post facto* attempt at justification. The Tribunal is satisfied that any problem that existed whether arising from construction or management was sorted out in the normal course of events.

263. Finally, it is not without significance that the third-party consulting firm of Booz-Allen Hamilton referred to Terminal 2B shortly before the events of December 2001 as "*one of Europe's safest and most modern establishments, which the Ministry of Transport can deservedly be proud of*" (sic).

### ***Effect of takeover***

264. The Tribunal accepts that since the Decree was issued ADC Affiliate Limited has received no dividends on its quota and no payment under the Note. Further, the Terminal Manager has received no management fees. Even dividends and management fees due prior to the Decree have not been paid.

265. To add insult to injury, the Respondent caused, permitted or allowed BA Rt to claim debt repayment from the Project Company. Even the Ministry of Finance has refused to clarify the status of the project loan until this arbitration has been concluded.

266. It is also clear beyond any doubt that as from the date of the Decree the rights of the Claimants ceased to exist (the very language used in the Information Memorandum prepared for the purposes of the recent tender exercise that eventuated in the sale to BAA) and that the Decree has resulted in a total loss of the Claimants' investment in the Airport Project.

## **D. Attempted Reasons for and Justification of the Decree**

267. During the course of this arbitration, the Respondent has sought to rely on the following justifications for the Decree:

- (a) compliance with EU law;
- (b) strategic interests;
- (c) contractual non-performance by the Claimants;
- (d) lack of operating license; and
- (e) financial interest in terminating the Project Agreements.

### **(a) EU Law**

268. As noted by the Claimants in their written closing submissions, two points have been raised under this head. The first is that ground handling at the Airport had to be harmonized with EU Directive 96/97 and the second is that air traffic control had to be separated from airport operation services pursuant to EU law.

269. As to ground handling, the Tribunal accepts the evidence of Mr. Tahy, who told the Tribunal that although the Project Company had responsibility for ground handling, it had discharged this responsibility by entering into contracts with ATAA as well as Malév, who were the actual ground handling providers. Furthermore, Mr. Tahy told the Tribunal, and the Tribunal accepts, that the EU Directive was never mentioned by Mr. Gansperger as a reason for the expropriation and that the Project Company was never asked to consider ground handling services being carried out by any third party. It is also not without significance that the position up to the BAA acquisition at the end of 2005 remains the same - ground handling is still in the hands of BA Rt (the legal successor of ATAA) and Malév.

270. As to the separation of air traffic control, it was never made clear to the Tribunal why ATAA could not have been reorganized to meet EU requirements relating to the separation of air traffic control from the commercial operation of the airport without the need for taking over the activities of the Project Company and without the need of the Decree. Mr. Somogyi-Tóth told the Tribunal that the transformation of ATAA did not require the exclusion of the Project Company.

271. Dr. Kiss was somewhat contradictory on this issue. However, he accepted that neither the Government Resolution of April 14, 2000 nor the May 2000 Draft Strategy paper contemplated the cancellation of the Operating Period Lease and the takeover of the activities of the Project Company. Mr. Gansperger's evidence on this point was also unconvincing because the Tribunal fails to see how the transformation of ATAA into a company limited by shares was in any way related to the takeover of the activities of the Project Company as in fact occurred.

272. The Tribunal does not accept that compliance with EU law mandated the steps actually taken by the Respondent, the subject matter of this arbitration.

**(b) Strategic Interests**

273. The term "*strategic interests*" finds its origins in the Amendment Motion dated November 8, 2001 put forward by Dr. Kosztolányi. The same sort of phraseology appears in the Respondent's memorials, Dr. Kiss' witness statements and the Respondent's opening statement.

274. Two points satisfied the Tribunal that this argument is groundless. First, it is a fact that the airport was privatized in December 2005 by the sale to BAA. Second, Mr. Gansperger in his attempt to minimize the role played by the Project Company said in terms "*I did not see that FUF would have dealt with activities of strategic importance...it did nothing*". It seems to the Tribunal that the Respondent cannot have it both ways. If it wishes to minimize the Project Company's role and allege non-performance, it cannot in the same breath justify its actions by the mantra of "*strategic interests*", economic or security.

**(c) Contractual Non-performance**

275. This has already been touched on by the Tribunal above. Three areas of contractual non-performance were mentioned. Terminal management issues, hub development and North American expertise.

276. The problem with all three grounds, in so far as they are relied upon as a justification for the Decree, was that neither the Respondent nor any other Hungarian instrumentality ever put the Claimants on notice that they were allegedly in breach of their contractual obligations. No written notice was ever given and Mr. Tahy stated, and the Tribunal accepts, that no suggestion was ever made to him that the Project Company was derelict in its contractual obligations.

277. The Tribunal has already referred to the favourable comments in the Booz-Allen Report. Dr. Kiss attempted to dismiss these conclusions by simply stating that he did not agree with them without stating why these conclusions were incorrect. It should be noted that this report was financed by the US Trade and Development Agency at the specific request of the Ministry of Transport and, significantly, was not made available to Parliament when it was considering the bill that resulted in the Decree.

278. As to complaints concerning terminal management, the Tribunal does not believe that Messrs Kiss and Gansperger had much knowledge as to what the Project Company actually did. However, Mr. Somogyi-Tóth did have such knowledge and was in regular contract with Messrs Tahy and Onozó. He did accept that there had been some construction problem at Terminal 2B but the Tribunal accepts the evidence of Mr. Huang that all such problems were dealt with under the contractual warranty provisions of the contract and that ATAA ultimately approved such work. Doubtless this was why no notice of default was ever served.

279. As to the allegation that the Claimants were in breach by not providing North American experience, the Tribunal is satisfied that there is nothing in the point. Mr. Huang was from Canada. Mr. Tahy had experience with Malév in the USA. Mr. Huang had satisfied himself that there was sufficient talent within Hungary and, absent complaint at the time, this just cannot stand as a reason for the extreme measures taken by the Respondent.

280. As to the allegation that the Claimants were somehow in breach of their contractual obligations by not developing a hub development at the airport, this simply cannot be accepted because obviously it is for the airline, not the airport operator, to decide where to hub. This was confirmed by the Claimants' aviation expert Mr. Ricover, whose testimony and expertise the Tribunal accepts.

281. The Tribunal accepts that the Project Company performed at the very least in accordance with the projections contained in the business plans agreed from time to time. It is highly significant that the 2002 Business Plan was signed off by Mr. Somogyi-Tóth on behalf of ATAA on December 11, 2001 just days before the events complained of in this arbitration. Further, Mr. Somogyi-Tóth fairly confirmed that his deputy at ATAA, Mr.

Vertes (also a member of the Supervisory Board), must have reviewed the 2002 business plan prior to Mr. Somogyi-Tóth signing it.

**(d) Lack of Operation License**

282. This point was raised for the first time at the hearing in London by Messrs Kiss and Gansperger. Furthermore, as Mr. Gansperger admitted, it was not stated at the time as a reason for the takeover. Still further, as is indicated by the discussion on this point during the evidence of Mr. Gansperger on Day 4, it was never satisfactorily explained why the authorizations contained in the Operating Period License did not of themselves constitute the necessary license. It was never explained why, if this was a valid reason, the Respondent accepted the position and never raised it until January 2006. On any basis this point is unconvincing to the Tribunal.

**(e) Financial Interest in Terminating the Project Agreements**

283. The absence of primary evidence as to the reasons for the takeover is, to say the least, surprising. If Hungarian law did in fact require these extremes steps to be taken, one might have expected some evidence from ministerial level.

284. The Claimants invite the Tribunal to draw the inference that the Respondent was simply unhappy with the contractual arrangement with the Project Company and wished to determine them unilaterally. Mr. Somogyi-Tóth told the Tribunal that there was talk that the current contractual arrangements were disadvantageous to Hungary's interests. It goes without saying that one option open to the Hungarian Government, if the contracts were truly disadvantageous to Hungary's interests, was to buy the Claimants out. There is no evidence before the Tribunal to suggest that Hungary ever considered doing this. The Claimants seek to rely upon contemporaneous newspaper articles quoting Mr. Gansperger and others. Mr. Gansperger denied making the statements attributed to him and the Tribunal does not think it necessary to resolve this factual issue.

285. The Tribunal concludes that no satisfactory explanation has ever been given for the takeover and none of the reasons now sought to be relied upon are tenable.

## **VII. ISSUES TO BE CONSIDERED IN THIS ARBITRATION**

286. Having considered all the submissions and evidence in this arbitration, the Tribunal is being asked to decide the following main issues:

a. **Applicable Law**

b. **Jurisdiction**

Does the Tribunal have jurisdiction to hear the present case? If it has, should the Tribunal limit its jurisdiction to certain claims of the Claimants and if so which ones?

c. **Breach of the BIT**

Has the Respondent breached any provision of the BIT by depriving the Claimants of their investments? If so, what are the consequences?

d. **Quantum of compensation**

If the Respondent's deprivation of the Claimants' assets breached the BIT, what compensation are the Claimants entitled to receive from the Respondent? In calculating the appropriate compensation due to the Claimants, what compensation standard should the Tribunal use? Is it the one set forth in the BIT or is the matter to be dealt with under customary international law? When deciding the quantum of the compensation, what should be the appropriate assessment approach? Is the Discounted Cash Flow ("DCF") approach the appropriate one? If it is not, what other approach is appropriate?

287. The Tribunal will decide each of these main issues as well as sub-issues arising thereunder. The Tribunal will refer to the main arguments put forward by each side in relation to the material arguments. However, the Tribunal will not mention each and every argument raised by the Parties although the Parties can rest assured that all of their arguments have been carefully considered by each member of the Tribunal and are subsumed in the reasons set forth below. Furthermore, because the Tribunal has attempted to do justice to the Parties' submissions, it proposes to give its decision on each material issue as succinctly as possible.

## **A. Applicable Law**

288. The Parties have engaged in a traditional discussion about the applicable law in investor-State arbitration. In essence, Claimants contend that the BIT is a *lex specialis* governed by international law, while Respondent argues that Hungarian law applies.

289. Article 42(1) of the ICSID Convention provides:

*"The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."*

290. In the Tribunal's view, by consenting to arbitration under Article 7 of the BIT with respect to "Any dispute between a Contracting Party and the investor of another Contracting Party concerning expropriation of an investment . . ." the Parties also consented to the applicability of the provisions of the Treaty, and in particular those set forth in Article 4 (*see, MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, Award, 25 May 2004, ICSID Case No. ARB/01/7, at ¶ 87). Those provisions are Treaty provisions pertaining to international law. That consent falls under the first sentence of Article 42(1) of the ICSID Convention ("*The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties*"). The consent must also be deemed to comprise a choice for general international law, including customary international law, if and to the extent that it comes into play for interpreting and applying the provisions of the

Treaty. This is so since the generally accepted presumption in conflict of laws is that parties choose one coherent set of legal rules governing their relationship (which is the case here as it will be seen below), rather than various sets of legal rules, unless the contrary is clearly expressed. Indeed, the State Parties to the BIT clearly expressed themselves to this effect in Article 6(5) of the BIT which Article pertains to disputes between the Contracting Parties concerning the interpretation and application of the BIT, as follows:

*“Article 6*

*...*

*5. The arbitral tribunal shall decide on the basis of respect for the law, including particularly the present Agreement and other relevant agreements existing between the two Contracting Parties and the universally acknowledged rules and principles of international law.”*

For example, where a term is ambiguous, or where further interpretation of a Treaty provision is required, the Tribunal will turn to Articles 31 and 32 of the Vienna Convention on the Law of Treaties of 1969.

291. That analysis also comports with the primary conflict of laws provisions in the various instruments listed in Article 7(2) of the BIT. Those appear to be similar by referring to party autonomy in the choice of law. In contrast, the subsidiary conflict of laws rules in those instruments differ, at least textually. For example, Article 42(1) of the ICSID Convention requires a tribunal to *“apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable,”* while Article 17(1) of the ICC Arbitration Rules (another option under Article 7(2) of the BIT) requires a tribunal to *“apply the rules of law which it determines to be appropriate.”* The application of those subsidiary conflict rules may give differing results, which in turn may affect the manner in which the Treaty provisions, in particular the substantive ones, are to be interpreted and applied. It cannot be deemed to have been the intent of the States Parties to the BIT to have agreed to such a potential disparity.

292. The sole exception to the foregoing is Article 4(3) of the BIT which provides: *“The amount of this compensation may be estimated according to the laws and regulations of the country where the expropriation is made.”* In the present case, that law is Hungarian law. As the reference to domestic law is used for one isolated subject matter only, it must be presumed that all other matters are governed by the provisions of the Treaty itself which in turn is governed by international law.

293. The Parties to the present case have also debated the relevance of international case law relating to expropriation. It is true that arbitral awards do not constitute binding precedent. It is also true that a number of cases are fact-driven and that the findings in those cases cannot be transposed in and of themselves to other cases. It is further true that a number of cases are based on treaties that differ from the present BIT in certain respects. However, cautious reliance on certain principles developed in a number of those cases, as

persuasive authority, may advance the body of law, which in turn may serve predictability in the interest of both investors and host States.

## **B. Jurisdiction**

294. The first main issue this Tribunal must decide is whether it has jurisdiction to hear all the claims made in the present case in the light of Art.25(1) of the ICSID Convention. While Article 25 of the Convention refers to the “*jurisdiction of the Centre*” and Article 41(1) to the “*competence*” of the Tribunal, the Tribunal will use the term “*jurisdiction*” and “*competence*” of the Tribunal interchangeably.

### ***The BIT Provisions and the ICSID Convention***

295. The following articles of the BIT are applicable or relevant in deciding the Tribunal’s jurisdiction. They read as follows:

“ *Article 1*

*For the purpose of this Agreement:*

*1. The term “investments” shall comprise every kind of asset connected with the participation in companies and joint ventures, more particularly, though not exclusively:*

*(a) movable and immovable property as well as any other property rights in respect of every kind of asset;*

*(b) rights derived from shares, bonds and other kinds of interests in companies [emphasis added];*

*(c) title to money, goodwill and other assets and to any performance having an economic value;*

*(d) rights in the field of intellectual property, technical processes and know-how.*

*These investments shall be made in compliance with the laws and regulations and any written permits that may be required thereunder of the Contracting Party in the territory of which the investment has been made.*

*A possible change in the form in which the investments have been made does not affect their substance as investments, provided that such a change does not contradict the laws and regulations and written permits of the Contracting Parties.*

*2. The term “income” means those net amounts received from the investments for a certain period of time [emphasis added], such as shares of profits, dividends, interest, royalties and other fees, proceeds from total or partial liquidation of the investments, as well as any other sums emanating*



from such investments which are considered as income under the laws of the host country.

3. **The term “investor” shall comprise with regard to either Contracting Party:**

- i. *natural persons having the citizenship of that Contracting Party in accordance with its laws;*
- ii. **legal persons constituted or incorporated in compliance with the law of that Contracting Party** [emphasis added],

who, in compliance with this Agreement are making investments in the territory of the other Contracting Party.

#### Article 2

...  
3. **In cases of approved reinvestments, the incomes ensuing therefrom enjoy the same protection as the original investments.** [emphasis added]

#### Article 3

1. **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** [emphasis added].

2. *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 to investments of investors of any third State.*

...

#### Article 4

1. **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.**[emphasis added]

2. ***The amount of compensation must correspond to the market value of the expropriated investments at the moment of the expropriation.*** [emphasis added]

3. *The amount of this compensation may be estimated according to the laws and regulations of the country where the expropriation is made.*

4. ***The compensation must be paid without undue delay upon completion of the legal expropriation procedure*** [emphasis added], *but not later than three months upon completion of this procedure and shall be transferred in the currency in which the investment is made. In the event of delays beyond the three-months' period, the Contracting Party concerned shall be liable to the payment of interest based on prevailing rates.*

#### Article 5

1. *In compliance with its regulations in force, either Contracting Party will permit the investors of the other Contracting Party to transfer, in any convertible currency, income from investments and proceeds from total or partial liquidation of the investments.*

#### Article 7

1. *Any dispute between either Contracting Party and the investor of the other Contracting Party concerning expropriation of an investment shall, as far as possible, be settled by the disputing parties in an amicable way.*

2. *If such disputes cannot be settled within six months from the date either party requested amicable settlement, it shall, upon request of the investor, be submitted to one of the following:*

- (a) *the Arbitration Institute of the Arbitral Tribunal of the Chamber of Commerce in Stockholm;*
- (b) *the Arbitral Tribunal of the International Chamber of Commerce in Paris;*
- (c) *the International Centre for the Settlement of Investment Dispute in case both Contracting Parties have become members of the Convention of 18 March 1965 on the Settlement of Investment Dispute between State and Nationals of Other States.”*

296. The governing provision in the ICSID Convention in regard to jurisdiction of the Centre is Article 25, which reads as follows:

***“(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision of agency of a Contracting State designated to the***

*Centre by that State) and a national of another Contracting State* [emphasis added], which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

(2) “National of another Contracting State” means:

(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include an person who on either date also had the nationality of the Contracting State party to the dispute; and

(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purpose of this Convention.

(3) Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.

(4) Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1). ”

297. The Respondent also refers to Article 26 of the ICSID Convention in support of its rebuttals concerning the Tribunal’s jurisdiction:

*“Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.”*

298. The Claimants contend in their submissions that all jurisdictional requirements in the ICSID Convention and the BIT have been satisfied and therefore the jurisdiction of the Tribunal has been duly established. The Respondent denies the Claimants’ claims and contends that the Tribunal lacks jurisdiction to hear the matter.

299. In order to do justice to all the points on jurisdiction raised by the Respondent, it is necessary to break the submissions down into a list of sub-issues. This involves breaking down the component parts of the Convention and the BIT. These sub-issues are:

- a. Is the nature of the dispute governed (a) by the BIT or (b) is it simply contractual in nature?
- b. If the answer to (a) is that it is governed by the BIT, did the Claimants make any investment in Hungary within the definition of the BIT and the ICSID Convention?
- c. Does the dispute arise “*directly*” out of an investment as required by the Convention?
- d. Does the dispute involve “*investors*” under the BIT who are nationals of a Contracting State to the ICSID Convention?
- e. Does the dispute fall within the scope of Art. 7 of the BIT?

### **1. Is the Nature of the Dispute Governed by the BIT or Is It Simply Contractual in Nature?**

300. The Claimants claim that the dispute between the Parties in this arbitration arose from Respondent’s breach of its BIT obligations towards the Claimants. The present dispute, therefore, is one between the investor and the host State where the investor made investments.

301. The Respondent, however, claims that all the claims brought by the Claimants are contractual in nature rather than those that arise between investors and host States. Further, the Respondent contended that due to the fact that the legal recourse for breach of contracts was fully available to the Claimants, the commencement of this arbitration was premature.

302. In its *Rebuttal*, the Claimants contended that the Respondent’s “*contractual in nature*” argument was a mischaracterization of their claims. In support, the Claimants referred to the ICSID case of *SGS Société Générale de Surveillance S.A. v. The Republic of the Philippines* (ICSID Case No. ARB/02/06), in which the Tribunal confirmed its jurisdiction to hear the case based on the fact that the Claimants in that case “*fairly raise questions of breach of one or more provisions of the BIT*”. The Claimants claimed that the facts in this case raised questions about the breach of the Respondent’s BIT obligations. On this basis, the Tribunal would have jurisdiction to hear the case.

303. At this point, it is necessary to have regard to the allegation of expropriation which the Claimants actually make. Professor van den Berg specifically raised the question as to what was expropriated and when, and on Day 7 of the Oral Hearing, Professor Crawford SC at pages 76 to 80 of the transcript answered as follows:

*“The first question asked by Professor van den Berg was the question: what was taken? What was expropriated? He associated that with the question: when was it expropriated? The information memorandum which was issued*

*on the authority of the privatization agency in October 2005 stated, paragraph 11.1.2 of the privatization agency information memorandum to which you have of course been taken numerous times, and I quote:*

*'Pursuant to legislative changes introduced with effect from 1st January 2002, certain rights of the project company to operate, use and exploit Terminal 2A and 2B ceased to exist.'*

*That is a Hungarian statement operative as of now. That is the view taken by the Hungarian Government persistently in December -- from the date of notice to the Project Company in December 2001 up to the present day. There has been no resiling from that statement. Thus the rights of the Project Company disappeared as a result of legislative acts attributable to the Hungarian state.*

*We do not have to ask who procured them, there is no problem of attribution here. This had the effect, direct and intended, of destroying the enterprise in which the claimants were directly involved and which was their investment, and of doing so without any compensation.*

*The Booz-Allen report, paragraph D.10, puts it this way:*

*'The right of use of the property assets earmarked for FUF', was transferred to Hungary without compensation.*

*'Under the BIT a stakeholder with a legal right or a legitimate expectation of income flows and other benefits under an investment agreement which has its investment destroyed or nullified in value as a direct result of such a transfer has been expropriated.'*

*That is plain hornbook law of expropriation. The fact it is indirect in the sense that the rights themselves were held by the Project Company is irrelevant, the BIT clearly contemplates that sort of situation. So that is the short answer.*

*The Chorzów case is fascinating because it prefigures so much of this and there is a very nice account of what constitutes the enterprise, as they put it, which you will find at page 17 of judgment A6, where it says -- it was actually referring to the phrase 'undertaking'...:*

*'An undertaking as such is an entity entirely distinct from the lands and buildings necessary for its working.'*

*...*

*The question here is: what was the undertaking? And it had to do in this case with the certain complications relating to who owned the actual land, not*

*entirely dissimilar from what we have here of course because we are talking about rights of use which can constitute an investment under the BIT:*

*‘But an undertaking as such is an entity entirely distinct from the lands and buildings necessary for its working, and in the present case, it can hardly be doubted that, in addition to the real property which belonged to the Reich, there were property, rights and interests, such as patents and licenses, probably of a very considerable value, the private character of which cannot be disputed.’*

*That carried right through the case up to the questions that were asked to the experts; what they were asked to value was the undertaking, in this case we would say the investment. So the short answer is that what was expropriated was that bundle of rights and legitimate expectations.*

*As to the date of expropriation, well, expropriations can take a few minutes or a few days or they can be a bit more protracted, we do not have to put a precise hour of the day on it, but it happened somewhere between 22nd December and 1st January, nothing turns on which particular date you choose within that very short window. That would be our response to the first question.” [sic]*

The Respondent’s position as regards taking and expropriation is summarized in paragraphs 234 to 236 above.

### ***Discussion***

304. As will be explained later in the section dealing with liability, it is the opinion of the Tribunal that Professor Crawford articulated the matter correctly. There can be no doubt whatsoever that the legislation passed by the Hungarian Parliament and the Decree had the effect of causing the rights of the Project Company to disappear and/or become worthless. The Claimants lost whatever rights they had in the Project and their legitimate expectations were thereby thwarted. This is not a contractual claim against other parties to the Project Agreements. An act of state brought about the end of this investment and, particularly absent compensation, the BIT has been breached. It is common ground that no compensation was offered in respect of this taking. Further, the Tribunal is satisfied that no case has been made out that the taking was in the public interest. The subsequent privatization of the airport involving BAA and netting Hungary US\$ 2.26 billion renders any public interest argument unsustainable. In the opinion of the Tribunal, this is the clearest possible case of expropriation.

## **2. Did the Claimants Make Any Investment in Hungary within the Definition of the BIT and the ICSID Convention?**

305. The issue of whether Claimants actually made investments in Hungary and therefore qualify as “*investors*” as defined in the ICSID Convention and the BIT was heavily debated by the Parties.

306. In their Memorial, the Claimants state that since the ICSID Convention does not provide a specific definition of “*investment*”, it is “*necessary to refer to the Cyprus-Hungary BIT*” to find what an “*investment*” is. After a brief review of Article 1 of the BIT, the Claimants conclude that their investment in the Airport and their corresponding returns, *i.e.*, ADC Affiliate’s 34% quota-holding in the Project Company, ADC & ADMC Management’s entitlement to 3% of each year’s net revenue of the Airport, “*qualify as ‘investments’*” under the BIT and the Convention. The Claimants further state that these investments are “*at the very least ‘assets’ connected with the participation in the Project Company.*”

307. The Respondent denies the Claimants’ above assertion vigorously and claims, in its Counter-Memorial, that the Claimants did not make any investment and cannot qualify as “*investors*” under the BIT and the Convention standards.

308. The Respondent lists four claims of the Claimants in relation to their “*alleged*” investments, namely:

1. ADC Affiliate’s claim in relation to its lost dividends derived from its 34% quota-holding in the Project Company;
2. ADC Affiliate’s claim in relation to non-payment under the Promissory Note;
3. ADC & ADMC Management’s claim of lost Terminal Management fees; and
4. the Claimants’ claim in relation to future development of the Airport.

309. In regard to the first claim of ADC Affiliate, the Respondent claims that it was ADC rather than ADC Affiliate who made the equity contribution in the amount of US\$5.7 million to the Project Company. The Respondent also claims that there is no evidence that ADC Affiliate paid any consideration when it received ADC’s assignment of its rights and obligations under the Quotaholders’ Agreement.

310. In line with the above claims, the Respondent raised the argument that in order to meet the BIT “*investment*” criteria, not only must the Claimants make investments in the host country, but also such investments must be “*fresh*”. Because ADC Affiliate merely received ADC’s rights and obligations via assignment, ADC Affiliate cannot be deemed to have made any “*fresh*” investment in Hungary.

311. Moreover, the Respondent further contends that under Article 25(1) of the ICSID Convention, only those investors who bear “*risk*” can claim they made an investment in the host State. Since ADC Affiliate did not bear much risk as a quotaholder of the Project Company, it cannot claim they made an investment in Hungary.

312. In regard to the other three claims listed above, the Respondent contends, in sequence, a) that ADC Affiliate did not make any investment through the Promissory Note, b) ADC & ADMC Management did not make any investment nor provide management services during the Operating Period and c) “*contractual provisions to which the Claimants are not a party does not constitute investment under the BIT.*”

313. The Claimants rebut each of the above claims of the Respondent in their *Reply*.

314. The Claimants contend that ADC Affiliate’s shareholding in the Project Company and its right under the Promissory Note fell well within the scope of “*investment*” as defined in the BIT. The Claimants refer in this regard to *Generation Ukraine, Inc. v. Ukraine* (ICSID Case No. ARB/00/9) where the Tribunal concluded that a shareholding interest is an “*investment*” when “*investment*” was defined to include “*shares of stock or other interest in a company*”.

315. The Claimants deny that there is a “*fresh*” investment requirement under the BIT and contend that the argument that an investment must be “*fresh*” in order to establish the Centre’s jurisdiction has been rejected by “*ICSID jurisprudence*”. In support of this assertion, the Claimants refer to *Fedax NV v. Venezuela* (ICSID Case No. ARB/96/3) and quote the Tribunal’s statement that:

*“[...] the investment itself will remain constant, while the issuer will enjoy a continuous credit benefit until the time the notes become due. To the extent that this credit is provided by a foreign holder of the notes, it constitutes a foreign investment which in this case is encompassed by the terms of the Convention and the [BIT] Agreement. [...]”*

316. In regard to the Promissory Note, the Claimants deny the Respondent’s claim that it is a loan to the ATAA. After a review of the economics of the Airport Project, the Claimants reaffirm that the Promissory Note is a finance instrument that constitutes a form of investment.

317. The Claimants deny that there is a “*risk-bearing*” requirement under Article 25 (1) of the ICSID Convention. The Claimants contend that the cases and legal literature relied upon by the Respondent in its Counter-Memorial were misread. The Claimants argue that rather than supporting the Respondent’s “*risk-bearing requirement*” conclusion, Professor Christopher Schreuer said in the same article which was relied upon by the Respondent that “*risk*” is only a factor for the Tribunal to consider when deciding jurisdiction, rather than a legal requirement under the ICSID Convention. The Claimants cite Professor Schreuer’s writing in regard to “*risk*” that:

*“These features should not necessarily be understood as jurisdictional requirements but merely as typical characteristics of investments under the Convention.”*



318. The Claimants deny that no investment was made by ADC & ADMC Management. The Claimants contend that ADC & ADMC Management's entitlement of the 3% net revenue qualifies as "*property rights*" and the Terminal Management Agreement qualifies as "*title to money [...] and to any [...] performance having an economic value*" under the BIT.

319. In response to the Respondent's claim that the Management Fees are "*income*" rather than "*investment*" under the definition in Article 1(2) of the BIT, the Claimants refer to Article 1(2), Article 2(3) and Article 5(1) of the BIT and contend that the BIT protects both "*original investments and approved re-investments and all income derived therefrom*". As a result, the Respondent's characterization of the Management Fees as "*income*" will not change the fact that they are protected by the BIT.

320. In regard to the Respondent's future development claims, the Claimants reply that the Respondent misunderstood their claims. As the Claimants put it, "*ADC Affiliate does not claim rights as an investor in lieu of the Project Company, but rights in the Project Company*". The Claimants also contend that arguments made by the Respondent in this regard are more quantum-related rather than jurisdiction-related.

321. Another round of debate on this "*investment*" issue followed between the Parties in their further submissions of the *Rejoinder* and the *Sur-Rejoinder*. Besides the reiteration and affirmation of certain arguments made in their previous submissions, a new point has been raised and argued by the Parties.

322. In the Respondent's *Rejoinder* submitted by its new legal counsel, it is argued that that the wording of Article 1(3) of the BIT that "*who...are making investments in the territory of the other Contracting Party [emphasis added]...*" indicates that only those who are taking active actions of investment are qualified to claim for BIT protection. The Respondent claims that since ADC Affiliate did not take any action of investment and at most could be said to be "*holding*" some investment in Hungary, it cannot claim for BIT protection.

323. In rebuttal to this point, the Claimants argue that the Respondent's argument is "*unavailing*" because Article 1(3) was drafted to limit the BIT's application to investments made "*in the territory of the other Contracting Party [emphasis added]*" and was not intended to and does not set another threshold for the injured party to seek BIT protection. Moreover, the Claimants contend that even if another test is imposed as argued by the Respondent, the fact that ADC Affiliate paid consideration for the assignment from ADC would pass such test.

324. In support of the above rebuttal, the Claimants, in their *Sur-Rejoinder*, again refer to *Fedax v. Venezuela* (Ibid.), which was challenged by the Respondent in its *Rejoinder*. The Claimants argue that the Tribunal should consider the substance of the transaction and examine whether any investment was made and should not be prevented from finding its jurisdiction by the wording of the relevant BIT.

## *Discussion*

325. The Tribunal is in favour of the Claimants’ “*substance*” approach in considering this issue. Whilst attention need to be paid to the wording of the BIT with respect to “*investment*”, the Tribunal believes it is the substance of the transaction that reveals the answer as to whether any investment was made. Based on a thorough examination of the facts and careful consideration of the applicable law, the Tribunal concludes that the Claimants did make investments in Hungary and therefore the present dispute does arise out of an investment made as contemplated in the BIT and the ICSID Convention. Again it is necessary to have regard to the effect of all the Project Agreements. The Project Documents are clear that an investment in the sum of US\$16.765 million had been made. As for the argument relating to the Management Fees, the Tribunal is satisfied, on the evidence it has heard and on the law, that the income stream derived from the Management Services Agreement was protected by the BIT and also falls within the ICSID Convention. The Tribunal is also satisfied that it was intended by the parties to these agreements that the Management Services Agreement was meant to reimburse the Claimants for work and services carried out prior to the Operation Commencement Date. The argument relating to the amount of the investment has been abandoned. It is thus common ground that if an investment was made, as the Tribunal so concludes, then the amount of it was US\$16.765 million. As stated above, the Respondent has withdrawn the argument that the investment should be valued excluding the value of the Promissory Note.

### **3. Does the Dispute Arise “Directly” out of An Investment as Required by the ICSID Convention?**

326. The Parties dispute the meaning of the phrase “*arising directly*” in Article 25 (1) of the ICSID Convention.

327. The Claimants claim that the current dispute arose directly out of their investments in Hungary. In the Claimants’ contention, a direct cause of action was rendered available to the Claimants by the Respondent’s issuance of the aforementioned Amending Act and the Decree, which, according to the Claimants, breached the obligation under the BIT and affected the investments made by the Claimants in Hungary. The Claimants also claimed that the jurisdiction of the Centre is established as long as the actions of the Respondent breached its BIT commitments of investment protection, even if such actions can be characterized as general economic measures.

328. Among all the cases the Claimants relied upon in support of their proposition in this regard, the Tribunal found the following passages of the following cases to be of particular relevance. In *CMS Gas Transmission company v. The Republic of Argentina* (ICSID Case No. ARB/01/8), the Tribunal held that:

*“27. It follows that, in this context, questions of general economic policy not directly related to the investment, as opposed to measures specifically addressed to the operations of the business concerned, will normally fall outside the jurisdiction of the Centre. A direct relationship can, however, be*

established if those general measures are adopted in violation of specific commitments given to the investor in treaties, legislations or contracts. What is brought under the jurisdiction of the Centre is not the general measures in themselves but the extent to which they may violate those specific commitments.” [emphasis added]

329. In *Enron Corporation, et al. v. The Argentine Republic* (ICSID Case No. ARB/01/03), the Tribunal wrote:

*“60. The Tribunal has noted above that the right of the Claimants can be asserted independently from the rights of TGS [the local project company] or CIESA [an intermediate holding company]. As the Claimants have a separate cause of action under the Treaty in connection with the investment made, the Tribunal concludes that the present dispute arises directly out of the investment made and that accordingly there is no obstacle to a finding of jurisdiction on this count.”* [emphasis added]

330. The Respondent denied that the Claimants met the “*directness requirement*” in Article 25(1) of the ICSID Convention. In its submissions, the Respondent claimed that the Claimants’ claims arose from contractual disputes under the Project Agreements and therefore do not pertain to disputes that arise “*directly*” out of an investment for the purpose of Article 25. The Respondent further challenged the Claimants “*directness*” arguments by saying that it is the rights of the Project Company which are “*directly*” affected and those of the Claimants can only be said as “*indirectly*” affected. The Respondent claimed that cases referred to by the Claimants were irrelevant.

### ***Discussion***

331. In considering whether the present dispute falls within those which “*arise directly out of an investment*” under the ICSID Convention, the Tribunal is entitled to, and does, look at the totality of the transaction as encompassed by the Project Agreements. The Tribunal does not find the “*commercial*” argument of Hungary to be availing. The Tribunal is not concerned whether the Claimants have rights against ATAA. This claim is posited on the basis that Hungary took action which had the effect of depriving the Claimants of their investment and that no compensation was offered or paid in respect thereof. The Tribunal fails to see how it can be contended that this dispute does not arise directly out of an investment. It plainly does. The fact that this case involved a complex series of carefully drafted agreements does not detract from the fact that the Claimants invested US\$16.765 million into the Hungarian Airport Project. By the Claimants making this investment, Hungary was relieved of having to find these funds for itself. This was a direct investment in Hungary within the terms contemplated in the BIT. The investment was no less direct because it was channelled through the Project Company. It would be absurd to argue that only cases where an investor transfers funds directly to the Hungarian Government would be covered by the Convention and the BIT. Further, when one reviews the Master Agreement which was executed by ATAA as early as March 1995, it can be seen that the

parties envisaged that a project structure of this sort actually executed. In one of the Recitals of the Master Agreement, it is clearly stated that

*“the parties wish to set forth the terms and conditions of the development of the Project by ADC and operation of the Terminal by the Project Company with the cooperation of the ATAA....”*

As a “roadmap”, this Master Agreement set forth the blueprint of how the Airport Project should be structured and financed. It was the Respondent who later demanded the adjustment of the project structure and who was furnished with a revised structure which met its needs. Nevertheless, it was still under the umbrella of the Master Agreement that the Project Agreements were executed. In the light of these facts, the Tribunal has to conclude that the Respondent was a willing party to the setting up of the structure through which the investments of the Claimants in Hungary were made. In this context, substance must be preferred over form.

#### **4. Does the dispute involve “investors” under the BIT who are nationals of a Contracting State to the ICSID Convention?**

332. It is clearly set forth in Article 25 of the ICSID Convention that the Centre’s jurisdiction shall only extend to disputes arising “*between a Contracting State...and a national of another Contracting State*”. Under the circumstances of the present case, the task of the Tribunal is to find out whether the Respondent is a “*Contracting State*” and whether, at the same time, each Claimant qualifies as “*a national of another Contracting State*”.

333. The Claimants contend in their Memorial that it is established that the Respondent is a “*Contracting State*” and the Claimants are “*nationals of another Contracting State*”. The Claimants contend that Hungary is a Contracting State to the ICSID Convention, which entered into force as to Hungary on March 6, 1987. On the other hand, the Claimants contend that both of them, namely ADC Affiliate and ADC & ADMC Management, are legal persons duly incorporated under the law of the Republic of Cyprus, which is also a Contracting State to the ICSID Convention. Moreover, since Article 25(2)(b) of the Convention states that the phrase “*national of another Contracting State*” includes “*any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration*”, and since the Claimants obtained their Cypriot nationality via due incorporation under the law of Cyprus prior to the date on which the Parties consented to submit their dispute to the Centre, the nationality requirement is fully met. In relation to the above claims, the Claimants also refer to the definition of “*investor*” set forth in Article 1(3)(b) of the BIT, which covers “*legal persons constituted or incorporated in compliance with the law*” of Cyprus.

334. The Respondent denies entirely in its Counter-Memorial that the Claimants’ case meets the “*nationality*” requirement under the Convention. The core arguments made by the Respondent are that:

1. the disputed investments in this case should in no way be deemed to be investments made by Cypriot nationals; instead, if any investment was ever made in Hungary, it was made by Canadian companies;
2. the claims made by the Claimants are not Cypriot pursuant to the object and purpose of the BIT and are not made by a Cypriot national pursuant to the BIT; and
3. the claims do not belong to a national of a Contracting State of the ICSID Convention.

335. The Respondent claims that the Claimants are nothing but two shell companies established by Canadian investors and all the facts, including those related to the structuring of the project, operation of the Project Company and even the involvement of the Canadian Government when the dispute initially arose, indicate that the investments were made by Canadian companies rather than Cypriot ones.

336. The Respondent further contends that the Claimants cannot establish their Cypriot nationality because the simple fact that they were incorporated in Cyprus under its law fails to meet the “*fundamental requirement of the rules of international law*” that there must be a genuine connection “*between the corporation and the State of its claimed nationality*”.

337. The Respondent cites in support of its argument the Barcelona Traction Case from the International Court of Justice. In that case Belgium sought relief on behalf of Belgian shareholders of the Barcelona Traction Company from Spain for actions taken against that company in Spain. The Court ruled, however, that as a matter of general international law only the State of the company's incorporation, namely Canada, would have standing to assert the company's rights against Spain, and that Belgium, not being the place of incorporation of the company, lacked such standing, in consequence of which the case was dismissed.

338. The Respondent also quotes from Professor Brownlie's well-recognized international law treatise that:

*“On the whole the legal experience suggests that a doctrine of real or genuine link has been adopted, and, as a matter of principle, the considerations advanced in connection with the Nottebohm case apply to corporations.”* (Ian Brownlie, *Principle of Public International Law* (6<sup>th</sup> ed, 2003))

339. The Respondent states, in the alternative, that if a presumption of the Claimants' Cypriot nationality can be established, such presumption must be disregarded “*when the corporate form is used to benefit from a connection with a jurisdiction that is not genuine and is only a matter of convenience.*” The Respondent argues that the legal principle of “*piercing the corporate veil*” shall apply to the present case and cites the following passage from another international law treatise, *Oppenheim's International Law*:

*“In many situations, however, it is permissible to look behind the formal nationality of the company, as evidenced primarily by its place of incorporation and registered office, so as to determine the reality of its relationship to a State, as demonstrated by the national location of the control and ownership of the company.” (Oppenheim’s International Law, (9<sup>th</sup> ed, 1992) vol I, p. 861)*

340. The Respondent also borrows the following statement of the ICJ in its *Barcelona Traction* judgment to strengthen its “*piercing the corporate veil*” argument:

*“[T]he process of lifting the veil, being an exceptional one admitted by municipal law indicates that the veil is lifted, for instance, to prevent misuse of the privileges of legal personality.”*

341. The Respondent thus contends that Cypriot nationality is being misused by the Claimants and therefore should be disregarded.

342. Additionally, the Respondent argues that when deciding the nationality of the investor, the origin of the capital must be considered by the Tribunal. It refers to the recent ICSID case of *Tokios Tokelés v. Ukraine* (ICSID Case No. ARB/02/18). In that case, Professor Prosper Weil, President of the Tribunal, dissented from the majority opinion, which held that the origin of the capital was irrelevant to the investor’s nationality and concluded that such majority opinion runs counter to “*the object and purpose of the ICSID Convention and system as explicitly defined both in the Preamble of the Convention and in the Report of the Executive Directors*”. (Ibid.)

343. The Respondent therefore contends that due to the fact that the origin of the capital in the present case is Canadian and Canada is not a Contracting State to the ICSID Convention, the Tribunal should reject the Claimants’ claims for the reason that the claims do not belong to nationals of a Contracting Party.

344. In their *Reply*, the Claimants countered each of the Respondent’s arguments.

345. Besides arguments previously raised in the Memorial, in response to the “*genuine connection*” argument, the Claimants contend that the general international law principle in this regard is that, in Professor Brownlie’s words, there is “*no certainty as to the criteria for determining [the] connection*” (Ian Brownlie, *Principle of Public International Law* (6<sup>th</sup> ed, 2003)) between the corporation and the State. While some treaties require the corporation to prove a “*genuine link*”, the Cyprus-Hungary BIT does not require so. The Claimants then compare the BIT at issue with five other BITs to which Hungary is a party. One of these five BITs was concluded before the one at issue and the rest of the BITs were concluded afterwards. The Claimants state that whether entered into before or after the Cyprus-Hungary BIT, these BITs all require that the relevant corporation not only was incorporated but also has business activities in the State the nationality of which the corporation claims. The Claimants conclude that had the parties to the BIT intended to require a “*genuine link*” requirement in the Cyprus-Hungary BIT, they could and would

have done so. The fact that there is no such requirement indicates that the parties to this BIT did not intend to set any limitation on the definition of an “investor”.

346. The Claimants reject the Respondent’s “*origin of capital*” argument. The Claimants first claim that ADC Affiliate, a Cypriot legal person and the lender of the US\$16.765 million which in turn was injected into the Project Company by ADC, is the “*real source*” of the investment.

347. The Claimants proceed to argue that the origin of the capital is irrelevant in the present case because, unlike other BITs, the Cyprus-Hungary BIT at issue does not address concerns about the origin of the capital. They claim that “*as long as one is a covered ‘investor’, one benefits from the provisions of the BIT, irrespective of the origin of the investment made.*” In support of this argument, the Claimants refer to *Olguin v. Republic of Paraguay* (ICSID Case No. ARB/98/5), where the ICSID Tribunal did not find an express “*origin of investment*” requirement in the Paraguay-Peru BIT and rejected Paraguay’s argument based on the assumption of such a requirement.

348. The Claimants also argue that the fact that Cyprus was chosen as the state of the Claimants’ incorporation was not a result of the Claimants’ “*arbitrary choice of jurisdiction*” but rather a “*commercially sensible*” decision of which the Respondent was fully aware.

349. In reply to the Respondent’s claim, which the Claimants labelled as the “*core assertion*”, that the real interests underpinning this dispute are Canadian rather than Cypriot, the Claimants argue that the nationality of the Claimants’ shareholders is not a “*relevant consideration*” under the Cyprus-Hungary BIT. The Claimants also argue that the alleged “*intervention*” of the Canadian Government does not prevent this Tribunal from finding jurisdiction.

350. In their *Rejoinder*, the Respondent’s new legal counsel re-emphasized the argument that there is no “*genuine link*” between the Claimants and Cyprus. They also reiterate that it is a Canadian interest, rather than one of Cyprus, that stands behind this dispute.

351. The Claimants further rebut the Respondent’s jurisdictional challenges in the *Sur-Rejoinder* based on an analysis of case law and the international law literature.

### ***Discussion***

352. The fact that Cypriot entities were to be used was known at the time to Hungary and consented to by it. The phrase “*a national of another Contracting State*” contained in Art 25 (1) of the Convention is defined in Art 25(2)(b) as “*any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date which the parties consented to submit the dispute to conciliation or arbitration*”. The definition of “*investor*” under Article 1 (3)(b) of the BIT also includes “*legal persons constituted or incorporated in compliance with the law of that Contracting Party*”.

353. The Tribunal also found the following facts through the submissions of the Parties and the hearing:

- It is not in dispute that Hungary and Cyprus are parties to the relevant BIT.
- It is not in dispute that ADC Affiliate was incorporated according to the laws of Cyprus on February 25, 1997, a date prior to the execution of the Project Agreements.
- It is not in dispute that ADC Affiliate has paid taxes in Cyprus since incorporation and has engaged Cypriot auditors to audit its financial statements. Furthermore, the Respondent admits that the Project Company has paid dividends to ADC Affiliate, one of its quotaholders in Cyprus.
- ADC Affiliate loaned US\$16.765 million to ADC for the project pursuant to the Loan Agreement. It also purchased the quota and the Note from ADC in exchange for the loan. By purchasing the quota it assumed rights and obligations under the Quotaholders Agreement as a quotaholder pursuant to the terms of the Assignment and Assumption Agreement. Finally, ADC Affiliate received payment pursuant to the Note and payment of dividends in accordance with the relevant Project Agreements and based on the business plan of the Project Company.
- It is not in dispute that ADC & ADMC Management was incorporated according to the laws of Cyprus on February 25, 1997. It is not in dispute that it has paid taxes in Cyprus since its incorporation and has engaged auditors to audit its financial statements since its incorporation.
- The Respondent admits that the Project Company has paid management fees to ADC & ADMC Management in Cyprus.
- It is contended, and not effectively denied, that ADC & ADMC Management had a perfectly lawful and legitimate role in the Project. It entered into the Terminal Management Agreement with ATAA and the Project Company in February 1997; it provided pre-billing services and supervision to the project through the efforts of Mr. Huang and others; it submitted annual reports and invoices from Cyprus relating to the performance of the Management Services; it was paid Management Fees in accordance with the Terminal Management Agreement and it owned a Hungarian subsidiary “ADC & ADMC Management Hungary Limited” which employed the staff of the Terminal Manager who undertook the day-to-day work of the Terminals. Some eight people were employed by the Hungarian subsidiary.

354. In light of the above, the Tribunal has before it two parties which fit into the definitions under the Convention and the BIT.



355. The Respondent's jurisdictional argument is however posited on the contention that the source of funds and the control of the Claimants rest with Canadian entities, thus preventing the Cyprus-Hungary BIT from being applicable.

356. The Tribunal cannot agree with the Respondent in this regard.

357. In this respect the BIT is governing, and in its Article 1(3)(b) Cyprus and Hungary have agreed that a Cypriot "investor" protected by that treaty includes a "legal person constituted or incorporated in compliance with the law" of Cyprus, which each Claimant is conceded to be. Nothing in Article 25(2)(b) of the ICSID Convention militates otherwise, as it grants standing to "any juridical person which had the nationality" of Cyprus as of the time the Parties consented to this arbitration. As the matter of nationality is settled unambiguously by the Convention and the BIT, there is no scope for consideration of customary law principles of nationality, as reflected in *Barcelona Traction*, which in any event are no different. In either case inquiry stops upon establishment of the State of incorporation, and considerations of whence comes the company's capital and whose nationals, if not Cypriot, control it are irrelevant.

358. The Respondent makes reference to the principle of "*piercing the corporate veil*". Although that principle does exist in domestic legal practice in some jurisdictions, it is rarely and always cautiously applied. Further, it would be inapplicable in this case. The reason is that this principle only applies to situations where the real beneficiary of the business misused corporate formalities in order to disguise its true identity and therefore to avoid liability. In this case, however, Hungary was fully aware of the use of Cypriot entities and manifestly approved it. Therefore, it is the opinion of the Tribunal that the Respondent's "*source of funds*" and "*control*" arguments as well as the "*piercing the corporate veil*" argument cannot stand.

359. The Tribunal cannot find a "*genuine link*" requirement in the Cyprus-Hungary BIT either. While the Tribunal acknowledges that such requirement has been applied to some preceding international law cases, it concludes that such a requirement does not exist in the current case. When negotiating the BIT, the Government of Hungary could have inserted this requirement as it did in other BITs concluded both before and after the conclusion of the BIT in this case. However, it did not do so. Thus such a requirement is absent in this case. The Tribunal cannot read more into the BIT than one can discern from its plain text.

360. The legal authority the Respondent heavily relies upon in its objection is the famous Dissenting Opinion of Professor Prosper Weil in the *Tokios Tokelés case*. In that case, Professor Weil opined, in the minority, that to ignore the origin of capital when determining the nationality of the corporation claimant would run against "*the object and purpose of the ICSID Convention*". This Tribunal, however, concurs with the majority opinion in *Tokios Tokelés* and holds that the origin of capital is not a relevant factor in determining the Claimants' nationality. This is not only because the majority opinion in *Tokios Tokelés* still represents good international law, but also because, in essence, the fact pattern in *Tokios Tokelés* differs substantially from the facts in this case and thus renders Professor Weil's conclusion, be it reasonable or not, inapplicable. In *Tokios Tokelés*, the

Tribunal was asked to deal with the situation where the corporate claimant of one BIT State Party was effectively owned and controlled by the nationals of the other BIT State Party. But this is not the case here. In the present case, nationals of a third State, with substantial business interests and the express consent of the Hungarian Government, incorporated the Claimants in Cyprus. In the light of these facts and the above reasons, the Tribunal concludes that the Dissenting Opinion of Professor Weil is not applicable and must be disregarded at least on the facts of this case.

361. With regard to the Respondent's argument concerning the Canadian Government's involvement in the early stages of this dispute, the Tribunal cannot see how it can affect the application of the well-established international law rule applicable in this case. The BIT applies or it does not. It cannot be made to disapply simply because, rightly or wrongly, the Claimants' shareholders appealed for help to Canada.

362. In conclusion, the Tribunal is of the opinion that the Claimants are nationals of Cyprus and this dispute is between a Contracting State and nationals of another Contracting State under the ICSID Convention and there is nothing in the Cyprus-Hungary BIT that requires any different result.

#### **5. Does the dispute fall within the scope of Art. 7 of the BIT?**

363. Article 25(1) of the ICSID Convention requires the parties' "*consent in writing*" to arbitration before the Centre. The consent of Hungary to the institution of the proceedings before ICSID can be found in Article 7(2)(c) of the Treaty. The Claimants consented to ICSID arbitration by their letter of consent dated November 29, 2002 which consent was confirmed by their lodging of their Request for Arbitration with the Centre on July 27, 2003.

#### **6. Conclusion on Jurisdiction**

364. Based on a thorough consideration and careful analysis of the facts found through the arbitration proceedings and the terms of the Convention, the Hungary-Cyprus BIT and applicable customary international law, the Tribunal is satisfied that it has full jurisdiction to hear all of the claims made in this case.

### **C. Expropriation**

365. The Tribunal now proceeds to consider the legal issues at the very heart of the present dispute, i.e., has the Respondent breached any provision of the BIT by depriving the Claimants of their investments? And if so, what are the consequences?

366. The Parties' positions submitted in different rounds of submissions in this regard are summarized as follows.

367. As mentioned in paragraphs 210 to 218 above, the Claimants' fundamental positions as set forth in their Memorial are that the Claimants' investment and the benefits to be

derived therefrom in and related to the Airport and the Airport Project were unlawfully and unjustifiably deprived by the Respondent through its unexpected, unjustified, illegal and non-compensatory appropriation in December 2001.

368. The Claimants contend that the Amending Act, the Decree and the actions taken in reliance thereon by the Respondent constitute a deprivation measure under Article 4 of the BIT, which, for the ease of reading, is set out again below:

- Article 4*
- 1. 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.*
- 2. The amount of compensation must correspond to the market value of the expropriated investments at the moment of the expropriation.*
- 3. The amount of this compensation may be estimated according to the laws and regulations of the country where the expropriation is made.*
- 4. The compensation must be paid without undue delay upon completion of the legal expropriation procedure, but not later than three months upon completion of this procedure and shall be transferred in the currency in which the investment is made. In the event of delays beyond the three-months' period, the Contracting Party concerned shall be liable to the payment of interest based on prevailing rates.*
- 5. Investors of either Contracting Party who suffer losses of their investments in the territory of the other Contracting Party due to war or other armed conflict or state of emergency in the territory of the other Contracting Party, shall be treated, with respect to the compensations for these losses, as Investor of any third State."*

369. The Claimants emphasized that the wording of Article 4(1), compared with that in many other BITs, has a “*very broad reach*” so the Decree and the actions taken in reliance thereon by the Respondent fall well into the orbit of this provision.

370. The Claimants further contend that Article 4 of the BIT above stipulates four conditions for the deprivation measures to be deemed lawful. They are, respectively, (a) that the measures are taken in the public interest; (b) that the measures are taken under due process of law; (c) that the measures are non-discriminatory and (d) that the measures are

accompanied by provision for the payment of just compensation. The Claimants claim that the measures taken by the Respondent met none of these conditions and therefore are unlawful.

371. The arguments made by the Claimants with respect to each of these four conditions in their Memorial are as follows:

372. With regard to the first condition that the deprivation measures must be taken in the public interest, the Claimants contend that nowhere in the Amending Act or in the Decree were public interest even proffered or articulated. Neither has the Respondent ever articulated any public interest justification to the Claimants before, during or after the taking. Nor is the financial purpose backing the expropriation reported in the Hungarian press and attributed to officials of the Hungarian Government sufficient to be a “*public interest*” justification.

373. Further, the Claimants contend that while the stated purpose of the initial overall statutory amendments was to harmonize Hungarian law with European Union law and policy, the intended purpose of the inclusion of a prohibition of transfer provision was in fact to exclude foreign investors from the operation of the Airport. Moreover, although it was mentioned in the Amendment Motion presented by Dr. Kosztolányi which resulted in the Amendment Act that the prohibition was for the “*strategic interest connected*” of Hungary, the meaning of said “*strategic interest of the State*” was never specified.

374. The Claimants conclude therefore that no “*public interest*” justification can be found and the Respondent fails to meet this first condition in Article 4 of the BIT.

375. The Claimants’ contention that the taking was not made under due process of law expands in two steps under the headings of “*Minimum Treaty Standard*” and “*Additional Treaty Requirements*”.

376. Under the heading of “*Minimum Treaty Standard*”, after referring to some international law literature discussing the meaning of “*due process of law*” in the expropriation context, the Claimants contend that in order for the Respondent to effect the taking under due process of law, it should have provided the Claimants with an opportunity to seek judicial review of the Amending Act and the Decree. At least, the Claimants proceed to argue, a “*legal expropriation procedure*” as mandated by Article 4 of the BIT should have been set up by the Respondent and such a procedure should have at a minimum provided the Claimants reasonable notice and the right to a fair hearing and an impartial adjudicator.

377. The Claimants contend that in contrast, however, the self-evident facts in the instant case indicate that the Respondent provided for the Claimants no procedure at all.

378. Under the second heading of “*Additional Treaty Requirements*”, the Claimants refer to Article 3 of the BIT which, for the ease of reading, is set out in part below again:

“

*Article 3*

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

2. *More particularly, each Contracting Party shall accord to such investment full security and protection which in any case shall not be less than that accorded to investments of investors of any third State.*

...”

379. The Claimants contend, in light of Article 3, that the Respondent failed to provide the Claimants “*fair and equitable treatment*”. According to the Claimants, the Amending Act, the Decree and the actions taken in reliance thereon destroyed the Claimants’ basic expectation to have their contractual rights honoured and were imposed on the Claimants to their total surprise. The Claimants further claim that the lack of “*due process*” amounts to a denial of justice which in turn constitutes a breach of the “*fair and equitable treatment*” requirement. The Claimants also argue that the Respondent failed to accord “*full security and protection*” to the Claimants’ investment as required under Article 3(2) of the BIT.

380. In regard to the third condition of non-discrimination, the Claimants contend that the Amending Act, the Decree and the actions taken in reliance thereon were discriminatory in that all are specifically targeted at the Claimants and the Claimants only.

381. Finally, the Claimants contend that the measures taken by the Respondent were not accompanied by “*provision of just compensation*” and no compensation was ever paid, “*let alone ‘without undue delay’*”. In so arguing, the Claimants claim that an expropriation not accompanied by provision for the payment of just compensation is unlawful per se under the BIT.

382. As a result of the above, the Claimants conclude that the Decree and the actions taken in reliance thereon were illegal and constituted an internationally wrongful act.

383. The Respondent denies the Claimants’ allegations above entirely and vigorously. In its Counter-Memorial, the Respondent asserts that it has not violated the BIT and it has not taken a measure that deprives the Claimants of their investments. It contends that even if such a measure was found to have been taken, it was lawful because the measure met all of the conditions specified in Article 4 of the BIT. The Respondent also denies that any of the other standards of protection specified in Article 3 of the BIT has been violated, which are (a) fair and equitable treatment, (b) no discriminatory measure and (c) full security and protection.

384. At the outset of its rebuttal, the Respondent raises the argument that the Claimants argument as to unlawful expropriation is “misconceived” in that it denies the Respondent’s inherent and essential international law right to “*regulate its own economy, to enact and*

*modify laws, to secure the proper application of law and to accede to international organizations*". The Respondent refers to international investment law jurisprudence and contends that when an investor invests in a State, it subjects itself to the regulatory regime of and assumes the risk of being regulated by the host State.

385. Next the Respondent contends that the BIT's deprivation standard is narrower in scope and that it should be interpreted "consistently with Hungarian law." It asserts that the BIT in this case is narrower in scope than other investment treaties and the term "deprivation" is narrower than the term "expropriation".

386. The Respondent proceeds to argue that because Article 4 of the BIT refers to "depriving measures" only, the cases relied upon by the Claimants that apply the wider concept of expropriation are not relevant to the present case.

387. The Respondent then contends that in order for there to be an expropriation, two conditions must be present at the same time, namely (a) that the measures taken constitute a substantial deprivation and (b) that the measure is permanent.

388. The Respondent concludes, however, that neither of these two conditions is met in this case.

389. The Respondent argues that the Claimants have not been substantially deprived of their contractual rights, nor has there been any permanence in the effect of the Decree on their rights. According to the Respondent, the Claimants still possess said rights and the remedies to enforce those rights in the form of UNCITRAL Rules arbitration still exist. Therefore, it cannot be said that there has been an expropriation of those rights. The Respondent asserts that due to the fact that the Claimants failed to use the remedies agreed upon in the Project Agreements, any deprivation which might have taken place is neither substantial nor permanent.

390. The Respondent also argues that while the implementation of the Decree "*impacted*" the Project Company's operation, because there has been no substantial deprivation of the Claimants' rights caused by the Decree, there is no causal link between the Decree and any loss suffered by the Claimants.

391. After establishing the above preliminary defence, the Respondent proceeds to build its second level of defence by arguing that even if the Tribunal finds that there was an expropriation of the Claimants' investments, the depriving measure taken by the Respondent was lawful in that the measure was in the public interest, under due process of law and was not discriminatory.

392. With respect to public interest, the Respondent contends that the actions amending the transport legislation and enacting the Ministerial Decree were important elements of the harmonization of the Government's transport strategy, laws and regulations with EU law in preparation of Hungary's accession to the EU in May 2004. The Respondent also contends

that the legislative changes were in “*the strategic interests of the State*” though it does not continue to substantiate this argument with details.

393. With respect to due process of law, the Respondent firstly contends that the actions taken by the Respondent were not arbitrary but were carefully considered and formulated in accordance with Hungarian laws and policies as well as EU regulations in the light of Hungary’s accession to the EU.

394. Secondly, the Respondent claims that contrary to the Claimants’ case that they were in a complete surprise when being notified of the legislative changes, the Claimants were fully aware of these proposed changes well before actions were taken to effect them. The Respondent also contends that the Claimants were also fully aware of the activities of BA Rt which was established in October 2001 for the sole purpose to operate the Airport as a result of the Decree.

395. The Respondent further contends that contrary to the Claimants’ allegation that no procedure at all was provided, Hungarian law does provide the Claimants a number of methods to review the expropriation in question. The Respondent also refers to the argument it made before that the Claimants retained their contractual rights for dispute resolution.

396. In conclusion, the Respondent claims that the actions taken by the Hungarian Government were not unfair, unreasonable, nor unjustifiable.

397. With respect to discriminatory treatment, the Respondent rebuts the Claimants’ contention that they were the only targets under the Amending Act and the Decree by saying that no other foreign parties were involved in the operation of the Airport. It also contends that the prohibition set forth in the Amending Act and the Decree applies against all persons and business entities other than the statutorily appointed operator and therefore cannot be said to be discriminatory against the Claimants.

398. With respect to compensation, the Respondent contends that ATAA did seek to settle the accounts of the Project Company but it was the Claimants who failed to cooperate. In addition, the Respondent claims that in any event, provision for obtaining just compensation for expropriation is available under Hungarian law by applying to the Hungarian courts.

399. Concerning the Claimants’ contention that the Respondent by taking the depriving actions also breached other standards of protection stipulated in Article 3 of the BIT, the Respondent firstly denies that the Tribunal has jurisdiction to hear these claims. The Respondent then claims that if the Tribunal finds its jurisdiction in this regard, all allegations of breach of Article 3 of the BIT are denied.

400. In particular, the Respondent claims that Article 3 of the BIT does not provide definitions of “*fair and equal treatment*”, “*unreasonable or discriminatory measures*” or “*full security and protection*” and the meaning of these key phrases can only be determined

under the specific circumstances of each specific case. In this case, the Respondent contends that the Claimants failed to establish a prima facie case that the Respondent breached any of these requirements.

401. The second round of arguments concerning the Respondent's liability in its depriving actions starts with the Claimants' Reply.

402. In response to the Respondent's argument that by taking the depriving actions it is in fact exercising its inherent and essential international law right to regulate its own economy and to enact and modify its laws, the Claimants assert that such a claim is "*nonsense*" in that the State's right to regulate is not absolute and is subject to the duty to compensate in the event of an expropriation. The Claimants contend that it is a "*truism*" that a State's right to regulate is subject to respect for the rule of law, including treaty obligations, as well as obligations imposed by customary international law. Where a State fails to act in accordance with the rule of law or breaches a treaty obligation, it shall be liable and must compensate a party who suffers prejudice as a result thereof.

403. The Claimants contend that it is not enough for the Respondent to justify its depriving actions with a broad-brush argument of "*right to regulate*" and neither the BIT nor customary international law supports such a contention. The Claimants then refer to the awards in a number of expropriation-related cases and assert that the obligation to compensate in the event of expropriation is widely recognized. The Claimants contend that the issue to be determined in the present case is not whether the Respondent felt justified to take the actions in question, but whether the measures taken fall within the terms of Article 4 of the BIT. To this question, the Claimants again emphasise their answer in the affirmative.

404. The Claimants then proceed to make their defence against the Respondent's claims in respect of the scope of Article 4 of the BIT.

405. The Claimants contend in the first place that Hungarian laws do not apply to the interpretation of the BIT's deprivation standard and there is no legal basis for the Respondent to argue that the BIT should be read to be consistent with Hungarian domestic law.

406. Second, the Claimants argue that the Respondent has failed to find any case to support its contention that the BIT is narrower in scope than other investment treaties and that the term "*deprivation*" is narrower than the term "*expropriation*." Contrarily, the Claimants quote a recent OECD report on this topic and contend that these two expressions are frequently used in conjunction with one another. The Claimants therefore reemphasised that the Respondent's Decree and related actions are the direct cause of the Claimants' loss of their investment, and accordingly they squarely fall within the scope of Article 4.

407. Next the Claimants rebut the Respondent's contention that, due to the reason the Claimants still possess the right to UNCITRAL Rules arbitration under the Project



Agreements, the “*conditions of expropriation*” have not been met. The Claimants’ response to this argument is that in nature the present case is a State-investor expropriation case rather than a contractual dispute as mischaracterized by the Respondent. As a result, the Claimants contend that the case law relied upon by the Respondent is not applicable to this case.

408. Regarding the Respondent’s denial of its failure to meet the requirements for a lawful expropriation in Article 4, besides points already made in the first round of debate, the Claimants’ further rebuttal arguments are listed as follows:

409. In respect of public interest, the Claimants contend that no evidence has been offered by the Respondent to explain how public interest was served and the “*harmonization with EU law*” and “*strategic interests of the State*” arguments remain hollow.

410. In respect of due process of law, the Claimants contend that the Respondent’s version of the story that the Claimants were well aware of the forthcoming legislative changes in advance is groundless. The Claimants emphasized by referring the Tribunal to the witness statements of Messrs. Huang and Onozo that the Claimants were never made aware of the fact and never suspected that the transformation of the ATAA would entail the expropriation of their investment and the frustration of the Project Agreements. The Claimants also claim that the Respondent does not provide any evidence of a connection between the alleged “*need to transform the ATAA*” and the frustration of the Project Agreements. According to the Claimants, such a connection does not exist.

411. In respect of non-discrimination, the Claimants contend that the Respondent’s argument that not only the Claimants but all foreign investors are prohibited from operating the Airport in fact helps the Claimants’ position that as foreign investors, the Claimants are specifically targeted by the Amending Act, the Decree and the actions taken in reliance thereupon.

412. In respect of just compensation, the Claimants reiterate that no expropriation procedures were even in place and contend that the arguments such as “*accounts settlement*” or “*resort to Hungarian courts*” do not in any way provide evidence of compliance with the obligation to provide for the payment of just compensation to the Claimants.

413. As regards other protection requirements in Article 3 of the BIT, the Claimants reiterate their position that the actions taken by the Respondent violated these obligations.

414. The Respondent, as represented by its new counsel, raises some further arguments in response to the Claimants’ rebuttal above in its Rejoinder.

415. As to the State’s right to regulation under international law, the Respondent claims that if the state discerns that the beneficiary of the concession right operates in several areas not in line with the legal regulations, then the State has the right to restore order of its law.

416. The Respondent also contends by referring to awards in prior expropriation-related cases that the recourse to national remedies was necessary in order to substantiate an alleged deprivation.

417. For the first time, the Respondent raises the point that the Claimants could have sought legal remedies before the Hungarian Constitutional Court by contesting the legality of the Amending Act and the Decree but failed to do so.

418. With respect to public interest, the Respondent refers to a provision in the Hungarian Expropriation Act which reads as follows:

*“Public interests...  
Section 4(1) Real estate properties may be expropriated for the following purposes:...  
f) transportation.”*

The Respondent then concludes that measures taken by the Respondent in dispute were actually for the public interest.

419. With respect to due process of law, the Respondent argues that the legislative process was public and the Claimants were able to inform themselves about the content of the amendment at any time. Further, the Respondent denies the allegation that no procedure was provided at all by saying that the Constitutional Court of Hungary was specifically established for a discontented party to request for judicial review of whatever it believes to be in conflict with the Constitution.

420. With respect to non-discrimination, the Respondent claims that since discrimination can only be argued when a comparable party which was treated differently exists, it is not possible to refer to discrimination in the present case due to the fact no such comparable parties exist.

421. With respect to just compensation, the Respondent claims that the Claimants have obtained significant benefits through the Project and such benefits meet the “*just compensation*” requirement. In any event, the Respondent claims, just compensation can be obtained by the Claimants by applying to the Hungarian courts under Hungarian law.

422. Finally, the Respondent again denies that it breached any other standard of protection in Article 3 of the BIT.

## ***Discussion***

### **(a) State’s Right to Regulate**

423. The Tribunal cannot accept the Respondent’s position that the actions taken by it against the Claimants were merely an exercise of its rights under international law to regulate its domestic economic and legal affairs. It is the Tribunal’s understanding of the

basic international law principles that while a sovereign State possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. As rightly pointed out by the Claimants, the rule of law, which includes treaty obligations, provides such boundaries. Therefore, when a State enters into a bilateral investment treaty like the one in this case, it becomes bound by it and the investment-protection obligations it undertook therein must be honoured rather than be ignored by a later argument of the State's right to regulate.

424. The related point made by the Respondent that by investing in a host State, the investor assumes the "risk" associated with the State's regulatory regime is equally unacceptable to the Tribunal. It is one thing to say that an investor shall conduct its business in compliance with the host State's domestic laws and regulations. It is quite another to imply that the investor must also be ready to accept whatever the host State decides to do to it. In the present case, had the Claimants ever envisaged the risk of any possible depriving measures, the Tribunal believes that they took that risk with the legitimate and reasonable expectation that they would receive fair treatment and just compensation and not otherwise.

425. The Respondent's contentions as to a State's right to regulate and the investor's assumption of risk are therefore rejected.

**(b) The Scope of Article 4 of the BIT**

426. It is obvious to the Tribunal that the measures taken by the Respondent against the Claimants fall well within the scope of Article 4 of the BIT. The logic in the Respondent's argument that the deprivation standard set out in Article 4 should be interpreted "*consistently with Hungarian law*" is hard for the Tribunal to see and follow. Neither is the Tribunal attracted by the Respondent's effort in differentiating the meaning and scope of the terms of "*deprivation*" and "*expropriation*". In the Tribunal's view, the plain language ("*any measure depriving...directly or indirectly...investors...of their investment*") of Article 4 says what it says and there is no room for the Respondent to challenge its broad scope of coverage nor to read it down.

427. The Respondent's arguments on the issue of the scope of Article 4 are therefore rejected.

428. The Tribunal now proceeds to examine each requirement specified in Article 4 of the BIT.

**(c) Public Interest**

429. The Tribunal can see no public interest being served by the Respondent's depriving actions of the Claimants' investments in the Airport Project.

430. Although the Respondent repeatedly attempted to persuade the Tribunal that the Amending Act, the Decree and the actions taken in reliance thereon were necessary and

important for the harmonization of the Hungarian Government's transport strategy, laws and regulations with the EU law, it failed to substantiate such a claim with convincing facts or legal reasoning.

431. The reference to the wording "*the strategic interest of the State*" as used in the Amendment Motion by Dr. Kosztolányi does not assist the Respondent's position either. While the Tribunal has always been curious about what interest actually stood behind these words, the Respondent never furnished it with a substantive answer.

432. In the Tribunal's opinion, a treaty requirement for "*public interest*" requires some genuine interest of the public. If mere reference to "*public interest*" can magically put such interest into existence and therefore satisfy this requirement, then this requirement would be rendered meaningless since the Tribunal can imagine no situation where this requirement would not have been met.

433. With the claimed "*public interest*" unproved and the Tribunal's curiosity thereon unsatisfied, the Tribunal must reject the arguments made by the Respondent in this regard. In any event, as the Tribunal has already remarked, the subsequent privatization and the agreement with BAA renders this whole debate somewhat unnecessary.

**(d) Due Process of Law**

434. The Tribunal concludes that the taking was not under due process of law as required by Article 4 of the BIT.

435. The Tribunal agrees with the Claimants that "*due process of law*", in the expropriation context, demands an actual and substantive legal procedure for a foreign investor to raise its claims against the depriving actions already taken or about to be taken against it. Some basic legal mechanisms, such as reasonable advance notice, a fair hearing and an unbiased and impartial adjudicator to assess the actions in dispute, are expected to be readily available and accessible to the investor to make such legal procedure meaningful. In general, the legal procedure must be of a nature to grant an affected investor a reasonable chance within a reasonable time to claim its legitimate rights and have its claims heard. If no legal procedure of such nature exists at all, the argument that "*the actions are taken under due process of law*" rings hollow. And that is exactly what the Tribunal finds in the present case.

436. One of the Respondent's defences in this regard is that the Claimants were aware of the depriving actions well before the legislative changes were adopted in December 2001. The Tribunal finds this assertion groundless. To recall, Dr. Kiss testified at the hearing that it was not until January 2002 that he first heard that the Project Company would be displaced and its operations taken over. Similarly, Mr. Gansperger denied at the hearing that he had any knowledge that the legislative changes were contemplated prior to the date they were adopted. Assuming these statements are true and correct, which the Tribunal does not accept, they would contradict the logic in the Respondent's argument. For if persons at the very centre of the decision making body had no prior knowledge of the

contemplated legislative changes, how could it be expected and argued that a foreign investor should have had such knowledge well in advance? Setting this evidence aside, the accepted evidence of Mr. Somogyi-Tóth indicates that the discussions of the takeover stayed well within governmental circles. The Tribunal therefore does not believe, as the Respondent has suggested, that Mr. Huang and his colleagues should have known the content of such discussions before the legislative changes were adopted on December 18, 2001.

437. The Respondent also failed to establish a connection between the “*need to transform the ATAA*” and the deprivation of the Claimants investments in the Airport Project.

438. As to Respondent’s argument that Hungarian law does provide methods for the Claimants to review the expropriation, the Tribunal fails to see how such claim was substantiated and in any event cannot agree in the light of the facts established in this case that there were in place any methods to satisfy the requirement of “*due process of law*” in the context of this case.

439. The Respondent’s argument that the Claimants still retain their contractual rights for dispute resolution is also unacceptable to the Tribunal due to the non-contractual nature of the current dispute.

440. The Respondent’s arguments in respect of “*due process of law*” are therefore rejected.

**(e) Non-discrimination**

441. The Tribunal cannot accept the Respondent’s argument that as the only foreign parties involved in the operation of the Airport, the Claimants are not in a position to raise any claims of being treated discriminately.

442. It is correct for the Respondent to point out that in order for a discrimination to exist, particularly in an expropriation scenario, there must be different treatments to different parties. However and unfortunately, the Respondent misses the point because the comparison of different treatments is made here between that received by the Respondent-appointed operator and that received by foreign investors as a whole.

443. The Tribunal therefore rejects the contentions made by the Respondent and concludes that the actions taken by the Respondent against the Claimants are discriminatory.

**(f) Just Compensation**

444. It is abundantly obvious to the Tribunal that no just compensation was provided by the Respondent to the Claimants and feels no need to expand its discussion here.

**(g) Protection Standards under Article 3 of the BIT**

445. As regards other investment protection standards set out in Article 3 of the BIT, the Tribunal has no objection to the approach suggested by the Respondent that the meaning of “*fair and equitable treatment*”, “*unreasonable or discriminatory measures*” and “*full security and protection*” are to be determined under the specific circumstances of each specific case. However, in the light of the facts established in this case and under the above approach, the Tribunal is satisfied to conclude that these requirements under Article 3 have all been breached by the Respondent.

#### **D. Miscellaneous Points Raised by the Respondent**

446. In the Respondent’s *Rejoinder*, under the heading “*Legal Risks of the Project*” in subsection B of Section VI Quantum, the Respondent raises the following points for the first time:

- a. the Operating Period Lease is invalid “*due to the inappropriate legal form of the Project Company*”;
- b. the Project Agreements are invalid “*due to the missing approval*” of a quotaholders’ meeting of the Project Company;
- c. the Project Agreements, especially the Operating Period Lease and Terminal Management Agreement, are subject to challenges because there is “*a grossly unfair difference in value*” regarding the service rendered and consideration for that service;
- d. the Terminal Management Agreement is “*unlawful*” since conclusion of this agreement violated the Public Procurement Act.

447. The Claimants set forth their rebuttal to each of these points in their *Sur-Rejoinder*.

448. Although these arguments are raised as arguments in response to Claimants’ claim for damages, it seems appropriate for the Tribunal to deal with them at this point and of course, if they are valid, take them into account when accessing quantum.

##### **1. Is the Operating Period Lease Invalid “*Due to the Inappropriate Legal Form of the Project Company*”?**

449. The Respondent contends that the Operating Period Lease is invalid “*due to inappropriate legal form of the Project Company*”. The Respondent’s legal basis of this argument is Section 45 of Act No. XCVII on Air Traffic (the “Air Traffic Act”). The relevant parts of Section 45 are as follows<sup>1</sup>:

*“(1) For the establishment, development, renovation, maintenance and operation of Budapest Ferihegy International Airport, and within this scope,*

---

<sup>1</sup> The translation of this Section 45 by the Claimants differs from that by the Respondent. However, the Tribunal notes that the discrepancies in translation only exist at a linguistic level and the substance of both translations is the same. The translation quoted here is from that provided by the Claimants in their *Sur-Rejoinder*.

*for the construction and operation of ground service facilities (hereinafter “operation”), the State shall:*

- a) establish a business organization (Section 685(c) of the Hungarian Civil Code) operating with majority interest of the State or shall found a budgetary agency; or*
- b) shall transfer the temporary right of operation within the framework of a concession agreement.*

*(2) The Minister shall be entitled to announce and evaluate the tender for the concession and to conclude the concession agreement.*

...

*(4) The winner of the tender shall establish the concession company as a company limited by shares, which shall be entitled to construct and operate commercial and catering facilities.”*

450. It is contended by the Respondent that due to the fact that the Project Company received from the Government of Hungary certain operational rights by means of a concession, the Project Company is in nature a concessionaire. As such, in order to comply with Section 45, the Project Company should have been incorporated as a company limited by shares (Rt.). The Project Company, however, was incorporated in contravention of the requirement in Section 45 as a limited liability company (Kft.).

451. The Respondent goes on to contend that according to the Hungarian Civil Code (Act IV/1959), Section 200(2), “*contracts in violation of legal regulations and contracts concluded by evading a legal regulation shall be null and void*”. The conclusion it reaches, therefore, is that since the Project Company’s incorporation was in violation of a relevant legal requirement, *i.e.* Section 45 of the Air Traffic Act, “*any person is thus entitled to plead the invalidity of the agreement due to violation of legal regulations without any time limit*”. Accordingly, the Respondent claims that the Operating Period Lease concluded by the Project Company is invalid.

452. On the other hand, the Claimants contend that Section 45(1)(b) is not applicable in this case. The reason is that the ATAA, the majority quotaholder of the Project Company, is a budgetary agency under Section 45(1)(a) and maintains the right of operation of the Airport. The Project Company, under the Operating Period Lease, only has the right to perform entrepreneurial operations and such operation is subject to the monitoring and supervision of ATAA. In addition, Hungary has a majority interest in the Project Company via ATAA’s majority quotaholding. Thus the legal requirement under Section 45(1)(a) has been fully met and the application of Section 45(1)(b) is not applicable .

453. The Claimants also contend that ATAA, as a budgetary agency of the Hungarian Government, has provided a full warranty in the Operating Period Lease as to its competence to enter into the same as well as the validity thereof. Further, after almost nine years since the execution of the Operating Period Lease, the argument made by the Respondent that the Operating Period Lease is invalid should be time-bared.

454. The Claimants further contend that even if the Respondent were correct in its contentions concerning Section 45(1)(b) and Section 45(4), if any breach of the legal requirement thereof exists, it is the Respondent, rather than the Claimants, who should bear the legal consequence of the breach because it is the duty of the Respondent under Section 45 to adopt appropriate measures to comply with it. The Claimants refer to Section 4 of the Hungarian Civil Code, which states that “*no person shall be entitled to refer to his own actionable conduct in order to obtain advantages*”. They also refer to the statement of official commentators on the Hungarian Civil Code that “*if any entity caused invalidity by its own actionable conduct the same entity is not entitled to refer to the invalidity of the agreement*”.

### ***Discussion***

455. The Tribunal finds the arguments of the Claimants convincing. It is established that ATAA, at the time of the execution of the Operating Period Lease, was a budgetary agency of the Hungarian Government. It is also established that ATAA is a majority quotaholder in the Project Company with a quotaholding of 66%. Given these established facts, it appears to the Tribunal that the project structure, which was under the mandate of the Respondent and features ATAA as a majority quotaholder in the Project Company, falls squarely within the situation specified in Section 45(1)(a). Since the key word connecting Section 45(1)(a) and (b) is “*or*”, as appeared in translations from both Parties, the Tribunal is satisfied that Section 45(1)(b) does not apply to this case as the legal requirement in Section 45(1)(a) was fully met.

456. Even if the Tribunal were wrong in concluding the above, the Respondent would still be time-barred to challenge the validity of the Operating Period Lease. In considering this contention, the Tribunal cannot ignore the fact that the whole structure of these complex interwoven agreements was insisted upon and voluntarily entered into by organs of the Hungarian Government. The Hungarian Government provided a guarantee. Still furthermore, the Respondent was represented by eminent external and internal legal and financial advisors. It is difficult for the Tribunal to conclude that such a defect as is alleged would not have been noticed. However, this point is only taken at a very late stage in these proceedings which themselves commenced many years after the matters complained of. Even though the Respondent contends that there is no time limit on the right to contest the validity of the Operating Period Lease, it is the opinion of the Tribunal that the “*five-year time bar*” rule generally accepted by Hungarian judicial practice applies on the facts of this case. As was stated in the Concept of the New Hungarian Civil Code:

*“It is disputed and will remain so what the term ‘without time limit’ means. In the monograph written by Emilia Weiss about invalid contracts, she correctly stated more than three decades ago that there is no reason why the five-year limitation period applicable for all contractual claims shall not apply to invalid agreements as specified in the Civil Code (the same is confirmed in the following rulings of the Supreme Court: Pf. IV. 21768/1993:*



*BH 1994/666, Gf. V. 30398/1981:BH 1982/298.). The proposal recommends that these principles shall be prescriptively set out in legislation.”*

## **2. Are the Project Agreements Invalid “Due to the Missing Approval” of a Quotaholders’ Meeting of the Project Company?**

457. The Respondent contends that in accordance with Item 8.2.7. of the Articles of Association of the Project Company and the Hungarian Company Act effective at the time of the incorporation of the Project Company, when a company is concluding a contract with a member of that company, the approval of a quotaholders’ meeting was necessary to make such a contract valid. The Operating Period Lease in the Project, the Respondent submits, is a contract between the Project Company and ATAA, a quotaholder and member of the Project Company. Accordingly, the approval of the Quotaholders’ Meeting of the Project Company “*would have been necessary for all Project Agreements as well as for valid issuance of the Promissory Note*”.

458. At this point, the Respondent refers to a published decision of the Hungarian Supreme Court which reads as follows:

*“I. Establishment of a sale and purchase agreement of the company with its own Quotaholder is not to be regarded as being part of the regular activities of the Company, thus in case the Quotaholders’ Meeting has not approved of such an agreement in its decision, invalidity of the agreement may be ascertained.”*

459. Given the Hungarian Supreme Court’s attitude expressed above and due to the fact that the said approvals were missing, the Respondent contends that the Project Agreements concluded by the Project Company are invalid.

460. The Claimants’ rebuttal to this argument is threefold. The Claimants firstly point out that not all of the Project Agreements were concluded between the Project Company and a member thereof. Rather, a number of the Project Agreements are between two members of the Project Company in which cases there is no need for an approval of a quotaholders’ Meeting.

461. Secondly, the Claimants argue that in the same paragraph of the Hungarian Company Act (ignored by the Respondent), it is clearly stated that where the conclusion of the contract “*is part of the regular activity of the company*”, the approval from a quotaholders’ meeting is unnecessary.

462. The Claimants then refer to the Master Agreement and the constitutional document of the Project Company and argue that the Project Company was established for the sole purpose of the Project and the conclusion of the Operating Period Lease fell well within its “*regular activity*”. Therefore, there was no need for the Project Company to obtain quotaholders’ meeting approval to conclude the Operating Period Lease.

463. Thirdly, the Claimants argue that a quotaholders' meeting of the Project Company did approve the conclusion of all of the Project Agreements. In this regard, the Claimants refer to the minutes of the quotaholders' Meeting dated February 26, 1997 as follows:

*“Authorization for the Company and the management to sign various agreements and documents, to take all actions that are necessary or desirable in connection therewith, and to fulfil all of the Company’s obligations arising from these agreements and the related documents.”*

464. The Claimants contend that the above indicates that approval of the Project Agreements was on the agenda of a quotaholders' meeting and a resolution concerning the approval under [the No.4/1997] has been duly and unanimously adopted and registered in the Book of Resolutions.

### ***Discussion***

465. In the light of the documentary evidence before it and the applicable sections of the Hungarian Company Act, the Tribunal sees no basis for the Respondent's “*lack of necessary approval*” argument.

466. It appears clear to the Tribunal that the Quotaholders have granted their approval to the execution of the Project Agreements. It is also clear to the Tribunal that the Project Company, as a company vehicle in a complex investment project, was incorporated for the sole purpose of taking part in the Project.

### **3. Is There “*a Grossly Unfair Difference in Value*” Regarding the Service Rendered and Consideration for That Service?**

467. The Respondent argues that there is “*a grossly unfair difference in value*” between the service provided by the Claimants and the “*counter performance*” provided by ATAA. Under Section 201 of the Hungarian Civil Code, when such a “*grossly difference in value*” exists, ATAA as the “*injured party*” in this case, “*was entitled to raise objection against Claimants under the Project Agreements*”. The Section reads as follows:

#### *“Section 201*

*(1) Unless the contract or the applicable circumstances expressly indicate otherwise, a consideration is due for services set forth in the contract.*

*(2) If at the time of the conclusion of the contract the difference between the value of a service and the consideration due, without either party having the intention of bestowing a gift, is grossly unfair the injured party shall be allowed to contest the contract.”*

468. There are thus three conditions which have to be met before this section of the Code bites. They are:

- a) at the time of the conclusion of the contract;
- b) a grossly unfair difference in value must exist between the service and the consideration due for the service; and
- c) the aggrieved party shall not have the intention of bestowing a gift.

469. The Claimants contend that such conditions are not established and that the Respondent's argument is unfounded. The Claimants refer to Decision No. PK 267 of the Civil Law Department of the Hungarian Supreme Court, which the Claimants contend are the "guidelines" for Hungarian judicial practice in this regard. Decision No. PK 276 states:

*"If a contract is challenged due to the grossly unfair difference in value between the service and the consideration due, in order to determine whether such difference is unfair the courts shall examine the circumstances of concluding the contract, the full content of the contract, the relation between the market values, the characteristics of the given transaction, the method of defining the services and the consideration due.*

...

*Section 201(2) grants the right to challenge a contract only if the difference between the service and the consideration due is grossly unfair. [...] Thus only after evaluating all of the circumstances of the case can it be stated that there is not only a difference between the value of the service and the consideration but that difference is also grossly unfair."*

470. Based on the observations quoted above from Decision No. PK 267, the Claimants contend that considering all the circumstances of the structuring of the Project and the conclusion of the Project Agreements, no grossly unfair difference in value existed. Additionally, the Claimants make the following arguments in response to the Respondent's claim as well:

- a) there was no legal risk at the time of expropriation since the ATAA did not challenge the Project Agreements;
- b) the ATAA did not challenge the Operating Period Lease and the Terminal Management Agreement; and
- c) the Respondent never had a right to challenge the Project Agreements and that right was only available to ATAA.

### ***Discussion***

471. The Tribunal is clearly of the view that section 201 of the Hungarian Civil Code could not have been intended to apply to the facts of this case. This is not a case involving parties with markedly different bargaining power – a situation for which most legal systems attempt to provide. ATAA, backed by the Hungarian State, entered into these agreements with full knowledge of all the facts and for good and genuine reason. The Tribunal does not think it necessary to analyse the benefits received by ATAA because they were, in the opinion of the Tribunal, real and substantial. No challenge to any of the Project Agreements was ever made until well into these proceedings. These arguments are far

removed from the thinking of the parties at the relevant time. It is also noted that ATAA has never challenged these agreements. It is only Hungary now that seeks to do so as a shield to fend off this claim under the BIT. For all of the above reasons, the Respondent's submissions to this point are rejected.

#### **4. Did the Conclusion of the Terminal Management Agreement Violate the Public Procurement Act and Therefore Become “Unlawful”?**

472. The Respondent contends that due to the fact that the Claimants “*had exclusive licenses to provide national public services*”, according to the Act XL/1995 on Public Procurement, the Project Company cannot validly enter into the Project Agreements without going through public procurement proceedings. Since the Project Company failed to go through such proceedings, the Project Agreements it concluded are unlawful.

473. The Claimants in response state that such argument is entirely baseless. The Claimants firstly challenge the Respondent's contention by stating that “*it is not up to the Claimants or the Respondent to decide what qualifies as national public service*” and the statutory provision pursuant to which the Claimants may be deemed to have an exclusive right to provide national public services does not exist and no public procurement proceeding was required in this case. The Claimants then argue that the ATAA not only was fully aware of the contents of the relevant Project Agreements, but also “*represented and warranted that the agreement constitutes a valid, legal and binding obligation...*”

#### ***Discussion***

474. This contention is unsustainable. Again an attempt is being made to challenge the validity of an agreement which was entered into with the full approval of the Respondent and which formed part of a complex structure of agreements. The whole corporate structure was insisted upon and/or fully approved by those representing the Respondent. ATAA took the benefits conferred by the Terminal Management Agreement and made no complaint about it at the time, nor at the time of the Decree, nor when the first round of Memorials had been completed. This point was only raised very late in these proceedings. If in fact the Project Company should have gone through some public procurement system, it can only be the fault of ATAA and the Respondent that they did not. ATAA went further and gave representations and warranties set out above and it would, in the opinion of the Tribunal, be unconscionable to permit them, at this very late stage, to resile from these representations and warranties. Furthermore, it is far too late now to complain of a matter of this nature given the factual scenario set out above.

#### **Hungary's Conduct**

475. Even if the Respondent was correct in any of its submissions on the miscellaneous points dealt with in Section D above, they would nevertheless fail on them simply because they have rested on their rights. These Agreements were entered into years ago and both parties have acted on the basis that all was in order. Whether one rests this conclusion on the doctrine of estoppel or a waiver it matters not. Almost all systems of law prevent

parties from blowing hot and cold. If any of the suite of Agreements in this case were illegal or unenforceable under Hungarian law one might have expected the Hungarian Government or its entities to have declined to enter into such an agreement. However when, after receiving top class international legal advice, Hungary enters into and performs these agreements for years and takes the full benefit from them, it lies ill in the mouth of Hungary now to challenge the legality and/or enforceability of these Agreements. These submissions smack of desperation. They cannot succeed because Hungary entered into these agreements willingly, took advantage from them and led the Claimants over a long period of time, to assume that these Agreements were effective. Hungary cannot now go behind these Agreements. They are prevented from so doing by their own conduct. In so far as illegality is alleged, they would in any event be seeking to rely upon their own illegality. This matter is put to rest by Section 4 of the Hungarian Civil Code which states:

*“4. §(1) In the course of exercising civil rights and fulfilling obligations, all parties shall act in the manner required by good faith and honesty, and they shall be obliged to cooperate with one another.*

...

*(4) Unless this Act prescribes stricter requirements, it shall be necessary to proceed in civil relations in a manner deemed reasonable under the given circumstances. No person shall be entitled to refer to his own actionable conduct in order to obtain advantages. Whosoever has not proceeded in a manner deemed reasonable under the given circumstances shall be entitled to refer to the other party’s actionable conduct.”*

## **E. Conclusion on Matters Other Than Quantum**

476. The conclusion of the Tribunal on matters other than quantum are as follows:

- a) the Tribunal has jurisdiction to hear and consider all the claims made by the Claimants in this case;
- b) all of Hungary’s jurisdictional arguments are rejected;
- c) all of the points raised by Hungary as set out in paragraph 446 above (whether going to liability or quantum) are rejected;
- d) the expropriation of the Claimants’ interest constituted a depriving measure under Article 4 of the BIT and was unlawful as: (a) the taking was not in the public interest; (b) it did not comply with due process, in particular, the Claimants were denied of “*fair and equitable treatment*” specified in Article 3(1) of the BIT and the Respondent failed to provide “*full security and protection*” to the Claimants’ investment under Article 3(2) of the BIT; (c) the taking was discriminatory and (d) the taking was not accompanied by the payment of just compensation to the expropriated parties.

## **F. Quantum**

477. Having reached the conclusions in the foregoing paragraph, the Tribunal now feels ready to consider the challenging issue of quantum. To recall and for the purpose of the discussion below, the “*date of expropriation*” and the “*date of taking*” both refer to January 1, 2002.

478. The Claimants’ claims for damages are set forth in paragraphs 242 and 243 above.

## **1. The Applicable Standard for Damages Assessment**

479. The applicable standard for assessing damages has given rise to considerable debate between the Parties.

480. The principal issue is whether the BIT standard is to be applied or the standard of customary international law. The Claimants argue that the Respondent’s deprivation of its investments was a breach of the BIT and as an internationally wrongful act is subject to the customary international law standard as set out in *Chorzów Factory (Claim for Indemnity) (Merits), Germany v. Poland, P.C.I.J. Series A., No. 17 (1928)*. The Respondent contends that the BIT standard is a *lex specialis* which comes in lieu of the customary international law standard.

481. There is general authority for the view that a BIT can be considered as a *lex specialis* whose provisions will prevail over rules of customary international law (*see, e.g., Phillips Petroleum Co. Iran v. Iran*, 21 Iran-U.S. Cl. Trib. Rep. at 121). But in the present case the BIT does not stipulate any rules relating to damages payable in the case of an unlawful expropriation. The BIT only stipulates the standard of compensation that is payable in the case of a lawful expropriation, and these cannot be used to determine the issue of damages payable in the case of an unlawful expropriation since this would be to conflate compensation for a lawful expropriation with damages for an unlawful expropriation. This would have been possible if the BIT expressly provided for such a position, but this does not exist in the present case.

482. The standard set forth in Article 4(1)(a) of the BIT refers to “*just compensation.*” Article 4 further provides:

“2. *The amount of compensation must correspond to the market value of the expropriated investments at the moment of the expropriation.* 3. *The amount of this compensation may be estimated according to the laws and regulations of the country where the expropriation is made.*”

The latter refers to Hungarian law in the present case. Section 132 of the Hungarian Constitution provides that expropriation of ownership must be accompanied by “*full, unconditional and prompt compensation*” (Respondent’s Counter-Memorial at para.584).

483. Since the BIT does not contain any *lex specialis* rules that govern the issue of the standard for assessing damages in the case of an unlawful expropriation, the Tribunal is required to apply the default standard contained in customary international law in the present case.

484. The customary international law standard for the assessment of damages resulting from an unlawful act is set out in the decision of the PCIJ in the *Chorzów Factory* case at page 47 of the Judgment which reads:

*“reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.”*

In the same case at page 21, the PCIJ also pointed out that *“reparation therefore is the indispensable complement of a failure to apply a convention.”*

485. Moreover, the PCIJ considered that the principles to determine the amount of compensation for an act contrary to international law are:

*“Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it.”* (Page 47 of the Judgment.)

486. This statement of the customary international law standard has subsequently been affirmed and applied in a number of international arbitrations relating to the expropriation of foreign owned property. Due to the considerable disagreement between the Parties on the continued existence of this standard it is necessary to recite the authorities in this area in some detail.

487. In *S.D. Myers, Inc. v. Canada*, UNICTRAL (NAFTA) Award (Merits), 13 November 2000, the Tribunal stated at para.311:

*“The principle of international law stated in the Chorzów Factory (Indemnity) case is still recognised as authoritative on the matter of general principle”.*

488. The Tribunal in *Metalclad Corporation v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, held at paragraph 122 of its Award that:

*“[t]he award to Metalclad of the cost of its investment in the landfill is consistent with the principles set forth in Chorzów ... namely, that where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and re-establish the situation which would in all probability have existed if that act had not been committed (the status quo ante).”*

489. Moreover, in *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Award, Case No. ARB/01/8, 12 May 2005, the ICSID Tribunal stated in para.400 of its Award the following:

*“Restitution is the standard used to re-establish the situation which existed before the wrongful act was committed, provided this is not materially impossible and does not result in a burden out of proportion as compared to compensation.”*

490. Similarly, in *Petrobart Limited v. The Kyrgyz Republic*, Arbitration No. 126/2003, Arbitration Institute of the Stockholm Chamber of Commerce (Energy Charter Treaty), 29 March 2005, the Tribunal held at pages 77 and 78 of its Award the following:

*“Petrobart refers to the judgment of the Permanent Court of International Justice in the Factory at Chorzów case and to the International Law Commission’s Draft Articles on State Responsibility for Internationally Wrongful Acts in order to show that the Kyrgyz Republic is obliged to compensate Petrobart for all damage resulting from its breach of the Treaty. The Arbitral Tribunal agrees that, in so far as it appears that Petrobart has suffered damage as a result of the Republic’s breaches of the Treaty, Petrobart shall so far as possible be placed financially in the position in which it would have found itself, had the breaches not occurred.”*

491. The *Chorzów Factory* case has also been generally accepted by *Oppenheim’s International Law* which states:

*“The principle is clear: out of an international wrong arises a right for the wronged state to request from the wrong-doing state the performance of such acts as are necessary for reparation of the wrong done. What kind of acts these are depends upon the merits of the case. For perhaps the majority of cases the guiding principle is as laid down in the Chorzów Factory (Indemnity) case, in the following terms: [the quotation omitted here is of the passage reproduced above from page 47 of the Judgment]. It is obvious that there must be pecuniary reparation for any material damage ... .”* (R. Jennings and A. Watts, *Oppenheim’s International Law* (9<sup>th</sup> ed., 1996), pages 528-529.)

492. For additional cases affirming and applying the *Chorzów Factory* standard for the assessment of damages in the context of expropriation of foreign owned property, see *Amoco International Finance Corporation v. Iran*, 15 IRAN–U.S. C.T.R. p.189 at p.246 (paras.191-194); and *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, ICSID Case No. ARB/01/7, 25 May 2004, para.238.

493. Finally, the International Court of Justice itself, the PCIJ's successor, in recent years repeatedly has reconfirmed the validity, indeed the primacy, of *Chorzów Factory* as the standard of compensation for acts by States unlawful under international law. Thus in 1997



in the Case Concerning the Gabčíkovo-Nagymaros Project, (Hung. v. Slovakia), 1997 I.C.J. 7 (Sept. 25), the Court, having found both Hungary and the Slovak Republic to have acted wrongfully in connection with a dam project, had been asked to “indicate on what basis they should be paid,” *id.* para.152, and in answering such petition referred in the first instance to *Chorzów Factory*, quoting the same phrase from that case as is set forth in paragraph 484 above. In 2001 the Court again, in the LaGrand Case, (Ger. v. U.S.), 2001 I.C.J. 466 (June 27), relied (at para.125) on the *Chorzów Factory* principle. In its 2002 Judgment in the Case Concerning the Arrest Warrant of 11 April 2000, (Democratic Rep. Of Congo v. Belg.), 2002 I.C.J. 3 (February 14), the Court again invoked (at para.76) the very same passage from *Chorzów Factory* it had cited in the Case Concerning the Gabčíkovo-Nagymaros Project as noted above (and which is quoted in paragraph 484 above) in connection with its finding that Belgium had committed an internationally wrongful act and its associated discussion of remedies. Just two years ago, in 2004, the Court twice had occasion to reconfirm *Chorzów Factory*'s principles. First, the Case Concerning Avena and other Mexican Nationals, (Mexico v. U.S.), 2004 I.C.J. 12 (March 31) at paras.119-121, relied on the same principle quoted from *Chorzów* in the Gabčíkovo-Nagymaros, LaGrand and Arrest Warrant Judgments (and set forth in paragraph 484 above) in fashioning the relief ordered in its Judgment. Then, in its Advisory Opinion on the Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory, 2004 I.C.J. 136 (July 9), the Court, after finding the “Wall” in question to be in breach of various international obligations incumbent on Israel, “recall[ed] that the essential forms of reparation in customary law were laid down by the Permanent Court of International Justice in the following terms” and then proceeded in paragraph 152 to invoke the same passage from *Chorzów Factory* (as set forth in paragraphs 484 and 485 above) on which it had relied in the Gabčíkovo-Nagymaros, LaGrand, Arrest Warrant and Avena Cases.

The Court then went on to prescribe actual restitution as the preferred remedy, and in default thereof equivalent compensation:

*“Israel is accordingly under an obligation to return the land, orchards, olive groves and other immovable property seized from any natural or legal person for purposes of construction of the wall in the Occupied Palestinian Territory. In the event such restitution should prove to be materially impossible, Israel has an obligation to compensate the persons in question for the damage suffered.”* (para.153)

Thus there can be no doubt about the present vitality of the *Chorzów Factory* principle, its full current vigor having been repeatedly attested to by the International Court of Justice.

494. It may also be noted that the International Law Commission's Draft Articles on Responsibility of States for Internationally Wrongful Acts, concluded in 2001, expressly rely on and closely follow *Chorzów Factory*. Article 31(1) provides:

*“The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.”*

The Commission's Commentary (at (2)) on this Article states that “*The general principle of the consequences of the commission of an internationally wrongful act was stated by the Permanent Court in the Factory at Chorzów case*” and then quotes the identical passage quoted by the International Court of Justice in all of the cases cited above (and set forth in paragraph 484 above). The Commission continues in Article 35 of the Draft Articles to conclude that restitution in kind is the preferred remedy for an internationally wrongful act, providing in Article 36 that only where restitution cannot be achieved can equivalent compensation be awarded.

495. The remaining issue is what consequence does application of this customary international law standard have for the present case. It is clear that actual restitution cannot take place and so it is, in the words of the *Chorzów Factory* decision, “*payment of a sum corresponding to the value which a restitution in kind would bear*”, which is the matter to be decided.

496. The present case is almost unique among decided cases concerning the expropriation by States of foreign owned property, since the value of the investment after the date of expropriation (1 January 2002) has risen very considerably while other arbitrations that apply the *Chorzów Factory* standard all invariably involve scenarios where there has been a decline in the value of the investment after regulatory interference. It is for this reason that application of the restitution standard by various arbitration tribunals has led to use of the date of the expropriation as the date for the valuation of damages.

497. However, in the present, *sui generis*, type of case the application of the *Chorzów Factory* standard requires that the date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed. This kind of approach is not without support. The PCIJ in the *Chorzów Factory* case stated that damages are “*not necessarily limited to the value of the undertaking at the moment of dispossession*” (Page 47 of the Judgment. This passage being cited with approval in *Amoco International Finance Corporation v. Iran*, 15 IRAN–U.S. C.T.R. p.189 at p.247 (para.196).) It is noteworthy that the European Court of Human Rights has applied *Chorzów Factory* in circumstances comparable to the instant case to compensate the expropriated party the higher value the property enjoyed at the moment of the Court's judgment rather than the considerably lesser value it had had at the earlier date of dispossession. In *Papamichalopoulos and Others v. Greece* ((1966) E.H.R.R. 439) (available also on Westlaw at 1995 WL 1082483 (ECHR)) the Greek Government in 1967 had expropriated unimproved real estate for the purpose of building housing for Greek Navy personnel, and in 1993 the Court had ruled that “*the applicants de facto...have been expropriated in a manner incompatible with their right to the peaceful enjoyment of their possession*” ((1993) 16 E.H.R.R. 440, paras.35-46 and points 1 and 2 of the operative provisions). In the remedies stage the Court ruled (para.36), just as in the case here, that “[*t*]he act of the Greek Government...contrary to the Convention was not an expropriation that would have been legitimate but for the failure to pay fair compensation.” The Court continued (para.36):

*“The unlawfulness of such a dispossession inevitably affects the criteria to be used for determining the reparation owed by the respondent State, since the pecuniary consequences of a lawful expropriation cannot be assimilated to those of an unlawful dispossession.”*

Then, citing the oft-quoted passage from *Chorzów Factory* set forth in paragraph 484 above and repeated by the International Court of Justice on numerous recent occasions as noted earlier, the Court concluded (para.37):

*“In the present case the compensation to be awarded to the applicants is not limited to the value of their properties at the date [1967] on which the Navy occupied them. . . For that reason [the Court had] requested the experts [appointed by the Court] to estimate also the current value of the land in issue.”*

The Court ordered restitution of the land, including all of the buildings and other improvements made over the intervening years by the Greek Navy, and further (para. 39), that if restitution would not be made:

*“[T]he Court holds that [Greece] is to pay the applicants, for damage and loss of enjoyment since the authorities took possession of the land in 1967, the current value of the land, increased by the appreciation brought about by the existence of the buildings and the construction costs of the latter.”*

498. Moreover, Sole Arbitrator Dupuy in *Texaco Overseas Petroleum Company v. Government of the Libyan Arab Republic* 53 ILR p.389 cited a number of authorities on the contours of the principle of *restitutio in integrum* as set out in the *Chorzów Factory* case. Dupuy cited in particular the view of former ICJ President Jiménez de Aréchaga, writing extra-judicially, who stated:

*“The fact that indemnity presupposes, as the PCIJ stated, the ‘payment sum corresponding to the value which a restitution in kind would bear’, has important effects on its extent. As a consequence of the depreciation of currencies and of delays involved in the administration of justice, the value of a confiscated property may be higher at the time of the judicial decision than at the time of the unlawful act. Since monetary compensation must, as far as possible, resemble restitution, the value at the date when indemnity is paid must be the criterion.”*

499. Based on the foregoing reasons, the Tribunal concludes that it must assess the compensation to be paid by the Respondent to the Claimants in accordance with the *Chorzów Factory* standard, i.e., the Claimants should be compensated the market value of the expropriated investments as at the date of this Award, which the Tribunal takes as of September 30, 2006.

500. Consequently, the Tribunal rejects the Claimants' claim for damages under the unjust enrichment approach, which, in the Tribunal's opinion, has not been substantiated by the Claimants with either sufficient facts or law.

## **2. Discounted Cash Flow (DCF) Method v. Balancing Payment Method**

501. The next focus of the legal debate between the Parties is the appropriate method to compute the fair market value of the expropriated investments of the Claimants. The Claimants submit, based on their expert reports, i.e., the LECG reports, that the DCF method is appropriate in the present case. The Respondent contends that, based on the NERA Report and the later Hunt Report, a Balancing Payment method is to be followed.

502. Like many other tribunals in cases such as the present one, the Tribunal prefers to apply the DCF method, although it is mindful of the Respondent's admonishment that: "*international tribunals have exercised great caution in using the [DCF] method due to its inherently speculative nature.*" (Counter-Memorial at para.590).

503. The Respondent's Balancing Payment method "*is the sum required to provide the Claimants with an IRR return of 17.5% at the date of termination, after accounting for the payments already made.*" (Counter-Memorial at para.739). In the Tribunal's view, the Balancing Payment method does not take into account, at least not sufficiently, the remaining term of the investments. In this connection, the Regulatory Framework specifies in Section 4.1 that the term "*IRR*" is:

*"discount rate that equates the discounted value of a stream of cash flows to the costs of the investment that produced the cash flows, calculated over the entire life of the investment."* (emphasis added)

Moreover, the Balancing Payment method would imply that investors entering into an agreement can be excluded therefrom almost the morning after signing. Article 4.5 of the Quotaholders' Agreement appears not to support Respondent's proposed method either because it provides that ATAA

*". . . undertakes that during the Term, it shall not vote its Quotas in favour of expulsion from the Project Company of any ADC Party that is a Quotaholder in the Project Company."*

Dr. Hunt also testified that he did not rely on Article 4.5. Rather, one should rely on Article 4.6 of the Agreement which requires the parties to cooperate in good faith and act to implement fully the terms of the Agreement. In addition, the Claimants have demonstrated to the satisfaction of the Tribunal that the Project Company had insufficient funds, and was unable to obtain those funds externally without the consent of ADC Affiliate, to effect the Balancing Payment. Consequently, it would have been impossible for ATAA to have unilaterally accelerated distributions to bring ADC Affiliate's IRR to 17.5% as of December 31, 2001.

504. The Respondent's argument that the Balancing Payment method shall be used instead of the DCF method is therefore rejected.

### **3. The Respondent's Other Attacks on the LECG Reports**

505. Except for the Respondent's attack on the DCF approach, the Respondent and its experts also criticize the LECG Reports on many other grounds, which the Tribunal will now consider in turn.

506. One of the Respondent's main criticisms concerns LECG's reliance on the 2002 Business Plan of the Project Company (subject to minor adjustments) as a basis for the DCF calculations, as incorporated in its own models (the "2002 LECG Model", "2004 LECG Model" and "2005 LECG Model"), because it would not provide a reliable basis on which to base projections as to the future performance of the Project Company for the purposes of assessing damages.

507. The Tribunal disagrees since the 2002 Business Plan was approved by ATAA in a letter of December 11, 2001, a few days before the Decree was issued that led to the expropriation and after five drafts had been discussed between the Quota Shareholders. The 2002 Business Plan, therefore, constitutes the best evidence before the Tribunal of the expectations of the parties at the time of expropriation for the expected stream of cash flows. The Respondent has not convincingly shown to the Tribunal that the 2002 Business Plan was limited to ascertaining whether in the short term Regulated Rates and Charges were to be changed or that LECG has failed to undertake scenario analysis or sensitivity testing (which LECG actually did).

508. The estimation of timing and magnitude of cash distributions to ADC Affiliate is, contrary to Dr. Hunt's criticism, based on a correct evaluation by LECG of contemporaneous forecasts of cash distributions as they are derived from the 2002 Business Plan. Dr. Hunt raised the question why ATAA would defer cash flows to later periods if the IRR of expected cash flows to ADC Affiliate is likely to be 17.5% maximum. That is conjecture which is contradicted by projections in the 2002 Business Plan. The same applies to the two alternative responses to better-than-expected Project Company performance (i.e., tariff adjustment and dividend waiver).

509. The Respondent further criticises the IRR used by LECG. Schedule C to the Agreement establishes a target IRR of 15.4% with an upper limit of 17.5%. In the Tribunal's view, LECG was justified in using the upper limit. As it is shown by the Claimants and it is borne out by the events subsequent to the expropriation, the Budapest Airport is indeed one of the fastest growing airports in the world. That increase in traffic would certainly have caused an IRR superior to the contractual cap of 17.5%. Furthermore, the fact that the 2002 Business Plan forecast substantially increased projected dividends in 2010 and 2011 is due to the fact that the Project Loan was scheduled to be repaid by the beginning of 2009, thereby decreasing the costs of the Project Company and increasing the revenues that were available for distribution as dividend in 2010 and 2011.

510. The Respondent's other criticism relates to the discount factor used by LECG. The Tribunal notes that the difference between the use of the cost of equity to discount dividends and promissory notes payments (9.11%) and of the WACC to discount the Management Fees (8%) is explained by the fact that the Management Fees have seniority over dividends. Revenue streams from dividends and promissory notes payments are indeed subordinate to other Project Company cash flows and therefore subject to increased risk. In this connection, BAA used an identical WACC of 8% for its acquisition in December 2005.

511. According to LECG, the cost of equity is equal to the return on risk-free securities, plus systemic risk of the investment (Beta), multiplied by the market risk premium. For a number of countries, an adjustment for country risk is also made. The Respondent's criticism of the use by LECG of the Beta is unfounded. It appears that LECG used a Beta of various representative airports, and not just one. The Respondent's assertion that the market risk premium as used by LECG "*may not be conservative*" falls short of any substantiation. The use of the geometric mean estimate rather than the arithmetic mean is professionally justified. Finally, the Respondent's contention that the country risk "*may be understated*" comes within the same category.

512. The Respondent also contends that LECG should have discounted the present value of the distributions for illiquidity and absence of control of ADC Affiliate's interest. The Tribunal cannot accept these contentions. As is correctly pointed out by Dr. Spiller of LECG, an illiquidity discount is usually associated with privately held companies that have erratic or volatile cash flows. Regulated entities, such as the Project Company, do not typically attract an illiquidity discount because of the relatively stable cash flows associated with them. This is also shown by BAA's acquisition of Budapest Airport Rt. on December 22, 2005 which did not involve an illiquidity discount. With respect to the alleged minority discount, no such discount is required to be applied since ADC Affiliate had adequate shareholder protections in the Project Agreements.

513. As regards the Management Fees, the Tribunal has already found that they are in essence deferred compensation for services rendered prior to the Operations Commencement Date. The Respondent asserts that LECG's compensation estimate is extreme as it is close to zero marginal cost. The evidence before the Tribunal shows, however, that the costs of the ongoing services provided in exchange for the management fees were approximately 2-3% of the overall fees. As a result, LECG was justified in making a corresponding deduction in its calculation of damages.

#### **4. Conclusion on Quantification**

514. In the light of all of the above, the Tribunal is fully satisfied that (a) the standard of compensation established in the *Chorzów Factory* case is the appropriate standard applicable to this case; (b) the restitution approach claimed by the Claimants shall accordingly be followed; (c) LECG's adoption of the DCF method is fully justified; and (d) the calculations carried out by LECG in line with the foregoing standard, approach and

method are reasonable and reliable and are endorsed by the Tribunal in calculating the final amount of damages.

515. With respect to Claimants' claim relating to Lost Future Development Opportunities (i.e., the parking garage facility and the additional terminal capacity), the Tribunal is of the view that they cannot be awarded since the Claimants had no firm contractual rights to those possible projects. Moreover, Claimants have been unable to quantify, with any fair degree of precision, the damages that would have resulted from the loss of those alleged opportunities.

516. The Tribunal would like to point out here that the LECG reports are, in the Tribunal's view, an example as to how damages calculations should be presented in international arbitration; they reflect a high degree of professionalism, clarity, integrity and independence by financial expert witnesses. LECG's valuation is fully validated by the amount of the acquisition by BAA of Budapest Airport Rt. on December 22, 2005, being US\$ 2.23 billion (£1.26 billion) for 75% minus one share and a 75-year assets management contract plus moveable assets.

## **5. The Amount of Compensation Payable to the Claimants**

517. As dictated by the nature of the restitution approach, an award date has to be determined in order to calculate the damages. In its first report dated July 29, 2004, LECG assumed July 31, 2004 as the award date and reached its first total amount of compensation under the restitution approach of US\$66.1 million. In its Supplemental Report dated July 22, 2005, this benchmark date is brought forward to July 2005 and the updated figure is US\$69.7 million. In its Post-Hearing Report, LECG lists the updated amounts of damages as of different assumed award dates month by month from July 2005 to December 2006. For the purpose of this Award, the Tribunal takes September 30, 2006, as the likely date of the Award.

518. The claim for damages under the restitution approach fall into two parts: (a) the estimated value of the Claimants' stake in the Project Company as of the award date; and (b) all unpaid dividends and management fees from the date of expropriation until the date of the award.

519. Taking September 30, 2006 as the date of the Award, the Tribunal notes that the Supplemental Report of LECG arrives at a total amount of damages payable to the Claimants by the Respondent in the sum of US\$76.2 million.

520. Since the calculation is based on the value of the expropriated investments as of the date of the award, no pre-award interest has accrued.

521. The Tribunal is of course grateful to the experts on both sides for their enormous help on the issue of damages. However the Tribunal feels bound to point out that the assessment of damages is not a science. True it is that the experts use a variety of methodologies and tools in order to attempt to arrive at the correct figure. But at the end of

the day, the Tribunal can stand back and look at the work product and arrive at a figure with which it is comfortable in all the circumstances of the case. In the light of all of the above and in the light of the admission that there was a very minor error in LECG's final figure (See Ogilvy Renault's Letter dated May 12, 2006), the Tribunal awards ADC Affiliate US\$55,426,973 and ADC & ADMC Management US\$20,773,027 both sums to carry interest at 6% per annum with monthly rests until payment. Such interest rate is the same as the interest rate agreed by the parties in the Promissory Note.

522. As to post-Award interest, contrary to Respondent's submission, the current trend in investor-State arbitration is to award compound interest. Respondent relies on the statement "[t]here are few rules within the scope of the subject of damages in international law that are better settled than the one that compound interest is not allowable" by Marjorie Whiteman in *Damages in International Law* (1943) Vol. III at 1997. While the Iran-U.S. Claims Tribunal echoed Ms. Whiteman's statement, tribunals in investor-State arbitrations in recent times have recognized economic reality by awarding compound interest (see, e.g., *Middle East Cement Shipping Co. S.A. v. Arab Republic of Egypt*, Final Award, 12 April 2002, ICSID Case No. ARB/99/6, at paras.174-175). In paragraph 104 of the award in *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), the Tribunal recognized that the reason for compound interest was not "to attribute blame to, or to punish, anybody for the delay in the payment made to the expropriated owner; it is a mechanism to ensure that the compensation awarded the Claimant is appropriate in the circumstances". Accordingly, the Tribunal determines that interest is to be compounded on a monthly basis in the present case.

## **G. Return of the Shares and Promissory Notes**

523. As previously noted, Claimant ADC Affiliate has undertaken to return its shares in the Project Company (i.e., 34%) to Respondent upon payment of the sum awarded by the Tribunal (see paras.248-249 *supra*). Accordingly, the Tribunal orders ADC Affiliate to transfer the unencumbered ownership in those shares to Respondent immediately after receipt of payment in full of the sum awarded in this Award (including interest and cost). The promissory notes shall be deemed to have ceased to have any legal force and effect upon payment in full of the sum awarded in this Award (including interest and costs).

524. For the sake of completeness, the Tribunal rules that all claims raised by the Claimants but not specifically dealt with in this Award are dismissed and that all defences raised by the Respondent not specifically dealt with in this Award are likewise rejected.

## **H. Costs**

525. Both Parties sought the costs of this arbitration in the event that they were successful.

526. The Tribunal ordered the Parties to set out their claims for costs in a brief schedule.

527. By letter dated August 21, 2006, Ogilvy Renault presented the Tribunal and the Respondent with a schedule claiming US\$7,623,693 in respect of the Claimants' costs and



expenses of this arbitration which included the sum of US\$350,000 paid to ICSID as deposit towards the fees and expenses of the arbitral Tribunal.

528. On the same date the Tribunal received a letter from the Bodnár Law Firm with a schedule claiming US\$4,380,335 in respect of the Respondent's costs and expenses of this arbitration which included the sum of US\$350,000 paid to ICSID as deposit towards the fees and expenses of the arbitral Tribunal.

529. The Claimants' counsel filed their comments on the Respondent's schedule of costs on September 6, 2006, and on September 18, 2006, the Tribunal received from the Respondent's counsel comments on the Claimants' claims for costs. The Respondent contended that the amount of the Claimants' costs and expenses was excessive and should be reduced. The Respondent noted that the Claimants' costs and expenses exceeded the Respondent's costs and expenses by approximately 74%. The Respondent makes the point that such a difference was incomprehensible. Accordingly, the Respondent requests the Tribunal to reduce the recoverable amounts of the Claimants' costs to a reasonable degree taking into account the costs and expenses of the Respondent.

## **1. Principle**

530. It is clear from Article 61(2) of the ICSID Convention and Rule 28 of the ICSID Arbitration Rules that the Tribunal has a wide discretion with regard to costs.

Article 61(2) states:

*“in the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.”*

Rule 28 provides:

*“(1) Without prejudice to the final decision on the payment of the cost of the proceeding, the Tribunal may, unless otherwise agreed by the parties, decide:*

*(b) at any stage of the proceeding, the portion which each party shall pay, pursuant to Administrative and Financial Regulation 14, of the fees and expenses of the Tribunal and the charges for the use of the facilities of the Centre;*

*(c) with respect to any part of the proceeding, that the related costs (as determined by the Secretary-General) shall be borne entirely or in a particular share by one of the parties.*

- (2) *Promptly after the closure of the proceeding, each party shall submit to the Tribunal a statement of costs reasonably incurred or borne by it in the proceeding and the Secretary-General shall submit to the Tribunal an account of all amounts paid by each party to the Centre and of all costs incurred by the Centre for the proceeding. The Tribunal may, before the award has been rendered, request the parties and the Secretary-General to provide additional information concerning the cost of the proceeding.*”

531. Further, it can be seen from previous awards that ICSID arbitrators do in practice award costs in favour of the successful party and sometimes in large sums (see for example *CSOB v. Slovakia* – US\$10 million).

532. In a recent article titled *Treaty Arbitration and Investment Dispute: Adding up the Costs* by M. Weiniger & M. Page, 2006 1:3 *Global Arb. Rev.*44), the authors state that “[r]ecently, ... some tribunals [in investment arbitration] have adopted a more robust approach, seeing no reason to depart from the principle that the successful party should have its costs paid by the unsuccessful party, as adopted in commercial arbitration.”

533. In the present case, the Tribunal can find no reason to depart from the starting point that the successful party should receive reimbursement from the unsuccessful party. This was a complex, difficult, important and lengthy arbitration which clearly justified experienced and expert legal representation as well as the engagement of top quality experts on quantum. The Tribunal is not surprised at the total of the costs incurred by the Claimants. Members of the Tribunal have considerable experience of substantial ICSID cases as well as commercial cases and the amount expended is certainly within the expected range. Were the Claimants not to be reimbursed their costs in justifying what they alleged to be egregious conduct on the part of Hungary it could not be said that they were being made whole.

## **2. Quantum**

534. At the outset it is worth recalling the wise comments of Howard Holtzmann who said:

*“A test of reasonableness is not, however, an invitation to mere subjectivity. Objective tests of reasonableness of lawyers’ fees are well-known. Such tests typically assign weight primarily to the time spent and complexity of the case. In modern practice, the amount of time required to be spent is often a gauge of the extent of the complexity involved. Where the Tribunal is presented with copies of bills for services or other appropriate evidence, indicating the time spent, the hourly billing rate, and a general description of the professional services rendered, its task need be neither onerous nor mysterious. The range of typical hourly billing rates is generally known and, as evidence before the Tribunal in various cases including this one indicates, it does not greatly differ between the United States and countries of Western Europe, where both claimants and respondents before the Tribunal typically hire their outside*

*counsel. Just how much time any lawyer reasonably needs to accomplish a task can be measured by the number of issues involved in a case and the amount of evidence requiring analysis and presentation. While legal fees are not to be calculated on the basis of the pounds of paper involved, the Tribunal by the end of a case is able to have a fair idea, on the basis of the submissions made by both sides, of the approximate extent of the effort that was reasonably required.*

*Nor should the Tribunal neglect to consider the reality that legal bills are usually first submitted to businessmen. The pragmatic fact that a businessman has agreed to pay a bill, not knowing whether or not the Tribunal would reimburse the expenses, is a strong indication that the amount billed was considered reasonable by a reasonable man spending his own money, or the money of the corporation he serves. That is a classic test of reasonableness.”* (Separate opinion of Judge Holtzmann at 7; reported in Iranian Assets Litigation Reporter 10, 860, 10, 863; 8 Iran-US C.T.R. 329, 332-333.)

535. In addition to the obvious good sense of the passage cited above there are a number of features in this case which justify the Tribunal in ordering the Respondent to reimburse the Claimants the full amount of their legal and other expenses of this arbitration. However, at the outset, the Tribunal should make clear that it is quite satisfied that the amount claimed for costs by the Claimants is reasonable in amount having regard to all the circumstances of this case. The Tribunal rejects the submission that the reasonableness of the quantum of the Claimants’ claim for costs should be judged by the amount expended by the Respondent. It is not unusual for claimants to spend more on costs than respondents given, among other things, the burden of proof. Although at the outset both sides were represented by top class international law firms, the Respondent changed counsel before the hearing and took on an able and dynamic younger legal team. The Respondent also engaged Dr. Hunt at the very last minute in place of its former expert firm NERA Consulting. All these factors can explain the discrepancy between the two sides’ costs and expenses.

536. The other factors are as follows. Firstly, the Tribunal has concluded that Hungary made no attempt to honour its obligations under the BIT. Hungary acted throughout with callous disregard of the Claimants’ contractual and financial rights.

537. Secondly, the Respondent took every conceivable point and put the Claimants to strict proof of every aspect of their case. Some of the points taken were unarguable but nevertheless they added to the time and cost of this arbitration.

538. Thirdly, the Respondent put forward an overly burdensome document request which the Tribunal ordered should be completely re-cast and which was.

539. Fourthly, not only did the Respondent change counsel in mid-arbitration thereby causing some extra expense, but it also changed experts at the very last minute. On change

of counsel, the Respondent sought an adjournment of the long fixed hearing dates which were properly opposed by the Claimants and rejected by the Tribunal.

540. Fifthly, the Tribunal can find no evidence of duplication of effort as between the co-counsel engaged by the Claimants. In fact, to the contrary, the division of labour at the hearing seemed most appropriate and was conducive to a smooth hearing.

541. The Tribunal hastens to add that no criticism whatsoever can be leveled at the new legal team which conducted the actual hearing with ability, clarity, expedition and above all extreme courtesy.

542. In the light of the foregoing, the Tribunal has no hesitation in concluding that it would be wholly appropriate, as well as just, in the exercise of its discretion to order the Respondent to reimburse the Claimants the sum of US\$7,623,693 in respect of their costs and expenses in this arbitration.

### **THE AWARD**

543. Having heard and read all the submissions and evidence in this arbitration, the Tribunal AWARDS AND ORDERS AS FOLLOWS:

- 1) within 30 days of the date of this Award, the Respondent shall pay to ADC Affiliate Ltd. the sum of US\$55,426,973 together with interest thereon calculated from the 30th day following the date of this Award at the rate of 6% per annum compounded with monthly rests until payment;
- 2) within 30 days of the date of this Award, the Respondent shall pay to ADC & ADMC Management Ltd. the sum of US\$20,773,027 together with interest thereon calculated from the 30th day following the date of this Award at the rate of 6% per annum compounded with monthly rests until payment;
- 3) within 30 days of the date of this Award, the Respondent shall pay to the Claimants the sum of US\$7,623,693 in full satisfaction of both Claimants' claims for costs and expenses of this arbitration together with interest thereon calculated from the 30th day following the date of this Award at the rate of 6% per annum compounded with monthly rests until payment;
- 4) immediately upon receipt of all of the sums referred to in paragraphs 1), 2) and 3) above, ADC Affiliate Ltd. shall transfer the unencumbered ownership in all its shares in the Project Company to the Respondent and to its order.

544. The Tribunal wishes to make clear that it has read and taken into account all of the voluminous material submitted to it in this arbitration even if not every point has been replicated herein. Finally, the Tribunal would like to thank and pay tribute to both legal teams for their clear, concise, able and courteous submissions at all stages of this difficult arbitration and particularly at the hearing.

\_\_\_\_\_ Signed \_\_\_\_\_

Professor Albert Jan van den Berg

Dated this 25<sup>th</sup> day of September 2006

\_\_\_\_\_ Signed \_\_\_\_\_

The Honorable Charles N. Brower

Dated this 22<sup>nd</sup> day of September 2006

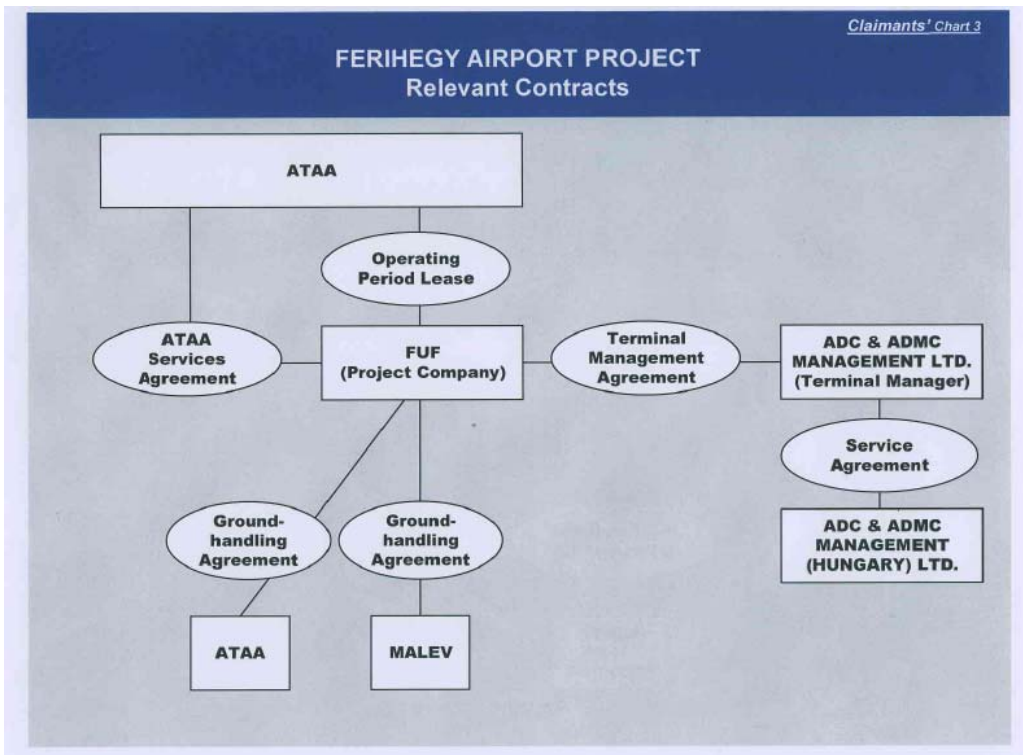
\_\_\_\_\_ Signed \_\_\_\_\_

Neil T. Kaplan CBE, QC

President

Dated this 27<sup>th</sup> day of September 2006

### Appendix 1 Claimants' Chart 3



**CLA-026**

INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION  
Independent Review Panel

CASE # 50 2013 001083

---

**DECLARATION ON THE IRP PROCEDURE**

---

**In the matter of an Independent Review Process (IRP) pursuant to the Internet Corporation for Assigned Names and Number's (ICANN's) Bylaws, the *International Dispute Resolution Procedures (ICDR Rules)* of the International Centre for Dispute Resolution (ICDR), and the *Supplementary Procedures for ICANN Independent Review Process***

**Between:** **DotConnectAfrica Trust;**  
("Claimant" or "DCA Trust")

Represented by Mr. Arif H. Ali, Ms. Marguerite Walter and Ms. Erica Franzetti of Weil, Gotshal, Manges, LLP located at 1300 Eye Street, NW, Suite 900, Washington, DC 20005, U.S.A.

**And**

**Internet Corporation for Assigned Names and Numbers (ICANN);**  
("Respondent" or "ICANN")

Represented by Mr. Jeffrey A. LeVee of Jones Day, LLP located at 555 South Flower Street, Fiftieth Floor, Los Angeles, CA 90071, U.S.A.

Claimant and Respondent will together be referred to as "Parties".

**IRP Panel:**  
**Babak Barin, *Chair***  
**Prof. Catherine Kessedjian**  
**Hon. Richard C. Neal (Ret.)**



## **I. BACKGROUND**

- 1) DCA Trust is a non-profit organization established under the laws of the Republic of Mauritius on 15 July 2010 with its registry operation – DCA Registry Services (Kenya) Limited – as its principal place of business in Nairobi, Kenya. DCA Trust was formed with the charitable purpose of, among other things, advancing information technology education in Africa and providing a continental Internet domain name to provide access to internet services for the people of Africa and for the public good.
- 2) In March 2012, DCA Trust applied to ICANN for the delegation of the .AFRICA top-level domain name in its 2012 General Top-Level Domains (“gTLD”) Internet Expansion Program (the “New gTLD Program”), an internet resource available for delegation under that program.
- 3) ICANN is a non-profit corporation established under the laws of the State of California, U.S.A., on 30 September 1998 and headquartered in Marina del Rey, California. According to its Articles of Incorporation, ICANN was established for the benefit of the Internet community as a whole and is tasked with carrying out its activities in conformity with relevant principles of international law, international conventions, and local law.
- 4) On 4 June 2013, the ICANN Board New gTLD Program Committee (“NGPC”) posted a notice that it had decided not to accept DCA Trust’s application.
- 5) On 19 June 2013, DCA Trust filed a request for reconsideration by the ICANN Board Governance Committee (“BGC”), which denied the request on 1 August 2013.
- 6) On 19 August 2013, DCA Trust informed ICANN of its intention to seek relief before an Independent Review Panel under ICANN’s Bylaws. Between August and October 2013, DCA Trust and ICANN participated in a Cooperative Engagement Process (“CEP”) to try and resolve the issues relating to DCA Trust’s application. Despite several meetings, no resolution was reached.
- 7) On 24 October 2013, DCA Trust filed a Notice of Independent Review Process with the ICDR in accordance with Article IV, Section 3, of ICANN’s Bylaws.

## **II. SUMMARY OF THE PARTIES’ POSITIONS ON THE MERITS**

- 8) According to DCA Trust, the central dispute between it and ICANN in the Independent Review Process (“IRP”) invoked by DCA Trust in October 2013 and described in its Amended Notice of Independent Review Process submitted to ICANN on 10 January 2014 arises out of:

“(1) ICANN’s breaches of its Articles of Incorporation, Bylaws, international and local law, and other applicable rules in the administration of applications for the .AFRICA top-level domain name in its 2012 General Top-Level Domains (“gTLD”) Internet Expansion Program (the “New gTLD Program”); and (2) ICANN’s wrongful decision that DCA’s application for .AFRICA should not proceed [...]”<sup>1</sup>

- 9) According to DCA Trust, “ICANN’s administration of the New gTLD Program and its decision on DCA’s application were unfair, discriminatory, and lacked appropriate due diligence and care, in breach of ICANN’s Articles of Incorporation and Bylaws.”<sup>2</sup> DCA Trust also advanced that “ICANN’s violations materially affected DCA’s right to have its application processed in accordance with the rules and procedures laid out by ICANN for the New gTLD Program.”<sup>3</sup>
- 10) In its 10 February 2014 [sic]<sup>4</sup> Response to DCA Trust’s Amended Notice, ICANN submitted that in these proceedings, “DCA challenges the 4 June 2013 decision of the ICANN Board New gTLD Program Committee (“NGPC”), which has delegated authority from the ICANN Board to make decisions regarding the New gTLD. In that decision, the NGPC unanimously accepted advice from ICANN’s Governmental Advisory Committee (“GAC”) that DCA’s application for .AFRICA should not proceed. DCA argues that the NGPC should not have accepted the GAC’s advice. DCA also argues that ICANN’s subsequent decision to reject DCA’s Request for Reconsideration was improper.”<sup>5</sup>
- 11) ICANN argued that the challenged decisions of ICANN’s Board “were well within the Board’s discretion” and the Board “did exactly what it was supposed to do under its Bylaws, its Articles of Incorporation, and the Applicant Guidebook (“Guidebook”) that the Board adopted for implementing the New gTLD Program.”<sup>6</sup>
- 12) Specifically, ICANN also advanced that “ICANN properly investigated and rejected DCA’s assertion that two of ICANN’s Board members had conflicts of interest with regard to the .AFRICA applications, [...] numerous African countries issued “warnings” to ICANN regarding DCA’s application, a signal from those governments that they had serious concerns regarding DCA’s application; following the issuance of those warnings, the GAC issued “consensus advice” against DCA’s application; ICANN then accepted the GAC’s advice, which was entirely consistent with ICANN’s Bylaws and the

---

<sup>1</sup> Claimant’s Amended Notice of Independent Review Process, *para.* 2.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> ICANN’s Response to Claimant’s Amended Notice contains a typographical error; it is dated “February 10, 2013” rather than 2014.

<sup>5</sup> ICANN’s Response to Claimant’s Amended Notice, *para.* 4. Underlining is from the original text.

<sup>6</sup> *Ibid*, *para.* 5.

Guidebook; [and] ICANN properly denied DCA's Request for Reconsideration."<sup>7</sup>

- 13) In short, ICANN argued that in these proceedings, "the evidence establishes that the process worked exactly as it was supposed to work."<sup>8</sup>
- 14) In the merits part of these proceedings, the Panel will decide the above and other related issues raised by the Parties in their submissions.

### III. PROCEDURAL BACKGROUND LEADING TO THIS DECISION

- 15) On 24 April 2013, 12 May, 27 May and 4 June 2014 respectively, the Panel issued a Procedural Order No. 1, a Decision on Interim Measures of Protection, a list of questions for the Parties to brief in their 20 May 2014 memorials on the procedural and substantive issues identified in Procedural Order No. 1 ("12 May List of Questions"), a Procedural Order No. 2 and a Decision on ICANN's Request for Partial Reconsideration of certain portions of its Decision on Interim Measures of Protection. The Decision on Interim Measures of Protection and the Decision on ICANN's Request for Partial Reconsideration of certain portions of the Decision on Interim Measures of Protection have no bearing on this Declaration. Consequently, they do not require any particular consideration by the Panel in this Declaration.
- 16) In Procedural Order No. 1 and the 12 May List of Questions, based on the Parties' submissions, the Panel identified a number of questions relating to the future conduct of these proceedings, including the method of hearing of the merits of DCA Trust's amended Notice of Independent Review Process that required further briefing by the Parties. In Procedural Order No. 1, the Panel identified some of these issues as follows:

**B. Future conduct of the IRP proceedings, including the hearing of the merits of Claimant's Amended Notice of Independent Review Process, if required.**

**Issues:**

- a) Interpretation of the provisions of ICANN's Bylaws, the *International Dispute Resolution Procedures* of the ICDR, and the *Supplementary Procedures for ICANN Independent Review Process* (together the "IRP Procedure"), including whether or not there should be *viva voce* testimony permitted.
- b) Document request and exchange.
- c) Additional filings, including any memoranda and hearing exhibits (if needed and appropriate).

---

<sup>7</sup> *Ibid.*

<sup>8</sup> ICANN's Response to Claimant's Amended Notice, *para.* 6. Underlining is from the original text.

- d) Consideration of method of hearing of the Parties, i.e., telephone, video or in-person and determination of a location for such a hearing, if necessary or appropriate, and consideration of any administrative issues relating to the hearing.

17) In that same Order, in light of: (a) the exceptional circumstances of this case; (b) the fact that some of the questions raised by the Parties implicated important issues of fairness, due process and equal treatment of the parties (“Outstanding Procedural Issues”); and (c) certain *primaie impressionis* or first impression issues that arose in relation to the IRP Procedure, the Panel requested the Parties to file two rounds of written memorials, including one that followed the 12 May List of Questions.

18) On 5 and 20 May 2014, the Parties filed their submissions with supporting material for consideration by the Panel.

#### **IV. ISSUES TO BE DECIDED BY THE PANEL**

19) Having read the Parties’ submissions and supporting material, and listened to their respective arguments by telephone, the Panel answers the following questions in this Declaration:

- 1) Does the Panel have the power to interpret and determine the IRP Procedure as it relates to the future conduct of these proceedings?
- 2) If so, what directions does the Panel give the Parties with respect to the Outstanding Procedural Issues?
- 3) Is the Panel's decision concerning the IRP Procedure and its future Declaration on the Merits in this proceeding binding?

#### **Summary of the Panel’s findings**

20) The Panel is of the view that it has the power to interpret and determine the IRP Procedure as it relates to the future conduct of these proceedings and consequently, it issues the procedural directions set out in paragraphs 58 to 61, 68 to 71 and 82 to 87 (below), which directions may be supplemented in a future procedural order. The Panel also concludes that this Declaration and its future Declaration on the Merits of this case are binding on the Parties.

## V. ANALYSIS OF THE ISSUES AND REASONS FOR THE DECISION

### 1) Can the Panel interpret and determine the IRP Procedure as it relates to the future conduct of these proceedings?

#### Interpretation and Future Conduct of the IRP Proceedings

##### DCA Trusts' Submissions

21) In its 5 May 2014 Submission on Procedural Issues ("DCA Trust First Memorial"), DCA Trust submitted, *inter alia*, that:

"[Under] California law and applicable federal law, this IRP qualifies as an arbitration. It has all the characteristics that California courts look to in order to determine whether a proceeding is an arbitration: 1) a third-party decision-maker; 2) a decision-maker selected by the parties; 3) a mechanism for assuring the neutrality of the decision-maker; 4) an opportunity for both parties to be heard; and 5) a binding decision[...]. Thus, the mere fact that ICANN has labeled this proceeding an independent review process rather than an arbitration (and the adjudicator of the dispute is called a Panel rather than a Tribunal) does not change the fact that the IRP – insofar as its procedural framework and the legal effects of its outcome are concerned – is an arbitration."<sup>9</sup>

22) According to DCA Trust, the IRP Panel is a neutral body appointed by the parties and the ICDR to hear disputes involving ICANN. Therefore, it "qualifies as a third-party decision-maker for the purposes of defining the IRP as an arbitration."<sup>10</sup> DCA Trust submits that, "ICANN's Bylaws contain its standing offer to arbitrate, through the IRP administered by the ICDR, disputes concerning Board actions alleged to be inconsistent with the Articles of Incorporation or the Bylaws."<sup>11</sup>

23) DCA Trust submits that, it "accepted ICANN's standing offer to arbitrate by submitting its Notice of Independent Review [...] to the ICDR on 24 October 2013 [...] when the two party-appointed panelists were unable to agree on a chairperson, the ICDR made the appointment pursuant to Article 6 of the ICDR Rules, amended and effective 1 June 2009. The Parties thus chose to submit their dispute to the IRP Panel for resolution, as with any other arbitration."<sup>12</sup>

24) According to DCA Trust, "the Supplementary Procedures provide that the IRP is to be comprised of 'neutral' [individuals] and provide that the panel shall be comprised of members of a standing IRP Panel or as selected by the

---

<sup>9</sup> DCA Trust First Memorial, *para.* 4 and 5.

<sup>10</sup> *Ibid*, *para.* 8.

<sup>11</sup> *Ibid*, *para.* 9.

<sup>12</sup> *Ibid*.

parties under the ICDR Rules. The ICDR Rules [...] provide that panelists serving under the rules, 'shall be impartial and independent', and require them to disclose any circumstances giving rise to 'justifiable doubts' as to their impartiality and independence [...] The IRP therefore contains a mechanism for ensuring the neutrality of the decision-maker, just like any other arbitration."<sup>13</sup>

25) DCA Trust further submitted that the "IRP affords both parties an opportunity to be heard, both in writing and orally" and the "governing instruments of the IRP - *i.e.*, the Bylaws, the ICDR Rules, and the Supplementary Procedures - confirm that the IRP is final and binding." According to DCA Trust, the "IRP is the final accountability and review mechanism available to the parties materially affected by ICANN Board decisions. The IRP is also the only ICANN accountability mechanism conducted by an independent third-party decision-maker with the power to render a decision resolving the dispute and naming a prevailing party [...] The IRP represents a fundamentally different stage of review from those that precede it. Unlike reconsideration or cooperative engagement, the IRP is conducted pursuant to a set of independently developed international arbitration rules (as minimally modified) and administered by a provider of international arbitration services, not ICANN itself."<sup>14</sup>

26) As explained in its 20 May 2014 Response to the Panel's Questions on Procedural Issues ("DCA Trust Second Memorial"), according to DCA Trust, "the IRP is the *sole forum* in which an applicant for a new gTLD can seek independent, third-party review of Board actions. Remarkably, ICANN makes no reciprocal waivers and instead retains all of its rights against applicants in law and equity. ICANN cannot be correct that the IRP is a mere 'corporate accountability mechanism'. Such a result would make ICANN - the caretaker of an immensely important (and valuable) global resource - effectively judgment-proof."<sup>15</sup>

27) Finally DCA Trust submitted that:

"[It] is [...] critical to understand that ICANN created the IRP as an alternative to allowing disputes to be resolved by courts. By submitting its application for a gTLD, DCA agreed to eight pages of terms and conditions, including a nearly page-long string of waivers and releases. Among those conditions was the waiver of all of its rights to challenge ICANN's decision on DCA's application in court. For DCA and other gTLD applicants, the IRP is their only recourse; no other legal remedy is available. The very design of this process is evidence that the IRP is fundamentally unlike the forms of

---

<sup>13</sup> *Ibid*, paras. 10, 11 and 12.

<sup>14</sup> *Ibid*, paras. 13, 16, 21 and 23.

<sup>15</sup> DCA Trust Second Memorial, para. 6. Bold and italics are from the original text.

administrative review that precede it and is meant to provide a final and binding resolution of disputes between ICANN and persons affected by its decisions.”<sup>16</sup>

### **ICANN’s Submissions**

28) In response, in its first memorial entitled ICANN’s Memorandum Regarding Procedural Issues filed on 5 May 2014 (“ICANN First Memorial”), ICANN argued, *inter alia*, that:

“[This] proceeding is *not* an arbitration. Rather, an IRP is a truly unique ‘Independent Review’ process established in ICANN’s Bylaws with the specific purpose of providing for ‘independent third-party review of Board actions alleged by an affected party to be inconsistent with the Articles of Incorporation or Bylaws’. Although ICANN is using the International Center [sic] for Dispute Resolution (‘ICDR’) to administer these proceedings, nothing in the Bylaws can be construed as converting these proceedings into an ‘arbitration’, and the Bylaws make clear that these proceedings are not to be deemed as the equivalent of an ‘international arbitration.’ Indeed, the word ‘arbitration’ does not appear in the relevant portion of the Bylaws, and as discussed below, the ICANN Board retains full authority to accept or reject the declaration of all IRP Panels [...] ICANN’s Board had the authority to, and did, adopt Bylaws establishing internal accountability mechanisms and defining the scope and form of those mechanisms. Cal. Corp. Code § 5150(a) (authorizing the board of a non-profit public benefit corporation to adopt and amend the corporation’s bylaws).”<sup>17</sup>

29) In its 20 May 2014 Further Memorandum Regarding Procedural Issues (“ICANN Second Memorial”), ICANN submitted that many of the questions that the Panel posed “are outside the scope of this Independent Review Proceeding [...] and the Panel’s mandate.”<sup>18</sup> According to ICANN:

“The Panel’s mandate is set forth in ICANN’s Bylaws, which limit the Panel to ‘comparing contested actions of the Board to the Articles of Incorporation and Bylaws, and [...] declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws’.”<sup>19</sup>

### **The Panel’s Decision on its power to interpret and determine the IRP Procedure**

#### **(i) Mission and Core Values of ICANN**

30) ICANN is not an ordinary California non-profit organization. Rather, ICANN has a large international purpose and responsibility, to coordinate, at the overall level, the global Internet’s systems of unique identifiers, and in particular, to ensure the stable and secure operation of the Internet’s unique identifier systems.

---

<sup>16</sup> DCA Trust First Memorial, *para.* 22.

<sup>17</sup> ICANN First Memorial, *paras.* 10 and 11. Bold and italics are from the original text.

<sup>18</sup> ICANN Second Memorial, *para.* 2.

<sup>19</sup> *Ibid.*

31) ICANN coordinates the allocation and assignment of the three sets of unique identifiers for the Internet. ICANN's special and important mission is reflected in the following provisions of its Articles of Incorporation:

3. This Corporation is a [non-profit] public benefit corporation and is not organized for the private gain of any person. It is organized under the California [Non-profit] Public Benefit Corporation Law for charitable and public purposes. The Corporation is *organized, and will be operated, exclusively for charitable, educational, and scientific purposes ...* In furtherance of the foregoing purposes, and in *recognition of the fact that the Internet is an international network of networks, owned by no single nation, individual or organization*, the Corporation shall, except as limited by Article 5 hereof, *pursue the charitable and public purposes of lessening the burdens of government and promoting the global public interest in the operational stability of the Internet* by (i) coordinating the assignment of Internet technical parameters as needed to maintain universal connectivity on the Internet; (ii) performing and overseeing functions related to the coordination of the Internet Protocol ("IP") address space; (iii) performing and overseeing functions related to the coordination of the Internet domain name system ("DNS"), including the development of policies for determining the circumstances under which new top-level domains are added to the DNS root system; (iv) overseeing operation of the authoritative Internet DNS root server system; and (v) engaging in any other related lawful activity in furtherance of items (i) through (iv).

4. The Corporation *shall operate for the benefit of the Internet community as a whole, carrying out its activities in conformity with relevant principles of international law and applicable international conventions and local law* and, to the extent appropriate and consistent with these Articles and its Bylaws, through *open and transparent processes* that enable competition and open entry in Internet-related markets. To this effect, the Corporation shall cooperate as appropriate with relevant international organizations. [Emphasis by way of italics is added]

32) In carrying out its mission, ICANN must be accountable to the global internet community for operating in a manner that is consistent with its Bylaws, and with due regard for its core values.

33) In performing its mission, among others, the following core values must guide the decisions and actions of ICANN: preserve and enhance the operational stability, security and global interoperability of the internet, employ open and transparent policy development mechanisms, make decisions by applying documented policies neutrally and objectively, with integrity and fairness and remain accountable to the internet community through mechanisms that enhance ICANN's effectiveness.

34) The core values of ICANN as described in its Bylaws are deliberately expressed in general terms, so as to provide useful and relevant guidance in the broadest possible range of circumstances. Because they are not narrowly prescriptive, the specific way in which they apply, individually and collectively, to each situation will necessarily depend on many factors that cannot be fully anticipated or enumerated.



## **(ii) Accountability of ICANN**

35) Consistent with its large and important international responsibilities, ICANN's Bylaws acknowledge a responsibility to the community and a need for a means of holding ICANN accountable for compliance with its mission and "core values." Thus, Article IV of ICANN's Bylaws, entitled "Accountability and Review," states:

"In carrying out its mission as set out in these Bylaws, ICANN should be accountable to the community for operating in a manner that is consistent with these Bylaws, and with due regard for the core values set forth in Article I of these Bylaws."

36) ICANN's Bylaws establish three accountability mechanisms: the Independent Review Process and two other avenues Reconsideration Requests and the Ombudsman.

37) ICANN's BGC is the body designated to review and consider Reconsideration Requests. The Committee is empowered to make final decisions on certain matters, and recommendations to the Board of Directors on others. ICANN's Bylaws expressly provide that the Board of Directors "*shall not be bound to follow the recommendations of the BGC.*"

38) ICANN's Bylaws provide that the "charter of the Ombudsman shall be to act as a neutral dispute resolution practitioner for those matters for which the provisions of the Reconsideration Policy [...] or the Independent Review Policy have not been invoked." The Ombudsman's powers appear to be limited to "clarifying issues" and "using conflict resolution tools such as negotiation, facilitation, and 'shuttle diplomacy'." The Ombudsman is specifically barred from "instituting, joining, or supporting in any way any legal actions challenging ICANN's structure, procedures, processes, or any conduct by the ICANN Board, staff, or constituent bodies."

39) The avenues of accountability for applicants that have disputes with ICANN do *not* include resort to the courts. Applications for gTLD delegations are governed by ICANN's Guidebook, which provides that applicants waive all right to resort to the courts:

"Applicant hereby releases ICANN [...] from any and all claims that arise out of, are based upon, or are in any way related to, any action or failure to act by ICANN [...] in connection with ICANN's review of this application, investigation, or verification, any characterization or description of applicant or the information in this application, any withdrawal of this application or the decision by ICANN to recommend or not to recommend, the approval of applicant's gTLD application. APPLICANT AGREES NOT TO CHALLENGE, IN COURT OR ANY OTHER JUDICIAL FORA, ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION, AND IRREVOCABLY WAIVES ANY RIGHT TO SUE OR PROCEED IN COURT OR ANY OTHER JUDICIAL FORA ON THE BASIS

OF ANY OTHER LEGAL CLAIM AGAINST ICANN ON THE BASIS OF ANY OTHER LEGAL CLAIM.”<sup>20</sup>

40) Thus, assuming that the foregoing waiver of any and all judicial remedies is valid and enforceable, the ultimate “accountability” remedy for applicants is the IRP.

**(iii) IRP Procedures**

41) The Bylaws of ICANN as amended on 11 April 2013, in Article IV (Accountability and Review), Section 3 (Independent Review of Board Actions), paragraph 1, require ICANN to put in place, in addition to the reconsideration process identified in Section 2, a separate process for independent third-party review of Board actions alleged by an affected party to be inconsistent with ICANN’s Articles of Incorporation or Bylaws.

42) Paragraphs 7 and 8 of Section 2 of the Bylaws, require all IRP proceedings to be administered by an international dispute resolution provider appointed by ICANN, and for that IRP Provider (“IRPP”) to, with the approval of the ICANN’s Board, establish operating rules and procedures, which shall implement and be consistent with Section 3.

43) In accordance with the above provisions, ICANN selected the ICDR, the international division of the American Arbitration Association, to be the IRPP.

44) With the input of the ICDR, ICANN prepared a set of Supplementary Procedures for ICANN IRP (“Supplementary Procedures”), to “supplement the [ICDR’s] International Arbitration Rules in accordance with the independent review procedures set forth in Article IV, Section 3 of the ICANN Bylaws.”

45) According to the Definitions part of the Supplementary Procedures, “Independent Review or IRP” refers to “the procedure that takes place upon filing of a request to review ICANN Board actions or inactions alleged to be inconsistent with ICANN’s Bylaws or Articles of Incorporation”, and “International Dispute Resolution Procedures or Rules” refers to the ICDR’s International Arbitration Rules (“ICDR Rules”) that will govern the process in combination with the Supplementary Rules.

46) The Preamble of the Supplementary Rules indicates that these “procedures supplement the [ICDR] Rules in accordance with the independent review procedures set forth in Article IV, Section 3 of the ICANN Bylaws” and Article

---

<sup>20</sup> Applicant Guidebook, Terms and Conditions for Top Level Domain Applications, *para.* 6. Capital letters are from the original text.

2 of the Supplementary Procedures requires the ICDR to apply the Supplementary Procedures, *in addition* to the ICDR Rules, in all cases submitted to it in connection with Article IV, Section 3(4) of ICANN's Bylaws. In the event there is any inconsistency between the Supplementary Procedures and the ICDR Rules, ICANN requires the Supplementary Procedures to govern.

- 47) The online Oxford English Dictionary defines the word "supplement" as "a thing added to something else in order to complete or enhance it". Supplement, therefore, means to complete, add to, extend or supply a deficiency. In this case, according to ICANN's desire, the Supplementary Rules were designed to "add to" the ICDR Rules.
- 48) A key provision of the ICDR Rules, Article 16, under the heading "Conduct of Arbitration" confers upon the Panel the power to "conduct [proceedings] in whatever manner [the Panel] considers appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case."
- 49) Another key provision, Article 36 of the ICDR Rules, directs the Panel to "interpret and apply these Rules insofar as they relate to its powers and duties". Like in all other ICDR proceedings, the details of exercise of such powers are left to the discretion of the Panel itself.
- 50) Nothing in the Supplementary Procedures either expressly or implicitly conflicts with or overrides the general and broad powers that Articles 16 and 36 of the ICDR Rules confer upon the Panel to interpret and determine the manner in which the IRP proceedings are to be conducted and to assure that each party is given a fair opportunity to present its case.
- 51) To the contrary, the Panel finds support in the "Independent Review Process Recommendations" filed by ICANN, which indicates that the Panel has the *discretion* to run the IRP proceedings in the manner it thinks appropriate. [Emphasis added].
- 52) Therefore, the Panel is of the view that it has the power to interpret and determine the IRP Procedure as it relates to the future conduct of these proceedings, and it does so here, with specificity in relation to the issues raised by the Parties as set out below.

## 2) What directions does the Panel give the Parties with respect to the Outstanding Procedural Issues?

### a) Document request and exchange

#### Parties' Submissions

- 53) In the DCA Trust First Memorial, DCA Trust seeks document production, since according to it, "information potentially dispositive of the outcome of these proceedings is in ICANN's possession, custody or control."<sup>21</sup> According to DCA Trust, in this case, "ICANN has submitted witness testimony that, among other things, purports to rely on secret documents that have not been provided." Given that these proceedings may be "DCA's only opportunity to present and have its claims decided by an independent decision-maker", DCA Trust argues "that further briefing on the merits should be allowed following any and all document production in these proceedings."<sup>22</sup>
- 54) According to DCA Trust, "by choosing the ICDR Rules, the Parties also chose the associated ICDR guidelines including the Guidelines for Arbitrators Concerning Exchanges of Information ("ICDR Guidelines"). The ICDR Guidelines provide that 'parties shall exchange, in advance of the hearing, all documents upon which each intends to rely' [...]"<sup>23</sup> DCA Trust submits that, "nothing in the Bylaws or Supplementary Procedures excludes such document production, leaving the ICDR Rules to cover the field."<sup>24</sup>
- 55) DCA Trust therefore, requests that the Panel issue a procedural order providing the Parties with an opportunity to request documents from one another, and to seek an order from the Panel compelling production of documents if necessary.
- 56) ICANN agrees with DCA Trust, that pursuant to the ICDR Guidelines, which it refers to as "Discovery Rules", "a party must request that a panel order the production of documents."<sup>25</sup> According to ICANN, "those documents must be 'reasonably believed to exist and to be relevant and material to the outcomes of the case,' and requests must contain 'a description of specific documents or classes of documents, along with an explanation of their materiality to the outcome of the case."<sup>26</sup> ICANN argues, however, that despite the requirement by the Supplementary Rules that, '**all necessary evidence** to demonstrate the requestor's claims that ICANN violated its Bylaws or Articles of Incorporation

---

<sup>21</sup> DCA Trust First Memorial, *para.* 61.

<sup>22</sup> *Ibid.*, *paras.* 61 and 66.

<sup>23</sup> *Ibid.*, *para.* 67.

<sup>24</sup> *Ibid.*

<sup>25</sup> ICANN First Memorial, *para.* 28.

<sup>26</sup> *Ibid.*

should be part of the [initial written] submission’, DCA Trust has not to date “provided any indication as to what information it believes the documents it may request may contain and has made no showing that those documents could affect the outcome of the case.”<sup>27</sup>

57) ICANN further submits that, “while ICANN recognizes that the Panel may order the production of documents within the parameters set forth in the Discovery Rules, ICANN will object to any attempts by DCA to propound broad discovery of the sort permitted in American civil litigation.”<sup>28</sup> In support of its contention, ICANN refers to the ICDR Guidelines and states that those Guidelines have made it ‘clear that its Discovery Rules do not contemplate such broad discovery. The introduction of these rules states that their purpose is to promote ‘the goal of providing a simpler, less expensive and more expeditious form of dispute resolution than resort to national courts.’ According to ICANN, the ICDR Guidelines note that:

“One of the factors contributing to complexity, expense and delay in recent years has been the migration from court systems into arbitration of procedural devices that allow one party to a court proceeding access to information in the possession of the other, without full consideration of the differences between arbitration and litigation. The purpose of these guidelines is to make it clear to arbitrators that they have the authority, the responsibility and, in certain jurisdictions, the mandatory duty to manage arbitration proceedings so as to achieve the goal of providing a simpler, less expensive, and more expeditious process.”<sup>29</sup>

### **The Panel’s directions concerning document request and exchange**

58) Seeing that the Parties are both in agreement that some form of documentary exchange is permitted under the IRP Procedure, and considering that Articles 16 and 19 of the ICDR Rules respectively specify, *inter alia*, that, “[s]ubject to these Rules the [Panel] may conduct [these proceedings] in whatever manner it considers appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case” and “at any time during the proceedings, the tribunal may order parties to produce other documents, exhibits or other evidence it deems necessary or appropriate”, the Panel concludes that some document production is necessary to allow DCA Trust to present its case.

59) The Panel is not aware of any international dispute resolution rules, which prevent the parties to benefit from some form of document production. Denying document production would be especially unfair in the circumstances of this case given ICANN’s reliance on internal confidential documents, as advanced by DCA Trust. In any event, ICANN’s espoused goals

---

<sup>27</sup> *Ibid*, para. 29. Bold and italics are from the original text.

<sup>28</sup> *Ibid*, para. 30.

<sup>29</sup> ICDR Guidelines for Arbitrators on Exchanges of Information, Introduction.

of accountability and transparency would be disserved by a regime that truncates the usual and traditional means of developing and presenting a claim.

60)The Panel, therefore, orders a reasonable documentary exchange in these proceedings with a view to maintaining efficiency and economy, and invites the Parties to agree by or before 29 August 2014, on a form, method and schedule of exchange of documents between them. If the Parties are unable to agree on such a documentary exchange process, the Panel will intervene and, with the input of the Parties, provide further guidance.

61)In this last regard, the Panel directs the Parties attention to paragraph 6 of the ICDR Guidelines, and advises, that it is very “receptive to creative solutions for achieving exchanges of information in ways that avoid costs and delay, consistent with the principles of due process expressed in these Guidelines.”

### **b) Additional filings, including memoranda and hearing exhibits**

#### **Parties’ Submissions**

62)In the DCA Trust First Memorial, DCA Trust submits that:

“[The] plain language of the Supplementary Procedures pertaining to written submissions clearly demonstrates that claimants in IRPs are not limited to a single written submission incorporating all evidence, as argued by ICANN. Section 5 of the Supplementary Procedures states that ‘initial written submissions of the parties shall not exceed 25 pages.’ The word ‘initial’ confirms that there may be subsequent submissions, subject to the discretion of the Panel as to how many additional written submissions and what page limits should apply.”<sup>30</sup>

63)DCA Trust also submits that, “Section 5 of the Supplementary Procedures [...] provides that ‘[a]ll necessary evidence to demonstrate the requestor’s claims that ICANN violated its Bylaws or Articles of Incorporation should be part of the submission.’ Use of the word ‘should’—and not ‘shall’—confirms that it is desirable, but not required that all necessary evidence be included with the Notice of Independent Review. Plainly, the Supplementary Procedures do not preclude a claimant from adducing additional evidence nor would it make any sense if they did given that claimants may, subject to the Panel’s discretion, submit document requests.”<sup>31</sup>

64)According to DCA Trust, in addition, “section 5 of the Supplementary Procedures provides that ‘the Panel may request additional written submissions from the party seeking review, the Board, the Supporting

---

<sup>30</sup> DCA Trust First Memorial, *para.* 57.

<sup>31</sup> *Ibid*, *para.* 58.

Organizations, or from other parties.’ Thus, the Supplementary Procedures clearly contemplate that additional written submissions may be necessary to give each party a fair opportunity to present its case.”<sup>32</sup>

65) In response, ICANN submits that, DCA Trust “has no automatic right to additional briefing under the Supplementary Procedures.”<sup>33</sup> According to ICANN, “paragraph 5 of the Supplementary Procedures, which governs written statements, provides:

The initial written submissions of the parties shall not exceed 25 pages each in argument, double-spaced and in 12-point font. ***All necessary evidence to demonstrate the requestor’s claims that ICANN violated its Bylaws or Articles of Incorporation should be part of the submission.*** Evidence will not be included when calculating the page limit. The parties may submit expert evidence in writing, and there shall be one right of reply to that expert evidence. ***The IRP Panel may request additional written submissions from the party seeking review,*** the Board, the Supporting Organizations, or from other parties.” [Bold and italics are ICANN’s]

ICANN adds:

“This section clearly provides that DCA [Trust’s] opportunity to provide briefing and evidence in this matter has concluded, subject only to a request for additional briefing from the Panel. DCA has emphasized that the rule references the ‘initial’ written submission, but the word ‘initial’ refers to the fact that the Panel ‘may request additional written submissions,’ not that DCA [Trust] has some ‘right’ to a second submission. There is no Supplementary Rule that even suggests the possibility of a second submission as a matter of right. The fact that DCA [Trust] has twice failed to submit evidence in support of its claims is not justification for allowing DCA [Trust] a third attempt.”<sup>34</sup>

66) ICANN further notes, that in its 20 April 2014 letter to the Panel, ICANN already submitted that, “DCA [Trust’s] argument that it submitted its papers ‘on the understanding that opportunities would be available to make further submissions’ is false. ICANN stated in an email to DCA [Trust’s] counsel on 9 January 2014—prior to the submission of DCA [Trust’s] Amended Notice—that the Supplementary [Procedures] bar the filing of supplemental submissions absent a request from the Panel.”<sup>35</sup>

67) According to ICANN:

“[The] decision as to whether to allow supplemental briefing is within the Panel’s discretion, and ICANN urges the Panel to decline to permit supplemental briefing for two reasons. First, despite having months to consider how DCA [Trust] might respond to ICANN’s presentation on the merits, DCA [Trust] has never even attempted to explain

---

<sup>32</sup> *Ibid*, para. 59.

<sup>33</sup> ICANN First Memorial, para. 24.

<sup>34</sup> *Ibid*.

<sup>35</sup> *Ibid*, para. 25.

what it could say in additional briefing that would refute the materials in ICANN's presentation. [...] The fact that DCA is unable to identify supplemental witnesses sixth months after filing its Notice of IRP is strong indication that further briefing would not be helpful in this case. Second, as ICANN has explained on multiple occasions, DCA [Trust] has delayed these proceedings substantially, and further briefing would compound that delay [...] as ICANN noted in its letter of 20 April 2014, despite DCA [Trust's] attempts to frame this case as implicating issues 'reach[ing] far beyond the respective rights of the parties as concerns the delegation of .AFRICA,' the issues in this case are in fact extremely limited in scope. This Panel is authorized only to address whether ICANN violated its Bylaws or Articles of Incorporation *in its handling of DCA's Application for .AFRICA*. The parties have had the opportunity to submit briefs and evidence regarding that issue. DCA [Trust] has given no indication that it has further dispositive arguments to make or evidence to present. The Panel should resist DCA's attempt to delay these proceedings even further via additional briefing."<sup>36</sup>

### **The Panel's directions concerning additional filings**

- 68) As with document production, in the face of Article 16 of the ICDR Rules, the Panel is of the view that both Parties ought to benefit from additional filings. In this instance again, while it is possible as ICANN explains, that the drafters of the Supplementary Procedures may have desired to preclude the introduction of additional evidence not submitted with an initial statement of claim, the Panel is of the view that such a result would be inconsistent with ICANN's core values and the Panel's obligation to treat the parties fairly and afford both sides a reasonable opportunity to present their case.
- 69) Again, every set of dispute resolution rules, and every court process that the Panel is aware of, allows a claimant to supplement its presentation as its case proceeds to a hearing. The goal of a fair opportunity to present one's case is in harmony with ICANN's goals of accountability, transparency, and fairness.
- 70) The Panel is aware of and fully embraces the fact that ICANN tried to curtail unnecessary time and costs in the IRP process. However, this may not be done at the cost of a fair process for both parties, particularly in light of the fact that the IRP is the exclusive dispute resolution mechanism provided to applicants.
- 71) Therefore, the Panel will allow the Parties to benefit from additional filings and supplemental briefing going forward. The Panel invites the Parties in this regard to agree on a reasonable exchange timetable. If the Parties are unable to agree on the scope and length of such additional filings and supplemental briefing, the Panel will intervene and, with the input of the Parties, provide further guidance.

---

<sup>36</sup> *Ibid*, paras. 26 and 27.



## **c) Method of Hearing and Testimony**

### **Parties' Submissions**

72) In the DCA Trust First Memorial, DCA Trust submitted that:

“[The] parties agree that a hearing on the merits is appropriate in this IRP. DCA [Trust] respectfully requests that the Panel schedule a hearing on the merits after document discovery has concluded and the parties have had the opportunity to file memorials on the merits. Although the Panel clearly has the authority to conduct a hearing in-person, in the interest of saving time and minimizing costs, DCA [Trust] would agree to a video hearing, as stated during the April 22 hearing on procedural matters.”<sup>37</sup>

73) In response, ICANN submitted that, “during the 22 April 2014 Call, ICANN agreed that this IRP is one in which a telephonic or video conference would be helpful and offered to facilitate a video conference.”<sup>38</sup> In addition, in the ICANN First Memorial, ICANN argued that according to Article IV, Section 3.12 of the Bylaws and paragraph 4 of the Supplementary Procedures, the IRP should conduct its proceedings by email and otherwise via Internet to the maximum extent feasible and in the extraordinary event that an in-person hearing is deemed necessary by the panel, the in-person hearing shall be limited to argument only.

74) ICANN also advanced, that:

“[It] does not believe [...] that this IRP is sufficiently ‘extraordinary’ so as to justify an in-person hearing, which would dramatically increase the costs for the parties. As discussed above, the issues in this IRP are straightforward – limited to whether ICANN’s Board acted consistent with its Bylaws and Articles of Incorporation in relation to DCA’s application for. AFRICA. – and can, easily [...], be resolved following a telephonic oral argument with counsel and the Panel.”<sup>39</sup>

75) In the DCA Trust First Memorial, DCA Trust also argued that, in “April 2013, ICANN amended its Bylaws to limit telephonic or in-person hearings to ‘argument only.’ At some point after the *ICM* Panel’s 2009 decision in *ICM v. ICANN*, ICANN also revised the Supplementary Procedures to limit hearings to ‘argument only.’ Accordingly, and as ICANN argued at the procedural hearing, ICANN’s revised Bylaws and Supplementary Procedures suggest that there is to be no cross-examination of witnesses at the hearing. However, insofar as neither the Supplementary Procedures nor the Bylaws expressly exclude cross-examination, this provision remains ambiguous.”<sup>40</sup>

---

<sup>37</sup> DCA Trust First Memorial, *para.* 63.

<sup>38</sup> ICANN First Memorial, *para.* 36.

<sup>39</sup> *Ibid*, *para.* 36.

<sup>40</sup> DCA Trust First Memorial, *para.* 64.

76)DCA Trust submitted that:

“[Regardless] of whether the parties themselves may examine witnesses at the hearing, it is clear that the Panel may do so. Article 16(1) provides that the Panel ‘may conduct the arbitration in whatever manner it considers appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case.’ It is, moreover, customary in international arbitration for tribunal members to question witnesses themselves – often extensively – in order to test their evidence or clarify facts that are in dispute. In this case, ICANN has submitted witness testimony that, among other things, purports to rely on secret documents that have not been provided. As long as those documents are withheld from DCA [Trust], it is particularly important for that witness testimony to be fully tested by the Panel, if not by the parties. Particularly in light of the important issues at stake in this matter and the general due process concerns raised when parties cannot test the evidence presented against them, DCA [Trust] strongly urges the Panel to take full advantage of its opportunity to question witnesses. Such questioning will in no way slow down the proceedings, which DCA [Trust] agrees are to be expedited – but not at the cost of the parties’ right to be heard, and the Panel’s right to obtain the information it needs to render its decision.”<sup>41</sup>

77)In response, ICANN submitted that:

“[Both] the Supplementary Procedures and ICANN’s Bylaws unequivocally and unambiguously prohibit live witness testimony in conjunction with any IRP.” Paragraph 4 of the Supplementary Procedures, which according to ICANN governs the “Conduct of the Independent Review”, demonstrates this point. According to ICANN, “indeed, two separate phrases of Paragraph 4 explicitly prohibit live testimony: (1) the phrase limiting the in-person hearing (and similarly telephonic hearings) to ‘argument only,’ and (2) the phrase stating that ‘all evidence, including witness statements, must be submitted in advance.’ The former explicitly limits hearings to the argument of counsel, excluding the presentation of any evidence, including any witness testimony. The latter reiterates the point that *all* evidence, *including witness testimony*, is to be presented in writing and prior to the hearing. Each phrase unambiguously excludes live testimony from IRP hearings. Taken together, the phrases constitute irrefutable evidence that the Supplementary Procedures establish a truncated hearing procedure.”<sup>42</sup>

78)ICANN added:

“[Paragraph] 4 of the Supplementary Procedures is based on the exact same and unambiguous language in Article IV, Section 3.12 of the Bylaws, which provides that ‘[i]n the unlikely event that a telephonic or in-person hearing is convened, **the hearing shall be limited to argument only; all evidence, including witness statements, must be submitted in writing in advance.**’ [...] While DCA [Trust] may prefer a different procedure, the Bylaws and the Supplementary Procedures could not be any clearer in this regard. Despite the Bylaws’ and Supplementary Procedures’ clear and unambiguous prohibition of live witness testimony, DCA [Trust] attempts to argue that the Panel should instead be guided by Article 16 of the ICDR Rules, which states that subject to the ICDR Rules, ‘the tribunal may conduct the arbitration in whatever manner it considers appropriate, provided that the parties are treated with equality and that each

---

<sup>41</sup> *Ibid*, paras. 65 and 66.

<sup>42</sup> ICANN First Memorial, paras. 15 and 16.

party has the right to be heard and is given a fair opportunity to present its case.’ However, as discussed above, the Supplementary Procedures provide that ‘[i]n the event there is any inconsistency between these Supplementary Procedures and [ICDR’s International Arbitration Rules], these Supplementary Procedures will govern,’ and the Bylaws require that the ICDR Rules ‘be consistent’ with the Bylaws. As such, the Panel **does not have discretion** to order live witness testimony in the face of the Bylaws’ and Supplementary Procedures’ clear and unambiguous prohibition of such testimony.”<sup>43</sup>

79) ICANN further submitted:

“[During] the 22 April Call, DCA vaguely alluded to ‘due process’ and ‘constitutional’ concerns with prohibiting cross-examination. As ICANN did after public consultation, and after the *ICM* IRP, ICANN has the right to establish the rules for these procedures, rules that DCA agreed to abide by when it filed its Request for IRP. First, ‘constitutional’ protections do not apply with respect to a *corporate accountability mechanism*. Second, ‘due process’ considerations (though inapplicable to corporate accountability mechanisms) were already considered as part of the design of the revised IRP. And the United States Supreme Court has repeatedly affirmed the right of parties to tailor unique rules for dispute resolution processes, including even *binding arbitration proceedings* (which an IRP is not). The Supreme Court has specifically noted that ‘[t]he point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute. . . . And the informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution’.”<sup>44</sup>

80) According to ICANN:

“[The] U.S. Supreme Court has explicitly held that the right to tailor unique procedural rules includes the right to dispense with certain procedures common in civil trials, including the right to cross-examine witnesses [...] Similarly, international arbitration norms recognize the right of parties to tailor their own, unique arbitral procedures. ***‘Party autonomy is the guiding principle in determining the procedure to be followed in international arbitration.’*** It is a principle that is endorsed not only in national laws, but by international arbitral institutions worldwide, as well as by international instruments such as the New York Convention and the Model Law.”<sup>45</sup>

81) In short, ICANN advanced that:

“[Even] if this were a formal ‘arbitration’, ICANN would be entitled to limit the nature of these proceedings so as to preclude live witness testimony. The fact that this proceeding is not an arbitration further reconfirms ICANN’s right to establish the rules that govern these proceedings [...] DCA [Trust] argues that it will be prejudiced if cross-examination of witnesses is not permitted. However, the procedures give both parties equal opportunity to present their evidence—the inability of either party to examine witnesses at the hearing would affect both the Claimant and ICANN equally. In this instance, DCA [Trust] did not submit witness testimony with its Amended Notice (as clearly it should have). However, were DCA [Trust] to present any written witness statements in support of its position, ICANN would not be entitled to cross examine

---

<sup>43</sup> *Ibid*, paras. 17 and 18. Bold and italics are from the original text.

<sup>44</sup> *Ibid*, para. 19.

<sup>45</sup> *Ibid*, paras. 20 and 21. Bold and italics are from the original text.

those witnesses, just as DCA [Trust] is not entitled to cross examine ICANN's witnesses. Of course, the parties are free to argue to the IRP Panel that witness testimony should be viewed in light of the fact that the rules do not permit cross-examination."<sup>46</sup>

**The Panel's directions on method of hearing and testimony**

- 82) The considerations and discussions under the prior headings addressing document exchange and additional filings apply to the hearing and testimony issues raised in this IRP proceeding as well.
- 83) At this juncture, the Panel is of the preliminary view that at a minimum a video hearing should be held. The Parties appear to be in agreement. However, the Panel does not wish to close the door to the possibility of an in-person hearing and live examination of witnesses, should the Panel consider that such a method is more appropriate under the particular circumstances of this case after the Parties have completed their document exchange and the filing of any additional materials.
- 84) While the Supplementary Procedures appear to limit both telephonic and in-person hearings to "argument only", the Panel is of the view that this approach is fundamentally inconsistent with the requirements in ICANN's Bylaws for accountability and for decision making with objectivity and fairness.
- 85) Analysis of the propriety of ICANN's decisions in this case will depend at least in part on evidence about the intentions and conduct of ICANN's top personnel. ICANN should not be allowed to rely on written statements of these officers and employees attesting to the propriety of their actions without an appropriate opportunity in the IRP process for DCA Trust to challenge and test the veracity of such statements.
- 86) The Panel, therefore, reserves its decision to order an in-person hearing and live testimony pending a further examination of the representations that will be proffered by each side, including the filing of any additional evidence which this Decision permits. The Panel also permits both Parties at the hearing to challenge and test the veracity of statements made by witnesses.
- 87) Having said this, the Panel acknowledges the Parties' desire that the IRP proceedings be as efficient and economical as feasible, consistent with the overall objectives of a fair and independent proceeding. The Panel will certainly bear this desire and goal in mind as these proceedings advance further.

---

<sup>46</sup> *Ibid*, paras. 22 and 23.

### 3) Is the Panel's Decision on the IRP Procedure and its future Declaration on the Merits in this proceeding binding?

#### DCA Trust's Submissions

88) In addition to the submissions set out in the earlier part of this Decision, DCA Trust argues that, the language used in the Bylaws to describe the IRP process is demonstrative that it is intended to be a binding process. When the language in the Bylaws for reconsideration is compared to that describing the IRP, DCA Trust explains:

“[It] is clear that the declaration of an IRP is intended to be final and binding [...] For example, the Bylaws provide that the [ICANN] [Board Governance Committee] BGC ‘shall act on a Reconsideration Request on the basis of the written public record’ and ‘shall make a final determination or recommendation.’ The Bylaws even expressly state that ‘**the Board shall not be bound to follow the recommendations**’ of the BGC. By contrast, the IRP Panel makes ‘**declarations**’ — defined by ICANN in its Supplementary Procedures as ‘decisions/opinions’— that ‘**are final and have precedential value.**’ The IRP Panel ‘shall specifically designate the prevailing party’ and may allocate the costs of the IRP Provider to one or both parties. Moreover, nowhere in ICANN’s Bylaws or the Supplementary Procedures does ICANN state that the Board shall not be bound by the declaration of the IRP. If that is what ICANN intended, then it certainly could have stated it plainly in the Bylaws, as it did with reconsideration. The fact that it did not do so is telling.”<sup>47</sup>

89) In light of the foregoing, DCA Trust advances:

“[The] IRP process is an arbitration in all but name. It is a dispute resolution procedure administered by an international arbitration service provider, in which the decision-makers are neutral third parties chosen by the parties to the dispute. There are mechanisms in place to assure the neutrality of the decision-makers and the right of each party to be heard. The IRP Panel is vested with adjudicative authority that is equivalent to that of any other arbitral tribunal: it renders decisions on the dispute based on the evidence and arguments submitted by the parties, and its decisions are binding and have *res judicata* and precedential value. The procedures appropriate and customary in international arbitration are thus equally appropriate in this IRP. But in any event, and as discussed below, the applicable rules authorize the Panel to conduct this IRP in the manner it deems appropriate regardless of whether it determines that the IRP qualifies as an arbitration.”<sup>48</sup>

#### ICANN's Submissions

90) In response, ICANN submits that:

“[The] provisions of Article IV, Section 3 of the ICANN Bylaws, which govern the Independent Review process and these proceedings, make clear that the declaration of the Panel will not be binding on ICANN. Section 3.11 gives the IRP panels the authority

---

<sup>47</sup> DCA Trust First Memorial, *paras.* 33, 34 and 35. Bold and italics are from the original text.

<sup>48</sup> *Ibid.* *para.* 44.

to 'declare whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws' and 'recommend that the Board stay any action or decision, or that the Board take any interim action, until such time as the Board reviews and acts upon the opinion of the IRP.' Section 3.21 provides that '[w]here feasible, the Board shall consider the IRP Panel declaration at the Board's next meeting.' Section 3 never refers to the IRP panel's declaration as a 'decision' or 'determination.' It does refer to the 'Board's subsequent action on [the IRP panel's] declaration [...].' That language makes clear that the IRP's declarations are advisory and not binding on the Board. Pursuant to the Bylaws, the Board has the discretion to consider an IRP panel's declaration and take whatever action it deems appropriate."<sup>49</sup>

#### 91) According to ICANN:

"[This] issue was addressed extensively in the *ICM* IRP, a decision that has precedential value to this Panel. The *ICM* Panel specifically considered the argument that the IRP proceedings were 'arbitral and not advisory in character,' and unanimously concluded that its declaration was 'not binding, but rather advisory in effect.' At the time that the *ICM* Panel rendered its declaration, Article IV, Section 3 of ICANN's Bylaws provided that 'IRP shall be operated by an international arbitration provider appointed from time to time by ICANN...using arbitrators . . . nominated by that provider.' *ICM* unsuccessfully attempted to rely on that language in arguing that the IRP constituted an arbitration, and that the IRP panel's declaration was binding on ICANN. Following that IRP, that language was removed from the Bylaws with the April 2013 Bylaws amendments, further confirming that, under the Bylaws, an IRP panel's declaration is not binding on the Board."<sup>50</sup>

#### 92) ICANN also submits that:

"[The] lengthy drafting history of ICANN's independent review process confirms that IRP panel declarations are not binding. Specifically, the Draft Principles for Independent Review, drafted in 1999, state that 'the ICANN Board should retain ultimate authority over ICANN's affairs - after all, it is the Board ... that will be chosen by (and is directly accountable to) the membership and supporting organizations.' And when, in 2001, the Committee on ICANN Evolution and Reform ('ERC') recommended the creation of an independent review process, it called for the creation of 'a process to require non-binding arbitration by an international arbitration body to review any allegation that the Board has acted in conflict with ICANN's Bylaws.' The individuals who actively participated in the process also agreed that the review process would not be binding. As one participant stated: IRP 'decisions will be nonbinding, because the Board will retain final decision-making authority'.<sup>51</sup>

#### 93) According to ICANN:

"[The] only IRP Panel ever to issue a declaration, the *ICM* IRP Panel, unanimously rejected the assertion that IRP Panel declarations are binding and recognized that an IRP panel's declaration 'is not binding, but rather advisory in effect.' Nothing has occurred since the issuance of the *ICM* IRP Panel's declaration that changes the fact that IRP Panel declarations are not binding. To the contrary, in April 2013, following the

---

<sup>49</sup> ICANN First Memorial, *para.* 33,

<sup>50</sup> *Ibid*, *para.* 34,

<sup>51</sup> ICANN Second Memorial, *para.* 5,

*ICM* IRP, in order to clarify even further that IRPs are not binding, all references in the Bylaws to the term ‘arbitration’ were removed as part of the Bylaws revisions. *ICM* had argued in the IRP that the use of the word ‘arbitration’ in the portion of the Bylaws related to Independent Review indicated that IRPs were binding, and while the *ICM* IRP Panel rejected that argument, to avoid any lingering doubt, ICANN removed the word ‘arbitration’ in conjunction with the amendments to the Bylaws.”<sup>52</sup>

94) ICANN further submits that:

“[The] amendments to the Bylaws, which occurred following a community process on the proposed IRP revisions, added, among other things, a sentence stating that ‘declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value.’ DCA argues that this new language, which does not actually use the word ‘binding,’ nevertheless provides that IRP Panel declarations are binding, trumping years of drafting history, the sworn testimony of those who participated in the drafting process, the plain text of the Bylaws, and the reasoned declaration of a prior IRP panel. DCA is wrong.”<sup>53</sup>

95) According to ICANN:

“[The] language DCA references was added to ICANN’s Bylaws to meet recommendations made by ICANN’s Accountability Structures Expert Panel (‘ASEP’). The ASEP was comprised of three world-renowned experts on issues of corporate governance, accountability, and international dispute resolution, and was charged with evaluating ICANN’s accountability mechanisms, including the Independent Review process. The ASEP recommended, *inter alia*, that an IRP should not be permitted to proceed on the same issues as presented in a prior IRP. The ASEP’s recommendations in this regard were raised in light of the second IRP constituted under ICANN’s Bylaws, where the claimant presented claims that would have required the IRP Panel to [re-evaluate] the declaration of the IRP Panel in the *ICM* IRP. To prevent claimants from challenging a prior IRP Panel declaration, the ASEP recommended that ‘[t]he declarations of the IRP, and ICANN’s subsequent actions on those declarations, should have precedential value.’ The ASEP’s recommendations in this regard did not convert IRP Panel declarations into binding decisions.”<sup>54</sup>

96) Moreover, ICANN argues:

“[One] of the important considerations underlying the ASEP’s work was the fact that ICANN, while it operates internationally, is a California non-profit public benefit corporation subject to the statutory law of California as determined by United States courts. That law requires that ICANN’s Board retain the ultimate responsibility for decision-making. As a result, the ASEP’s recommendations were premised on the understanding that the declaration of the IRP Panel is not ‘binding’ on the Board. In any event, a declaration clearly can be both non-binding and precedential.”<sup>55</sup>

97) In short, ICANN argues that the IRP is *not* binding. According to ICANN, “not only is there no language in the Bylaws stating that IRP Panel declarations

---

<sup>52</sup> *Ibid*, para. 6.

<sup>53</sup> *Ibid*, para. 7.

<sup>54</sup> *Ibid*, paras. 8 and 9.

<sup>55</sup> *Ibid*, paras. 9 and 10.

are binding on ICANN, there is no language stating that an IRP Panel even may determine if its advisory Declarations are binding.”<sup>56</sup> According to ICANN, words such as “arbitration” and “arbitrator” were removed from the Bylaws to ensure that the IRP Panel’s declarations do not have the force of normal commercial arbitration. ICANN also argues that DCA Trust, “fails to point to a *single piece of evidence* in all of the drafting history of the Bylaws or any of the amendments to indicate that ICANN intended, through its 2013 amendments, to convert a non-binding procedure into a binding one.”<sup>57</sup> Finally, ICANN submits that “it is not within the scope of this Panel’s authority to declare whether IRP Panel declarations are binding on ICANN’s Board...the Panel does not have the authority to re-write ICANN’s Bylaws or the rules applicable to this proceeding. The Panel’s mandate is strictly limited to ‘comparing contested actions of the Board [and whether it] has acted consistently with the provisions of those Articles of Incorporation and Bylaws, and [...] declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws’.”<sup>58</sup>

**The Panel’s Decision on Binding or Advisory nature of IRP decisions, opinions and declarations**

98) Various provisions of ICANN’s Bylaws and the Supplementary Procedures support the conclusion that the Panel’s decisions, opinions and declarations are binding. There is certainly nothing in the Supplementary Rules that renders the decisions, opinions and declarations of the Panel either advisory or non-binding.<sup>59</sup>

99) In paragraph 1, the Supplementary Procedures define “Declaration” as the “decisions and/or opinions of the IRP Panel”. In paragraph 9, the Supplementary Procedures require any Declaration of a three-member IRP Panel to be signed by the majority and in paragraph 10, under the heading “Form and Effect of an IRP Declaration”, they require Declarations to be in writing, based on documentation, supporting materials and arguments submitted by the parties. The Supplementary Procedures also require the Declaration to “specifically designate the prevailing party”.<sup>60</sup>

---

<sup>56</sup> ICANN letter of 2 June 2014 addressed to the Panel.

<sup>57</sup> *Ibid.* Italics are from the original decision.

<sup>58</sup> *Ibid.*

<sup>59</sup> The Reconsideration process established in the Bylaws expressly provides that ICANN’s “Board shall not be bound to follow the recommendations” of the BGC for action on requests for reconsideration. No similar language in the Bylaws or Supplementary Procedures limits the effect of the Panel’s IRP decisions, opinions and declarations to an advisory or non-binding effect. It would have been easy for ICANN to clearly state somewhere that the IRP’s decisions, opinions or declarations are “advisory”—this word appears in the Reconsideration Process.

<sup>60</sup> Moreover, the word “Declaration” in the common law legal tradition is often synonymous with a binding decision. According to Black’s Law Dictionary (7<sup>th</sup> Edition 1999) at page 846, a “declaratory



- 100) Section 10 of the Supplementary Procedures, resembles Article 27 of the ICDR Rules. Whereas Article 27 refers to “Awards”, section 10 refers to “Declarations”. Section 10 of the Supplementary Procedures, however, is silent on whether Declarations made by the IRP Panel are “final and binding” on the parties.
- 101) As explained earlier, as per Article IV, Section 3, paragraph 8 of the Bylaws, the Board of Directors of ICANN has given its approval to the ICDR to establish a set of operating rules and procedures for the conduct of the IRP set out in section 3. The operating rules and procedures established by the ICDR are the ICDR Rules as referred to in the preamble of the Supplementary Procedures. These Rules have been supplemented<sup>61</sup> with the Supplementary Procedures.
- 102) This is clear from two different parts of the Supplementary Procedures. First, in the preamble, where the Supplementary Procedures state that: “These procedures supplement the International Centre for Dispute Resolution’s International Arbitration Rules in accordance with the independent review procedures set forth in Article IV, Section 3 of the ICANN Bylaws”.
- 103) And second, under section 2 entitled (Scope), that states that the “ICDR will apply these Supplementary Procedures, in addition to the INTERNATIONAL DISPUTE RESOLUTION PROCEDURES, in all cases submitted to the ICDR in connection with the Article IV, Section 3(4) of the ICANN Bylaws”. It is therefore clear that ICANN intended the operating rules and procedures for the independent review to be an international set of arbitration rules supplemented by a particular set of additional rules.
- 104) There is also nothing inconsistent between section 10 of the Supplementary Procedures and Article 27 of the ICDR Rules.
- 105) One of the hallmarks of international arbitration is the binding and final nature of the decisions made by the adjudicators. Binding arbitration is the essence of what the ICDR Rules, the ICDR itself and its parent, the American Arbitration Association, offer. The selection of the ICDR Rules as the baseline

---

judgment” is, “a binding adjudication that establishes the rights and other legal obligations of the parties without providing for or ordering enforcement”.

<sup>61</sup> As explained by the Panel before, the word “supplement” means to complete, add to, extend or supply a deficiency. The Supplementary Procedures, therefore, *supplement* (not replace or supersede) the ICDR Rules. As also indicated by the Panel before, in the event there is any inconsistency between the Supplementary Procedures and the ICDR Rules, ICANN requires the Supplementary Procedures to govern.

set of procedures for IRP's, therefore, points to a binding adjudicative process.

106) Furthermore, the process adopted in the Supplementary Procedures is an adversarial one where counsel for the parties present competing evidence and arguments, and a panel decides who prevails, when and in what circumstances. The panelists who adjudicate the parties' claims are also selected from among experienced arbitrators, whose usual charter is to make binding decisions.

107) The above is further supported by the language and spirit of section 11 of ICANN's Bylaws. Pursuant to that section, the IRP Panel has the authority to summarily dismiss requests brought without standing, lacking in substance, or that are frivolous or vexatious. Surely, such a decision, opinion or declaration on the part of the Panel would not be considered advisory.

108) Moreover, even if it could be argued that ICANN's Bylaws and Supplementary Procedures are ambiguous on the question of whether or not a decision, opinion or declaration of the IRP Panel is binding, in the Panel's view, this ambiguity would weigh against ICANN's position. The relationship between ICANN and the applicant is clearly an adhesive one. There is no evidence that the terms of the application are negotiable, or that applicants are able to negotiate changes in the IRP.

109) In such a situation, the rule of *contra proferentem* applies. As the drafter and architect of the IRP Procedure, it was open to ICANN and clearly within its power to adopt a procedure that expressly and clearly announced that the decisions, opinions and declarations of IRP Panels were advisory only. ICANN did not adopt such a procedure.

110) ICANN points to the extensive public and expert input that preceded the formulation of the Supplementary Procedures. The Panel would have expected, were a mere advisory decision, opinion or declaration the objective of the IRP, that this intent be clearly articulated somewhere in the Bylaws or the Supplementary Procedures. In the Panel's view, this could have easily been done.

111) The force of the foregoing textual and construction considerations as pointing to the binding effect of the Panel's decisions and declarations are reinforced by two factors: 1) the exclusive nature of the IRP whereby the non-binding argument would be clearly in contradiction with such a factor<sup>62</sup>;

---

<sup>62</sup> If the waiver of judicial remedies ICANN obtains from applicants is enforceable, and the IRP process is non-binding, as ICANN contends, then that process leaves TLD applicants and the Internet community with no compulsory remedy of any kind. This is, to put it mildly, a highly watered down notion of "accountability". Nor is such a process "independent", as the ultimate decision maker,

and, 2) the special, unique, and publicly important function of ICANN. As explained before, ICANN is not an ordinary private non-profit entity deciding for its own sake who it wishes to conduct business with, and who it does not. ICANN rather, is the steward of a highly valuable and important international resource.

112) Even in ordinary private transactions, with no international or public interest at stake, contractual waivers that purport to give up *all* remedies are forbidden. Typically, this discussion is found in the Uniform Commercial Code Official Comment to section 2719, which deals with “Contractual modification or limitation of remedy.” That Comment states:

“Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect. However, *it is the very essence of a sales contract that at least minimum adequate remedies be available.* If the parties intend to conclude a contract for sale within this Article *they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract.*”  
[Panel’s emphasis by way of italics added]

113) The need for a minimum adequate remedy is indisputably more important where, as in this case, the party arguing that there is no compulsory remedy is the party entrusted with a special, internationally important and valuable operation.

114) The need for a compulsory remedy is concretely shown by ICANN’s longstanding failure to implement the provision of the Bylaws and Supplementary Procedures requiring the creation of a standing panel. ICANN has offered no explanation for this failure, which evidences that a self-policing regime at ICANN is insufficient. The failure to create a standing panel has consequences, as this case shows, delaying the processing of DCA Trust’s claim, and also prejudicing the interest of a competing .AFRICA applicant.

115) Moreover, assuming for the sake of argument that it is acceptable for ICANN to adopt a remedial scheme with no teeth, the Panel is of the opinion that, at a minimum, the IRP should forthrightly explain and acknowledge that the process is merely advisory. This would at least let parties know before embarking on a potentially expensive process that a victory before the IRP panel may be ignored by ICANN. And, a straightforward acknowledgment that the IRP process is intended to be merely advisory might lead to a legislative or executive initiative to create a truly independent compulsory process. The Panel seriously doubts that the Senators questioning former ICANN President Stuart Lynn in 2002 would have been satisfied had they

---

ICANN, is also a party to the dispute and directly interested in the outcome. Nor is the process “neutral,” as ICANN’s “core values” call for in its Bylaws.

understood that a) ICANN had imposed on all applicants a waiver of all judicial remedies, and b) the IRP process touted by ICANN as the “ultimate guarantor” of ICANN accountability was only an advisory process, the benefit of which accrued only to ICANN.<sup>63</sup>

### **ICM Case**

- 116) The Parties in their submissions have discussed the impact on this Decision of the conclusions reached by the IRP panel in the matter of *ICM v. ICANN* (“*ICM Case*”). Although this Panel is of the opinion that the decision in the *ICM Case* should have no influence on the present proceedings, it discusses that matter for the sake of completeness.
- 117) In the *ICM Case*, another IRP panel examined the question centrally addressed in this part of this Decision: whether declarations and/or decisions by an IRP panel are binding, or merely advisory. The *ICM Case* panel concluded that its decision was advisory.<sup>64</sup>
- 118) In doing so, the *ICM Case* panel noted that the IRP used an “international arbitration provider” and “arbitrators nominated by that provider,” that the ICDR Rules were to “govern the arbitration”, and that “arbitration connotes a binding process.” These aspects of the IRP, the panel observed, were “suggestive of an arbitral process that produces a binding award.”<sup>65</sup> But, the panel continued, “there are other indicia that cut the other way, and more deeply.” The panel pointed to language in the Interim Measures section of the Supplementary Procedures empowering the panel to “recommend” rather than order interim measures, and to language requiring the ICANN Board to “consider” the IRP declaration at its next meeting, indicating, in the panel’s view, the lack of binding effect of the Declaration.
- 119) The *ICM Case* panel specifically observed that “the relaxed temporal proviso to do no more than ‘consider’ the IRP declaration, and to do so at the next meeting of the Board ‘where feasible’, emphasized that it is not binding. If the IRP’s declaration were binding, there would be nothing to consider but rather a determination or decision to implement in a timely manner. The Supplementary Procedures adopted for IRP, in the article on ‘Form and Effect of an IRP Declaration’, significantly omit provision of Article 27 of the ICDR Rules specifying that an award ‘shall be final and binding on the parties’. Moreover, the preparatory work of the IRP provisions...confirms that the

---

<sup>63</sup> See in this regard the Memorandum of Jack Goldsmith dated 29 July 2010 at <https://cyber.law.harvard.edu/pubrelease/icann/pdfs/Jack%20Goldsmith%20on%20ICANN-final.pdf>, referred to in footnote 58 of DCA Trust’s Second Memorial.

<sup>64</sup> *ICM Case*, footnote 30. The panel’s brief discussion on this issue appears in *paras.* 132-134 of the *ICM Decision*.

<sup>65</sup> *Ibid*, *para.* 132.

intention of the drafters of the IRP process was to put in place a process that produced declarations that would not be binding and that left ultimate decision-making authority in the hands of the Board.”<sup>66</sup>

120) Following the issuance of the *ICM* Case Declaration, ICANN amended its Bylaws, and related Supplementary Procedures governing IRPs, removing most, but not all, references to “arbitration”, and adding that the “declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value.”

### **Difference between this IRP and the *ICM* Case**

121) According to DCA Trust, the panel in the *ICM* Matter, “based its decision that its declaration would not be binding, ‘but rather advisory in effect,’ on specific language in both a ***different*** set of Bylaws and a ***different*** set of Supplementary Procedures than those that apply in this dispute...one crucial difference in the Bylaws applicable during the *ICM* was the absence of the language describing panel declarations as ‘final and precedential.’”<sup>67</sup> The Panel agrees.

122) Section 3(21) of the 11 April 2013 ICANN Bylaws now provides: “Where feasible, the Board shall consider the IRP Panel declaration at the Board’s next meeting. The declarations of the IRP Panel, and the Board’s subsequent action on those declarations, are final and have precedential value.” At the time the *ICM* Matter was decided, section 3(15) of Article IV of ICANN’s Bylaws did not contain the second sentence of section 3(21).

123) As explained in the DCA Trust First Memorial:

“[In] finding that the IRP was advisory, the *ICM* Panel also relied on the fact that the Bylaws gave the IRP [panel] the authority to ‘declare,’ rather than ‘decide’ or ‘determine,’ whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or the Bylaws. However, the *ICM* Panel did not address the fact that the Supplementary Procedures, which govern the process in combination with the ICDR Rules, defined ‘declaration’ as ‘decisions/opinions of the IRP’. If a ‘declaration’ is a ‘decision’, then surely a panel with the authority to ‘declare’ has the authority to ‘decide’.”<sup>68</sup>

The Panel agrees with DCA Trust.

124) Moreover, as explained by DCA Trust:

---

<sup>66</sup> *Ibid*, para. 133.

<sup>67</sup> DCA Trust First Memorial, para. 36. Bold and italics are from the original text.

<sup>68</sup> *Ibid*, para. 39.

“[The] *ICM* Panel [...] found it significant that the Supplementary Procedures adopted for the IRP omitted Article 27 of the ICDR Rules – which specifies that an award ‘shall be final and binding on the parties.’ On that basis, the *ICM* Panel concluded that Article 27 did not apply. ICANN’s Supplementary Rules, however, were – and continue to be – silent on the effect of an award. In the event there is inconsistency between the Supplementary Procedures and the ICDR Rules, then the Supplementary Procedures govern; but there is nothing in the applicable rules suggesting that an *omission* of an ICDR Rule means that it does not apply. Indeed, the very same Supplementary Procedures provide that ‘the ICDR’s International Arbitration Rules [...] will govern the process *in combination* with these Supplementary Procedures. Furthermore, it is only in the event there is ‘any inconsistency’ between the Supplementary Procedures and the ICDR Rules that the Supplementary Procedures govern.”<sup>69</sup>

Again, the Panel agrees with DCA Trust.

125) With respect, therefore, this Panel disagrees with the panel in the *ICM* Case that the decisions and declarations of the IRP panel are not binding. In reaching that conclusion, in addition to failing to make the observations set out above, the *ICM* panel did not address the issue of the applicant’s waiver of all judicial remedies, it did not examine the application of the *contra proferentem* doctrine, and it did not examine ICANN’s commitment to accountability and fair and transparent processes in its Articles of Incorporation and Bylaws.

126) ICANN argues that the panel’s decision in the *ICM* Case that declarations are not binding is dispositive of the question. ICANN relies on the provision in the Bylaws, quoted above, (3(21)) to the effect that declarations “have precedential value.” Like certain other terms in the IRP and Supplementary Procedures, the Panel is of the view that this phrase is ambiguous. Legal precedent may be either binding or persuasive.<sup>70</sup> The Bylaws do not indicate which kind of precedent is intended.

127) *Stare decisis* is the legal doctrine, which gives binding precedential effect, typically to earlier decisions on a settled point of law, decided by a higher court. The doctrine is not mandatory, as illustrated by the practice in common law jurisdictions of overruling earlier precedents deemed unwise or unworkable. In the present case, there is no “settled” law in the usual sense of a body of cases approved by a court of ultimate resort, but instead, a single decision by one panel on a controversial point, which this Panel, with respect, considers to be unconvincing.

128) Therefore, the Panel is of the view that the ruling in the *ICM* Case is *not* persuasive and binding upon it.

---

<sup>69</sup> *Ibid*, para. 40. Bold and italics are from the original text.

<sup>70</sup> Black’s Law Dictionary, (7<sup>th</sup> Edition 1999), p. 1195.

## **VI. DECLARATION OF THE PANEL**

129)Based on the foregoing and the language and content of the IRP Procedure, the Panel is of the view that it has the power to interpret and determine the IRP Procedure as it relates to the future conduct of these proceedings.

130)Based on the foregoing and the language and content of the IRP Procedure, the Panel issues the following procedural directions:

(i) The Panel orders a reasonable documentary exchange in these proceedings with a view to maintaining efficacy and economy, and invites the Parties to agree by or before 29 August 2014, on a form, method and schedule of exchange of documents between them;

(ii) The Panel permits the Parties to benefit from additional filings and supplemental briefing going forward and invites the Parties to agree on a reasonable exchange timetable going forward;

(iii) The Panel allows a video hearing as per the agreement of the Parties, but reserves its decision to order an in-person hearing and live testimony pending a further examination of the representations that will be proffered by each side, including the filing of any additional evidence which this Decision permits; and

(iv) The Panel permits both Parties at the hearing to challenge and test the veracity of statements made by witnesses.

If the Parties are unable to agree on a reasonable documentary exchange process or to agree on the scope and length of additional filings and supplemental briefing, the Panel will intervene and, with the input of the Parties, provide further guidance.

131)Based on the foregoing and the language and content of the IRP Procedure, the Panel concludes that this Declaration and its future Declaration on the Merits of this case are binding on the Parties.

132)The Panel reserves its views with respect to any other issues raised by the Parties for determination at the next stage of these proceedings. At that time, the Panel will consider the Parties' respective arguments in those regards.

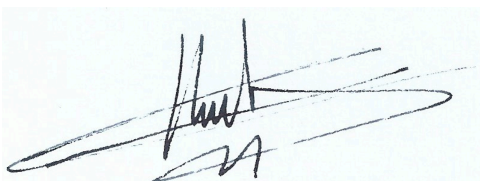
133)The Panel reserves its decision on the issue of costs relating to this stage of the proceeding until the hearing of the merits.

This Declaration may be executed in any number of counterparts, each of which shall be deemed an original, and all of which together shall constitute the Declaration of this Panel.

This Declaration on the IRP Procedure has thirty-three (33) pages.

Thursday, 14 August 2014

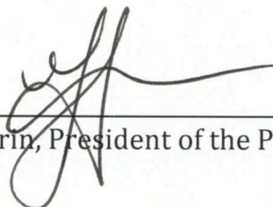
Place of the IRP, Los Angeles, California.



Professor Catherine Kessedjian



Hon. Richard C. Neal



Babak Barin, President of the Panel



**CLA-027**

INDEPENDENT REVIEW PROCESS  
INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

GULF COOPERATION COUNCIL, ) ICDR CASE NO. 01-14-0002-1065  
 )  
Claimant, )  
 )  
and )  
 )  
INTERNET CORPORATION FOR ASSIGNED )  
NAMES AND NUMBERS, )  
 )  
Respondent. )  
\_\_\_\_\_ )

**ICANN'S RESPONSE TO GULF COOPERATION COUNCIL'S  
REQUEST FOR EMERGENCY RELIEF**

Jeffrey A. LeVee  
Eric P. Enson  
Rachel Zernik  
JONES DAY  
Contact Information Redacted

Counsel to Respondent  
The Internet Corporation  
For Assigned Names and Numbers

## TABLE OF CONTENTS

	<b>Page</b>
INTRODUCTION .....	1
FACTUAL AND PROCEDURAL BACKGROUND .....	2
STANDARD OF REVIEW .....	14
ARGUMENT .....	17
I.    EMERGENCY RELIEF IS NOT WARRANTED BECAUSE THE GCC IS NOT REASONABLY LIKELY TO SUCCEED ON THE MERITS OF ITS IRP .....	17
A.    The GCC's IRP Request Is Time-Barred .....	18
B.    The GCC Fails To Identify an ICANN Board Action That Violated ICANN's Articles or Bylaws.....	18
II.   EMERGENCY RELIEF IS NOT WARRANTED BECAUSE THE GCC UNREASONABLY DELAYED IN SEEKING SUCH RELIEF .....	23
III.  EMERGENCY RELIEF IS NOT WARRANTED BECAUSE GCC HAS NOT DEMONSTRATED THAT THE HARM IT WOULD SUFFER IN THE ABSENCE OF SUCH RELIEF OUTWEIGHS THE HARM TO OTHERS.....	23
CONCLUSION .....	25

## INTRODUCTION

The Internet Corporation for Assigned Names and Numbers (“ICANN”) hereby submits its Response to the Request for Emergency Independent Review Process Relief (“Emergency Request”) submitted by claimant Gulf Cooperation Council (“the GCC”) on 5 December 2014.

1. The GCC objects to the application for a .PERSIANGULF generic top level domain (“gTLD”) because the “Arab nations that border the Gulf prefer the name ‘Arabian Gulf.’”<sup>1</sup> The GCC, and certain of its member States, first raised these concerns in 2012. Since then, in December 2012, ICANN’s Independent Objector (“IO”) reviewed GCC’s concerns and found that he had no basis to object to the .PERSIANGULF application (“Application”). Thereafter, in July 2013, the Governmental Advisory Committee (“GAC”), an independent body that provides advice to ICANN on behalf of governments, completed its review of the application and informed ICANN that it “d[id] not object” to the .PERSIANGULF application proceeding. Following that, an independent expert appointed by the International Chamber of Commerce (“ICC”) to assess the GCC’s community objection to the Application determined, in a report issued on 30 October 2013, that the GCC’s community objection should be rejected. Since then, rather than timely pursuing ICANN accountability mechanisms or other processes to challenge these findings and determinations, the GCC waited for *over one year* to file its Emergency Request.

2. There is no question that the GCC believes strongly in its position in this naming dispute. There are, however, significant questions about the merits of the GCC’s Request for Independent Review (“IRP Request”) and even more questions about the GCC’s Emergency Request to stay ICANN’s processing of the .PERSIANGULF Application pending resolution of this independent

---

<sup>1</sup> Emergency Request, ¶ 8.

Review process (“IRP”).

3. Specifically, the GCC has failed to demonstrate a reasonable possibility that it will succeed on the merits of this IRP for at least two reasons. First, the GCC filed its IRP Request *over a year too late* and its request is therefore time barred pursuant to ICANN’s Bylaws.

Second, the GCC has not identified any ICANN Board action or decision that was inconsistent with ICANN’s Articles of Incorporation (“Articles”) or Bylaws, which is the only question at issue in IRP proceedings such as this.

4. Emergency relief is even more unwarranted here because the GCC unreasonably delayed in bringing this IRP, which belies the GCC’s claims of urgency, necessity, and harm. Moreover, as both the IO and the ICC expert found previously, the GCC has not demonstrated any real, legally-recognized detriment were the Application to proceed.

5. ICANN’s Board has complied with its Articles and Bylaws at every step with respect to the Application. The GCC’s Emergency Request, as well as its IRP Request, present no evidence to the contrary. The GCC’s Emergency Request should therefore be denied.

## **FACTUAL AND PROCEDURAL BACKGROUND**

### **ICANN**

6. ICANN was formed in 1998. It is a California not-for-profit public benefit corporation. ICANN’s mission “is to coordinate, at the overall level, the global Internet’s system of unique identifiers, and in particular to ensure the stable and secure operation of the Internet’s unique identifier systems,” including the domain name system (“DNS”).<sup>2</sup>

7. ICANN is a complex organization that facilitates input from stakeholders around the globe. ICANN has an international Board of Directors, over 300 staff members, and an

---

<sup>2</sup> ICANN Bylaws (“Bylaws”), Art. I, § 1 (Ex. R-ER-1).

Ombudsman. ICANN is much more than just the corporation—it is a community of participants. In addition to the Board, the staff, and the Ombudsman,<sup>3</sup> the ICANN community includes a Nominating Committee,<sup>4</sup> three Supporting Organizations,<sup>5</sup> four Advisory Committees,<sup>6</sup> a group of technical expert advisors,<sup>7</sup> and a large, globally distributed group of community members who participate in ICANN’s processes.

8. ICANN’s Governmental Advisory Committee (“GAC”), which consists of members appointed by and representing governments, was created to “consider and provide advice on the activities of ICANN as they relate to concerns of governments, particularly matters where there may be an interaction between ICANN’s policies and various laws and international agreements, or where they may affect public policy issues.”<sup>8</sup> Membership in the GAC is open to all national governments and distinct economies as recognized in international fora. The importance of the GAC’s advice to ICANN is built into ICANN’s Bylaws:

The advice of the Governmental Advisory Committee on public policy matters shall be duly taken into account, both in the formulation and adoption of policies. In the event that the ICANN Board determines to take an action that is not consistent with the Governmental Advisory Committee advice, it shall so inform the Committee and state the reasons why it decided not to follow that advice. The Governmental Advisory Committee and the ICANN Board will then try, in good faith and in a timely and efficient manner, to find a mutually acceptable solution.<sup>9</sup>

#### **ICANN’s Unique Accountability Mechanisms**

9. ICANN has a proven commitment to accountability and transparency in all of its practices. ICANN considers these principles to be fundamental safeguards in ensuring that its bottom-up, multi-stakeholder model remains effective. The mechanisms through which ICANN

---

<sup>3</sup> *Id.*, Art. V.

<sup>4</sup> *Id.*, Art. VII.

<sup>5</sup> *Id.*, Arts. VIII-X.

<sup>6</sup> *Id.*, Art. XI.

<sup>7</sup> *Id.*, Art. XI-A, § 2.

<sup>8</sup> *Id.*, Art. XI, § 2.1.

<sup>9</sup> *Id.*, Art. XI, § 2.1.j.

achieves accountability and transparency are built into every level of its organization and mandate. In order to reinforce its transparency and accountability, ICANN has established specific accountability mechanisms for review of ICANN actions.<sup>10</sup>

10. For instance, ICANN's Bylaws permit an entity that has been adversely and materially affected by an ICANN staff or Board action or inaction to request that the Board reconsider that action or inaction ("Reconsideration Request").<sup>11</sup> Reconsideration Requests are reviewed and considered by ICANN's Board Governance Committee, which can either make a final determination if evaluating staff conduct, or make a recommendation to the Board if evaluating Board conduct.

11. Similarly, and in addition to Reconsideration Requests, ICANN has also established a separate independent review process of Board actions alleged by an affected party to be inconsistent with ICANN's Articles or Bylaws, which the GCC has invoked in this matter.<sup>12</sup>

### **The New gTLD Program**

12. In its early years, and in accordance with its Core Values, ICANN focused on increasing the number of companies that could sell domain name registrations to consumers ("registrars"). ICANN also focused on expanding, although more slowly, the number of companies that operate gTLDs ("registries"). In 2000, ICANN approved seven gTLDs in a "proof of concept" phase that was designed to confirm that the addition of new gTLDs would not adversely affect the stability and security of the Internet. In 2004 and 2005, ICANN approved a handful of additional TLDs.

---

<sup>10</sup> *Id.*, Art. IV; *see also* ICANN Accountability Mechanisms Available to the ICANN Community (Ex. R-ER-2), *also available at* <https://www.icann.org/sites/default/files/assets/accountability-mechanisms-5100x3300-19mar14-en.png>.

<sup>11</sup> Bylaws, Art. IV, § 2.2.

<sup>12</sup> *Id.*, Art. IV, § 3.

13. The New gTLD Program (“Program”) constitutes by far ICANN’s most ambitious expansion of the Internet’s naming system. The Program’s goals include enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of new gTLDs, including both new ASCII gTLDs and new non-ASCII, internationalized domain name (“IDN”), gTLDs.<sup>13</sup> In developing the Program with the ICANN community, numerous versions of the Applicant Guidebook (“Guidebook”) were prepared and publicly distributed. Ultimately, ICANN went forward with the Program based on the version of the Guidebook published on 4 June 2012, which provides detailed instructions to gTLD applicants and sets forth the procedures for ICANN’s evaluation of new gTLD applications, and objections thereto.

14. Pursuant to the Guidebook, all applications for new gTLDs are made available for review and public comment.<sup>14</sup> Concurrent with the public comment period, the GAC is able to issue “Early Warning” notices concerning particular applications.<sup>15</sup> An Early Warning notice is not an official GAC statement against an application, but is intended to provide the applicant with an indication that one or more governments view the application as potentially sensitive or problematic.<sup>16</sup> Applicants are advised that a GAC Early Warning should be taken seriously as it raises the likelihood that the application could be the subject of GAC advice against it at a later stage in the process.<sup>17</sup>

15. The Guidebook also sets out a process whereby the GAC may issue advice to ICANN concerning any application for a new gTLD. As set forth in Section 3.1 of the Guidebook, GAC

---

<sup>13</sup> IDN gTLDs are gTLDs that include characters not within the US-ASCII (American Standard Code for Information Exchange) or Latin alphabets.

<sup>14</sup> New gTLD Applicant Guidebook (“Guidebook”), § 1.1.2.3 (Ex. R-ER-3).

<sup>15</sup> *Id.*, § 1.1.2.4.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*



advice regarding a new gTLD application may take one of three forms. First, pursuant to Section 3.1 of the Guidebook, the GAC may issue “consensus advice” as follows:

The GAC advises ICANN that it is the consensus of the GAC that a particular application should not proceed. This will create a strong presumption for the ICANN Board that the application should not be approved.<sup>18</sup>

16. Second, the GAC may issue non-consensus advice indicating “that there are concerns about a particular application.”<sup>19</sup> If the GAC issues non-consensus advice against an application, the ICANN Board is expected to enter into dialogue with the GAC to understand the scope of the concerns.<sup>20</sup>

17. Third, pursuant to Module 3.1, Part III of the Guidebook, the GAC may issue advice to ICANN “that an application should not proceed unless remediated.”<sup>21</sup> This type of advice “will raise a strong presumption for the Board that the application should not proceed unless there is a remediation method available in the Guidebook (such as securing the approval of one or more governments), that is implemented by the applicant.”<sup>22</sup>

18. With respect to gTLD applications, the GAC has generally provided its advice to ICANN in the form of communiqués associated with one of ICANN’s Public meetings, such as the “London Communiqué,” which is advice from the GAC borne out of the GAC’s meeting at the ICANN Public meeting in London.

19. The New gTLD Program Committee (“NGPC”) of the ICANN Board, which has the full authority of the Board with respect to the New gTLD program and is comprised of all Board members that have no actual, potential or perceived conflict of interest in pending New gTLD

---

<sup>18</sup> *Id.*, § 3.1.

<sup>19</sup> *Id.*, § 3.1(II)

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*, § 3.1(III).

<sup>22</sup> *Id.*

applications, is tasked with evaluating and responding to GAC advice on gTLD applications as well as communicating with the GAC regarding its advice.<sup>23</sup> Throughout the Program, the NGPC has publicly issued “scorecards” relating to GAC advice, which are statements that track the GAC’s advice on certain issues and ICANN’s response to that advice.<sup>24</sup>

### **The Public Objection and Dispute Resolution Process**

20. In addition to the accountability mechanisms mentioned above and advice from the GAC, governments, as well as other entities and individuals, can formally object to a gTLD application through the Objection and Dispute Resolution Process.<sup>25</sup> The Guidebook enumerates several grounds on which an objection may be filed. As is relevant here, an established institution associated with a clearly delineated community may file a “Community Objection” claiming that there is “substantial opposition to the gTLD application from a significant portion of the community to which the gTLD string may be explicitly or implicitly targeted.”<sup>26</sup> All Community Objections are heard by independent, expert panels selected by the ICC.<sup>27</sup>

21. In order to succeed on a Community Objection, an objector must establish the following: (i) the community invoked by the objector is a clearly delineated community; (ii) community opposition to the application is substantial; (iii) there is a strong association between the community invoked and the applied-for gTLD string; and (iv) the application creates a likelihood of material detriment to the rights or legitimate interests of a significant portion of the

---

<sup>23</sup> See Board Resolution 2012.04 10.02 (Ex. R-ER-4), also available at <https://features.icann.org/2012-04-10-establishment-new-gtld-program-committee>. Accordingly, any advice to the ICANN Board is advice to the NGPC, and if Board action is required, action by the NGPC may be considered Board action for purposes of these proceedings.

<sup>24</sup> See <http://newgtlds.icann.org/en/applicants/gac-advice>.

<sup>25</sup> Guidebook, §§ 3.2, 3.2.3. (Ex. R-ER-3).

<sup>26</sup> *Id.*, § 3.2.1.

<sup>27</sup> *Id.*, § 3.2.2.

community to which the string may be explicitly or implicitly targeted.<sup>28</sup> The Guidebook makes clear that “[i]f opposition by a community is determined, but there is no likelihood of material detriment to the targeted community resulting from the applicant’s operation of the applied-for gTLD, the objection will fail.”<sup>29</sup>

22. The Guidebook does not provide any procedure by which ICANN (or anyone else) is to conduct a substantive review of an expert panel’s determination on a Community Objection.<sup>30</sup> Notably, the decision not to have an appellate mechanism for objection proceedings was not an ICANN Board decision. Rather, it was a community-driven decision, which, among other things, was intended to help reduce the time and expense associated with the objection process and to ensure that those with the requisite expertise were making the ultimate determinations.

### **The Independent Objector**

23. Another check on the Program is found in ICANN’s creation of an Independent Objector.<sup>31</sup> The IO is tasked with filing certain objections against “highly objectionable” gTLD applications to which no formal objection has been filed.<sup>32</sup> Pursuant to the Guidebook and ICANN’s practices and policies, “[n]either ICANN staff nor the ICANN Board of Directors has authority to direct or require the IO to file or not to file any particular objection. If the IO determines that an objection should be filed, he or she will initiate and prosecute the objection in the public interest.”<sup>33</sup>

24. The IO’s standing to file a Community Objection is triggered when there is at least one

---

<sup>28</sup> *Id.*, § 3.5.4.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*, § 3.4.6.

<sup>31</sup> *Id.*, § 3.2.5.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

comment in opposition to the application made in the public sphere.<sup>34</sup>

**The .PERSIANGULF Application and Evaluation Thereof**

25. On 8 July 2012, Asia Green IT System Ltd. (“Asian Green”) submitted an application for the .PERSIANGULF gTLD. Subsequently, the governments of the United Arab Emirates, Oman, Baharain and Qatar sent virtually identical letters to the GAC and ICANN seeking to invoke the GAC’s Early Warning system regarding the Application and requesting that the GAC issue advice regarding whether a .PERSIANGULF gTLD is appropriate.<sup>35</sup>

26. On 20 November 2012, as set forth in the Guidebook, these four countries caused the GAC to issue an Early Warning on the Application claiming that “[t]he applied for new gTLD is problematic and refers to a geographical place with [a] disputed name” and “[l]ack[s] [...] community involvement and support.”<sup>36</sup>

27. As required by the Guidebook, ICANN informed Asia Green of the GAC Early Warning, and publicly posted the Early Warning on ICANN’s website. However, as is clear in the Guidebook, this Early Warning was “not a formal objection, nor [did] it lead to a process that can result in rejection of the application.”<sup>37</sup> Rather, the GAC Early Warning served as notice to Asia Green “that the application [was] seen as potentially sensitive or problematic by one or more governments.”<sup>38</sup>

28. In December 2012, the IO, Professor Alain Pellet, expressed his view regarding the

---

<sup>34</sup> *Id.*

<sup>35</sup> See GAC Early Warnings (CI’s ER Annexes 6-9). Citations to “CI’s ER Annexes” refer to Annexes to the GCC’s Emergency Request. Citations to “CI’s Annexes” refer to annexes to the GCC’s IRP Request.

<sup>36</sup> CI’s ER Annex 12.

<sup>37</sup> Guidebook, § 1.1.2.4 (Ex. R-ER-3).

<sup>38</sup> *Id.*

Application.<sup>39</sup> The IO reviewed the history of this naming dispute, noted public comments against and in favor of a .PERSIANGULF gTLD, and described several, recognized authorities that utilize the name Persian Gulf for the sea area located between the Arabian Peninsula and the Islamic Republic of Iran.<sup>40</sup> Based upon this, the IO concluded that the Application was not contrary to generally accepted legal norms of morality and public order.<sup>41</sup> The IO also concluded that there was no basis for him to file a Community Objection because “it is most debatable” whether a .PERSIANGULF gTLD creates a likelihood of material detriment to members of the Arabian Gulf community.<sup>42</sup> Finally, the IO noted that the Arabian Gulf community could file its own objection to the application.<sup>43</sup>

29. On 13 March 2013, the GCC filed a Community Objection to the Application.<sup>44</sup> The ICC appointed Stephen M. Schwebel to serve as the Expert Panelist to hear the GCC’s Community Objection.<sup>45</sup>

30. While the GCC’s Community Objection was pending, the GAC met during ICANN’s Beijing, China meeting in April 2013, and reviewed a number of gTLD applications. In what is known as the “Beijing Communiqué,” the GAC issued several different types of advice on numerous gTLD applications.<sup>46</sup> First, the GAC provided consensus advice to ICANN that two applications, .AFRICA and .GCC, should not proceed,<sup>47</sup> which under Section 3.1 of the

---

<sup>39</sup> The IO’s Comments on Controversial Applications (Ex. R-ER-5), *also available at* <http://www.independent-objector-newgtlds.org/home/the-independent-objector-s-comments-on-controversial-applications/persianguf-general-comment/>

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *See* Expert Determination on the GCC’s Expert Determination, ¶ 1 (Cl.’s ER Annex 2).

<sup>45</sup> *See id.*, ¶ 5.

<sup>46</sup> Beijing Communiqué, ¶ IV.1.a.i.i.1-2 & n.3 (Cl.’s ER Annex 13).

<sup>47</sup> Those two applications were DotConnect Africa’s application for .AFRICA and the GCCIX WILL’s application for .the GCC.

Guidebook creates “a strong presumption for the ICANN Board that the application[s] should not be approved.”<sup>48</sup> Second, the GAC provided non-consensus advice to ICANN that some GAC members have raised concerns about two applications for religious terms, .ISLAM and .HALAL, and “it is the view of these GAC members that these applications should not proceed,” which under Section 3.1 of the Guidebook means that the “ICANN Board is expected to enter into dialogue with the GAC to understand the scope of the concerns.”<sup>49</sup> Third, the GAC advised ICANN that it wanted to give further consideration at its next meeting in Durban, South Africa to several gTLD applications, including the application for .PERSIANGULF, and requested that ICANN not proceed beyond initial evaluation of these applications until the further consideration was concluded.<sup>50</sup>

31. As required by the Guidebook, in May and June 2013, the NGPC considered the GAC advice provided in the Beijing Communiqué. On 4 June 2013, the NGPC adopted a Scorecard reflecting its response to the GAC advice.<sup>51</sup> First, the NGPC accepted the GAC consensus advice that two applications, .AFRICA and .GCC, should not proceed, noting that both “will not be approved,” pursuant to the Guidebook.<sup>52</sup> Second, the NGPC accepted the GAC non-consensus advice regarding the two religious terms, .ISLAM and .HALAL, stating that “the NGPC stands ready to enter into a dialogue with the GAC on this matter,” pursuant to the Guidebook.<sup>53</sup> Third, the NGPC accepted the GAC’s request for additional time to consider several other applications, including the .PERSIANGULF Application, clarifying that “ICANN

---

<sup>48</sup> Beijing Communiqué, ¶ IV.1.a.i.i.1-2 & n.4 (CI’s ER Annex 13).

<sup>49</sup> *Id.*, ¶ IV.1.a.i.ii.1.

<sup>50</sup> *Id.*, ¶ IV.1.c.

<sup>51</sup> NGPC Resolution 2013.06.04.NG01 (Ex. R-ER-6), also available at <https://features.icann.org/consideration-non-safeguard-advice-gac%E2%80%99s-beijing-communicu%C3%A9?language=fr>.

<sup>52</sup> Annex 1 to NGPC Resolution 2013.06.04.NG01 at GAC Register #1-2 (Ex. R-ER-7), also available at <https://www.icann.org/en/system/files/files/resolutions-new-gtld-annex-1-04jun13-en.pdf>.

<sup>53</sup> *Id.* at GAC Register #3.

will not proceed beyond initial evaluation of these identified strings” until the GAC has had additional time to provide advice on the applications.<sup>54</sup> The NGPC also noted that Community Objections had been filed regarding several of these applications, including the .PERSIANGULF Application.<sup>55</sup>

32. In July 2013, the United States Government issued a public statement to the GAC regarding gTLD applications with geographic implications, including .PERSIANGULF.<sup>56</sup> In this statement, the U.S. Government urged all relevant parties and GAC members to attempt to resolve any concerns about these gTLDs.<sup>57</sup> In addition, the U.S. Government noted that “the current rules for the new gTLD program do not specifically prohibit or condition these strings,” but stated that it was “willing in Durban to abstain and remain neutral on” these applications, “thereby allowing the GAC to present consensus objections on these strings to the [ICANN] Board, if no other government objects.”<sup>58</sup>

33. The GAC next met during the ICANN Public meeting in Durban. In its IRP Request and Emergency Request, the GCC mistakenly cites to the GAC’s publicly posted minutes of its Durban meeting as the “Durban Communiqué.”<sup>59</sup> In any event, both the minutes from this meeting and the actual Durban Communiqué are significantly different from how the GCC portrays them.

34. The GCC is correct that in the minutes of the GAC’s July 2013 Durban meeting, the GAC noted the opinions of UAE, Oman, Bahrain and Qatar, that the Application should not

---

<sup>54</sup> *Id.* at GAC Register #4.

<sup>55</sup> *Id.*

<sup>56</sup> U.S. Statement on Geographic Names in Advance of ICANN Durban Meeting (Ex. R-ER-8), *also available at* [http://www.ntia.doc.gov/files/ntia/publications/usg\\_nextsteps\\_07052013\\_0.pdf](http://www.ntia.doc.gov/files/ntia/publications/usg_nextsteps_07052013_0.pdf).

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> IRP Request ¶ 41 n.67; Emergency Request ¶ 13 n.26.

proceed.<sup>60</sup> But the meeting minutes also state that “[t]he GAC finalized its consideration of .persiangulf after hearing opposing views, the GAC determined that it was clear that there would not be consensus on an objection regarding this string **and therefore the GAC does not provide advice against this string proceeding.**”<sup>61</sup> More importantly, in the Durban Communiqué, which is the official statement from the GAC to ICANN and which the GCC did not attach to its Emergency Request, the GAC informed ICANN that it “finalized its consideration” of the Application and that the GAC “**does not object**” to the application proceeding.<sup>62</sup>

35. Thereafter, ICANN’s NGPC met to consider the Durban Communiqué and again adopted an NGPC Scorecard reflecting the NGPC’s response to that advice.<sup>63</sup> In its Scorecard, which was publicly posted over a year ago, on 12 September 2013, the NGPC noted that the GAC “has finalized its consideration of the following string, and does not object to it proceeding: .persiangulf.”<sup>64</sup> In addition, the NGPC stated that “ICANN will continue to process that application in accordance with the established procedures in the [Guidebook],” but noted that the GCC’s Community Objection to the Application remained pending.<sup>65</sup>

36. On 30 October 2013, the Expert Panelist in the GCC’s Community Objection, Judge Schwebel, issued his determination.<sup>66</sup> Judge Schwebel found that the GCC had failed to establish that “the application creates a likelihood of material detriment to the rights or legitimate interests of a significant portion of the community to which the string may be

---

<sup>60</sup> GAC Meeting Minutes, Durban, South Africa at 2 (CI’s ER Annex 14).

<sup>61</sup> *Id.*

<sup>62</sup> Durban Communiqué, ¶ IV.1.3 (CI’s Annex 24).

<sup>63</sup> NGPC Resolution 2013.09.10.NG03 (R-ER-9), *also available at* <https://features.icann.org/gac-communicu%C3%A9-durban-scorecard?language=es>.

<sup>64</sup> Annex 1 to NGPC Resolution 2013.09.10.NG03 at GAC Register #9 (R-ER-10), *also available at* <https://www.icann.org/en/system/files/files/resolutions-new-gtld-annex-1-10sep13-en.pdf>.

<sup>65</sup> *Id.*

<sup>66</sup> Expert Determination on the GCC’s Expert Determination (CI’s ER Annex 2).



explicitly or implicitly targeted.”<sup>67</sup> Judge Schwebel determined—as the IO had suggested almost a year earlier—that the GCC’s claim that the existence of a .PERSIANGULF string would allow Asia Green to interfere with the core activities of the Arabian gulf community “d[id] not provide or constitute proof that the Application if granted will create a likelihood of material detriment to the community of the Objector.”<sup>68</sup> Judge Schwebel continued: “Nor is it easy to see what material detriment is likely to occur, which may explain why the Objection is so terse in this regard. In the perception of the Expert, the fact remains that the practical effect of registration of .PERSIANGULF gTLD is difficult to discern and weigh. Hence it follows that a likelihood of material detriment has not been established.”<sup>69</sup>

37. Finally, Judge Schwebel noted that:

The dispute between Arab States and supporters, on the one hand, and the Islamic Republic of Iran, on other hand, over the denomination of the Gulf, has subsisted for more than fifty years. It is far from clear that registration of .PERSIANGULF gTLD would resolve, or exacerbate, or significantly affect, that dispute. In any event, the GCC and other Arab interests are and would remain free to seek registration of a domain such as .ARABIANGULF gTLD.<sup>70</sup>

38. The GCC did not file a Reconsideration Request, or pursue any other ICANN accountability process, with respect to either the NGPC’s statement that ICANN would proceed with the Application or Judge Schwebel’s determination. Instead, the GCC waited for *over one year* after these events to file this IRP.

#### STANDARD OF REVIEW

39. The IRP is a unique, non-binding process available under ICANN’s Bylaws for persons or entities that claim to have been materially and adversely affected by a decision or action of the

---

<sup>67</sup> *Id.*, ¶¶ 38, 40.

<sup>68</sup> *Id.*, ¶ 40.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*, ¶ 42.

ICANN Board, but only to the extent that Board action was inconsistent with ICANN’s Articles or Bylaws.<sup>71</sup> The IRP Panel, when it is constituted, will be tasked with providing its opinion as to whether the challenged Board actions violated ICANN’s Articles or Bylaws.<sup>72</sup> ICANN’s Bylaws specifically identify the deferential standard of review that the IRP Panel must apply when evaluating the actions of the ICANN Board, focusing on:

- a. Did the Board act without conflict of interest in taking its decision?;
- b. Did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. Did the Board members exercise independent judgment in taking the decision, believed to be in the best interests of the company?<sup>73</sup>

The IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.<sup>74</sup>

40. Moreover, ICANN’s Bylaws specifically state that a “request for independent review must be filed within *thirty days* of the posting of the minutes of the Board meeting (and the accompanying Board Briefing Materials, if available) that the requesting party contends demonstrates that ICANN violated its Bylaws or Articles of Incorporation.”<sup>75</sup>

41. In addition to the Bylaws, IRPs are conducted pursuant to the Supplementary Procedures for ICANN IRPs (“Supplementary Procedures”). Neither ICANN’s Bylaws nor Supplementary Procedures<sup>76</sup> provide for interim or emergency relief proceedings. ICANN, however, has consented to permitting an IRP Emergency Panelist to consider the GCC’s request that ICANN be enjoined “from executing the .PERSIANGULF registry agreement while the GCC’s IRP

---

<sup>71</sup> Bylaws, Art. IV, §§ 3.1, 3.2.

<sup>72</sup> *Id.* Art. IV, § 3.4.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*, Art. IV, § 3.3.

<sup>76</sup> Supplementary Procedures (Ex. R-ER-11), *also available at* <https://www.adr.org/cs/groups/international/documents/document/z2uv/mde0/~edisp/adrstage2014403.pdf>.

request is ongoing.”<sup>77</sup>

42. As the GCC’s Emergency Request notes, in order to obtain the emergency relief the GCC seeks, the GCC must demonstrate a reasonable possibility of success on the merits of its IRP.<sup>78</sup> Indeed, both international and U.S. law recognize this principle. Article 27(A)(1)(b) of the United Nations Commission on International Trade Law’s (“UNCITRAL’s”) Model Law on International Commercial Arbitration states that a party requesting an interim measure must demonstrate that “[t]here is a reasonable possibility that the requesting party will succeed on the merits of the claim.”<sup>79</sup>

43. Similarly, tribunals under the International Chamber of Commerce have required a party seeking interim relief to demonstrate a likelihood of success on the merits, noting that the requirement is generally “found both in judicial and arbitral practice.”<sup>80</sup> Likewise, under U.S. law, a party seeking a preliminary injunction must demonstrate, at a minimum, that “the likelihood of success is such that serious questions going to the merits were raised.”<sup>81</sup> This requirement is appropriate in light of the fact that interim measures are, as one international tribunal has noted, “extraordinary measures not to be granted lightly.”<sup>82</sup>

44. In addition, under U.S. and international law, a party seeking interim relief must demonstrate that it will suffer “irreparable” or “grave” harm<sup>83</sup> in the absence of such relief and that the harm it would incur in the absence of interim relief would “exceed[] greatly the damage

---

<sup>77</sup> Emergency Request, ¶ 3.

<sup>78</sup> *Id.*, ¶ 17.

<sup>79</sup> UNCITRAL Model Law on International Commercial Arbitration, Art. 17A(1)(b) (Ex. R-ER-12).

<sup>80</sup> See, e.g., *Distributor A v. Manufacturer B*, ICC Case No. 10596, Interlocutory Award of 2000, Yearbook Commercial Arbitration, Vol. XXX 68 n.3 (2005) (Ex. R-ER-13).

<sup>81</sup> *Alliance for the Wild Rockies v. Cottrell*, 632 F.3d 1127, 1131-32 (9th Cir. 2011) (internal quotation marks omitted); see also *Winter v. Nat’l Resources Defense Council, Inc.*, 555 U.S. 7, 31 (2008).

<sup>82</sup> *Paushok v. Mongolia*, Order on Interim Measures of 2 September 2008, ¶ 39 (Ex. R-ER-14).

<sup>83</sup> *Winter*, 555 U.S. at 20; Ali Yesilirmak, Interim and Conservatory Measures in ICC Arbitral Practice at 9-10 (Ex. R-ER-15)

caused to the party affected” by the issuance of interim relief.<sup>84</sup> Moreover, one of the hallmarks of emergency relief is a demonstration that the applicant has diligently pursued such relief.

### ARGUMENT

45. The GCC’s requested emergency relief should be denied for several independent reasons. First, there is no reasonable likelihood that the GCC will succeed on the merits of its IRP because it is time barred – the deadline for the GCC to file its IRP request expired over a year ago when the NGPC publicly stated that it would proceed with the .PERSIANGULF application. Second, the GCC has not identified a single ICANN Board action that violated ICANN’s Articles and Bylaws. Third, the emergency relief the GCC seeks is unwarranted because the GCC’s delay in bringing its IRP undercuts its claims of urgency, necessity and harm. Fourth, the GCC still cannot identify any legally-recognizable harm it will suffer if a .PERSIANGULF new gTLD is approved, as the IO and Judge Schwebel previously found. For all these reasons, or any one of them independently, the GCC’s requested emergency relief should be denied.

#### **I. EMERGENCY RELIEF IS NOT WARRANTED BECAUSE THE GCC IS NOT REASONABLY LIKELY TO SUCCEED ON THE MERITS OF ITS IRP.**

46. The GCC is not entitled to emergency relief because it has not demonstrated a reasonable likelihood of success on the merits of its claims in this IRP. First, the GCC’s claims are time-barred. Even if they were not so barred, the GCC’s claims would still not succeed because the GCC has failed to demonstrate that the ICANN Board violated the ICANN Articles or Bylaws with respect to .PERSIANGULF. To the contrary, the evidence demonstrates that ICANN and

---

<sup>84</sup> *Burlington Resources Inc. v. Republic of Ecuador & Empresa Estatal Petroleos del Ecuador*, ICSID Case No. ARB/08/5, Procedural Order No. 1 on Burlington Oriente’s Request for Provisional Measures, 29 June 2009, ¶ 81 (quoting *City Oriente Ltd. v. Republic of Ecuador*, ICSID Case No. ARB/06/21, Decision on revocation of provisional measures of 13 May 2008, ¶ 72) (CI’s ER Annex 16); *see also* UNCITRAL’s Model Law on Commercial Arbitration Art. 17(A)(1)(a) (requiring that a party requesting relief demonstrate that “[h]arm not adequately reparable by an award of damages is likely to result if the measure is not ordered, and such harm substantially outweighs the harm that is likely to result to the party against whom the measure is directed if the measure is granted”) (emphasis added) (Ex. R-ER-12); *Paushok v. Mongolia*, Order on Interim Measures of 2 September 2008, ¶¶ 68-69 (R-ER-14).

its Board followed the Guidebook at every step of the process.

**A. The GCC's IRP Request is Time-Barred.**

47. ICANN's Bylaws specifically state that a "request for independent review must be filed within *thirty days* of the posting of the minutes of the Board meeting (and the accompanying Board Briefing Materials, if available) that the requesting party contends demonstrates that ICANN violated its Bylaws or Articles of Incorporation."<sup>85</sup>

48. The only ICANN Board action that even arguably could have injured the GCC was the NGPC's decision to "process" the .PERSIANGULF application after the GAC advised that it did not object to the application proceeding. That decision was set forth in the NGPC's Durban Communiqué Scorecard, which was approved by the NGPC on 10 September 2013 and publicly posted on 12 September 2013.<sup>86</sup> The minutes and Board Briefing Materials related to that decision were posted on 30 September 2013.<sup>87</sup> Thus, the GCC's deadline to file its IRP Request expired on 30 October 2013, *nearly 14 months ago*.

49. Accordingly, the GCC's IRP Request is time-barred and, as such, there is no likelihood that the GCC will succeed on the merits of its IRP. The GCC's Emergency Request should therefore be denied, as other courts and tribunals have found in similar settings.<sup>88</sup>

**B. The GCC Fails To Identify An ICANN Board Action That Violated ICANN's Articles Or Bylaws.**

50. As set forth in ICANN's Bylaws, an IRP is available only to persons "materially affected

---

<sup>85</sup> Bylaws, Art. IV, § 3.3 (emphasis added).

<sup>86</sup> NGPC Resolution 2013.09.10NG03 (Ex. R-ER-9; Annex 1 to NGPC Resolution 2013.09.10NG03 (Ex. R-ER-10).

<sup>87</sup> Minutes of 10 September 2013 Meeting of the NGPC (Ex. R-ER-14), *also available at* <https://www.icann.org/resources/board-material/minutes-new-gtld-2013-09-10-en>.

<sup>88</sup> *Coto Settlement v. Eisenberg*, 593 F.3d 1031, 1041 (9th Cir. 2010) (affirming denial of a motion for preliminary injunction because the plaintiff's claims were barred by the applicable statute of limitations); *Silvas v. G.E. Money Bank*, 449 F. App'x. 641, 644-45 (9th Cir. 2011) (same); Ali Yesilirmak, 5 PROVISIONAL MEASURES IN INTERNATIONAL CRIMINAL ARBITRATION at 184-185 (noting a case denying a request for interim relief where the claimant had waited an unreasonable amount of time before seeking such relief and therefore did not have "clean hands") (Ex. R-ER-17).

by a decision or action of the [ICANN] Board that he or she asserts is inconsistent with the Articles of Incorporation or Bylaws.”<sup>89</sup> Yet the GCC fails to identify any Board action or decision that violated ICANN’s Articles or Bylaws. In its Emergency Request, the GCC appears to claim that ICANN violated its “guidelines” by: (i) failing to respect the GCC’s objections to the .PERSIANGULF application; (ii) failing to properly consider the GAC’s advice; and (iii) failing to require that the .PERSIANGULF application obtain support from “relevant governments.”<sup>90</sup> In its IRP Request, the GCC further claims that it was improper for ICANN to treat the .PERSIANGULF application differently than the applications for .ISLAM and .HALAL,<sup>91</sup> and that Judge Schwebel incorrectly decided the GCC’s Community Objection.<sup>92</sup>

51. None of these claims demonstrates a violation of the Articles or Bylaws by ICANN’s Board, or supports the GCC’s Emergency Request or its IRP Request. To the contrary, at every step of the process, ICANN’s Board followed the Articles, Bylaws and Guidebook with respect to the .PERSIANGULF application.

52. The GCC’s general claims that ICANN did not respect the GCC’s objections and failed to properly consider the GAC’s advice are incorrect. ICANN properly processed the GCC’s objections and ICANN’s Board (through the NGPC) properly considered the GAC’s advice regarding the .PERSIANGULF gTLD. When the GAC advised the ICANN Board to not proceed beyond initial evaluation of the .PERSIANGULF application so that the GAC would have additional time to consider the GCC’s concerns, the NGPC did just that, stating that “ICANN will allow evaluation and dispute resolution processes to go forward, but will not enter into registry agreements with applicants for the identified strings for now.” Then, when the

---

<sup>89</sup> Bylaws, Art. IV., § 3.2 (Ex. R-ER-1).

<sup>90</sup> Emergency Request, ¶¶ 22-24.

<sup>91</sup> IRP Request, ¶¶ 60-69.

<sup>92</sup> *Id.*, ¶¶ 70-74.

GAC advised ICANN that the GAC had completed its consideration of .PERSIANGULF and “does not object” to the application proceeding, the NGPC accepted that advice, stating that ICANN would continue to process that application in accordance with the procedures in the Guidebook. Even at this step, however, the NGPC noted that the GCC’s Community Objection was still pending, and allowed that process to resolve before taking any definitive action on .PERSIANGULF. ICANN’s Board took all the steps required of it when presented with the GCC’s Objections to, and the GAC’s advice regarding, the .PERSIANGULF application, and the GCC has presented no evidence to the contrary.

53. Likewise, the GCC’s argument that ICANN acted inconsistently with the GAC Principles Regarding New gTLDs (“GAC Principles”) by permitting the .PERSIANGULF application to proceed without the support of “relevant governments” is misplaced.<sup>93</sup> As an initial matter, the GAC Principles are not part of ICANN’s Articles or Bylaws, which are the only documents relevant in this IRP and Emergency Request. The GAC Principles were presented to ICANN in March 2007 in order to inform the development of the New gTLD Program and eventually the Guidebook.<sup>94</sup> The GAC’s statement in the GAC Principles that “ICANN should avoid country, territory or place names, and country, territory or regional language or people descriptions, unless in agreement with the relevant government or public authorities,”<sup>95</sup> informed the drafting of Section 2.2.1.4 of the Guidebook regarding “geographic names.”<sup>96</sup> In this section of the Guidebook, the phrase “geographic names,” is defined to include certain city names, certain sub-national place names listed in the ISO 3166-2 standard, and names listed as a UNESCO region or appearing on the “Composition of macro geographical (continental) regions, geographical sub-

---

<sup>93</sup> Emergency Request, ¶ 24.

<sup>94</sup> GAC Principles Regarding New gTLDs, ¶ 1.1 (Cl.’s ER Annex 1).

<sup>95</sup> *Id.*, ¶ 2.2.

<sup>96</sup> Guidebook, § 2.2.1.4 (Ex. R-ER-3).

regions, and selected economic and other groupings” list.<sup>97</sup> It is true that any gTLD application that falls within this definition of a “geographic name” must obtain support of the “relevant governments,”<sup>98</sup> as the GAC Principles suggested. But applications that do not fit within the Guidebook’s definition of a “geographic name” “will not require documentation of government support in the evaluation process.”<sup>99</sup> Persian Gulf, as the GCC well knows, is not a “geographic name” as that phrase is defined in the Guidebook, and therefore did not (and does not) require the support of relevant governments.

54. Thus, there is no merit to the claims that ICANN did not consider the GCC’s objections, did not properly implement the GAC’s advice, or failed to require government support for .PERSIANGULF. ICANN did precisely what it was supposed to do pursuant to the Guidebook, and the GCC forwarded its complaints through the two appropriate vehicles, the GAC and the Community Objection process. There is no Article, Bylaws provision or “guideline” that requires the ICANN Board to do anything more than follow the processes that it has followed.

55. Nor is there any merit to the GCC’s claim that the ICANN Board improperly treated the .PERSIANGULF application differently than the applications for .ISLAM and .HALAL.<sup>100</sup> In fact, ICANN’s Board *did* treat these applications differently, but the Board did so because these applications were the subject of *different types of advice* from the GAC, which called for different treatment. As set forth above, the GAC’s Beijing Communiqué provided “non-consensus” advice to ICANN, pursuant to Section 3.1 of the Guidebook, that .ISLAM

---

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> IRP Request ¶¶ 60-69.



and .HALAL should not proceed.<sup>101</sup> Pursuant to the Guidebook, “non-consensus” advice from the GAC regarding an application means that the “ICANN Board is expected to enter into dialogue with the GAC to understand the scope of the concerns.”<sup>102</sup> This is precisely what ICANN’s Board did.<sup>103</sup>

56. On the other hand, with respect to .PERSIANGULF, the GAC advised that it “does not object” to the application going forward.<sup>104</sup> This is why the .PERSIANGULF application has proceeded, and why .ISLAM and .HALAL have not. The applications were treated differently because the GAC viewed them differently and provided significantly different advice with respect to each.

57. Finally, the issues that the GCC takes with Judge Schwebel’s determination on the GCC’s Community Objection are not a proper basis for an IRP.<sup>105</sup> A determination by an Expert Panelist in connection with the Objection and Dispute Resolution Process is not a **Board** action; it is an action of an independent dispute resolution provider (in this case the ICC) and therefore not subject to an IRP challenge.<sup>106</sup> Moreover, there is nothing in the Articles, Bylaws or Guidebook that requires, or permits, ICANN’s Board to substantively review the determinations of an Expert Panelist.<sup>107</sup> The GCC may disagree with the expert determination, but that disagreement does not support the GCC’s IRP or its Emergency Request.

58. Put simply, the GCC has failed to identify any Board action or decision that violated ICANN’s Articles or Bylaws with respect to the .PERSIANGULF application. Accordingly, the

---

<sup>101</sup> Beijing Communiqué (CI’s ER Annex 13).

<sup>102</sup> Guidebook, § 3.1.

<sup>103</sup> 7 February 2014 Letter from S. Crocker to M. Abbasnia (CI’s Annex 31).

<sup>104</sup> Durban Communiqué, ¶ IV.1.3 (CI’s Annex 24).

<sup>105</sup> IRP Request, ¶¶ 70-74.

<sup>106</sup> Guidebook, § 3.2.3 (Ex. R-ER-3); Bylaws, Art. IV, § 3.2.

<sup>107</sup> Guidebook, § 3.4.6 (Ex. R-ER-3).

GCC is not reasonably likely to succeed on the merits of its IRP, and its Emergency Request should therefore be denied.

**II. EMERGENCY RELIEF IS NOT WARRANTED BECAUSE THE GCC UNREASONABLY DELAYED IN SEEKING SUCH RELIEF.**

59. A hallmark of proper emergency or interim relief is urgency, as the GCC concedes in its Emergency Request.<sup>108</sup> A long delay in seeking relief, however, implies that there is no urgency, nor any irreparable harm, and a request for interim relief should be denied on this basis.<sup>109</sup>

60. In this matter, the GCC waited over a year from the NGPC's announcement that ICANN would proceed with the .PERSIANGULF application to file its IRP and seek emergency relief. This kind of delay undercuts the GCC's claims of urgency and harm. The GCC's claims of urgency and harm are also belied by the fact that the GCC never filed a Reconsideration Request regarding the NGPC's action in September 2013 or Judge Schwebel's determination in October 2013. The GCC's unreasonable delay in filing its IRP, standing alone, is grounds for denying the GCC's Emergency Request.

**III. EMERGENCY RELIEF IS NOT WARRANTED BECAUSE GCC HAS NOT DEMONSTRATED THAT THE HARM IT WOULD SUFFER IN THE ABSENCE OF SUCH RELIEF OUTWEIGHS THE HARM TO OTHERS.**

61. Another requirement for emergency or interim relief is that the applicant demonstrate that the harm it would incur in the absence of that relief would "exceed[] greatly the damage caused

---

<sup>108</sup> Emergency Request ¶¶ 17-18.

<sup>109</sup> *Oakland Tribune, Inc. v. Chronicle Pub. Co.*, 762 F.2d 1374, 1377 (9th Cir. 1985) ("Plaintiff's long delay before seeking a preliminary injunction implies a lack of urgency and irreparable harm."); *Lydo Enters. v. Las Vegas*, 745 F.2d 1211, 1213 (9th Cir. 1984) ("A delay in seeking a preliminary injunction is a factor to be considered in weighing the propriety of relief."); *Kobell v. Suburban Lines, Inc.*, 731 F.2d 1076, 1091 n.27 (3rd Cir. 1984) ("The district court may legitimately think it suspicious that the party who asks to preserve the status quo through interim relief has allowed the status quo to change through unexplained delay."); *Bendone-Derossi International v. Iran*, reprinted in 6 Iran US CTR 133, 140 (upon the respondents' application to stay parallel court proceedings initiated in Germany to obtain a provisional measure, Judge Holtzmann concurred with the Tribunal by arguing, inter alia, that the "Respondent has made no showing of urgency justifying the issuance of interim relief: the court order was entered in June 1983, ten months before Respondent sought a stay") (Ex. R-ER-15).

to the party affected” by the issuance of interim relief.<sup>110</sup> Indeed, the GCC acknowledges in its Emergency Request that it must demonstrate that the harm it will suffer in the absence of emergency relief “outweighs” that caused by issuance of such relief.<sup>111</sup>

62. Nevertheless, other than a conclusory statement that a .PERSIANGULD gTLD “will promote Iranian beliefs . . . and falsely create the perception that the Arab nations that reside in the Gulf accept the disputed name,” the GCC fails to describe any harm it is likely to suffer if emergency relief is not granted. In fact, as two others—the IO and Judge Schwebel— have previously found, there is a real question about whether the GCC will suffer any legally-recognizable harm at all if the .PERSIANGULF gTLD is approved. Moreover, as Judge Schwebel recognized in his expert determination on the GCC’s Community Objection, any perception that Arab states in the region accept the disputed name could be counteracted by their “registration of a domain such as .ARABIANGULF gTLD.”

63. Although the GCC is dismissive of it, there will be harm to Asia Green if its application is stayed pending the outcome of this IRP. All gTLD applicants, including Asia Green, invested time, money, and energy in preparing and promoting their applications. ICANN is dedicated to processing these applications as quickly and efficiently as possible.

64. There is simply no indication that creation of a .PERSIANGULF gTLD will cause the

---

<sup>110</sup> *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 24 (2008) (courts “must balance the competing claims of injury and must consider the effect on each party of the granting or withholding of the requested relief.”) (citation and internal quotation marks omitted); *Burlington Resources Inc. v. Republic of Ecuador & Empresa Estatal Petroleos del Ecuador*, ICSID Case No. ARB/08/5, Procedural Order No. 1 on Burlington Oriente’s Request for Provisional Measures, 29 June 2009, ¶ 81 (quoting *City Oriente Ltd. v. Republic of Ecuador*, ICSID Case No. ARB/06/21, Decision on revocation of provisional measures of 13 May 2008, ¶ 72) (CI’s ER Annex 16); see also UNCITRAL’s Model Law on Commercial Arbitration Art. 17(A)(1)(a) (requiring that a party requesting relief demonstrate that “[h]arm not adequately reparable by an award of damages is likely to result if the measure is not ordered, **and such harm substantially outweighs the harm that is likely to result to the party against whom the measure is directed if the measure is granted**”) (emphasis added) (Ex. R-ER-12); *Paushok v. Mongolia*, Order on Interim Measures of 2 September 2008, ¶¶ 68-69 (Ex R-ER-14).

<sup>111</sup> Emergency Request ¶¶ 17, 19.

GCC any material detriment or legally-recognized injury. What is more, any possible harm to the GCC by a denial of emergency relief is greatly diminished by the scant probability of the GCC succeeding on the merits of IRP Request. The lack of harm to the GCC, taken alone, is another ground for denying the GCC's Emergency Request.

#### CONCLUSION

65. The ICANN Board's conduct with respect to the .PERSIANGULF application was consistent with ICANN's Articles and Bylaws. ICANN allowed the GCC's objections to work their way through the objection processes set out in the Guidebook, and ICANN's Board (through the NGPC) properly considered the GAC's advice on these issues. Not only has the GCC failed to demonstrate that ICANN's Board violated the Articles and Bylaws, its IRP was submitted more than a year after the deadline to do so and does not identify any legally-recognized injury to the GCC if the .PERSIANGULF application proceeds. Accordingly, the GCC's Emergency Request should be denied.

Respectfully submitted,

JONES DAY

Dated: December 17, 2014

By: Eric P. Enson / PHZ  
Eric P. Enson

Counsel for Respondent ICANN

**CLA-028**

INDEPENDENT REVIEW PROCESS  
INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

GULF COOPERATION COUNCIL,	)	ICDR CASE NO. 01-14-0002-1065
	)	
Claimant,	)	
	)	
and	)	
	)	
INTERNET CORPORATION FOR ASSIGNED	)	
NAMES AND NUMBERS,	)	
	)	
Respondent.	)	
<hr/>		

**ICANN'S RESPONSE TO GULF COOPERATION COUNCIL'S  
REQUEST FOR INDEPENDENT REVIEW PROCESS**

Jeffrey A. LeVee  
Eric P. Enson  
Rachel Zernik  
JONES DAY  
Contact Information Redacted

Counsel to Respondent  
The Internet Corporation  
For Assigned Names and Numbers

## TABLE OF CONTENTS

	Page
INTRODUCTION .....	1
BACKGROUND FACTS.....	2
I.    ICANN.....	2
II.   THE NEW GTLD PROGRAM .....	3
A.    GAC Advice On New gTLDs .....	4
B.    The Independent Objector.....	6
C.    The Objection And Dispute Resolution Process.....	7
III.  ICANN’S ACCOUNTABILITY MECHANISMS .....	8
IV.  THE EVALUATION OF THE .PERSIANGULF APPLICATION.....	10
STANDARD OF REVIEW .....	15
ARGUMENT .....	16
I.    THE GCC’S REQUEST IS TIME BARRED .....	17
II.   THE GCC FAILS TO IDENTIFY ANY ICANN BOARD ACTION THAT VIOLATED ICANN’S ARTICLES OR BYLAWS.....	19
A.    The NGPC Adhered To The Guidebook And Violated No Article Or Bylaws Provision In Allowing The .PERSIANGULF Application To Proceed .....	19
B.    The NGPC Properly Treated The .PERSIANGULF Application Differently Than The .ISLAM And .HALAL Applications.....	22
C.    The GCC’S Argument That The Expert Panelist Incorrectly Overruled Its Community Objection Is Not An Appropriate Basis For An IRP .....	23
III.  THE GCC HAS NOT BEEN NEGATIVELY AND “MATERIALLY AFFECTED” BY THE NGPC’S DECISION TO PROCEED WITH THE APPLICATION .....	23
IV.  ICANN’S RESPONSE TO THE REQUESTED RELIEF .....	24
CONCLUSION.....	25

## INTRODUCTION

The Internet Corporation for Assigned Names and Numbers (“ICANN”) hereby submits its Response to the Request for Independent Review Process (“IRP Request”) submitted by claimant Gulf Cooperation Council (the “GCC”) on 5 December 2014.

1. The GCC argues that it objects to the application for the .PERSIANGULF generic top level domain (“gTLD”) submitted by Asia Green IT System Ltd. (“Asia Green”) because the “Arab nations that border the Gulf prefer the name ‘Arabian Gulf.’”<sup>1</sup> The GCC, and certain of its member States, first voiced concerns over the potential gTLD in 2012. Since then, in December 2012, ICANN’s Independent Objector (“IO”) reviewed GCC’s concerns and found that he had no basis to object to Asia Green’s .PERSIANGULF application (the “Application”). Thereafter, in July 2013, the Governmental Advisory Committee (“GAC”), a body that provides advice to ICANN on behalf of governments, informed ICANN that it “d[id] not object” to the .PERSIANGULF Application proceeding. Following that, on 30 October 2013, an independent expert appointed by the ICC<sup>2</sup> determined that the GCC’s formal Community Objection to the Application did not prevail. Then, rather than timely pursuing ICANN’s well-documented accountability mechanisms to challenge ICANN’s processing of the Application, the GCC waited for over one year to file this IRP Request.

2. There is no question that the GCC believes strongly in its position in this naming dispute. There are, however, significant questions about the timeliness and merits of the GCC’s IRP Request. First, the GCC filed its IRP Request *over a year too late*. It is therefore time barred pursuant to ICANN’s Bylaws. To now permit the GCC to proceed with its IRP not only violates ICANN’s documented procedures, but it also prejudices ICANN and others, such as

---

<sup>1</sup> IRP Request, ¶ 3.

<sup>2</sup> The International Chamber of Commerce



Asia Green, who have rightfully relied on the absence of any IRP claims in continuing to process and invest in the Application. Second, even if the GCC's IRP Request were timely, the GCC has not identified any ICANN Board action or decision that was inconsistent with ICANN's Articles of Incorporation ("Articles") or Bylaws, which is the only question at issue in IRP proceedings such as this. To the contrary, the record demonstrates that the actions of ICANN's Board with respect to the .PERSIANGULF Application were in all respects consistent with the processes set out in the Bylaws and in the New gTLD Applicant Guidebook ("Guidebook"). Third, the GCC has not been negatively and "materially affected" by the ICANN Board's decision to proceed with the .PERSIANGULF Application, as is required to properly assert an IRP, because the GCC has not identified any legally-recognized injury that it will suffer if the Application proceeds.

## **BACKGROUND FACTS**

### **I. ICANN**

3. ICANN was formed in 1998. It is a California not-for-profit public benefit corporation. ICANN's mission "is to coordinate, at the overall level, the global Internet's system of unique identifiers, and in particular to ensure the stable and secure operation of the Internet's unique identifier systems," including the domain name system ("DNS").<sup>3</sup>

4. ICANN is a complex organization that facilitates input from stakeholders around the globe. ICANN has an international Board of Directors, over 300 staff members, and an Ombudsman. ICANN is much more than just a corporation—it is a community of participants. In addition to the Board, the staff, and the Ombudsman,<sup>4</sup> the ICANN community includes a Nominating Committee,<sup>5</sup> three Supporting Organizations,<sup>6</sup> four Advisory Committees,<sup>7</sup> a group

---

<sup>3</sup> ICANN Bylaws ("Bylaws"), Art. I, § 1 (Ex. R-1).

<sup>4</sup> *Id.*, Art. V.

<sup>5</sup> *Id.*, Art. VII.

of technical expert advisors,<sup>8</sup> and a large, globally distributed group of community members who participate in ICANN's processes.

5. One of ICANN's Advisory Committees is the Governmental Advisory Committee ("GAC"), which is a body consisting of members appointed by and representing governments. The GAC was created to "consider and provide advice on the activities of ICANN as they relate to concerns of governments, particularly matters where there may be an interaction between ICANN's policies and various laws and international agreements, or where they may affect public policy issues."<sup>9</sup> Membership in the GAC is open to all national governments and distinct economies as recognized in international fora. The importance of the GAC's advice to ICANN is built into ICANN's Bylaws:

The advice of the Governmental Advisory Committee on public policy matters shall be duly taken into account, both in the formulation and adoption of policies. In the event that the ICANN Board determines to take an action that is not consistent with the Governmental Advisory Committee advice, it shall so inform the Committee and state the reasons why it decided not to follow that advice. The Governmental Advisory Committee and the ICANN Board will then try, in good faith and in a timely and efficient manner, to find a mutually acceptable solution.<sup>10</sup>

## II. THE NEW GTLD PROGRAM

6. In its early years, and in accordance with its Core Values, ICANN focused on increasing the number of companies that could sell domain name registrations to consumers ("registrars"). ICANN also focused on expanding, although more slowly, the number of companies that operate gTLDs ("registries"). In 2000, ICANN approved seven gTLDs in a

---

(continued...)

<sup>6</sup> *Id.*, Arts. VIII-X.

<sup>7</sup> *Id.*, Art. XI.

<sup>8</sup> *Id.*, Art. XI-A, § 2.

<sup>9</sup> *Id.*, Art. XI, § 2.1.

<sup>10</sup> *Id.*, Art. XI, § 2.1.j.

“proof of concept” phase that was designed to confirm that the addition of new gTLDs would not adversely affect the stability and security of the Internet. In 2004 and 2005, ICANN approved a handful of additional TLDs.

7. The New gTLD Program (“Program”) constitutes ICANN’s most ambitious expansion of the Internet’s naming system, by far. The Program’s goals include enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of new gTLDs, including both new ASCII gTLDs and new non-ASCII, internationalized domain name (“IDN”) gTLDs.<sup>11</sup> In developing the Program with the ICANN community, numerous versions of the Guidebook were prepared and distributed throughout the ICANN community. Ultimately, ICANN went forward with the Program based on the version of the Guidebook published on 4 June 2012, which provides detailed instructions to gTLD applicants and sets forth the procedures for ICANN’s evaluation of new gTLD applications.

**A. GAC Advice On New gTLDs**

8. Pursuant to the Guidebook, all applications for new gTLDs are made available for review and public comment.<sup>12</sup> Concurrent with the public comment period, the GAC is able to issue “Early Warning” notices concerning particular applications.<sup>13</sup> An Early Warning notice is not an official GAC statement against an application, but instead provides the applicant with an indication that one or more governments view the application as potentially sensitive or problematic.<sup>14</sup> Applicants are advised that a GAC Early Warning should be taken seriously as it

---

<sup>11</sup> IDN gTLDs are gTLDs that include characters not within the US-ASCII (American Standard Code for Information Exchange) or Latin alphabets.

<sup>12</sup> New gTLD Applicant Guidebook (“Guidebook”), § 1.1.2.3 (Ex. R-2).

<sup>13</sup> *Id.*, § 1.1.2.4.

<sup>14</sup> *Id.*

raises the likelihood that the application could be the subject of GAC advice against it at a later stage in the process.<sup>15</sup>

9. The Guidebook also sets out a process whereby the GAC may issue advice to ICANN concerning any application for a new gTLD. As set forth in Section 3.1 of the Guidebook, GAC advice regarding a new gTLD application may take one of three forms. First, pursuant to Module 3.1, Part I of the Guidebook, the GAC may issue “consensus advice” as follows:

The GAC advises ICANN that it is the consensus of the GAC that a particular application should not proceed. This will create a strong presumption for the ICANN Board that the application should not be approved.<sup>16</sup>

10. Second, pursuant to Module 3.1, Part II of the Guidebook, the GAC may issue non-consensus advice indicating “that there are concerns about a particular application.”<sup>17</sup> If the GAC issues non-consensus advice against an application, the ICANN Board is expected to enter into dialogue with the GAC to understand the scope of the concerns.<sup>18</sup>

11. Third, pursuant to Module 3.1, Part III of the Guidebook, the GAC may issue advice to ICANN “that an application should not proceed unless remediated.”<sup>19</sup> This type of advice “will raise a strong presumption for the Board that the application should not proceed unless there is a remediation method available in the Guidebook (such as securing the approval of one or more governments), that is implemented by the applicant.”<sup>20</sup>

12. With respect to gTLD applications, the GAC has generally provided its advice to

---

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*, § 3.1(I).

<sup>17</sup> *Id.*, § 3.1(II)

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*, § 3.1(III).

<sup>20</sup> *Id.*

ICANN in the form of communiqués associated with one of ICANN’s Public Meetings, such as the “London Communiqué,” which is advice from the GAC borne out of the GAC’s meeting at the ICANN Public Meeting in London in June 2014.

13. The New gTLD Program Committee (“NGPC”) of the ICANN Board, which has the full authority of the Board with respect to the New gTLD Program and is comprised of all Board members that have no actual, potential, or perceived conflict of interest in pending new gTLD applications, is tasked with evaluating and responding to GAC advice on gTLD applications as well as communicating with the GAC regarding its advice.<sup>21</sup> Throughout the Program, the NGPC has publicly issued “scorecards” relating to GAC advice, which are statements that track the GAC’s advice on certain issues and ICANN’s response to that advice.<sup>22</sup>

**B. The Independent Objector**

14. Another aspect of the New gTLD Program is found in ICANN’s creation of an Independent Objector.<sup>23</sup> The IO is tasked with filing certain objections against “highly objectionable” gTLD applications to which no formal objection has been filed.<sup>24</sup> Pursuant to the Guidebook and ICANN’s practices and policies, “[n]either ICANN staff nor the ICANN Board of Directors has authority to direct or require the IO to file or not to file any particular objection. If the IO determines that an objection should be filed, he or she will initiate and prosecute the objection in the public interest.”<sup>25</sup>

15. The IO’s standing to file a Community Objection is triggered when there is at

---

<sup>21</sup> See Board Resolution 2012.04.10.02 (Ex. R-3), also available at <https://features.icann.org/2012-04-10-establishment-new-gtld-program-committee>. Accordingly, any advice to the ICANN Board is advice to the NGPC, and if Board action is required, action by the NGPC may be considered Board action for purposes of these proceedings.

<sup>22</sup> See <http://newgtlds.icann.org/en/applicants/gac-advice>.

<sup>23</sup> Guidebook, § 3.2.5 (Ex. R-2).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

least one comment in opposition to the application made in the public sphere.<sup>26</sup>

**C. The Objection And Dispute Resolution Process**

16. In addition to the advice from the GAC and the existence of the IO, governments, as well as other entities and individuals, can formally object to a gTLD application through ICANN’s Objection and Dispute Resolution Process.<sup>27</sup> The Guidebook enumerates several grounds on which an objection may be filed. As is relevant here, an established institution associated with a clearly delineated community may file a “Community Objection” claiming that there is “substantial opposition to the gTLD application from a significant portion of the community to which the gTLD string may be explicitly or implicitly targeted.”<sup>28</sup> All Community Objections are heard by independent, expert panels selected by the ICC.<sup>29</sup>

17. In order to succeed on a Community Objection, an objector must establish the following: (i) the community invoked by the objector is a clearly delineated community; (ii) community opposition to the application is substantial; (iii) there is a strong association between the community invoked and the applied-for gTLD string; and (iv) the application creates a likelihood of material detriment to the rights or legitimate interests of a significant portion of the community to which the string may be explicitly or implicitly targeted.<sup>30</sup> The Guidebook makes clear that “[i]f opposition by a community is determined, but there is no likelihood of material detriment to the targeted community resulting from the applicant’s operation of the applied-for gTLD, the objection will fail.”<sup>31</sup>

---

<sup>26</sup> *Id.*

<sup>27</sup> Guidebook, §§ 3.2, 3.2.3. (Ex. R-2).

<sup>28</sup> *Id.*, § 3.2.1.

<sup>29</sup> *Id.*, § 3.2.2.

<sup>30</sup> *Id.*, § 3.5.4.

<sup>31</sup> *Id.*

18. The Guidebook does not provide any procedure by which ICANN (or anyone else) is to conduct a substantive review of an expert panel’s determination on a Community Objection.<sup>32</sup> Notably, the decision not to have an appellate mechanism for objection proceedings was a community-driven decision, which, among other things, was intended to help reduce the time and expense associated with the objection process and to ensure that those with the requisite expertise were making the ultimate determinations.

### **III. ICANN’S ACCOUNTABILITY MECHANISMS**

19. ICANN has a proven commitment to accountability and transparency in all of its practices. ICANN considers these principles to be fundamental safeguards in ensuring that its bottom-up, multi-stakeholder model remains effective. The mechanisms through which ICANN achieves accountability and transparency are built into every level of its organization and mandate. In order to reinforce its transparency and accountability, ICANN has established specific accountability mechanisms for review of ICANN actions.<sup>33</sup>

20. For instance, ICANN’s Bylaws permit an individual or entity that purportedly has been adversely and materially affected by an action or inaction of ICANN’s staff or Board to request that the Board reconsider that action or inaction (a “Reconsideration Request”).<sup>34</sup> Reconsideration Requests are reviewed and considered by ICANN’s Board Governance Committee (“BGC”). The BGC can make a final determination on the Reconsideration Request when the request involves staff conduct; when the Reconsideration Request involves Board conduct the BGC makes a recommendation to the Board for a final determination.

21. In addition to Reconsideration Requests, ICANN has also established the

---

<sup>32</sup> *Id.*, § 3.4.6.

<sup>33</sup> *Id.*, Art. IV; *see also* ICANN Accountability Mechanisms Available to the ICANN Community (Ex. R-4), *also available at* <https://www.icann.org/sites/default/files/assets/accountability-mechanisms-5100x3300-19mar14-en.png>.

<sup>34</sup> Bylaws, Art. IV, § 2.2 (Ex. R-1).

separate IRP that may be invoked by parties that claim they were materially and adversely by a Board action alleged to be inconsistent with ICANN’s Articles or Bylaws.<sup>35</sup> As set forth in the Bylaws, prior to initiating a request for IRP, complainants are urged to enter into a cooperative engagement process (“CEP”) with ICANN “for the purpose of resolving or narrowing the issues that are contemplated to be brought to the IRP.”<sup>36</sup> The CEP is invoked “by providing written notice to ICANN at [independentreview@icann.org], noting the invocation of the process, identifying the Board action(s) at issue, identifying the provisions of the ICANN Bylaws or Articles of Incorporation that are alleged to be violated, and designating a single point of contact for the resolution of the issue.”<sup>37</sup>

22. Although ICANN’s Bylaws specifically state that a “request for independent review must be filed within *thirty days* of the posting of the minutes of the Board meeting (and the accompanying Board Briefing Materials, if available) that the requesting party contends demonstrates that ICANN violated its Bylaws or Articles of Incorporation,”<sup>38</sup> the running of this thirty-day period is stayed, or tolled, while the parties are engaged in a CEP.<sup>39</sup> Likewise, according to ICANN’s documented procedures, a potential IRP claimant and ICANN may modify the timing of a CEP or IRP while engaged in the CEP, as long as that modification is memorialized in writing.<sup>40</sup>

#### **IV. THE EVALUATION OF THE .PERSIANGULF APPLICATION**

23. On 8 July 2012, Asia Green submitted an application for the .PERSIANGULF

---

<sup>35</sup> *Id.*, Art. IV, § 3.

<sup>36</sup> *Id.*, Art. IV, § 3.14.

<sup>37</sup> “Cooperative Engagement Process – Request for Independent Review, Pg. 1 (Ex. R-5), *also available at* <https://www.icann.org/en/system/files/files/cep-11apr13-en.pdf> .

<sup>38</sup> *Id.*, Art. IV, § 3.3 (Ex. R-1).

<sup>39</sup> “Cooperative Engagement Process – Request for Independent Review, Pg. 2 (Ex. R-5), *also available at* <https://www.icann.org/en/system/files/files/cep-11apr13-en.pdf> .

<sup>40</sup> *Id.* at ¶ 6.



gTLD. Subsequently, the governments of the United Arab Emirates, Oman, Baharain and Qatar sent virtually identical letters to the GAC and ICANN invoking the GAC’s Early Warning system regarding the Application and requesting that the GAC issue advice regarding whether a .PERSIANGULF gTLD is appropriate.<sup>41</sup>

24. On 20 November 2012, as set forth in the Guidebook, these four countries caused the GAC to issue an Early Warning on the Application claiming that “[t]he applied for new gTLD is problematic and refers to a geographical place with [a] disputed name” and “[I]ack[s] [...] community involvement and support.”<sup>42</sup>

25. As required by the Guidebook, ICANN informed Asia Green of the GAC Early Warning, and publicly posted the Early Warning on ICANN’s website. However, as is clear in the Guidebook, this Early Warning was “not a formal objection, nor [did] it lead to a process that can result in rejection of the application.”<sup>43</sup> Rather, the GAC Early Warning served as notice to Asia Green “that the application [was] seen as potentially sensitive or problematic by one or more governments.”<sup>44</sup>

26. In December 2012, the IO, Professor Alain Pellet, expressed his view regarding the Application.<sup>45</sup> The IO reviewed the history of this naming dispute, noted public comments against and in favor of a .PERSIANGULF gTLD, and described several, recognized authorities that utilize the name Persian Gulf for the sea area located between the Arabian Peninsula and

---

<sup>41</sup> Letters to ICANN from the Governments of the United Arab Emirates, Bahrain, Qatar, and Oman (Exs. R-6-9).

<sup>42</sup> GAC Early Warning from Regarding the Application (Ex. R-10).

<sup>43</sup> Guidebook, § 1.1.2.4 (Ex. R-2).

<sup>44</sup> *Id.*

<sup>45</sup> The IO’s Comments on the .PERSIANGULF Application (Ex. R-11), *also available at* <http://www.independent-objector-newgtlds.org/home/the-independent-objector-s-comments-on-controversial-applications/persiangulf-general-comment/>.

the Islamic Republic of Iran.<sup>46</sup> Based upon this, the IO concluded that the Application was not contrary to generally accepted legal norms of morality and public order.<sup>47</sup> The IO also concluded that there was no basis for him to file a Community Objection because “it is most debatable” whether a .PERSIANGULF gTLD creates a likelihood of material detriment to members of the Arabian Gulf community.<sup>48</sup> Finally, the IO noted that the Arabian Gulf community could file its own objection to the application.<sup>49</sup>

27. On 13 March 2013, the GCC filed a Community Objection to the Application.<sup>50</sup> The ICC appointed Stephen M. Schwebel, former President of the International Court of Justice, to serve as the Expert Panelist to hear the GCC’s Community Objection.<sup>51</sup>

28. While the GCC’s Community Objection was pending, the GAC met during ICANN’s Beijing, China meeting in April 2013, and reviewed a number of gTLD applications. In what is known as the “Beijing Communiqué,” the GAC issued several different types of advice on numerous gTLD applications.<sup>52</sup> First, the GAC provided consensus advice to ICANN that two applications, for .AFRICA and .GCC, should not proceed,<sup>53</sup> which under Section 3.1 of the Guidebook creates “a strong presumption for the ICANN Board that the application[s] should not be approved.”<sup>54</sup> Second, the GAC provided non-consensus advice to ICANN that some GAC members have raised concerns about two applications for religious terms, .ISLAM and .HALAL, and “it is the view of these GAC members that these applications should not

---

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> See Expert Determination in ICC Case No. EXP/423/ICANN/40, ¶ 2 (Ex. R-12).

<sup>51</sup> See *id.*, ¶ 5.

<sup>52</sup> Beijing Communiqué, ¶ IV.1.a.i.i.1-2 (Ex. R-13).

<sup>53</sup> The two applications were DotConnect Africa’s application for .AFRICA and the GCCIX WILL’s application for .the GCC.

<sup>54</sup> Beijing Communiqué, ¶ IV.1.a.i.i (Ex. R-13).

proceed,” which under Section 3.1 of the Guidebook means that the “ICANN Board is expected to enter into dialogue with the GAC to understand the scope of the concerns.”<sup>55</sup> Third, the GAC advised ICANN that it wanted to give further consideration at its next meeting in Durban, South Africa to several gTLD applications, including the application for .PERSIANGULF, and requested that ICANN not proceed beyond initial evaluation of these applications until the further consideration was concluded.<sup>56</sup>

29. As required by the Guidebook, in May and June 2013, the NGPC considered the GAC advice provided in the Beijing Communiqué. On 4 June 2013, the NGPC adopted a Scorecard reflecting its response to the GAC advice.<sup>57</sup> First, the NGPC accepted the GAC consensus advice that two applications for .AFRICA and .GCC should not proceed, noting that both “will not be approved,” pursuant to the Guidebook.<sup>58</sup> Second, the NGPC accepted the GAC non-consensus advice regarding the two religious terms, .ISLAM and .HALAL, stating that “the NGPC stands ready to enter into a dialogue with the GAC on this matter,” pursuant to the Guidebook.<sup>59</sup> Third, the NGPC accepted the GAC’s request for additional time to consider several other applications, including the .PERSIANGULF Application, clarifying that “ICANN will not proceed beyond initial evaluation of these identified strings” until the GAC has had additional time to provide advice on the applications.<sup>60</sup> The NGPC also noted that Community Objections had been filed regarding several of these applications, including

---

<sup>55</sup> *Id.*, ¶ IV.1.a.i.ii.

<sup>56</sup> *Id.*, ¶ IV.1.c.

<sup>57</sup> NGPC Resolution 2013.06.04.NG01 (Ex. R-14), *also available at* <https://features.icann.org/consideration-non-safeguard-advice-gac%E2%80%99s-beijing-communic%C3%A9?language=fr>.

<sup>58</sup> Annex 1 to NGPC Resolution 2013.06.04.NG01 at GAC Register #1-2 (Ex. R-15), *also available at* <https://www.icann.org/en/system/files/files/resolutions-new-gtld-annex-1-04jun13-en.pdf>.

<sup>59</sup> *Id.* at GAC Register #3.

<sup>60</sup> *Id.* at GAC Register #4.

the .PERSIANGULF Application.<sup>61</sup>

30. In July 2013, the United States Government issued a public statement to the GAC regarding gTLD applications with geographic implications, including .PERSIANGULF.<sup>62</sup> In this statement, the U.S. Government urged all relevant parties and GAC members to attempt to resolve any concerns about these gTLDs.<sup>63</sup> In addition, the U.S. Government noted that “the current rules for the new gTLD program do not specifically prohibit or condition these strings,” but stated that it was “willing in Durban to abstain and remain neutral on” these applications, “thereby allowing the GAC to present consensus objections on these strings to the [ICANN] Board, if no other government objects.”<sup>64</sup>

31. The GAC next met during the ICANN Public Meeting in Durban. In the Durban Communiqué, which was the official statement from the GAC to ICANN as a result of the Durban meeting, the GAC informed ICANN that it “finalized its consideration” of the Application and that the GAC “*does not object*” to the application proceeding.<sup>65</sup>

32. Thereafter, ICANN’s NGPC met to consider the Durban Communiqué and again adopted an NGPC Scorecard reflecting the NGPC’s response to that advice.<sup>66</sup> In its Scorecard, which was publicly posted over a year ago, on 12 September 2013, the NGPC noted that the GAC “has finalized its consideration of the following string, and does not object to it

---

<sup>61</sup> *Id.*

<sup>62</sup> U.S. Statement on Geographic Names in Advance of ICANN Durban Meeting (Ex. R-16), *also available at* [http://www.ntia.doc.gov/files/ntia/publications/usg\\_nextsteps\\_07052013\\_0.pdf](http://www.ntia.doc.gov/files/ntia/publications/usg_nextsteps_07052013_0.pdf).

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> Durban Communiqué, ¶ IV.1.3 (CI’s Annex 24). Citations to “CI’s Annexes” refer to annexes to the GCC’s IRP Request.

<sup>66</sup> NGPC Resolution 2013.09.10.NG03 (Ex. R-17), *also available at* <https://features.icann.org/gac-communicu%C3%A9-durban-scorecard?language=es>.

proceeding: .persiangulf.”<sup>67</sup> In addition, the NGPC stated that “ICANN will continue to process that application in accordance with the established procedures in the [Guidebook],” but noted that the GCC’s Community Objection to the Application remained pending.<sup>68</sup>

33. On 30 October 2013, the Expert Panelist hearing the GCC’s Community Objection, Judge Schwebel, issued his determination.<sup>69</sup> Judge Schwebel found that the GCC had failed to establish that “the application creates a likelihood of material detriment to the rights or legitimate interests of a significant portion of the community to which the string may be explicitly or implicitly targeted.”<sup>70</sup> Judge Schwebel determined—as the IO had suggested almost a year earlier—that the GCC’s claim that the existence of a .PERSIANGULF string would allow Asia Green to interfere with the core activities of the Arabian gulf community “d[id] not provide or constitute proof that the Application if granted will create a likelihood of material detriment to the community of the Objector.”<sup>71</sup> Judge Schwebel continued: “Nor is it easy to see what material detriment is likely to occur, which may explain why the Objection is so terse in this regard. In the perception of the Expert, the fact remains that the practical effect of registration of .PERSIANGULF gTLD is difficult to discern and weigh. Hence it follows that a likelihood of material detriment has not been established.”<sup>72</sup>

34. Finally, Judge Schwebel noted that:

The dispute between Arab States and supporters, on the one hand, and the Islamic Republic of Iran, on other hand, over the denomination of the Gulf, has subsisted for more than fifty years. It is far from clear that registration of .PERSIANGULF gTLD would resolve, or exacerbate, or

---

<sup>67</sup> Annex 1 to NGPC Resolution 2013.09.10.NG03 at GAC Register #9 (Ex. R-18), *also available at* <https://www.icann.org/en/system/files/files/resolutions-new-gtld-annex-1-10sep13-en.pdf>.

<sup>68</sup> *Id.*

<sup>69</sup> Expert Determination in ICC Case No. EXP/423/ICANN/40 (Ex. R-12).

<sup>70</sup> *Id.*, ¶¶ 38, 40.

<sup>71</sup> *Id.*, ¶ 40.

<sup>72</sup> *Id.*

significantly affect, that dispute. In any event, the GCC and other Arab interests are and would remain free to seek registration of a domain such as .ARABIANGULF gTLD.<sup>73</sup>

35. The GCC did not file a Reconsideration Request, did not institute a CEP, and did not pursue any other ICANN accountability process with respect to the NGPC's statement that the .PERSIANGULF Application would proceed. Instead, the GCC waited for *over one year* after the NGPC's decision, until 5 December 2014, to file this IRP. On the same date, the GCC filed a Request for Emergency Relief ("Emergency Request"), seeking to stay finalization of a registry agreement between ICANN and Asia Green while the GCC's IRP is pending. ICANN and the GCC have fully briefed the Emergency Request, but the Emergency Request panelist selected by the ICDR has not yet issued his interim declaration.

#### STANDARD OF REVIEW

36. The IRP is a unique, non-binding process available under ICANN's Bylaws for persons or entities that claim to have been materially and adversely affected by a decision or action of the ICANN Board, but only to the extent that Board action was inconsistent with ICANN's Articles or Bylaws.<sup>74</sup> The IRP Panel, when it is constituted, will be tasked with providing its opinion as to whether the challenged Board actions violated ICANN's Articles or Bylaws.<sup>75</sup> ICANN's Bylaws specifically identify the deferential standard of review that the IRP Panel must apply when evaluating the actions of the ICANN Board, focusing on:

- a. Did the Board act without conflict of interest in taking its decision?;
- b. Did the Board exercise due diligence and care in having a reasonable amount of facts in front of them?; and
- c. Did the Board members exercise independent judgment in taking the decision,

---

<sup>73</sup> *Id.*, ¶ 42.

<sup>74</sup> Bylaws, Art. IV, §§ 3.1, 3.2 (Ex. R-1).

<sup>75</sup> *Id.* Art. IV, § 3.4.

believed to be in the best interests of the company?<sup>76</sup>

The IRP Panel is neither asked to, nor allowed to, substitute its judgment for that of the Board.<sup>77</sup>

37. ICANN has appointed the ICDR as ICANN’s IRP Provider. ICANN’s Bylaws and the Supplementary Procedures that the ICDR has adopted specifically for ICANN IRP proceedings apply here.<sup>78</sup> The Bylaws provide that the IRP be conducted via “email and otherwise via the Internet to the maximum extent feasible.”<sup>79</sup> The IRP Panel may also hold meetings via telephone where necessary, and “[i]n the unlikely event that a telephone or in-person hearing is convened, the hearing shall be limited to argument only; all evidence, including witness statements, must be submitted in writing in advance.”<sup>80</sup>

38. Consistent with ICANN’s Bylaws, the IRP Panel is to issue a written “declaration,” rather than some sort of arbitration award, designating, among other things, the prevailing party.<sup>81</sup> The Board will give serious consideration to the IRP Panel’s declaration and, “where feasible,” shall consider the IRP Panel’s declaration at the Board’s next meeting.<sup>82</sup>

### ARGUMENT

39. The GCC’s IRP Request fails for three, independent reasons. First, the GCC’s request is time barred—the deadline for the GCC to file its IRP request expired over a year ago when the NGPC publicly stated that it would proceed with the .PERSIANGULF application.

---

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> Absent a governing provision in ICANN’s Bylaws or the ICDR’s Supplemental Procedures, the ICDR Rules apply. In the event of any inconsistency between the Supplementary Procedures and the ICDR’s Rules, the Supplementary Procedures shall govern. *Id.*, Art. IV, § 3.8; *see also* ICDR Supplementary Procedures for Internet Corporation for Assigned Names and Numbers, Independent Review Process (“Supplementary Procedures”), § 2 (Ex. R-19), *also available at* <https://www.adr.org/cs/groups/international/documents/document/z2uy/mde0/~edisp/adrstage2014403.pdf>.

<sup>79</sup> Bylaws, Art. IV, § 3.12 (Ex. R-1).

<sup>80</sup> *Id.*, Art. IV, § 3.12; Supplementary Procedures ¶ 10 (Ex. R-19).

<sup>81</sup> Bylaws, Art. IV, § 3.18 (Ex. R-1).

<sup>82</sup> *Id.*, Art. IV, § 3.21.

Second, the GCC has not identified a single ICANN Board action that violated ICANN's Articles and Bylaws. Third, the GCC has not been "materially affected" by the NGPC's decision to proceed with the .PERSIANGULF Application because it has not suffered a cognizable injury.

**I. THE GCC'S REQUEST IS TIME BARRED.**

40. As is clearly set forth in ICANN's Bylaws and documented procedures, an IRP must be initiated within thirty days of the posting of the Board meeting minutes that the IRP claimant contends demonstrate that ICANN violated its Bylaws or Articles of Incorporation, unless extended by a CEP or a written agreement between the claimant and ICANN.<sup>83</sup>

41. The only ICANN Board action that even arguably could have injured the GCC was the NGPC's decision to direct ICANN staff to continue processing the .PERSIANGULF Application after the GAC advised that it did not object to the Application proceeding. That decision was set forth in the NGPC's Durban Communiqué Scorecard, which was approved by the NGPC on 10 September 2013 and publicly posted on 12 September 2013.<sup>84</sup> The minutes and Board Briefing Materials related to that decision were posted on 30 September 2013.<sup>85</sup> Thus, the GCC's deadline to file its IRP Request expired on 30 October 2013, *nearly 14 months ago*. As such, this IRP Request is now time barred.

42. In support of its Emergency Request, the GCC submitted a witness declaration from Abdulrahman Al Marzouqi, who represents the United Arab Emirates ("UAE") on the GAC and in the UAE's dealings with ICANN.<sup>86</sup> Mr. Al Marzouqi states that he engaged in discussions with ICANN about the .PERSIANGULF Application after the NGPC action in

---

<sup>83</sup> See ¶¶ 21-22, above.

<sup>84</sup> NGPC Resolution 2013.09.10NG03 (Ex. R-17); Annex 1 to NGPC Resolution 2013.09.10NG03 (Ex. R-18).

<sup>85</sup> Minutes of 10 September 2013 Meeting of the NGPC (Ex. R-20), *also available at* <https://www.icann.org/resources/board-material/minutes-new-gtld-2013-09-10-en>.

<sup>86</sup> Witness Statement of Abdulrahman Al Marzouqi in Support of GCC's Emergency Request (Ex. R-23).



September 2013. Mr. Al Marzouqi's witness statement, however, does not show that the running of the IRP's 30-day timeline was tolled or stayed by these informal discussions. First, there is no claim that the GCC or Mr. Al Marzouqi invoked the CEP, because they did not. Second, there is no claim that Mr. Al Marzouqi sought an extension in the time to file an IRP Request, because he did not. Third, there is no claim or evidence that ICANN representatives told Mr. Al Marzouqi that the 30-day deadline for filing an IRP Request was extended, because they did not.

43. The GCC knew or should have known about ICANN's documented procedures governing the timing of requests for IRP and CEP. Those procedures, as set forth in the Bylaws and the Supplementary Procedures, are publicly available and were last amended in April 2013. ICANN was under no duty to affirmatively inform the GCC, or Mr. Al Marzouqi, of the timing for filing an IRP Request, as Mr. Al Marzouqi's witness statement seems to imply.

44. The GCC also seems to argue that the 30-day deadline was tolled because the informal resolution discussions between Mr. Al Marzouqi and ICANN were equivalent to a CEP. The CEP, however, is a formal resolution process that is invoked by the sending of an email to a particular ICANN address with specific information, and is distinct from the informal discussions that Mr. Al Marzouqi describes and that ICANN routinely engages in.<sup>87</sup> Moreover, ICANN's documented procedures make clear that any modification of the timing of an IRP or CEP must be in writing.<sup>88</sup> The GCC never invoked the CEP or formally sought any sort of extension in the GCC's time to file its IRP Request.

45. By asserting that the GCC's IRP Request is time barred, ICANN is not seeking to evade its own accountability mechanisms or this IRP. Rather, ICANN is seeking to ensure that all IRP claimants are treated in the same manner and in a manner that is consistent with

---

<sup>87</sup> Bylaws, Art. IV, § 3.14.

<sup>88</sup> Cooperative Engagement Process – Request for Independent Review (Ex. R-5).

ICANN's documented procedures. Indeed, the GCC's late IRP Request affects the rights of third parties, including the applicant for the .PERSIANGULF gTLD, and ICANN, which has established procedures for all applicants and third parties when it comes to objecting to new gTLD applications. The GCC simply failed to follow these procedures.

## **II. THE GCC FAILS TO IDENTIFY ANY ICANN BOARD ACTION THAT VIOLATED ICANN'S ARTICLES OR BYLAWS.**

46. Even if the GCC's IRP Request were not time barred, the GCC has not stated any basis for independent review because the GCC fails to identify any Board action or decision that violated ICANN's Articles or Bylaws.<sup>89</sup> Instead, the GCC claims that ICANN violated its "guidelines" by: (i) failing to respect the GCC's concern regarding the .PERSIANGULF Application; (ii) failing to properly consider the GAC's advice; and (iii) failing to require that the .PERSIANGULF Application obtain support from "relevant governments."<sup>90</sup> The GCC further claims that ICANN improperly treated the .PERSIANGULF Application differently than the applications for .ISLAM and .HALAL,<sup>91</sup> and that Judge Schwebel incorrectly decided the GCC's Community Objection.<sup>92</sup> None of these claims demonstrates a violation of the Articles or Bylaws by ICANN's Board, or supports the GCC's IRP Request.

### **A. The NGPC Adhered To The Guidebook And Violated No Article Or Bylaws Provision In Allowing The .PERSIANGULF Application To Proceed.**

47. The GCC's general claims that ICANN did not respect the GCC's concern about the Application and failed to properly consider the GAC's advice are incorrect. As detailed above, ICANN properly processed the Early Warning prompted by the GCC as well as the GCC's Community Objection.

---

<sup>89</sup> Bylaws, Art. IV., § 3.2 (Ex. R-1).

<sup>90</sup> IRP Request, ¶¶ 55-58.

<sup>91</sup> *Id.*, ¶¶ 60-69.

<sup>92</sup> *Id.*, ¶¶ 70-74.

48. Moreover, ICANN’s Board (through the NGPC) properly considered the GAC’s advice regarding the .PERSIANGULF gTLD. In its Beijing Communiqué, the GAC initially advised the NGPC not to proceed beyond initial evaluation of the .PERSIANGULF Application so that the GAC would have additional time to consider the GCC’s concerns.<sup>93</sup> The NGPC did just that, stating that “ICANN will allow evaluation and dispute resolution processes to go forward, but will not enter into registry agreements with applicants for the identified strings for now.”<sup>94</sup> Subsequently, in its Durban Communiqué, the GAC advised ICANN that the GAC had completed its consideration of .PERSIANGULF and “d[id] not object” to the Application proceeding.<sup>95</sup> Again, the NGPC accepted that advice, stating that ICANN would continue to process that Application in accordance with the procedures in the Guidebook.<sup>96</sup> Even at this step, however, the NGPC noted that the GCC’s Community Objection was still pending, and allowed that process to resolve before taking any definitive action on .PERSIANGULF.<sup>97</sup>

49. ICANN’s Board took all the steps required of it when presented with the GCC’s concerns about, as well as the GAC’s advice regarding, the .PERSIANGULF Application, and the GCC has presented no evidence to the contrary.

50. Likewise, the GCC’s argument that ICANN acted inconsistently with the GAC Principles Regarding New gTLDs (“GAC Principles”) by permitting the .PERSIANGULF Application to proceed without the support of “relevant governments” is misplaced.<sup>98</sup> As an initial matter, the GAC Principles are not part of ICANN’s Articles or Bylaws, which are the

---

<sup>93</sup> Beijing Communiqué ¶ IV.1.c (Ex. R-13).

<sup>94</sup> Annex 1 to NGPC Resolution 2013.06.04.NG01 at GAC Register #1-2 (Ex. R-15), *also available at* <https://www.icann.org/en/system/files/files/resolutions-new-gtld-annex-1-04jun13-en.pdf>.

<sup>95</sup> Durban Communiqué (CI’s Annex 24).

<sup>96</sup> Annex 1 to NGPC Resolution 2013.09.10.NG03 at GAC Register #9 (R-18), *also available at* <https://www.icann.org/en/system/files/files/resolutions-new-gtld-annex-1-10sep13-en.pdf>.

<sup>97</sup> *Id.*

<sup>98</sup> IRP Request, ¶ 57.

only documents relevant to this IRP. The GAC Principles were presented to ICANN in March 2007 in order to inform the development of the New gTLD Program and eventually the Guidebook.<sup>99</sup> The GAC’s statement in the GAC Principles that “ICANN should avoid country, territory or place names, and country, territory or regional language or people descriptions, unless in agreement with the relevant government or public authorities,”<sup>100</sup> informed the drafting of Section 2.2.1.4 of the Guidebook regarding “geographic names.”<sup>101</sup> That section of the Guidebook specifies that in accordance with the GAC Principles, applications for countries or territories listed in the ISO 3166-1 standard will not be approved.<sup>102</sup> It further specifies that applications for certain geographic names, defined to include certain city names, certain sub-national place names listed in the ISO 3166-2 standard, and names listed as a UNESCO region or appearing on the “Composition of macro geographical (continental) regions, geographical sub-regions, and selected economic and other groupings” list, must obtain support of the “relevant governments.”<sup>103</sup> However, applications that do not fit within the Guidebook’s definition of “geographic names requiring government support” “will not require documentation of government support in the evaluation process.”<sup>104</sup> “Persian Gulf” is not a designated “geographic name” as that phrase is defined in the Guidebook, and therefore did not (and does not) require the support of relevant governments.

---

<sup>99</sup> GAC Principles Regarding New gTLDs, ¶ 1.1 (Ex. R-21).

<sup>100</sup> *Id.*, ¶ 2.2.

<sup>101</sup> Guidebook, § 2.2.1.4 (Ex. R-2).

<sup>102</sup> *Id.*, § 2.2.1.4.1.

<sup>103</sup> *Id.*, § 2.2.1.4.2.

<sup>104</sup> *Id.* ICANN’s Geographic Names Panel is one of multiple panels that are involved in ICANN’s initial evaluation process for new gTLDs. The Geographic Names Panel is responsible for determining if a proposed new gTLD represents a “geographic name” (country or territory name, sub-national geographic name, city name, continent or UN Region) under the standards set forth by Guidebook. The Geographic Names Panel also evaluates whether geographic name applications require government support and, if so, ensures that the supporting documents from government authorities included in the application are verified and original. *See* Guidebook, § 2.2.1.4.2.

51. Accordingly, there is no support for the claims that ICANN did not consider the GCC’s concerns, did not properly implement the GAC’s advice, or failed to require government support for the .PERSIANGULF gTLD. The GCC expressed its concerns about the Application through the two appropriate vehicles, the GAC and the Community Objection process. In response, ICANN did precisely what it was supposed to do pursuant to the Guidebook—it considered and followed the GAC’s advice, and it waited for and respected the expert determination on the GCC’s Community Objection to the Application. There is no Article, Bylaws provision or “guideline” that requires the ICANN Board to do anything more than follow the processes that it has followed.

**B. The NGPC Properly Treated The .PERSIANGULF Application Differently Than The .ISLAM And .HALAL Applications.**

52. Similarly, there is no merit to the GCC’s claim that the ICANN Board improperly treated the .PERSIANGULF Application differently than the applications for .ISLAM and .HALAL.<sup>105</sup> In fact, the NGPC *did* treat these applications differently, but it did so because these applications were the subject of *different types of advice* from the GAC, which required different treatment. As set forth above, the GAC’s Beijing Communiqué provided “non-consensus” advice to ICANN, pursuant to Section 3.1 of the Guidebook, that .ISLAM and .HALAL should not proceed.<sup>106</sup> Pursuant to the Guidebook, “non-consensus” advice from the GAC regarding an application means that the “ICANN Board is expected to enter into dialogue with the GAC to understand the scope of the concerns.”<sup>107</sup> Following receipt of such advice, ICANN’s Board (through the NGPC) required the applicant for .ISLAM and .HALAL to

---

<sup>105</sup> IRP Request ¶¶ 60-69.

<sup>106</sup> Beijing Communiqué ¶ IV.1.a.ii (Ex. R-13).

<sup>107</sup> Guidebook, § 3.1 (II).

engage with relevant parties in an effort to address the concerns stated in the GAC advice.<sup>108</sup>

53. On the other hand, with respect to the .PERSIANGULF Application, the GAC (after extended consideration) specifically advised that it “does not object” to the Application going forward.<sup>109</sup> Accordingly, the .PERSIANGULF Application has proceeded, while .ISLAM and .HALAL have not. The applications were treated differently because the GAC viewed them differently and provided significantly different advice with respect to each.

**C. The GCC’S Argument That The Expert Panelist Incorrectly Overruled Its Community Objection Is Not An Appropriate Basis For An IRP.**

54. Finally, the issues that the GCC raises regarding Judge Schwebel’s determination on the GCC’s Community Objection are not a proper basis for an IRP.<sup>110</sup> A determination by an Expert Panelist in connection with the Objection and Dispute Resolution Process is not a *Board* action; it is an action of an independent expert selected and appointed by an independent dispute resolution provider (in this case the ICC) and therefore not subject to an IRP challenge.<sup>111</sup> Moreover, there is nothing in the Articles, Bylaws or Guidebook that requires, or permits, ICANN’s Board to substantively review the determinations of an Expert Panelist.<sup>112</sup> The GCC may disagree with the expert determination, but that disagreement does not support an IRP.

**III. THE GCC HAS NOT BEEN NEGATIVELY AND “MATERIALLY AFFECTED” BY THE NGPC’S DECISION TO PROCEED WITH THE APPLICATION.**

55. An IRP is only available to those negatively and “materially affected” by an ICANN Board action or decision.<sup>113</sup> Other than a conclusory statement that a .PERSIANGULF gTLD “will promote Iranian beliefs . . . and falsely create the perception that the Arab nations

---

<sup>108</sup> 7 February 2014 Letter from S. Crocker to M. Abbasnia (Ex. R-22).

<sup>109</sup> Durban Communiqué, ¶ IV.1.3 (CI’s Annex 24).

<sup>110</sup> IRP Request, ¶¶ 70-74.

<sup>111</sup> Guidebook, § 3.2.3 (Ex. R-2); Bylaws, Art. IV, § 3.2 (Ex. R-1).

<sup>112</sup> Guidebook, § 3.4.6 (Ex. R-2).

<sup>113</sup> Bylaws, Art. IV, § 3.2 (Ex. R-1).

that reside in the Gulf accept the disputed name,” the GCC fails to describe any legally-recognizable harm or injury it will suffer if a .PERSIANGULF gTLD is created.<sup>114</sup> As previously determined by both the IO and Judge Schwebel, there is a real question about whether the GCC will suffer any legally-recognizable harm at all if the .PERSIANGULF gTLD is approved. Moreover, as Judge Schwebel recognized in his expert determination on the GCC’s Community Objection, any misperception that Arab states in the region accept the disputed name could be counteracted by the “registration of a domain such as .ARABIANGULF gTLD.”<sup>115</sup>

56. Although the GCC clearly has strong convictions regarding the .PERSIANGULF Application, there is simply no indication that creation of a .PERSIANGULF gTLD will cause the GCC any material detriment or legally-recognized injury. In other words, the GCC has not been negatively and materially affected by the ICANN Board’s decision to proceed with the .PERSIANGULF Application.

#### **IV. ICANN’S RESPONSE TO THE REQUESTED RELIEF.**

57. The GCC’s IRP Request should be denied in its entirety, including its request for relief. The GCC asks that this IRP Panel issue a declaration “requiring ICANN to refrain from signing the registry agreement with Asia Green, or any other entity.”<sup>116</sup> An IRP Panel, however, is limited to stating its opinion by “declar[ing] whether an action or inaction of the Board was inconsistent with the Articles of Incorporation or Bylaws” and recommending that the Board stay any action or decision or take any interim action until such time as the Board reviews and acts upon the opinion of the IRP Panel.<sup>117</sup> Even if there were a basis for some kind of relief here (which there is not), neither this nor any IRP panel has the authority to award affirmative relief.

---

<sup>114</sup> IRP Request, ¶ 58.

<sup>115</sup> Expert Determination in ICC Case No. EXP/423/ICANN/40, ¶ 42.

<sup>116</sup> IRP Request, ¶ 75.

<sup>117</sup> Bylaws, Art. IV, § 3.11 (Ex. R-1).

58. The GCC also requests that this IRP Panel award the GCC “its costs in this proceeding, including, without limitation, all legal fees and expenses.”<sup>118</sup> However, ICANN’s Bylaws specifically provide that “each party to the IRP proceeding shall bear its own expenses.”<sup>119</sup> On the other hand, the Bylaws do provide that where, as here, a claimant fails to engage in a CEP prior to filing its IRP Request, “the IRP Panel must award to ICANN all reasonable fees and costs incurred by ICANN in the proceeding, including legal fees,” if ICANN prevails.<sup>120</sup>

### CONCLUSION

59. The ICANN Board’s conduct with respect to the .PERSIANGULF Application was consistent with ICANN’s Articles and Bylaws. ICANN allowed the GCC’s concerns and Community Objection to work their way through the processes set out in the Guidebook, and ICANN’s Board (through the NGPC) properly considered the GAC’s advice on these issues. Not only has the GCC failed to demonstrate that ICANN’s Board violated the Articles and Bylaws, its IRP was submitted more than a year after the deadline to do so and does not identify any legally-recognized injury to the GCC if the .PERSIANGULF Application proceeds. Accordingly, the GCC’s IRP Request should be denied.

Respectfully submitted,

JONES DAY

By: Eric P. Enson / RHZ  
Eric P. Enson

Counsel for Respondent ICANN

Dated: January 20, 2015

---

<sup>118</sup> IRP Request, ¶ 75.

<sup>119</sup> Bylaws, Art. IV, § 3.18 (Ex. R-1).

<sup>120</sup> *Id.*, Art. IV, § 3.16.